

Friday 8 Jan 2016

NSW Hire Car Association – Response to ATO Questionnaire

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Dear Paul,

Thank you for the opportunity to respond to this questionnaire and to be part of the ATO review of the Effective Life of Hire Cars.

It is very important before pressing into the detail of the questionnaire to outline some thoughts on the definitions in use and the implications of the new framework of the point-to-point transport landscape as announced by the NSW Ministry of Transport in late December 2015.

The two definitions used in the introduction and throughout the questionnaire are:

Physical Life	<p>We agree this definition <i>can be seen as the outer limit of a vehicles effective life and is a useful starting point for an analysis of the factors to be considered in determining the effective life of the asset.</i></p> <p>What we would like to add is that “physical life” is not the primary determinant of the effective commercial life of a vehicle used for hire car services.</p>
Effective Life	<p>We agree that the <i>effective life is used to work out an asset’s decline in value (depreciation deduction) and it is made having regard to the period the depreciating asset can be used for a purpose specified in subsection 40-100(5) of the Income Tax Assessment Act 1997 (ITAA 1997), one of which is a taxable purpose.</i></p> <p>We also agree on the basic factors that the Commissioner considers in determining the effective life a vehicle as outlined in TR 2015/2 outlines in paragraph 23:</p> <ol style="list-style-type: none"><li>1. physical life</li><li>2. manufacturing specifications/engineering information</li><li>3. use of the asset in a particular industry</li><li>4. use of the asset in different industries</li><li>5. industry standards</li><li>6. repairs and maintenance</li><li>7. retention period</li><li>8. obsolescence</li><li>9. scrapping or abandonment practices</li></ol> <p>We cannot determine if this list is based on order of importance. If the answer is yes then would like to submit that the order of importance is not accurate for the hire car industry. The 2 most important factors in this list as they relate to the hire car industry are i) obsolescence and ii) retention period.</p>

One aspect of operating hire cars that is not addressed in this questionnaire is vehicle depreciation and associated cost limits currently in place. I have made reference to this in the last questionnaire point under **General** but wanted to table it up front also.

Currently updates to the depreciation cost limits are released by the Tax Office once a year.

The depreciable cost of motor vehicle is also subject to the Luxury Car Limits, which assumes an upper limit on the cost. If the vehicle costs more than the limit, depreciation is only calculated on the limit:

- for 2014-15 \$57,466 (TD 2014/17)
- for 2013-14 \$57,466 (TD 2013/15)
- for 2011-12 \$57,466 (TD2012/16)
- for 2012-13 \$57,466 (TD2011/18)

Given the new framework announced by the NSW Ministry of Transport in December 2015 and the introduction of ride sharing as a class of point-to-point transport it is our view that hire car services will continue to evolve towards a premium service requested by private wealth and executive corporate travellers.

Given this customer demographic we predict that more than ever before hire car operators will have to provide top-end differentiated vehicles and services in order to stay ahead of the competitive curve.

It is our view that the real effective commercial life of a hire car will be a maximum of 4 years although there will continue to be operators who turn their vehicles around every 2-3 years by requirement of their high end customer base.

In addition it is our view that increasingly hire car operators will invest in higher value vehicles as required by their customers and that depreciation laws should take this into account and allow depreciation across the full value of a vehicle used for hire car purposes. This is now especially valid given the new industry framework regulations have capped the number of hire car plates and indicated that no new hire plates will be issued. This means that all issued hire car plates are currently operated by genuine hire car operators and that increasing the depreciation limits will not be subject to fraud or abuse but will allow existing operators to depreciate specialised vehicles genuinely purchased for provision of services to clients.

If you have any questions regarding the introduction or any of the responses, please don't hesitate to contact me via phone or email on 0421 339 559 or [ritta.khoury@carsondemand.com.au](mailto:ritta.khoury@carsondemand.com.au).

