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Official Committee Hansard

SENATE

SELECT COMMITTEE ON A NEW TAX SYSTEM

Reference: A new tax system

THURSDAY, 4 MARCH 1999

SYDNEY

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SENATE
SELECT COMMITTEE ON A NEW TAX SYSTEM
Thursday, 4 March 1999

Members: Senator Cook (*Chair*), Senator Ferguson (*Deputy Chair*), Senators Conroy, Gibson, Murray, O'Chee and Sherry

Substitute members: Senators Brownhill, Chapman or Watson for Ferguson, Gibson or O'Chee; Senators George Campbell, Mackay or Murphy for Senators Cook, Conroy or Sherry; Senator Bartlett for Senator Murray

Participating members: Senators Brown, Colston, Harradine and Margetts

Senators in attendance: Senators Bartlett, George Campbell, Conroy, Cook, Ferguson, Gibson, Harradine, O'Chee and Sherry

Terms of reference for the inquiry:

- (1) That a select committee, to be known as the Select Committee on a New Tax System, be established to inquire into and report, on or before 18 February 1999, on the economic theories, assumptions, calculations, projections, estimates and modelling which underpinned the Government's proposals for taxation reform, contained in *Tax reform: not a new tax, a new tax system*.
- (2) That, in conducting its inquiry, the committee examine the following matters:
 - (a) the estimated levels of revenue to be generated or foregone due to the proposed changes, including the estimated level of revenue to be generated by imposing a goods and services tax (GST) on the basic necessities of life (such as food, clothing, shelter and essential services) and books;
 - (b) the effects of the proposed changes on:
 - (i) national Gross Domestic Product,
 - (ii) national export performance and national debt,
 - (iii) the national Consumer Price Index, and
 - (iv) the distribution of wealth in the Australian community;
 - (c) the effects of the package on future federal budget revenues, expenditures and surpluses, including a critical assessment of the economic assumptions underpinning the Treasury's projections in this regard;

- (d) the effects of the taxation and compensation package on disposable income and household spending power for a range of 'cameo profiles', including but not limited to those presented in the proposals, under the following scenarios:
 - (i) a GST extended to the necessities of life (such as food, clothing, shelter and essential services), and
 - (ii) a GST not extended to the necessities of life (such as food, clothing, shelter and essential services);
 - (e) with the aim of identifying families and groups who may be disadvantaged by the Government's proposals, focusing on lower and fixed income individuals, families with dependent children or adult members, groups and organisations, and those with special needs, such as people with disabilities;
 - (f) the assumptions made as to consumption and saving patterns and the cost of living for the various 'cameo profiles';
 - (g) whether the stated objectives of the package can be met by using an alternative and fairer approach; and
 - (h) such other matters as the committee considers fall within the scope of this inquiry.
- (3) That the committee also inquire into and report, on or before 19 April 1999, on the broad economic effects of the Government's taxation reform legislation proposals with regard to the fairness of the tax system, the living standards of Australian households (especially those on low incomes), the efficiency of the economy, and future public revenues, including:
- (a) the effects on equity, efficiency and compliance costs of including, or not including, food or other necessities of life in the GST, together with any related adjustments to the package if food or other necessities of life were GST zero-rated;
 - (b) the effectiveness of the package in easing the poverty traps facing people on low incomes, and reforming and streamlining tax and income support for families with children, taking into account the static and life-cycle impacts on families with children;
 - (c) options for amending the income tax schedule to make it more equitable;
 - (d) the findings of the Tax Consultative Committee chaired by David Vos;
 - (e) options for improving the effectiveness and fairness of the tax system and reducing inequitable or unreasonable tax avoidance and minimisation, including consideration of alternative areas for tax generation, either where there are current tax concessions or where Australia's taxation system does not address major tax potential, and without limiting the foregoing, the consideration of taxation of foreign companies operating in Australia, including the relative merits of resource rent taxes, royalties or land taxes as compared to company tax in securing a fair compensation to Australia for use of its resources, whether the 150% tax concession for research and development should be restored and whether small companies should be allowed to be taxed as partnerships.
 - (f) the potential for tax avoidance and evasion, including an examination of the effects on the cash economy, and the potential impact of electronic commerce on the future viability of a GST;

- (g) the effects on compliance costs;
- (h) the potential for reducing payroll tax, including by providing incentives to create long-term employment and by replacing payroll tax with a carbon tax;
- (i) whether there are other means available for rebating or reducing the indirect taxes or excessive user charges embedded in exporters costs;
- (j) excises, including those on fuel, tobacco and alcohol - identifying the industries which benefit, and to what extent, from the proposed changes to taxes on fuels;
- (k) the effects on interest rates;
- (l) the effects on investment, in both physical and human capital formation;
- (m) the effects on small business;
- (n) the effects on the non-profit sector, including the total amounts of money contributed by the sector, administrative costs, impacts on the viability of the organisations, and the consequent effects on the wellbeing of the community;
- (o) the effects of the GST on particular industries, including:
 - (i) key service industries such as tourism,
 - (ii) the Australian automobile and related industries, having particular regard to the effects of changes to fuel excises,
 - (iii) other 'invisible' export industries, such as education and financial services, and
 - (iv) the international competitiveness generally of Australian industries;
- (p) the implications of not requiring that the GST component of goods and services be itemised on receipts;
- (q) the effects of the taxation reform legislation proposals on rural and regional stakeholders, including:
 - (i) the effects on particular regions,
 - (ii) the effects on rural and regional communities of different tax regimes on fuel - especially the cost of transport of goods to rural communities,
 - (iii) the effects on primary industry of replacing the current sales tax exemption on agricultural machinery with a GST, and
 - (iv) the effects of imposing a GST on food and other necessities of life on remote communities, including Aboriginal and Islander communities;
- (r) the effects of the Government's taxation reform legislation proposals on state and local government administration, including:
 - (i) the effects of the package on future federal-state financial relations and the capacities of state and local governments to adequately finance their respective responsibilities in both the short-term and the long-term, including the effects of the proposed transfer of responsibility for local government financial assistance to the states, and whether it discriminates between states,

- (ii) the implications for specific purpose programs,
 - (iii) mechanisms required to lock in commitments made by federal and state governments with regard to the new arrangements,
 - (iv) the implications for future federal-state financial relations of not extending the GST to the necessities of life (such as food, clothing, shelter and essential services) and books, and any adjustments to the proposed arrangements which would be required to federal-state financial relations,
 - (v) the implications of the package for the quality and affordability of public utility services and for the public utility concessions for social security recipients,
 - (vi) the effects of application of the GST, and of changes to tax status, on local government and its activities, particularly commercial activities,
 - (vii) the implications for the delivery of Commonwealth Government services, including employment services, welfare and other social and cultural services, and
 - (viii) the extent to which the proposed compensation arrangements are secure from change to below adequate levels;
- (s) the adequacy of measures to ensure that consumers fully benefit from the abolition of existing taxes;
- (t) the effects of the taxation reform legislation proposals on legal and constitutional matters, including:
- (i) the constitutionality of the proposed mechanism for future changes to the GST, including whether such changes would present a significant hurdle to future increases, or reductions if deemed necessary to stimulate the economy,
 - (ii) the constitutionality of the proposed reorganisation of federal-state tax arrangements and whether the powers and functions of states and territories are materially affected by this reorganisation, and
 - (iii) the effects of the proposals on the cost of access to justice; and
- (u) options for amending the proposed legislation to improve its fairness or efficiency.
- (4) That, in reporting on the matters referred to in paragraph (3), the committee have regard to the reports of the references committees referred to in paragraph (17) and integrate the findings of those committees into its final report where relevant.
- (5) That the committee consist of 7 senators, 3 nominated by the Leader of the Government in the Senate, 3 nominated by the Leader of the Opposition in the Senate, and 1 nominated by the Leader of the Australian Democrats.
- (6) That the committee may proceed to the dispatch of business notwithstanding that not all members have been duly nominated and appointed and notwithstanding any vacancy.
- (7) That:
- (a) senators may be appointed to the committee as substitutes for members of the committee in respect of particular matters before the committee;
 - (b) on the nominations of the Greens or independent senators, participating members may be appointed to the committee; and
 - (c) participating members may participate in hearings of evidence and deliberations of the committee, and have all the rights of members of the committee, but may not vote on any

questions before the committee.

