



Tourism & Transport Forum (TTF)  
Position Paper  
**Tax Incentives for  
Sustainable Transport**  
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## CONTENTS

INTRODUCTION	2
TRANSPORT IN AUSTRALIAN CITIES	3
REDUCING CONGESTION & TRANSPORT SECTOR EMISSIONS	3
THE IMPERATIVE FOR REFORM	4
USING PRICE SIGNALS TO MANAGE TRANSPORT DEMAND	5
A TAX SYSTEM FOR SUSTAINABLE TRANSPORT	7
RECOMMENDATIONS	8
CONCLUDING REMARKS	10

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## In short

1. There is a strong case to revisit the idea of using tax incentives to encourage sustainable transport choices.
2. Greater use of public transport will play a significant role in tackling urban congestion and reducing transport sector carbon emissions.
3. Tax-free fringe benefits for commuters in the US have proven an effective means of reducing the cost of commuting and easing the tax burden on individuals and business.
4. If implemented in Australia, a similar initiative would provide an effective complimentary measure to offset the impact of carbon pricing on the demand for transport.

## Introduction

Recent discussions on tax reform, most notably the Henry Tax Review and carbon tax debate, have focussed on rationalising inefficiencies in the tax and transfer system and rewarding behaviour more conducive to economic productivity and environmental sustainability. Unfortunately, passenger transport – a key driver of productivity and sustainability – has been largely overlooked in these discussions.

The cost of traffic congestion in Australian capital cities is \$12.9 billion, a figure set to increase to over \$20 billion if current trends in transport continue unabated.<sup>1</sup> Carbon emissions from passenger cars have risen 18 per cent over the last two decades, and currently represent 7.7 per cent of Australia's total annual carbon emissions.<sup>2</sup> Key to overcoming these trends is the encouragement of sustainable transport choices such as public transport, walking, cycling and carpooling.

Australia's current tax system accommodates private motorists while providing little or no encouragement for the use of alternative modes. TTF believes the Australian tax system can do more to provide incentives for commuters to make sustainable transport choices and for employers to encourage these choices.

This paper advocates the introduction of a tax-free allowance for commuting expenses such as public transport fares and park and ride costs. Similar initiatives in the US and Ireland have proven beneficial for commuters through higher take-home pay and lower taxable incomes, and for employers through improved productivity and lower payroll tax liabilities. For government, the proposed tax measures provide an effective lever to stimulate transport demand and capture the triple bottom-line benefits associated with reduced urban congestion.

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<sup>1</sup> Bureau of Infrastructure, Transport and Regional Economics, *Estimating urban traffic and congestion cost trends for Australian cities*, Working Paper No 71 (2007), p109.

<sup>2</sup> TTF position paper: *Public Transport and Climate Change*: October 2009, <http://www.ttf.org.au/Content/ptclimatechange.aspx>

## Transport in Australian cities

The concentration of the Australian population in major cities is among the highest in the world, with 60 per cent of our total population residing in our five largest cities<sup>3</sup> and just over 75 per cent residing in the 17 largest cities.<sup>4</sup>

Australia has a high dependence on cars by international standards. Of the 158 billion passenger kilometres completed in journeys across all Australian capitals in 2008, the overwhelming majority (89 per cent) were completed by private car<sup>5</sup>. While cars are a vital component of the global urban transport mix, compared to cities overseas, car use in Australia's major cities is disproportionate to public transport use.

An international comparison of public transport mode share (based on journeys to work) shows that Australian cities are below European cities and some of the largest cities in the US, including New York and Chicago.<sup>6</sup> Sydney has the highest public transport mode share among Australian cities, at only a 21 per cent share. However, the low overall share of public transport in Australia does not reflect the importance of public transport to certain populations. For example, 77 per cent of people who work in Sydney's CBD use public transport to get to and from work.<sup>7</sup> With cycling and walking included, this figure increases to 85 per cent.<sup>8</sup>

## Reducing congestion and transport sector emissions

Efficient transport networks are pivotal in overcoming urban congestion and reducing carbon emissions as well as optimising the productivity, sustainability and liveability of cities. It is therefore incumbent upon policy makers to promote greater use of public transport and more efficient use of private transport.