Regards

**Ritta Khoury**  
**Director NSW Hire Car Association**

## **ATO Questionnaire – Effective life of Motor cars - Hire cars**

This questionnaire seeks information on the factors the Commissioner typically considers when making determinations of the effective life of a depreciating asset, in this case, **hire cars, being cars operating on a pre-booked basis only (as opposed to taxis). The determination is meant to cover luxury sedans, stretched limousines, hybrids and non-luxury vehicles as they are used as hire cars.** The ATO's effective life ruling ([Taxation Ruling TR 2015/2](#)) currently shows an effective life of 5 years for 'hire and travellers' cars' – an entry that can be traced back to at least 1936. This entry is currently being reviewed.

The effective life is used to work out that asset's decline in value (depreciation deduction) and it is made having regard to the period the depreciating asset can be used for a purpose specified in subsection 40-100(5) of the Income Tax Assessment Act 1997 (ITAA 1997), one of which is a taxable purpose.

TR 2015/2 outlines in paragraph 23 the factors the Commissioner typically considers when making a determination of effective life. These factors form the basis of the questionnaire below:

Factor	General comments	Observations in relation to hire cars	Queries	Reply/comments
<p><b>Physical life:</b></p>	<p>An asset can be used while it continues to have a physical life, that is until it is physically exhausted.</p> <p>An asset's physical life can be seen as the outer limit of its effective life and is a useful starting point for an analysis of the factors to be considered in determining the effective life of the asset.</p>	<p>Hire cars are similar to taxis in terms of the service they provide, but being a pre-paid booking service, it would appear that such vehicles would not be required to travel the same high number of kilometres a taxi would typically be subject to in any given year.</p>	<p>(i) Do you have any data as to the typical operating life of a hire car?</p> <p>(iii) Would you agree with the statement that hire cars would generally have a longer operating life or economic life compared to a taxi because they would typically not be required to be driven as often as a taxi?</p>	<p>(i) We do not have conclusive data regarding the operating life of a hire car. But, we can provide information based on collective experience of tenured operators who have been in the industry for the past 20-40 years. The average "physical life" that would allow a vehicle to be safely operated as a hire car would on average be 7 years. But it is very important to understand that the "physical life" of a hire car is not the primary determinant of the practical "commercial life" of a hire car.</p> <p>(ii) The "physical life" of a hire car would definitely be longer than the "physical life" of a taxi due to the likelihood that on average they would travel slightly less kilometres compared with taxis and subsequent related wear and tear on the vehicles.</p> <p>(iii) <b><u>IMPORTANT ADDITIONAL CONSIDERATION</u></b> Kilometres travelled and general road worthiness are not the primary determinants of the effective life of a hire car. Hire cars are retired much sooner than their "physical life" allows due to other pressures</p>

Factor	General comments	Observations in relation to hire cars	Queries	Reply/comments
				<p>and requirements of providing a premium service to customers with high expectation for the vehicle used to fulfil the hire car service.</p> <p>One particular operator in our industry currently retires their cars after 2 years as they service a large celebrity base who have very high standards for type of vehicle.</p> <p>Another operator has indicated they could turn around vehicles 2-3 years due to very high standards of premium high wealth travellers travelling into Australia for the Casino and gambling venues and facilities.</p> <p>It is imperative that these factors be taken into consideration when determining the true “effective life” of a hire car.</p>