- (8) That the committee shall elect as its chair a member nominated by the Leader of the Opposition in the Senate.
- (9) That the committee shall elect as its deputy chair, immediately after the election of the chair, a member nominated by the Leader of the Government in the Senate.
- (10) That the deputy chair act as chair when there is no chair or the chair is not present at a meeting.
- (11) That the committee have power to send for and examine persons and documents, to move from place to place, to sit in public or in private, notwithstanding any prorogation of the Parliament or dissolution of the House of Representatives, and have leave to report from time to time its proceedings and the evidence taken and such interim recommendations as it may deem fit.
- (12) The quorum of the committee shall be a majority of the members of the committee.
- (13) The committee set 29 January 1999 as the date for receipt of submissions.
- (14) That the committee hold hearings in each state and territory as required.
- (15) That the committee be provided with all necessary staff, facilities and resources and be empowered to appoint persons with specialist knowledge for the purposes of the committee with the approval of the President.
- (16) That the committee be empowered to print from day to day such documents and evidence as may be ordered by it and a daily Hansard be published of such proceedings as take place in public.
- (17) That the following matters be referred to references committees in accordance with the schedule below for inquiry and report by 31 March 1999, and that in undertaking these inquiries the committees have regard to the report of the Select Committee referred to in paragraph (1) and consult widely, holding hearings in each state and territory, as required. Submissions to these inquiries are to be made by 29 January 1999.

Committee	Matters for Inquiry
Community Affairs	<p>The impacts of the Government's taxation reform legislation proposals on the living standards of Australian households (especially those on low incomes), including:</p> <p>(a) the scope and effectiveness of the proposed arrangements on charities, child care services, aged care services, welfare services, local government human services and all not-for-profit organisations in maintaining the quality and affordability of essential community services, including the implications for the public funding of these services and the implications for the commercial activities of these organisations, and whether unconditional GST-free status should apply to <i>bona fide</i> charities;</p>

	<ul style="list-style-type: none"> (b) a detailed examination of the zero-rating of health services, including an examination of which services should be zero-rated; (c) the effects on community sector organisations of changes to their tax exempt status, and of the compliance costs of the proposed tax arrangements; (d) the effects of the proposed private health insurance rebate; (e) the effects on people with disabilities; (f) the effects on public, community and private housing, including the levels of rents; and (g) options for amendments to improve the fairness or efficiency of the proposed legislation.
<p>Employment, Workplace Relations, Small Business and Education</p>	<p>The employment incentive and education impacts of the Government's taxation reform legislation proposals, including:</p> <ul style="list-style-type: none"> (a) the scope and effectiveness of the proposed zero-rating arrangements for education in maintaining its quality, accessibility and affordability; (b) the effects on employment; (c) the effects of the proposed GST treatment on the quality, accessibility and affordability of employment services; (d) the effects on education of imposing a GST on, or zero-rating or exempting books and associated education resources; (e) the effects on education of imposing a GST on ancillary resources, services and commercial activities, including the effects on overseas students; (f) the effects of the proposed changes to the tax system on employment; (g) the effects on wage costs, particularly if the basic necessities of life are taxed; (h) the scope and effectiveness of changing the unemployment benefits, pensions and Newstart Allowance 'tapers'; (i) the effects of the proposed changes to the tax system on training and adult education; and (j) options for amendments to improve the fairness or efficiency of the proposed legislation.

Environment,
Communications,
Information Tech-
nology and the
Arts

The broad effects of the Government's taxation reform legislation proposals on the environment, the arts and information technology, including:

- (a) the environmental effects, and likely impacts of changes to fuel excises, particularly but not only diesel, and the replacement of WST with GST on vehicles and other transport services including:
 - (i) possible increases in greenhouse gas emissions,
 - (ii) increases by amount and type of air pollution,
 - (iii) the effects on public and rail transport,
 - (iv) the effects on alternative energy use in transport including, but not limited to, compressed natural gas,
 - (v) the changed effects on native forests of logging or woodchipping due to the tax package, and
 - (vi) the changed effects of mining in environmentally sensitive areas due to the tax package;
- (b) the environmental effects of the replacement of Wholesale Sales Tax by the GST and associated changes in fuel excises on electricity and natural gas;
- (c) the impacts of the proposed tax changes on the prices and existing and potential use of renewable energy particularly but not only solar energy technology and energy efficiency equipment;
- (d) the environmental effects of any changes to taxes on exports;
- (e) the consistency or otherwise of the proposed changes in taxation and excise arrangements with Australia's international treaty obligations, including its obligations under the Framework Convention on Climate Change;
- (f) options for a tax system which better achieve environmental objectives, including incentives for fuel efficiency and alternative energy sources, such as measures which promote both environmental protection and employment generation;
- (g) the extent to which environmental impacts were considered in the drafting and final copy of the Government's tax package;

- (h) the scope of any consultation on environmental matters with experts in Environment Australia or any other Government departments other than the Treasury and Finance departments;
- (i) the impact of a GST on ticket sales for the performing arts;
- (j) the effects of a GST on the transfer of grant monies for arts projects;
- (k) the effects of the tax proposals on sponsorship provided by the private sector to individual artists and arts organisations;
- (l) the extent to which the package will block consideration and introduction of 'ecotaxes';
- (m) the effects of a GST on not-for-profit conservation and arts organisations; and
- (n) options for improving the environmental effects of the package.

(18) That the provisions of the bills implementing the proposed new tax system stand referred to the previously mentioned committees for inquiry and report in conjunction with the terms of reference authorised by this resolution, as soon as the bills have been introduced in the House of Representatives.

(19) That when the bills referred to in paragraph (18) are first introduced in the Senate and a motion is moved for the second reading of the bills, debate on that motion shall be adjourned at the conclusion of the speech of the senator moving the motion and resumption of the debate shall be made an order of the day for 19 April 1999 without any question being put.

WITNESSES

BARNES, Mr Peter Eric, Chairman of Tax Committee, Insurance Council of Australia Ltd	1554
BOWE, Mr John Laurence, President, Australian Taxi Industry Association	1542
CHARLES, Ms Therese Anne, Chief Executive, Association of Consulting Engineers Australia	1658
COOPER, Mr Gordon Stewart, Senior Vice President, Taxation Institute of Australia	1586
DENOVAN, Mr Jon, Partner, Mortgage Industry Association of Australia	1571
EDEMA, Mrs Victoria Anne Massey, President, Mortgage Industry Association of Australia, National Vice President, Mortgage Industry Association of Australia	1571
ELLIOTT, Mr Rob, Manager, Research and Policy, Australian Institute of Company Directors	1625
GOLDBERG, Dr John, Hon. Associate, Department of Architectural and Design Science, University of Sydney	1607

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STEWART, Mr Donald Grant, Finance Manager of Member Firm (Ove Arup and Partners), Association of Consulting Engineers Australia	1658
SYMOND, Mr John, Managing Director and Founder, Aussie Home Loans	1571
WARTON, Mr Paul John, Chairman, Indirect Tax Committee, Taxation Institute of Australia	1586

Committee met at 9.05 a.m.

CHAIR—Today the committee continues its inquiry into the proposed changes to the Australian taxation system. The Senate referred the inquiry to the committee on 25 November last year.