### The role of public transport

In terms of moving people in an urban environment, the efficiency of public transport is unparalleled. A typical commuter bus is capable of removing 50 to 100 cars from the road, while a commuter train can remove up to 1,000 cars from city streets.<sup>9</sup> Operating at capacity, a typical two-track passenger railway can carry up to 25,000 passengers an hour in each direction, the equivalent of more than 20 lanes of freeway.<sup>10</sup>

Public transport also provides an alternate means of travel to the private vehicle which will be important to reducing carbon emissions. Being significantly less emissions- and resource-intensive, increasing the market share of public transport services – particularly in major urban centres – will reduce the negative impacts of congestion and cut carbon emissions. During peak periods, public transport (bus and rail) is up to six times less emissions-intensive per passenger kilometre than private vehicles.

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<sup>3</sup> Australian Bureau of Statistics, *Australian Demographic Statistics, March 2009* pp15-16.

<sup>4</sup> Infrastructure Australia, Major Cities Unit: *State of Australian Cities 2010*, p2.

<sup>5</sup> Australian transport statistics yearbook, Bureau of Infrastructure, Transport and Regional Economics, 2009

<sup>6</sup> American Census Bureau, 2008 ; EU Census, 2004; Australian Census, 2006

<sup>7</sup> NSW State of the Environment Report, NSW Department of Energy, Climate Change and Water, 2009

<sup>8</sup> Lord Mayor of Sydney Cr Clover Moore, City of Sydney, City Talks Lecture, 16 September 2009.

<sup>9</sup> Based on assumption of average commuter train capacity of 1,200 passengers, and average car occupancy of 1.2 passengers per vehicle.

<sup>10</sup> Victorian Department of Infrastructure: East West Rail Link, analysis on rail capacity. March 2008, p6.

### **Daily urban commute - carbon abatement comparison**

By switching from road to rail, commuters on Victoria's Regional Rail Link travelling between Wyndham Vale and Melbourne City would save an average of 4.7 tonnes of carbon dioxide emissions per person per year. Similarly, if a rail link to Sydney's north west were in place, commuting between Castle Hill and the Sydney City would yield emissions savings of 3.5 tonnes per person per year. In comparison with other emissions reduction measures, this modal switch can deliver between 25 and 34 times the annual carbon abatement as one household using energy saving light globes.<sup>11</sup>

## **The imperative for reform**

A number of factors support the case to use the tax and transfer system to create price signals that incentivise sustainable transport choices such as public transport. Foremost of these is the urgent need to address the distortionary impacts that the proposed carbon price will have on transport demand. The rising cost of living, tax burden on business and the inequity in transport taxation can also be addressed by the tax measures proposed in this paper.

### **Complimenting climate change policy**

In the long term, TTF is confident that pricing carbon emissions will drive sustainable consumption choices, however there are currently no measures in place that will serve to rationalise commuter behaviour in favour of low-emitting transport modes.

In announcing details of the Commonwealth government's carbon price policy, Prime Minister Julia Gillard acknowledged the importance of public transport in the abatement of transport sector emissions. Curiously, petrol for private motorists will not be subject to a carbon price, yet public transport fares will, through the application of a carbon price on inputs such as electricity and diesel fuel after 2014. In its current form, the carbon price effectively reinforces the modal inequity between private and public transport.

It is important to acknowledge that household compensation measures will be designed to incorporate price impacts on public transport fares. However, relative to petrol prices, the visible price impact on public transport fares resulting from the carbon tax is likely to drive a mode shift away from public transport. This must be addressed by complimentary measures to provide a price incentive for consumers to choose public transport.