<p><b>Manufacturing specifications / Engineering information</b></p>	<p>The effective life of a new asset cannot be based solely on evidence of past use of the asset. The current design may differ for a variety of reasons including advances in technology and different construction materials.</p> <p>Accordingly, an analysis of manufacturing specifications and engineering information relevant to the new asset is an important factor in estimating its effective life.</p>	<p>The current effective life of 5 years for hire cars was determined in 1936. In the 70+ years since then there have been significant changes in the design of cars generally.</p>	<p>(i) Have there been any increases in the operating lives of hire cars because of the changes in vehicle design over the years i.e. are today's vehicles operationally viable for significantly longer periods than vehicles used as hire cars in the previous century when the current 5 year effective life was determined?</p> <p>(ii) Has there been any effect on the operating life of hire cars due to the use of new vehicle types e.g. hybrid vehicles?</p> <p>(iii) Is there anything on the horizon that might significantly impact the expected operating life of hire cars e.g. electric vehicles?</p>	<p>(i) Yes, as previously stated a new vehicle used to provide hire car services can have a "physical life" of up to 7 years if it is operated by one driver.</p> <p>This "physical life" is significantly reduced if the vehicle is operated by 2 drivers who take one day-shift and one night-shift each each day. In this scenario the hire car would accumulate substantially more kilometres and associated wear and tear similar to that of a taxi and the physical life would be substantially reduced to around 4 years.</p> <p>(ii) UNABLE TO COMMENT Hybrid vehicles have not been in use long enough or widely enough to understand any impact on the operating life of such vehicles.</p> <p>(iii) Yes, there are definitely a number of emerging technologies such as <b>electric cars</b> and <b>driverless cars</b> which are most likely to have substantial impact on both the physical life and effective life of vehicles used for hire car purposes.</p> <p>But, such vehicles are not currently in use and only time and experience will determine the suitability of such vehicles and the subsequent physical and effective life of using them for hire car purposes.</p>
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<p><b>Use of the asset in a particular industry</b></p>	<p>How intensively an asset is used in an industry would have a direct impact on the asset's effective life. In establishing the industry norm, the relevant industry is consulted wherever possible.</p>	<p>Intuitively, a hire car would not typically be expected to travel the same number of kilometres as a taxi would in any given period.</p>	<p>(i) Would this observation mean the effective life of hire cars would reasonably be expected to be longer than the 4 years determined for taxis?</p>	<p>As outline above it is generally reasonable to expect that the "physical life" and therefore "effective life" of a hire car can be extended up to 7 years if operated by a single independent driver.</p> <p>This physical life is substantially reduced to 4 years if there are 2 independent drivers who operate the vehicle in partnership. This is quite commonplace – especially for ex-taxi drivers who leave the taxi industry with private clients who follow them and they run their hire car as they used to run a taxi with day/night shifts. Even with the exception of hail and rank privileges such cars can rack up substantial kilometres and associated wear and tear similar to a taxi.</p> <p>Also very importantly, for larger operators in the hire car industry physical life is NOT the primary determinant of the effective life a vehicle in their fleet. For larger operators who work with premium clients it is imperative that vehicles be kept current and immaculate to the standard of the very demanding private wealth and corporate customers. For such operators the <i>true effective life</i> a hire car is 2-3 years.</p>
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<p><b>Use of the asset in different industries</b></p>	<p>The use of an asset in different industries is another important factor.</p>	<p>The Commissioner's effective life ruling (TR 2015/2) uses a taxi as an example of how this factor would generally operate so that different effective lives are appropriate for different vehicles:</p> <p><i>For example, the use of a car in the taxi industry would subject the car to more wear and tear than the use of a car in another industry. Accordingly, the effective life determined by the Commissioner in each industry would be different, reflecting that different use.</i></p> <p>The operation of this factor has led to different effective lives being determined for cars as generally used (8 years) and a taxi (4 years).</p>	<p>(i) If the observation that a hire car is not as heavily utilised as a taxi is correct then an effective life as short as 4 years may not be appropriate. Nonetheless, in your opinion, does the degree of utilisation of hire cars mean an effective life shorter than the 8 years determined for motor cars as generally used is appropriate?</p>	<p>Yes we absolutely agree that the effective life of hire cars is shorter than 8 years.</p> <p>What we would add is that there is no definitive "effective life" for hire cars and instead a range must be used depending on the type of hire car operator and the purpose of the vehicles used to the hire car service.</p> <p><b>General Hire Car Usage</b> For the general use of hire cars by driver managing the vehicle as an independent operator then the "effective life" of the hire car could be up to 7 years and should be eligible for depreciation over that period.</p> <p><b>Specialised Hire Car Usage</b> For larger operators it is a critical requirement of their business that they keep their cars more current and will need to turn their cars around every 2-3 years. For such operators the depreciation period will not likely run the full allowed period per vehicle but be renewed with each new vehicle upgrade.</p> <p>For these specialised hire car operators it is very important to also consider the cost of the vehicle and allow for depreciation across the full cost of the vehicle and beyond the current limits of \$57,466.00.</p>