This hearing continues the second stage of the inquiry. In this stage, the committee will examine the broad economic effects of the government's taxation reform legislation proposals. It will take regard to the fairness of the tax system, the living standards of Australians, especially those on low incomes, the efficiency of the economy and future public revenues. The committee will report on the second stage of its inquiry by 19 April this year.

This committee called for submissions to be lodged by 29 January 1999. In fact, the committee is still accepting submissions and so far has received well over 1,300. This is the third public hearing to be held by the committee in Sydney in the course of this inquiry. In addition to this hearing, the committee will be conducting further public hearings around Australia.

The committee has released the submissions relating to stage 1 of the inquiry and the submissions of those witnesses who gave evidence at earlier hearings. The committee does not intend to release all of the remaining submissions as yet, except for the submissions by the witnesses who are giving evidence today.

It being the wish of the committee that submissions 964, 638, 899, 1268, 714, 589, 1072, 614 and 1319 be made public, I now declare that those submissions to this inquiry, together with their attachments, be released. For the record, this is a public hearing and as such members of the public are welcome to attend.

Before we commence taking evidence, let me place on record that all witnesses are protected by parliamentary privilege with respect to submissions made to the committee and evidence given before it. Parliamentary privilege means special rights and immunities attached to the parliament, or its members and others, necessary for the discharge of the functions of parliament without obstruction and without fear of prosecution. Any act by any person who operates to the disadvantage of a witness, on account of evidence given by him or her before the Senate or any committee of the Senate, is treated as a breach of privilege.

[9.07 a.m.]

BOWE, Mr John Laurence, President, Australian Taxi Industry Association

GUNNING, Mr Robert John, Adviser, Australian Taxi Industry Association

CHAIR—I now welcome Mr John Bowe and Mr Robert Gunning of the Australian Taxi Association. I invite you to make an opening statement addressing your written submission. Would you then be kind enough to be available for questions from the committee.

Mr Bowe—We are certainly pleased for the opportunity to appear on behalf of the Australian Taxi Industry Association to background the committee. The Australian Taxi Industry Association is a national association. It represents the associations and councils of taxi owner-operators in all states and territories of the Commonwealth.

We represent, as I said, the owner, the operator, the lessee operator and the taxidriver. As an industry we have taken the view that the Australian government is committed to implementing a new tax system, including a goods and services tax in the community interest. Our members will be best served by the Australian Taxi Industry Association concentrating on ensuring that a goods and services tax is implemented as efficiently as possible.

Over recent years we have had a number of contacts with the Australian Taxation Office. More particularly, since 1992 through to December of last year we have worked with the Australian Taxation Office to lift the level of compliance throughout the industry. There has been a significant improvement and I am pleased to say that we have achieved a high level of compliance within the industry.

The task the taxi industry faces in successfully introducing the government's tax package is undoubtedly more onerous than that faced by any other transport industry, and quite possibly any industry at all. Unlike other industries, the \$50,000 per annum threshold under which the individuals can effectively opt out of the GST system is denied to the Australian taxi industry.

Unlike any other industry, everyone in our industry will have to act as a GST tax collector. Our industry operates over 15,000 cabs with up to five drivers or operators per vehicle. This means around 70,000 taxidrivers and operators will be required to become registered businesses which charge GST.

On top of that, we have quite complex arrangements in our industry compared to other industries. Most of the taxidrivers in our industry work on a bailee system, either on a fixed pay-in or revenue share basis. Bailee drivers effectively hire the cab from the owner or head lessee operator, and operate the cab as their own business. Without going too far into all the different complexities involved, this means that we not only have around 70,000 taxidrivers and operators who are required to become registered businesses under the GST and charge taxicab customers but also have many participants involved in the taxi industry dealing with someone else in the industry.

Estimates by our state associations suggest that the drop-out rate from the industry amongst taxidrivens entering the industry is at least as high as 20 per cent after the first year and at times can be as high as 50 per cent. In the major cities of Australia, 70 to 80 per cent of our drivers have English as a second language.

To put this in another perspective, the federal government small business area has indicated to us that there are about 900,000 small businesses in Australia. We estimate that the taxi industry alone accounts for around seven per cent of this total. The number of transactions involved is very large. On average, each taxi undertakes around 11,500 to 12,000 hirings per year. As we said earlier, this is done with around 4.5 to five taxidrivens and operators per vehicle and, in most cases, there is a bailee-bailor relationship between the owner of the taxi lease, or the person who holds the head lease, and the driver. Furthermore, there is a relationship between the cab itself and the couple of hundred or so taxi cooperatives and networks that we have around Australia.

Our industry will be one of the most visible industries when the GST is applied. Without adequate support from the government's transitional support for the GST, we believe that the effectiveness of the whole system could be undermined. As we said earlier, the Australian Taxi Industry Association has made our major goal the task of ensuring that this does not happen.

To give the committee some idea of the issues: with the high levels of turnovers amongst drivers typically operating as bailees, we would not wish to see a situation emerge where people pay GST when they use the taxi, but the tax office does not receive those funds. We believe that this would generate significant adverse community reaction. We also do not wish to see a situation where our industry goes through a costly and confusing process as bailee drivers, taxi plate owners and operators, and networks or cooperatives work out how to handle the new system by trial and error.

To cope with implementing this system, we have identified a five-stage program to enable our industry to respond appropriately as outlined in our submission. We also have a number of specific areas which we believe require clarification. Of course, our submission makes clear that we see the Senate Select Committee on A New Tax System as a key part of developing a productive approach to implementation and assisting in resolving some of those uncertainties. Thank you.

CHAIR—Is it your intention to invite your colleague to supplement your remarks, or shall we go straight to questions?

Mr Gunning—We will go straight to questions.

Senator FERGUSON—Mr Bowe, have you surveyed the Australian Taxi Industry Association to find out what percentage of your users are business users and what are private? Have you ever done that sort of a survey?

Mr Bowe—Of business users?

Senator FERGUSON—Business users of taxis, yes.

Mr Bowe—As near as we can get—it has been a rough rule of thumb, at best—we are talking somewhere between 30 or 40 per cent.

Senator FERGUSON—Of business users?

Mr Bowe—Of business users. As I say, that is a very rough rule of thumb.

Senator FERGUSON—Of the private users of taxis, would it be generally accepted that they tend to come more from middle income people than they would from the lower end of the income range?

Mr Bowe—There has been a changing pattern, in my experience in the industry over many years. We find now that a large number of our users, certainly on a Monday to Friday, come from the lower social scheme of things—the pensioners, young people on the dole and the like. It has certainly altered over the years. When I was actively involved at the coalface, in the late 1960s and early 1970s, it was as you say, but that pattern has changed.

Senator FERGUSON—Do you think that is because taxis are now more affordable, or do you think people at the lower end of the scale have more disposable income?

Mr Bowe—I think that is something else that has changed. I think taxis are more affordable in the overall scale of things.

Senator FERGUSON—Your figures, in the table in your submission, indicate that there will have to be roughly a seven to eight per cent increase in the cost of fares to cover the added costs to your industry. In fact, that is going to make taxis cheaper for business, isn't it?

Mr Bowe—Yes, because they can—

Senator FERGUSON—They can claim it all back.

Mr Bowe—Yes.

Senator FERGUSON—There is a chance that businesses might find that using taxis becomes more attractive than it is today?

Mr Bowe—Yes.

Senator FERGUSON—How many of your taxis still use petrol rather than gas?

Mr Bowe—The percentage nationally would be somewhere between one and five per cent, and probably closer to four per cent. I am talking about the outlying areas, where the cost of transportation of LPG has narrowed that gap. The gap between petrol and LPG, both on economy and on the power of the vehicle, has always been ruled to be such that the industry should never ever get much beyond half the price of a litre of petrol.

Senator FERGUSON—Which it does in country areas, I suppose.