### **Easing cost of living pressures**

One of the consequences of a high dependency on cars and a low population density is that transportation costs in Australian cities (both private and public transport) as a proportion of each city's wealth (measured in gross regional product, or GRP)<sup>12</sup> are amongst the highest in the developed world. Transport costs rank alongside food and housing costs as one of the top expenditure items for Australian households – 16 per cent of disposable income is spent on transport, and as much as 20 per cent for families with dependent children.<sup>13</sup>

Volatility in global oil prices poses an omnipresent risk to household budgets, and the upward trend in petrol prices over recent decades means that the proportion of disposable income

<sup>11</sup> TTF position paper: *Public Transport and Climate Change*: October 2009, <http://www.ttf.org.au/Content/ptclimatechange.aspx>

<sup>12</sup> *Overcoming Automobile Dependence*, Newman and Kenworthy, 1999

<sup>13</sup> ABS Data: Household Expenditure Survey, Australia: Summary of Results, 2009-10.

allocated to transport costs is more than likely to increase over time. Indeed, ABS statistics show that household expenditure on transport increased by 17 per cent between 2003-04 and 2009-10.<sup>14</sup> As it stands, this trend carries obvious implications for the cost of living. In the future, if continued unabated, increasing transport costs will seriously threaten the economic, social and environmental sustainability of our cities.

### **Easing the tax burden on business**

Current discussion and debate around tax reform suggests there is unanimous acknowledgement of the need to ease the tax burden faced by businesses. Fringe benefits provide an opportunity for businesses to reduce payroll tax liabilities, thereby improving cash-flow. It is worth noting that the Henry review rated state-based payroll tax among the most economically inefficient taxes in terms of consumer welfare.<sup>15</sup>

The measures proposed in this paper would enable businesses to take advantage of a reduction in payroll tax liability, whilst simultaneously contributing to the broader economic, environmental and social benefits associated with public transport use. Increasingly, US employers are choosing to offer such tax incentives as part of corporate social responsibility obligations – a recent survey revealed that 75 per cent of companies agreed they had a responsibility to support the use of public transport in the communities they serve.<sup>16</sup> Similar incentives, if implemented in Australia, would encourage the business community to play a more active role in fostering productivity and reducing carbon emissions.

### **A level playing field for transport modes**

Recent reforms to fringe benefits tax (FBT) concessions for salary packaged vehicles have removed incremental tax incentives based on the distance driven. TTF believes the single rate of 20 per cent for all statutory formula FBT claims is an important first step in addressing the inequity in the tax treatment of private and public transport. Notwithstanding this, the standard FBT rate for employer-provided public transport expenses (46.5 per cent) remains more than double that of the statutory formula rate for car fringe benefits.

The economic, environmental and social benefits of public transport, outlined previously, are well documented and undisputed. There is therefore a compelling argument for the treatment of transport under the tax system to provide an equal or greater incentive for those taxpayers who make more sustainable transport choices.

## **Using price signals to manage transport demand**

### **Stimulating demand**

Taxation is the most powerful and effective lever available for governments to encourage consumption and spending that achieves favourable economic, social and environmental outcomes. Currently, FBT provisions for private vehicles and the carbon price mechanism create a set of price signals that threaten to increase urban congestion and transport sector carbon emissions by increasing the relative cost of public transport.

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<sup>14</sup> Ibid.

<sup>15</sup> Australia's Future Tax System (Henry Review), Report to the Treasurer (2009): Overview, page 13.

<sup>16</sup> TransitCenter: 2010 Commuter Benefit Impact Survey.. Page 23.

By the same measure, the provision of a price incentive to use public transport can result in a significant shift in demand toward the more sustainable option. In Melbourne, for example, a 20 per cent increase in the price of a train ticket would result in an eight per cent decrease in preference away from that mode, while an equivalent discount would result in a 42 per cent increase in demand.<sup>17</sup>

Tax incentives for public transport should be seen as an opportunity for government to directly influence transport demand and exert a degree of control over externalities such as congestion and carbon emissions.