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<p><b>Industry standards</b></p>	<p>Industry standards and regulations may dictate the time at which a particular asset must be retired from use in an industry.</p> <p>There may also be industry standards and regulations which set the level of repairs and maintenance that must be carried out.</p>	<p>None</p>	<p>(i) Are there any industry standards or regulations that dictate the maximum age a vehicle can be used for hire car purposes and/or an age at which a hire car must be retired from use as a hire car?</p> <p>(ii) Are there any other regulations that impact the effective life of a hire car e.g. are there any industry standards or regulations that dictate the timing of maintenance etc.?</p>	<p>(i) The hire car industry has been deregulated since 2001. During that time there have not been any specific industry standards other than general roadworthiness of a vehicle.</p> <p>It is entirely up to individual or fleet operators to maintain their vehicles to the standards that are required by their target customers.</p> <p>(ii) Regarding industry standards: As previously indicated some individual operators might retain a vehicle for up to 7 years while others turn their vehicles around every 2 years.</p> <p>In general the operators who generally target the private wealth and executive corporate clients are by the nature of their premium service required to keep vehicles current and near new in order to remain competitive and satisfy the taste and demand of their customer base.</p>
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<p><b>Repairs and maintenance</b></p>	<p>It might be suggested that the life of an asset can be extended indefinitely if there is unlimited expenditure on repairs and maintenance. However, paragraph 40 100(6)(b) requires the Commissioner to assume that an asset will be maintained only in reasonably good order and condition. Accordingly, an asset's effective life will generally be limited by the period it is economic to maintain the asset, even though it would still be possible to continue repairs and maintenance to keep it operational.</p> <p>An asset can be subject to such a level of repairs and maintenance that the point of time arrives when it has been wholly or substantially physically replaced. In those circumstances, the effective life of the asset would be considered to have ended and a new asset to have come into place.</p>	<p>If hire cars are typically more heavily utilised than motor cars generally, additional repairs and maintenance might be required.</p>	<p>(i) Are additional repairs and maintenance required for hire cars compared to motor cars as generally used?</p> <p>(ii) What is the typical repair and maintenance regime for a hire car?</p> <p>(iii) Are there any major repairs over and above normal maintenance that are required after a certain number of kilometres have been driven e.g. replacement of the engine?</p> <p>(iv) Is there a time (e.g. after a certain number of kilometres have driven) where it is typically more economical to replace the hire car rather than incur further costs of major repairs?</p>	<p>(i) Yes definitely.</p> <p>(ii) This varies according to make of care but generally it is the recommended service intervals of the manufacturer – which are reached quicker as hire cars on average travel 10,000 km every 2 months.</p> <p>(iii) Again this varies by make of car but after 300,000 km vehicles will invariably require some major fix such as new gear box, engine, diff and wheel bearings</p> <p>(iv) Yes, usually at 500,000 km maximum.</p>
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<p><b>Retention period</b></p>	<p>The effective life of an asset is the total period it can be used by any entity for a specified purpose<sup>1</sup>. The retention period is the time a particular taxpayer expects to hold a depreciating asset for any purpose.</p>	<p>TR 2015/2 uses a car as an example of how this factor impacts effective life. That is, it is common practice in some businesses to dispose of a car after it has been driven a pre-determined number of kilometres. That would be the retention period for that taxpayer. The effective life of the car, however, would end only when the car cannot be used by any taxpayer for a specified purpose.</p> <p>However, this might not be the case where a car has been used as a hire car because of the larger number of kilometres a hire car will likely travel when initially owned.</p>	<p>(i) Do hire cars typically only have one owner in their operating life or is there a second-hand market for hire cars within the industry i.e. they typically have more than one owner in their use as a hire car?</p> <p>(ii) If there is a viable second-hand market within the industry, that is, is it commonplace for hire cars to be on-sold as relatively short-lived vehicles?</p>	<p>(i) Generally a hire car is not on-sold within the industry. An operator will usually sell the car for private use outside the industry.</p> <p>(ii) As indicated previously, some operators can turn over vehicles after 2 years. But the most common practice is to sell them onto to private customers within 4-5 years and not within the industry.</p>
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<sup>1</sup> A specified purpose is a taxable purpose, the purpose of producing exempt income or non-assessable non-exempt income, or the purpose of conducting R&D activities (assuming that this is reasonably likely).