Mr Bowe—Which it does in country areas, yes.

Senator FERGUSON—If you have got a situation such as you have in your submission, where up to 40 per cent of your users are now going to find that taxis are cheaper, and if you have got a situation where people on middle incomes are going to receive substantial income tax cuts, which increase their capacity to pay, it is quite likely that there is not going to be a great effect on the demand for the use of taxis overall, isn't it?

Mr Bowe—I would not like to venture an opinion on that. That is still one of the unknowns for us to try to work through but, yes, I take your point.

CHAIR—In other words, they are not tax cuts at all.

Senator FERGUSON—Is this a comment?

CHAIR—Yes, it is a comment. They are cuts in order that people can afford to pay for taxi service and other services where a new tax has imposed higher costs.

Senator FERGUSON—Yes.

Senator BARTLETT—One of the issues that are often raised in relation to the GST is the issue of the black economy. I guess the taxi industry is often pointed to by the tax office as one of the areas of tax evasion—which I am sure you do not support. What is the current state of play in relation to income tax compliance in the industry?

Mr Bowe—The levels have risen dramatically since 1992. The system has been tightened significantly, using the state and territory licensing system as a crosscheck. The tax office has developed a model by which it can now estimate—and it does—the return per kilometre of each taxicab in each state and it applies that rule. It is now up to the operator to keep full compliance records of all drivers and these are crosschecked. As I said, there has been a significant improvement. We have worked with the tax office to develop this model because, as you stated, that situation was rampant in the late 1980s and early 1990s.

Senator BARTLETT—Do you see much of a problem in terms of compliance with the GST, with the taxis being a potential problem area for avoidance?

Mr Bowe—We see the need to get out in the field, if this tax becomes the system, and start classes for all of our drivers and introduce it into our training skills so that they understand fully the implications. We do dwell on the fact that, if the taxi industry is seen to collect but it does not remit, it will soon become known that people are not remitting. We believe that this would have a disastrous effect not only on the tax system but on the taxi industry, by implication.

Senator BARTLETT—You make a lot of mention in your submission of the potential compliance difficulties. Could you just step me through very briefly how it would be likely to work, how the tax would need to be remitted. Would it simply be that at the end of every shift the person would get their total takings and then take the 10 per cent out?

Mr Gunning—I might try and tackle that question. Ours is a very complex industry and so there are other parts to the story, but because of one of the very particular features of our industry a typical story is that, in essence, the driver of the cab is a bailee—in fact, hires the cab for a business purpose. So you need to move back from the customer.

In the first instance, the customer gets a taxi bill and there is a 10 per cent GST on it. But behind that the driver themselves will have a relationship with the operator of the lease and there will be a payment stream going between those two parties. So there will be a GST arrangement between those two parties. Going further into our industry, there is an arrangement between the person who holds the head lease and, typically, what we call a network these days or a cooperative, and again there is a payment passing in that area.

Unlike a lot of other transport industries, inside our industry not only do we have 70,000 people who are driving cabs and who are in the first instance collecting a GST, but behind that scene we have a number of interactions between people within the industry. We see that as requiring quite a deal of clarification in terms of getting systems right and quite a deal of complexity, just in technical terms.

Senator BARTLETT—Your understanding, as I read your submission, is that each individual driver would need to be licensed and do that administrative work, as opposed to just the actual cab owner?

Mr Gunning—Very much so. Like a lot of Australian industries, I guess, we have talked to our colleagues in New Zealand quite a lot about this issue. We were not entirely surprised when the government's legislation took our industry in a fairly unique way: there are about four or five industries in the same category. Everyone in our industry is deemed as being a GST collector. That means that people in the industry cannot take advantage of the threshold. With the \$50,000 threshold you can, effectively, opt out.

We, obviously, as a national association, have worried about our standing in the community, essentially, partly because of the experience that you referred to earlier with tax compliance. We know that at least late last year some problems started to emerge in New Zealand in a way that was not expected by the authorities. To summarise it, some taxidriers managed to position themselves so that they could opt out. So we have potentially a situation in New Zealand at the moment where customers are paying GST but that GST is not being passed on to the tax office. We think that would be a fairly debilitating thing to happen in our industry, not the sort of image we would like to project and not the sort of image that really encourages the kind of professionalism we are looking for.

So they are some of the complexities. Just to reiterate: in our industry there is no threshold that applies. Everyone who works in the industry is deemed to be a GST tax collector.

Senator BARTLETT—I have just a couple of other points, briefly. This was touched on before. I guess it is a moot point about whether or not this new tax system would lead to an increase or decrease in usage. Have you done any modelling or are you aware of any modelling about whether or not it would provide a bonus to the industry?

Mr Gunning—That is one of the roles that have fallen to me at the national level. It is probably important to say that a lot of the business side of the industry exists at the state level—that is where the primary focus is—and it is the networks and the companies and the individuals who are all making their own assessment. Market positions vary. In essence, as our president referred to earlier, we concluded in the end that it could, in principle, go either way. You can make a strong argument in both directions.

You obviously will have to make an assumption about how the economy grows, too, because the taxi industry is one of those industries where, when the economy is doing well, we are doing well. When the economy drops off a bit, the taxi industry feels it very early. We are a leading indicator in that sense. In the end, I think, we have not taken a firm view. We can see there are a number of arguments either way.

Senator BARTLETT—Finally, there was a question before about your rough idea of business users. One of the issues again with this tax system is the impact on tourism, particularly inbound tourism. Obviously it would vary from one city to another, but do you have any rough idea how much the tourism market contributes to the taxi industry?

Mr Bowe—Yes. It is very difficult to get an accurate handle on, but certainly with any stoppage at the airport—by our last measurement in Sydney, and I can only tell you about Sydney because that is my home city—we found that on average there was a 25 per cent drop in daily takings for drivers. This may be interstate as well as international. It certainly does have a big effect on the taxi industry.

CHAIR—The industry must be a leading economic indicator, a sensitive one, because it is very price sensitive.

Mr Bowe—Very much so, Senator.

CHAIR—Do we look forward, if the GST comes in, to taxidriviers not just being political opinion makers and a source of racing tips and weather forecasts but also tax collectors?

Mr Bowe—Yes.

Senator SHERRY—Senator Ferguson asked you a question relating to business people being able to claim the GST. What about the non-business consumer, the ordinary person in the street? They will not be able to claim the cost of the GST, will they?

Mr Bowe—It is our understanding that they will not.

Senator SHERRY—So it infers an advantage on business travel, but not ordinary consumers?

Mr Bowe—Yes.

Senator SHERRY—You mentioned 70 to 80 per cent of cab drivers have English as a second language. You also mentioned the very high drop-out rate ranging between 20 and 50

per cent. That must pose very significant educational problems in ensuring that the 70,000 cab drivers who become tax collectors are apprised of the administrative requirements of collecting a GST?

Mr Bowe—We see that as being an enormous task for us. It has been a significant task since 1992 to get that through to our industry, the need to keep records, whether you are a bailee driver or you are the owner-operators of taxicabs, because there are incidences on records, significant numbers of those, where these people were business people but did not keep any records. We see that any change to the tax system is going to need an intensified education program.

Senator SHERRY—You just said that a proportion did not keep records. So 100 per cent of cab drivers now keep records?

Mr Bowe—I cannot say that that happens, but certainly in our training schools, right from the time the guy steps through the door to be trained for a taxi authority, part of the curriculum is the necessity to keep records and to comply.

Senator SHERRY—You have mentioned in your submission that you would like a fund for this training program. Do you have any figures in mind? What would be the per head cost of having to train taxidriviers with the sorts of problems that your industry has to an adequate level to collect a GST?