### Distributing demand

Equally important to how commuters choose to travel is when they choose to travel. Distributing transport demand to minimise congestion externalities already occurs through differential pricing of public transport fares, toll roads and parking fees at different times of the day – typically in off-peak or peak-shoulder periods. However, a significant obstacle to the take up of these discounts by commuters is the lack of flexibility in working hours. Put simply, employers are given no incentive to offer workers flexible start and finish times.

In tandem with measures to drive a broader mode shift, further tax incentives must be offered to employers who encourage off-peak and contra-peak commuting. TTF research indicates that while patronage growth is desirable in terms of positive externalities, growth in peak periods alone would place substantial pressure on funding sources in the provision of extra capacity.

**Table: Qualitative impacts of patronage growth<sup>18</sup>**

Type of patronage growth	Impact	Employer impact	Employer benefit
	Public Transport Cost	Congestion	Other externality benefits
Growth in super-peak			
Growth in peak-shoulders			
Growth in contra-peak			
Growth in off-peak (day)			
Growth in off-peak (night)			

Favourable   Neutral   Unfavourable

<sup>17</sup> Metlink (2010): Melbourne Transport Demand Modelling Phase 2 initial report.

<sup>18</sup> Source: LEK Consulting (2010), 'Meeting the funding challenges of public transport', a report for TTF Australia, page 43.

As shown in the above table, maximum benefits for both employers and government can be achieved through patronage growth in the shoulder-peak and contra-peak. Accordingly, government can stimulate demand through the provision of progressive tax incentives for CBD employers who offer flexible work hours, and further incentives for employers in decentralised locations to encourage greater contra-peak use of public transport.

Tax incentives can also serve to underpin overall demand for public transport, providing a degree of certainty to operators with regards to fare revenue. For example, the US commuter benefits scheme provides a steady and reliable source of revenue for transport operators – in 2005, operators reported that up to 30 per cent of total fare revenue in Washington, DC and 42 per cent in Seattle was attributed to commuter benefits programs.<sup>19</sup> Furthermore, some 41 per cent of employees who use the scheme increase their use of public transport during the week and 46 per cent do so on weekends.<sup>20</sup> Higher fare revenue equates to better service standards and lower public subsidies. Sustained growth in demand for public transport services can also support higher urban densities along growth corridors, playing an important role in the sustainable growth of major cities.

## A tax system for sustainable transport

As Australia moves toward a carbon-constrained economy and a tax and transfer system that rewards sustainable consumption choices, TTF believes there is a strong case to revisit the idea of using taxation to encourage the shift towards sustainable transport.

The proposal to offer tax incentives for individuals' public transport expenses, whilst popular in countries such as the US, Canada and Ireland, has gained little support from policy makers in Australia. In the past, Treasury officials have been dismissive of the notion, claiming it would in effect provide a tax deduction for private expenditure.<sup>21</sup> This assertion overlooks the overwhelming triple bottom line benefits associated with public transport use, and reduced urban congestion. To this end, TTF believes tax reform in the passenger transport sector must be approached in the context of the productivity and sustainability gains associated with expenditure, rather than arbitrary definitions of 'private' versus 'work-related' expenditure.

There are three obvious methods available to stimulate transport demand through tax measures; tax deductions, rebates and fringe benefits tax (FBT) exemptions. Analysis of these three options based on efficiency, visibility, equity and simplicity suggests that an FBT exemption, as provided in the US Commuter Benefits scheme, would provide the most effective tax incentive for public transport users.<sup>22</sup> Furthermore, the requirement for employers to opt in means that tax-free fringe benefits or allowances would be closely linked to workplace productivity gains.

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<sup>19</sup> Mass Transit Magazine (US), August 2007: 20 Years of Commuter Benefits: Where We've Been and Where We're Going.

<sup>20</sup> TransitCenter: 2010 Commuter Benefit Impact Survey. Page 1.