<p><b>Obsolescence</b></p>	<p>An asset may become obsolete because of commercial or technological reasons.</p> <p>Commercial obsolescence may occur if, for instance, market demand for the goods produced by the asset ceases through consumer preference or Government regulation.</p> <p>Technology may advance so that another asset is better suited for the relevant purpose for which an existing asset is used.</p> <p>There are two types of obsolescence – that which can be predicted at the time the asset is first used and that which is unpredictable and emerges later. Unpredictable obsolescence cannot be taken into account when making an estimate of effective life. Predicted obsolescence would only be taken into account if it is predicted with a high level of certainty across a majority of users.</p>	<p>Commercial obsolescence may have some impact on the hire car industry because of the greater need for a hire car to be an attractive, well maintained late model vehicle compared to a taxi where appearance is of less importance.</p> <p>Technological obsolescence may also be a factor if new car making technologies e.g. electric vehicles develop. However, this would appear to be too far in the future to be predictable and therefore not be a factor in determining the effective life of hire cars now.</p>	<p>(i) How much of an influence is commercial obsolescence on the effective life of a hire car i.e. does the need for a hire car to be well presented and a late model vehicle mean a hire car will be replaced or retired from use as a hire car even though it is still operating effectively mechanically speaking?</p> <p>(ii) Are there any technological changes happening now or in the immediate future in relation to rental cars that should be considered in the review of the current 5 year effective life?</p>	<p>(i) Commercial obsolescence is of paramount importance to hire cars operators.</p> <p>As indicated above many hire cars need to be maintained to extremely high standards as well-presented, late model vehicles are seen as mandatory by the target customer groups of private wealth and executive corporate clients. For such operators they turn their cars around every 2-3 years and at that time the cars are still operating mechanically and sometimes with still comparably low kilometres travelled. But, as stated above kilometres travelled and general wear and tear of the vehicle are NOT the primary determinants of the “effective life” of hire cars used at the premium end of the serve.</p> <p>(ii) As stated previously it is still too early to make any educated statements about the impact of new technologies on the effective life of hire cars. Hybrid cars have not been in use long enough to understand the impact on physical or effective life of vehicles used for hire car purposed. Also emerging technologies such as electric cars and driverless cars are not yet in place in our industry and therefore we have no understanding on how these types of vehicles might perform in terms of physical or effective life as hire cars.</p>
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<p><b>Scrapping or abandonment practices</b></p>	<p>Once a taxpayer has scrapped or abandoned an asset, there is a presumption it can no longer be used by anyone for a specified purpose. The scrapping of an asset can demonstrate that the asset is either physically exhausted or obsolete.</p> <p>This factor is only relevant to the Commissioner's determination of the effective life of an asset if a general scrapping or abandonment practice can be established across users of the asset.</p>	<p>The relevance of this factor largely depends on what typically happens to a vehicle when it is retired from use as a hire car.</p>	<p>(i) Are hire cars typically scrapped after they are retired from use as a hire car or are they sold into a second-hand market, be that within the industry or in the wider second-hand car market?</p> <p>(ii) If sold second-hand, are they only sold for what amounts to be scrap value or near scrap value?</p> <p>(iii) If there is a viable second-hand market for hire cars, are they most typically sold into private use rather than a taxable purpose (e.g. to be used in a business)?</p>	<p>(i) In general hire cars are usually sold into the wider private second hand car market.</p> <p>It should be noted that in some rare instances an individual operator may use the car well beyond its "effective date"</p> <p>(ii) In general ex-hire cars are sold for some inherent value (above scrap value) but they are usually identified as hire cars by their higher than normal kilometres travelled and therefore fetch a lower value than comparable age vehicles with lower kilometres.</p> <p>It is important to note that for hire cars sold at 2-3 years of age they are usually still in very good condition and can fetch good value in the private second hand car market.</p> <p>(iii) Hire cars would predominantly be sold into the private second hand car market.</p>