Mr Bowe—We approached it as a national executive in a two-pronged way. There was the education situation and there was also the methodology of issuing a receipt. We are looking at 15,000 taxicabs that may need the capacity to issue a GST-type receipt. We were talking in numbers of probably around \$10 million to run the education program in all states and territories and address the mechanical side of the taximeter and its ability to print out a receipt that is acceptable to the Australian Taxation Office.

Senator SHERRY—And it is not just the start-up cost. It is obviously an ongoing cost given your industry turnover.

Mr Bowe—Yes.

Senator SHERRY—That would be a particular problem they will have to resolve.

Mr Bowe—Yes. It is very difficult to get hard numbers at this point in time. You are walking a little bit in the dark, but we do know that there will be the necessity to issue receipts so that the passage of money can be tracked.

Senator SHERRY—When do cab drivers normally do their paperwork? Is it at the end of their shift, at the end of the week or at the end of the month?

Mr Bowe—The taxi operator does it daily and is obliged to do it daily. The operator of the taxicab is treated as a provisional taxation-type taxpayer—direct tax and provisional. A taxidriver falls into no-man's-land, mainly because he is not seen as a PAYE employee and he does not fit into the prescribed payment system. So the department has instituted a system

where they can buy tax credits during the year or, alternatively, pay a tax on an estimated income at the end of the year.

Senator SHERRY—I know a number of cab drivers who work 10-, 12- and 14-hour shifts—incredibly long days—and obviously a lot work at night as well—the graveyard shift. Do you think they are going to welcome having to do additional paperwork at the end of each shift to work out a tax?

Mr Bowe—I do not think anybody welcomes the situation of paperwork, but I think that, if that is the regime as set out in the legislation, then it is going to be that the cap will fit everybody.

Senator SHERRY—But do cab drivers want a GST?

Mr Bowe—I think that by and large there is probably about a fifty-fifty split. That is a guesstimate, if you like, from me because we have not done any polling on that.

Senator SHERRY—So you would contend 50 per cent in your judgment look forward to a GST and the paperwork at the end of the year.

Mr Bowe—Senator, that is a finger in the air exercise, I had better tell you.

Senator SHERRY—I would not have thought it would be hard for you to do some research, but you might take it on notice.

Mr Bowe—Yes. Thank you.

Senator SHERRY—As to the sale of cab plates, I do not know how many states' plates are still traded. What is your understanding of the GST application to the sale of plates?

Mr Bowe—In the state of New South Wales there is a transfer of public vehicle tax, which is a state tax. There is also the stamp duty on the contract for the purchaser coming in. The Queensland government sell all the plates in Queensland. They do it by an auction process, and I am not sure if there are any other state charges that apply. No doubt there would be stamp duty, I would think, on a contract. Victoria have a similar system. That would be about the extent of my knowledge. Western Australia certainly do not, and in the Northern Territory the government have taken over ownership of all the plates.

Senator SHERRY—But where there is a sale of plates, do you expect a GST to apply?

Mr Bowe—I certainly do not, no.

Senator SHERRY—Have you taken any advice on that?

Mr Bowe—Only on the way we broadly see it that state taxes—I am sorry, you did ask about GST on the sale of a taxi plate. I am sorry, I got off the track then. Yes, I think we do but, as I say, we have not gone deeply into it. We are only starting to deal with Treasury officials now.

Senator SHERRY—Again, from conversations I have had with cab drivers, for those that own their own plates it is seen as a very valuable asset. Again, do you have any view about whether a GST should apply to the sale of plates? A lot of cab drivers expressed to me a view that it is, in one sense, their superannuation fund. The value of the plate is very important to them.

Mr Bowe—I have not given it a lot of in-depth thought, but certainly you have raised a very valid concern.

Mr Gunning—I might be able to assist; we have actually looked at that in some detail. It is an area where I think we are looking for some clarification too. Certainly to date sales of plates have attracted, for example, capital gains tax and there has been some relief from that. We are certainly interested in that area and from an industry point of view I think we would be looking for the same kinds of issues to apply in terms of the relief from capital gains tax that applies to small businesses. Broadly, we do expect that sale of plates would be caught by the GST system.

Senator FERGUSON—And refundable as a business input.

Mr Bowe—Yes.

Senator SHERRY—Just one final area. Obviously in rural areas cab fares would be higher than in urban areas, broadly speaking. Is that true?

Mr Bowe—No.

Senator SHERRY—It is not? Why not?

Mr Bowe—No, they are state-wide. Certainly in the states of New South Wales, Victoria and Queensland, the only differentials at times are in one-cab towns where there may be a tariff from midnight to 5 a.m.

Senator SHERRY—Is that because the tariffs are controlled in those states?

Mr Bowe—Yes.

Senator SHERRY—What is your position on the control of tariffs?

Mr Bowe—I believe the industry should remain a regulated industry in the interests of the public.

Senator SHERRY—What about the differences between costs for rural versus urban drivers?

Mr Bowe—Fuel would be the main component of any differential and it would certainly be the cartage costs of that fuel.

Senator SHERRY—This is my final point and I do not know whether you have thought about this. Because in rural areas there are generally lower incomes and a smaller proportion of business operators, would you expect rural cab drivers and their customers to be more sensitive to price increases than those, say, in urban areas?

Mr Bowe—Dealing with a taxi fare increase in isolation, I would say that there is always a reaction. That is why the industry always tries to keep its increases to a minimum, but, looking at the question of GST across the board, I think that would fit into the scope of things because it would not be taxis in isolation.

Senator SHERRY—I would just ask you to have a think about that issue again and you may want to do some research in the area. I have had this response from regional cab drivers in Tasmania who have conveyed a view to me about it. Thank you.

Senator FERGUSON—Mr Bowe, I want to go back to one of the issues that was raised by Senator Sherry about the keeping of records. Did I understand you to say that, in your training programs, entrants to the taxi industry are required to keep good records?

Mr Bowe—Yes. The emphasis is placed on their responsibility to keep records.

Senator FERGUSON—That means that, for income tax purposes and a whole range of other things, the amount of income that is actually generated by a taxi or by the driver can be well documented and is well documented?

Mr Bowe—It does vary from state to state and it varies between a lease payment for the use of the vehicle and a percentage share of the gross takings. Certainly the taxation office, at state and territory level, has made it a task force of training right through all levels of the industry and significant seriousness is given to that obligation of the people in the industry.

Senator FERGUSON—Because GST returns only have to be put in every quarter, it is rubbish to suggest that a taxidriver should go home from his shift and fill out his tax returns on that day. In fact, it is only applied to total takings and, at the end of each quarter, the 10 per cent would only have to be deducted because everybody pays GST. In fact, it is only one item at the end of every quarter to determine what GST is payable, so is it fair to say that it is rubbish to suggest that anybody would have to go home from their shift and fill out their forms for GST?

Mr Bowe—I would not say that it would be on a shift by shift basis and I would certainly say that, once the system bedded in, the record keeping could be done a lot more spasmodically.

Senator FERGUSON—And it could be done as it is today?

Mr Bowe—Yes.

Senator FERGUSON—In other words, it would not change. It just means that at the end of every quarter a percentage of their gross revenue is calculated as GST and forwarded to the tax office. In relation to tariffs and the effect of any price increases on the industry, I

just want to reinforce one thing: individuals do not set their fare rates. In fact they are the same for everybody in the industry?

Mr Bowe—Yes, in the state.

Senator FERGUSON—Senator Sherry talked about regional Tasmania. Is Tasmania different from the rest of Australia in the fact that their fares are not regulated by the central body?

Mr Bowe—They are regulated by a central body.

Senator SHERRY—I did not suggest they weren't.

Senator FERGUSON—I was not quite sure what point Senator Sherry was making. Was it about rural taxidriviers being more worried about increases in fares compared with city taxi drivers?

Senator SHERRY—Because of their increased costs. You look at fuel costs in Tasmania—terrific!