<sup>21</sup> Australian Senate Rural and Regional Affairs and Transport References Committee (2009) *Investment of Commonwealth and State funds in public passenger transport infrastructure and services*.

<sup>22</sup> Ernst and Young (2006) NSW Ministry of Transport: Tax Incentives for Public Transport Users, p12

### **Case study – Commuter benefits in the USA**

For over 20 years, US commuters have had access to tax-free fringe benefits for employer-provided public transport costs. Internal Revenue Service code section 132(f) allows employers to provide employees with a tax-free allowance for the payment of expenses related to commuting such as public transport fares, eligible parking, vanpooling or bicycle commuting.<sup>23</sup> In practice, participating employers use this provision to allocate a proportion of employees' pre-tax earnings to relevant commuting costs up to a monthly cap of \$230 per employee (\$2,760 per year).<sup>24</sup> Eligible employees are also able to "cash out" the value of employer-provided parking spaces as a tax-free salary bonus.<sup>25</sup>

For employees, the use of pre-tax earnings reduces the cost of commuting and results in a comparative increase in take-home pay, after transport costs are paid for. The benefits to employers include a reduction in payroll tax liability, the ability to encourage employees to choose efficient modes of commuting thus minimising lost productivity due to congestion, and an attractive employment condition to offer workers in a competitive labour market.

Nationally, approximately 21 per cent of companies offer tax-free commuter benefits, a number that has increased at a time when the scope and volume of benefits offered by employers has generally declined due to deteriorating economic circumstances in the US.<sup>26</sup> The percentage of all commuter journeys covered by the scheme varies between 10 and 20 per cent, and is higher in cities with heavier public transport use. In 2009, the city of San Francisco made it mandatory for companies with more than 20 employees to offer tax-free commuter benefits and other major cities are now set to follow this initiative.

The US Environmental Protection Agency (EPA) estimates that a full commuter benefits program can achieve a 30 per cent reduction in peak motor vehicle use and associated emissions for any given workplace.<sup>27</sup> Overall use of public transport by employees increased 10 to 50 per cent at workplaces that implemented a commuter benefits program, with 10 to 25 per cent of participants being new users.<sup>28</sup> These congestion and emissions reductions are likely to have further increased since the monthly allowance cap was doubled in 2009.

## Recommendations

TTF recommends the following reform measures for the taxation of passenger transport:

1. *The provision of tax-free fringe benefits for commuting costs, applicable to public transport fares and park-and-ride costs.*

This would provide multifaceted benefits to employees, employers and government. Employees benefit through lower relative commuting costs and higher take-home pay after these costs are

<sup>23</sup> TransitCenter: IRS Tax Code 132(f). Retrieved 15/08/2011 from: [http://www.transitcenter.com/employers/irs\\_tax132f.aspx](http://www.transitcenter.com/employers/irs_tax132f.aspx)

<sup>24</sup> It is important to note that this allowance was increased from \$120 in March 2009 as part of the US economic stimulus package. The Washington Post, (26/2/2009): *Stimulus Fund Package Almost Doubles Allowance*, retrieved 5 October 2010 from <http://www.washingtonpost.com/wp-dyn/content/article/2009/02/25/AR2009022503303.html> and Washington Metropolitan Transit Authority, *Tax Advantages and the Law*, retrieved 5 October 2010 from [http://www.wmata.com/business/employer\\_fare\\_program/tax\\_advantages.cfm](http://www.wmata.com/business/employer_fare_program/tax_advantages.cfm).

<sup>25</sup> Ernst and Young (2006) *NSW Ministry of Transport: Tax Incentives for Public Transport Users*, p22-23.

<sup>26</sup> TransitCenter: 2010 Commuter Benefit Impact Survey. Page 1.

<sup>27</sup> Figures cited relate to a monthly benefit cap of \$100 and 100 per cent take-up by employees. Replogle, M. (2002): Address to the Committee on Transportation and Infrastructure, U.S. House of Representatives, May 21, 2002.