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<p><b>Lease periods</b></p>	<p>Because effective life is, among other things, the period a depreciating asset can be used for a specified purpose, it is unlikely that an asset would be leased for a period greater than its effective life.</p> <p>Consideration of this factor will, in many instances, suggest that the effective life of an asset is no shorter than the period it is leased.</p>	<p>For this factor to be relevant we would need to establish if leasing of vehicles to be used as hire cars is a common practice.</p>	<p>(i) Are vehicles used as hire cars generally purchased outright by operators or does leasing such vehicles sometimes occur?</p> <p>(ii) If leasing is undertaken, who are the major leasing companies operating as lessors of vehicles for use as hire cars?</p> <p>(iii) Do you have any idea of the typical leasing arrangements – operating leases or finance leases? Lease terms?</p>	<p>(i) Vehicles used for hire car purposes are predominantly leased through 'hire purchase' arrangements. This is almost always the case for new vehicles.</p> <p>Used vehicles are usually purchased from dealers and also predominantly via hire-purchase leases.</p> <p>In rare instances much older vehicles sometimes purchased by older individual operators can be purchased outright but generally that is not the practice.</p> <p>(ii) There is no common practice here and it could be through any lending institution – dealers, bank etc</p> <p>(iii) 3-5 years</p>
<p><b>Market value</b></p>	<p>The defining character of a depreciating asset is that its market value actually falls, or is expected to fall, over time.</p> <p>An analysis of the decline of market value of an asset class, therefore, is an important factor to ensure that a determination of effective life provides appropriate deductions for that decline in value.</p>	<p>When the 8 year effective life for cars generally was determined, market value analysis was able to be undertaken because of the deep secondary market.</p> <p>The extent of the secondary market for hire cars will determine if market value analysis will be a factor</p>	<p>(i) If in answering the questions regarding retention period and scrapping practices, you advised there is a viable second-hand market for hire cars, how difficult would it be obtain data on the decline of market value of vehicles that were previously used as hire cars?</p>	<p>We don't have access to that data and it would be hard to determine.</p> <p>Typically and ex hire car could be half the price of a comparable age vehicle with less kilometres travelled.</p>

<b>Generally</b>			After considering all the above factors, what is your estimate of the effective life of hire cars?	<p>Given the new framework announced by the NSW Ministry of Transport in December 2015 and the introduction of ride sharing as a class of point-to-point transport it is our view that hire car services will continue to evolve towards a premium service requested by private wealth and executive corporate travellers.</p> <p>Given this customer demographic we predict that more than ever before hire car operators will have to provide top-end differentiated vehicles and services in order to stay ahead of the competitive curve.</p> <p>It is our view that the real effective commercial life of a hire car will be a maximum of 4 years and that their will continue to be operators who turn their vehicles around every 2-3 years.</p> <p>In addition it is our view that increasingly hire car operators will invest in higher value vehicles as required by their customers and that depreciation laws should take this into account <b>and allow depreciation across the full value of a vehicle used for hire car purposes.</b> This is now especially valid given the new industry framework that has capped the number of hire car plates and indicated that no new hire plates will be issue. <b>This means that all hire car plates are currently operated by genuine hire car operators and that increasing the depreciation limits will not be subject to fraud or abuse.</b></p>
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