Senator FERGUSON—Mr Bowe, one thing was overlooked in your submission. I know that, in rural South Australia, practically every taxi runs on petrol. There are very few gas taxis because gas is so much more expensive in rural areas than it is in the city. In fact they are going to get an extra 10 per cent reduction in their costs because they will be able to claim the GST that they pay on their petrol. There will be less pressure on rural providers of taxi services than there will on their urban counterparts in some places because of the extra cost saving in getting the GST back on the petrol they use in their business.

Mr Bowe—I certainly take the point but, in the overall 15,000, the majority of taxis in that 15,000 are in the cities or in the larger urban centres.

Senator FERGUSON—I take that point but it is just that rural and regional taxis were brought into the equation when in fact a far greater percentage of taxis in rural and regional areas run on petrol rather than gas, especially in smaller towns, so they have the added advantage of being able to claim the GST back that they pay on petrol.

CHAIR—This is a tough industry, Mr Bowe. It is a hard way to make a buck being a taxi operator?

Mr Bowe—It certainly is at times.

CHAIR—When the industry suffers difficulties given an economic downturn, does that mean redundancies from the industry or have people gone bankrupt?

Mr Bowe—The incidence of bankruptcy in the industry is negligible and usually we try to advise the purchasers of plates as best we can what is in store for them, particularly in the area of borrowings. There have been a number of lessee operators who have leased a taxicab and not provided for the outgoings but, comparing businesses and businesses, the taxi

industry is unique inasmuch as there is no opening time or closing time. You can work for as long and as many days in the week as you wish and generally your market is still there.

CHAIR—So in the tough times people might just sell their plate and get out rather than go bankrupt?

Mr Bowe—Yes.

CHAIR—You said earlier in answer to a question from Senator Ferguson that the pattern of taxi use has changed. It is not so much middle class people who, when you were earning your stripes in the 1960s and 1970s, were the main fare; it is now lower socioeconomic groups like pensioners and others. A price hike would impact on them most directly?

Mr Bowe—Yes, it would.

CHAIR—What sort of reaction do you get from the public any time prices go up. They are not very keen on it, I would imagine?

Mr Bowe—Over latter years, the fare increases certainly in this state have been accepted without the press that we came to expect 10 years ago. It is generally a very small news item because it mainly cuts in at about the same time as public transport review their fares. Usually it is kept in general lines of the same percentage.

CHAIR—Have you given any thought to how you would show the impact of the GST on the fare? Would you let the tariff meter run, clock the tariff at the end of the journey, then punch in 10 per cent so that the passenger can see how much extra tax they are paying by courtesy of the federal government or would you just do one flat fare?

Mr Bowe—For acceptability, it would be my opinion—and it is only my opinion—that whatever the GST is should be built into the meter. In other words, the fare should be a finished product. If a receipt is required, it can do the split.

CHAIR—Would you think it was fair, though, if the legislation required that this tax be transparent—that is to say, people can see what your tariff is, plus the level of tax you have to charge? It would be no problem for your industry to show that on any receipt that was offered or to show that on the meter either, would it?

Mr Bowe—No, not at all. It can be a sticker on the meter that says that the fare includes a GST at whatever percentage and also a receipt, yes.

CHAIR—Okay. There are no further questions. Thank you, Mr Bowe and Mr Gunning, for your assistance to the inquiry.

[9.46 a.m.]

BARNES, Mr Peter Eric, Chairman of Tax Committee, Insurance Council of Australia Ltd

MASON, Mr Alan John, Chief Executive, Insurance Council of Australia Ltd

MORGAN, Mr John, Legal Adviser, and member of Tax Committee, Insurance Council of Australia Ltd

CHAIR—I welcome representatives of the Insurance Council of Australia to the witness table. Mr Mason, would you briefly address us on your submission? After that, perhaps you will be kind enough to allow us to ask you some questions about it.

Mr Mason—Thank you, Chair, and other members of the committee. ICA greatly appreciates the opportunity to appear in front of you today to add to the submission that we have already made and to answer any questions that you have. I thought it might be helpful if I gave you a little bit of background to the Insurance Council, which is the representative body of the general insurance industry in Australia. We have 120 member insurance companies that collectively account for more than 90 per cent of the business transacted in the country. I have a list of those companies, if the committee would like to receive it. It was not part of our original submission.

CHAIR—I am sure we would like to receive it. Do you want that included in your submission?

Mr Mason—Yes, please.

CHAIR—We will so include it.

Mr Mason—By way of further explanation about the insurance industry, I should add that general insurance—which is the sector of the industry we represent, not the life sector—embraces products such as motor insurance, household insurance, small and large business risks, marine, professional indemnity and particularly workers compensation and third party bodily injury.

In some states in Australia the risks of compulsory insurance—workers compensation and motor third party bodily injury—are still underwritten by state governments. Where that is the case, we have referred to that in our submission as public sector insurance as opposed to private sector. We included the public sector in our submission because of the transitional effects and because we believe that it is the intent and the spirit of the legislation—and we strongly agree that this should be the case—that private and public sector provision of insurance services be treated equally and, therefore, the effects are the same.

I do have a further document for the committee which separately shows the impact of the transitional provisions on the public and private sector. These figures were prepared for us by internationally recognised firms of consultants, Tillinghast-Towers Perrin and also Ernst Young. I also have that to table, if I may.

CHAIR—You may, and we will incorporate it with the committee's documents as well.

Mr Mason—The Insurance Council has supported the need for tax reform generally and we have specifically supported the government's tax reform package. We are, I should say, disappointed that in our view the tax reforms have not gone far enough with regard to state taxation as applied to insurance, and this is covered in some detail in our submission.

The key issues for us for general insurance relate to the transitional provisions in the legislation. The transitional provisions by implication we believe should be neutral in their impact and should result in a smooth implementation. The provisions presently contained in sections 11, 12 and 20 of the GST transition bill do neither.

We believe that the present provisions will have adverse and unintended consequences not only for insurers but for their customers and, as our submission has highlighted, could result in up to \$2½ billion of unintended and unforeseen additional costs. Unless we satisfactorily resolve this, the cost will inevitably fall to be borne by consumers, but these consumers will not have received the corresponding and counterbalancing benefits of other aspects of the tax reform package at that time, such as the personal income tax reductions.

We are at the moment closely engaged with members of Treasury and the Australian Taxation Office about these issues and those discussions are continuing. But since we made our first submission to yourselves, we have done some further research as to how these transitional problems were tackled in other countries.

CHAIR—Can I just ask one question?

Mr Mason—Yes.

CHAIR—You are in continuous discussion with Treasury about these matters. Is there an expectation that these discussions will conclude at some point and you will get a yes or no answer? We need to know this because, if the bills are before us and these matters are unresolved, we will have to make a judgment about what the answer is likely to be.

Mr Mason—We very much hope we will reach a satisfactory conclusion in the discussions with Treasury.

CHAIR—But there is no commitment to a date by which it will be resolved.

Mr Mason—Certainly not at the present time.

Mr Barnes—We are hoping to achieve that at a meeting tomorrow.

Senator HARRADINE—To achieve a date?

Mr Barnes—Yes.

Senator HARRADINE—But the Treasurer is asking us to deal with the matter prior to 30 June. Is he likewise going to provide you with the required information so that you can

provide us with it by that date, or certainly if not by that date, hopefully by the date that we report?

Mr Mason—Certainly, if we achieve resolution of these transitional problems which we believe are unintended, then certainly we would let this committee know, yes. But at the moment, we do not know how the thing is going to fall and that really is the purpose of explaining it to yourselves.

CHAIR—We have to put a timetable around it. We have to deal with these. We have to report by 19 April and, if we do not know the answer to your question, do we assume there is a transitional cost of \$2.5 billion or not? I am interfering with your submission.