<sup>28</sup> Mass Transit Magazine (US), August 2007: 20 Years of Commuter Benefits: Where We've Been and Where We're Going.

incurred. Employers stand to benefit through lower payroll tax liabilities and the option of attracting employees by offering such benefits.

For government, the provision of commuter benefits provides an additional lever to stimulate demand for transport modes that combat urban congestion and reduce carbon emissions. As stated, this tax incentive would also serve as a complimentary policy measure to offset the impact on public transport costs resulting from the carbon price.

TTF believes an initial monthly cap of \$75 per employee<sup>29</sup> would provide an effective price incentive to address the modal inequity provided by the current FBT provisions for private vehicles, as well as price impacts resulting from the carbon tax. The quantum of a monthly or annual cap would of course be set at the discretion of government, and may be increased or decreased as demand or budgetary factors dictate. The US example shows how an allowance cap can be increased to promote sustainable transport and ease cost of living pressures during periods of recession.

*2. Tax incentives for employers A) in CBD areas offering flexible work hours; and B) in decentralised areas offering public transport incentives such as those outlined above.*

As mentioned previously, patronage growth on peak-shoulder and contra-peak public transport services provides optimal outcomes for government and employers. If implemented, this measure would ensure state and federal tax policies complement one another, achieving the common goal of tackling congestion and reducing transport related carbon emissions.

While recommendation 1 would adversely impact state payroll tax revenue, linking progressive payroll tax rates with sustainable transport incentives would create savings elsewhere, by promoting the optimal use of existing infrastructure and improving the cost efficiency of public transport services, which are already subsidised by up to 80 per cent.

### **Implementation**

With electronic smartcard ticketing now in place or in the process of implementation in every major metropolitan transport network, the implementation of salary packaged public transport incentives would be simple, and resilient to fraud. Stored-value smartcards allow for employers to simply transfer a nominated amount of pre-tax earnings to an employee's smartcard account, either directly or via a third party administrator.

### **Budget impact**

The impact of this reform on the budget bottom line is difficult to quantify, as it would depend on both the rate at which employers choose to initiate schemes and the rate at which employees take up the offer. Evidence from the US suggests that a realistic medium term penetration rate would be between 10 and 20 per cent of total public transport patronage.

In considering the budget impact of the proposed measure, it is important to note firstly that on average, Australian taxpayers claim \$2,008 in work related tax deductions per year, with little guarantee that this expenditure is linked to increased productivity. Secondly, the Commonwealth

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<sup>29</sup>Based on approximately half of the average annual expenditure on public transport by Australian commuters of \$1,760. Source: Ernst and Young (2006) *NSW Ministry of Transport: Tax Incentives for Public Transport Users* p18. Based on assumed average annual expenditure on public transport of \$1,573, CPI adjusted to 2010 values.

already subsidises salary packaged private vehicles and related expenses to the tune of \$600 million per year, reinforcing the existing inequity between modes, and exacerbating urban congestion – the cost of which is currently \$12.1 billion per year, and set to increase to over \$20 billion by 2020. TTF contends that reductions in these externalities, improvements in workplace productivity and consumer welfare as well as reductions in transport sector carbon emissions would effectively offset the budget impact of the proposed measures.

## Concluding remarks

Recent debate over tax reform has sought to iron out economic inefficiencies and promote sustainable consumption. Relatively progressive transport taxation policies are in place in countries such as the USA, Canada and Ireland, suggesting that Australia can do more to use taxation to drive sustainable transport choices.

With public transport set to play an increasingly important role in the mitigation of climate change and productivity of our cities, there is a strong case to use taxation to underpin demand for public transport. Sustaining this demand through price signals will reduce congestion and maximise economic returns on investments made in transport infrastructure and services.

As this paper argues, tax-free fringe benefits for public transport expenses provide an effective mechanism to promote patronage, whilst providing favourable tax outcomes for both employees and employers.