Mr Mason—We have to assume the same at the moment. We have looked to see how it was dealt with in New Zealand; in the UK, where they brought in an insurance premium tax on 1 October 1994; and also in Singapore where they introduced a GST on 1 April. Whilst I do not want to overburden the committee with paper, we have one other short piece of paper which I thought we could table. It lists what happened in those three jurisdictions.

CHAIR—Please, and we will add it to your submission.

Mr Mason—It is our submission that section 20 of the transition bill should be amended to provide for input tax credits, which we believe should be allowed for all claims reported on or after 1 July 2000. Further, that section 20 should be amended to allow for partial input tax credits, based on actuarial calculations by major class of insurance for claims that were reported before 1 July 2000, but where they will be paid after 1 July 2000. We believe that those two changes would produce a revenue neutral solution to this problem.

We have also proposed that sections 11 and 12 be amended to define insurance policies as GST-free for the transitional period only, provided that those policies are entered into in the normal course of business and for a normal period. They are not entered into for any avoidance purpose. That concludes our opening remarks. We will be happy to respond to any questions.

Senator FERGUSON—Firstly, I was pleased to hear you say that you do support the proposed taxation reforms because I read your submission and nowhere in your submission did you say that. I am very pleased in your evidence you have said that you do support the reforms. Are you aware of any country in the world which has a GST or a VAT which treats insurance more favourably than is proposed under our system?

Mr Mason—In these transitional arrangements, yes, New Zealand.

Senator FERGUSON—Overall?

Mr Mason—Overall? The application of GST or value added taxes in different jurisdictions is not entirely the same. The New Zealand approach which makes insurance taxable is the same as the approach that has been taken here. We believe that is the preferred approach. In some overseas countries, insurance is input taxed, which creates anomalies in our view.

We think insurance is a product that is capable of being priced because it is a product in the same way as any hard commodity. The overall philosophy of a GST says that it should be taxed, and that is what this package proposes.

Senator FERGUSON—Can I give you one example, for instance, personal liability insurance? Is it not a fact that it is treated more favourably in our proposed package than in any other country that has a GST?

Mr Mason—In what way do we regard it as being more preferentially taxed?

Senator FERGUSON—Just in general terms, the tax treatment of personal liability insurance in other countries?

Mr Barnes—I think we may need to take that question on notice. I do not believe that the Australian treatment is any more favourable than any other country.

Senator FERGUSON—Will you check on that, please?

Mr Barnes—Yes, we will take that on notice.

Senator FERGUSON—The other area that I want to move to in particular is outstanding claims, where you talk about section 20. Mr Mason, I was involved in general insurance for seven years, so I should declare that before I ask a question. In fact, in the time that I was involved in general insurance, I would have thought that the ratio of house break-ins to claims for fire or physical damage on homes was probably in the vicinity of 500 to one. I am only taking an estimate on the claims that I had. Have you got any idea what the ratio of house break-ins and burglaries is compared to claims for fire or storm damage to a home?

Mr Mason—I do not have that information with me.

Senator FERGUSON—Would it be fair to say that it is much greater? The incidents of house break-ins are much greater than the incidents of fire?

Mr Mason—Of fire—it would be, yes. As for the incidents of claims overall, the industry issues or renews about 30 million policies a year and about 2.9 million claims are submitted on those policies every year. About one in 10 insurance contracts results in a claim every year.

Senator FERGUSON—What are the most common articles that are stolen in a house burglary?

Mr Mason—Usually it is electronic equipment—computers and videos—jewellery and cash.

Senator FERGUSON—So it includes watches, furs, jewellery and electronic equipment.

Senator SHERRY—They took my front door when they did my place!

Senator FERGUSON—I am not surprised, Senator Sherry.

Senator SHERRY—They took the carpets, and the kitchen cupboards!

Senator FERGUSON—Can I get back to my original question. Mr Mason, I just cannot follow your reasoning about the input taxes. Does that mean that if you have claims for video recorders and watches and jewellery and furs, items which currently attract either 32 per cent or 22 per cent wholesale sales tax, and which are items which will be much cheaper after 1 July 2000, you are going to pay the full tote odds as if the wholesale sales tax had not been taken off all of those items in fixing up any claims after 1 July 2000? I would have thought that, judging by the ratio of house break-ins to fires, you guys are in for a bit of windfall.

Mr Mason—In our modelling—and this is part of our proposal—we have analysed the effect of the reductions in the existing indirect taxes and the additional cost of a GST for each class of business, and the effects are quite different from one class to the other. The overall impact on household and motor insurance is much less than it is on the areas that cause us the greatest problem in the transitional area, which is on what we call the long tail classes of insurance, which are liability, workers' compensation and motor third party bodily injury. Our modelling says that the cost of those claims is going to rise significantly, and that is where the bulk of our transitional problem arises.

As you would probably be aware, someone can be injured in a motor vehicle accident today, could report it to the insurer in six months time, but that claim may, because of the due process of the medical service and the legal service, not be settled for five, six, or seven years from now.

Senator FERGUSON—In your submission you refer specifically to family homes, jewellery, computers and all sorts of things. You do not mention the other things, not that I can remember, and I read it quickly.

Mr Mason—We used the family home as an example; that is correct. If someone has a fire in their home in June 2000 and reports that claim and if they have suffered a loss and they are insured under their policy on the pre GST basis, the costs of settling that claim after 1 July will increase by the net effect of the GST.

Senator FERGUSON—What figure did you use—5.8 per cent?

Mr Mason—I can look up the figure.

Senator FERGUSON—Can I just move to a couple of other areas because I know we are reasonably strapped for time. In your submission you referred to the claim in the ANTS package that the cost of insurance would rise by only 0.8 per cent and you highlighted the fact that insurance is, in effect, an amalgam of life, health and general insurance.

Mr Mason—Yes.

Senator FERGUSON—You also noted that the life product is input taxed and that health is GST free. Therefore, is that 0.8 per cent an estimate just on general insurance or is it an estimate of the whole lot?

Mr Mason—I believe that was an estimate that covered the whole of the insurance heading. It was not specific to general insurance.

Senator FERGUSON—So you do not know what the estimate is on just general—

Mr Mason—We have done that work.

Mr Barnes—I might be able to answer that question, Senator. The 0.8 per cent was a government figure. We have done a significant amount of modelling which Alan was referring to earlier and concluded that we would expect general insurance prices to increase by 2.7 per cent as opposed to a 10 per cent increase for GST. You can see there that the savings in sales tax are flowing through. We have done that on a class by class basis and also, as Alan said, the changes on a class by class basis are all different as well—on a class of business basis, that is.

Senator FERGUSON—Could you supply us with the detail?

Mr Barnes—Yes, we could do that.

Senator FERGUSON—Thank you. I am conscious of the time. There is one other particular thing that I want to raise; that is the table that you have about the effect of the GST on householders' insurance. You are an Australian organisation, aren't you? You are not just based in Sydney.

Mr Barnes—Yes.

Senator FERGUSON—What do you think the table would be if you were doing an effect of GST on householders' insurance, for instance, in South Australia?

Mr Mason—It would be quite different in South Australia. I do not have the numbers in front of me because the South Australian government has just passed legislation to remove fire service levies from insurance, and Western Australia is doing exactly the same thing. The effect in South Australia and Western Australia will be quite different. This was an example based only on New South Wales.

Senator FERGUSON—Seeing you are an Australian organisation, it would be fair if you did a table that accounted for other states as well because the effect in South Australia and Western Australia is going to be markedly different. That is because the stamp duty in this calculation is also paid on the fire services levy, which was always a bone of contention when I was in the industry. Also, the stamp duty rates differ from state to state.

Mr Barnes—Our overall modelling did take that into account. In fact, we selected one example for the purposes of this presentation.

Senator FERGUSON—It is quite conceivable that in South Australia and Western Australia the increase might be in the order of perhaps \$15 and \$20, rather than \$38.

CHAIR—Not Western Australia yet.

Senator FERGUSON—No, but it will.

Mr Mason—Insurance premiums are also much lower in those states. We have got the information on the impact in different states on different products.

Senator FERGUSON—In our submission you have used something that applies to New South Wales, although you are an Australian insurance council. It ought to be highlighted that it is different in other states and that the impact will be much less.

Mr Mason—Certainly. I might add that New South Wales and Victoria are the most populous states.

Senator FERGUSON—I understand that. We notice that in a lot of other areas as well.

Senator BARTLETT—Following on from that, if you do have that information of different states variations, if you could provide that at some stage, I would certainly be interested.

You talk in your submission about the potential effect of the GST on generating increased underinsurance and non-insurance. Presumably the ongoing discussions you are having with Treasury have the potential to significantly impact on that, at least during the transition phase. What sort of information have you got about the relationship between price rises and a reduction in insurance coverage, particularly in this case where there will be an increase not just in the insurance industry but in other areas where prices are going up and compensation is coming in, and all that sort of thing?

Mr Mason—We do not have any direct modelling that shows the price elasticity of insurance. All we have is research which shows the level of take up of insurance in different product lines in different places and market research which says that the absolute cost of insurance is clearly a large determining factor in people's buying decisions. The issue from our point of view in the tax reform package is not the GST per se, it is what we said earlier: our disappointment that we did not remove these indirect state taxes which are specifically designed to impact on insurance. As you can see from the example in our submission, it is the indirect state taxes rather than the GST that add a significant component to the cost. We are still hopeful, and we are still working with all the state governments, of seeing some longer term relief in that area.

One of the other issues that we are trying to get clarification on, which is not at all clear in the bills at the moment, is whether or not the state taxes will apply to the GST and the GST apply to the state taxes. Our reading of the legislation at the moment is quite unclear. We seem to have a merry-go-round of taxes at the moment, and that is one of the issues we would really like to clear up.

Senator BARTLETT—Is that something you have raised in your discussions with Treasury to date?

Mr Mason—Yes.

Senator BARTLETT—It is still unclear at this stage by the sound of it?

Mr Mason—Yes.

Senator BARTLETT—It will be something else we will be getting a deadline date on. It would be nice to get it clear from our perspective as well. You are saying, in terms of the state levies and charges, that you are negotiating with various state governments as well. I presume this is also something you are raising with Treasury. Is there any sign of progress there, or positive feedback?

Mr Mason—The only sign of positive progress I am aware of with the states—and we have raised these issues with all the state governments—is that I believe all the state stamp duty commissioners and officers of state revenue are meeting next week and this matter is on their agenda. But, more than that, I do not have any other information.

Senator BARTLETT—No likely deadlines in relation to that either, I suppose?

Mr Mason—No. But getting certainty on that is going to be crucial for insurance companies, because we need to know what to do with our systems and billing and everything else.

Senator BARTLETT—Yes. I know your general support for tax reform has already been raised, and you do mention in your submission that you were an early and enthusiastic supporter of tax reform which was tempered somewhat by the lack of progress on existing indirect taxes. How would you describe yourself now—a begrudging supporter of tax reform or a less enthusiastic supporter of tax reform?

Mr Mason—It is correct to say that we are very disappointed about the reform of specific insurance taxes at state level, but from a broader economic perspective we still strongly support the tax reform package generally. We believe its explicit nature, its transparent nature, its equitable application across the whole community is much better for the economy in the long term. For the consumer purchasers of insurance, it will make the tax explicit and not implicit, so we still support the overall reform process.

Senator BARTLETT—As part of that, there is the question I heard Senator Cook asking a lot on Monday. I am probably stealing his favourite question.

CHAIR—You can steal it.

Senator BARTLETT—Given all these areas of uncertainty that you are still pursuing—and from my position it is always a bit uncomfortable deciding what to do with something when there are a lot of unanswered questions—if all the concerns you have are not addressed

in a positive way by the time we have to decide what to do with this legislation, would you still believe it is something that should be supported?

Mr Mason—To answer your question in two ways: firstly, the core issue for us is that we would like to see the legislation passed as quickly as possible so that we achieve certainty, because we are facing great uncertainty at the moment; and, secondly, and as part of that, from our industry's perspective we need to have these transitional issues cured and cured quickly.

Just to give you an outline of the sort of problem we face, one of the transitional provisions says that there will be a tax payable on the unearned portion of premiums. So, with any policy issue where the risk goes past 1 July 2000, a GST will be payable on the unused portion of that premium. As insurance companies, we will be issuing policies and issuing renewal invitations for policies from the middle of May this year which will go over the projected starting date of a GST. We have complications with the Insurance Contracts Act. We will be faced with a position where we know we will have to pay additional tax on those policies but we have no certainty as to the legislation, we do not have the timing to be able to charge the policyholders any more at the moment and we would probably have no legal basis for doing so. Those are the sorts of issues that are really of great concern to us.

Senator FERGUSON—These guys will probably have it passed by May, so you will not have to worry about it.

Senator BARTLETT—But the concerns about transitional issues are not to do with certainty; they are issues to do with avoiding unintended costs and consequences.

Mr Mason—Yes.

Senator BARTLETT—There are two separate aspects there: you may still have certainty, but you will be certain you have annoying unintended expenses and consequences.

Mr Mason—Yes, and ultimately, if we have an unintended consequence which is an enormous cost and if we do not have a satisfactory resolution, there is only one place where we are going to get that money from in the end, which will be from the buyers of insurance, and that will certainly be an unintended consequence because that would be in advance of the general effect of the tax package.

Senator BARTLETT—Without being able to quantify it, you suggest that that would lead to a significant increase in underinsurance and non-insurance?

Mr Mason—It would certainly have an impact.

Senator CONROY—I want to return to that bonanza that Senator Ferguson was predicting for you and the impact from the outstanding claim problem. I am looking at the ANTS document, and while it is not a document that I often quote, on page 171 under, 'The price effects by industry,' it talks about electronic equipment having a price reduction of 5½ per cent but household appliances and electrical equipment all going up in price by a small amount, which I do not think, when you put all of that together, is going to come up with

quite the bonanza that Senator Ferguson was suggesting. Can you take us through those implications from the outstanding claim funds and expand on them a little more?

Mr Mason—Certainly. The insurance companies will create reserves to pay for claims that are reported now, or have happened now but are not yet reported, which they will have to settle in the future. The problem is that those claims will have to be settled, in some cases, many years after the introduction of a GST, and the tax reform package in its totality will alter the ultimate settlement cost of those claims. There will be a trade-off: there will be savings in wholesale sales tax, but with the added cost of a GST. There will also be a further effect in personal injury classes of business in that the reduction in personal income tax rates will in fact have the unusual effect of increasing the cost of claims because, in things like motor vehicle third party bodily injury, part of the cover is an income replacement cover, but an after-tax income replacement cover.

So these costs that will arise from the tax reform package have not been factored into the prices we charge under the policies that cover those claims. There is no opportunity to go back and get any more money out of anybody for those things. Also, the reserves that have been created to pay for them do not have any element in them to cover these further unintended costs. That is why we are seeking an input tax credit, but specific to each class of business so that there is no windfall to us, to cater for this. Once the GST is fully operating, we will not have the same problem because we will get input tax credits for the cost of settling claims to offset against the GST on premiums.

Senator CONROY—What is your estimate of the cost of that to you?

Mr Mason—The total estimate on the outstanding claims is \$1½ billion, as a one-off cost.

Senator CONROY—Will that impact at all on your prudential situation?

Mr Mason—It will have an impact. We do not have available to us the individual financial position of companies, but if the money is not recovered from consumers, it will only come out insurance companies' shareholders' funds. It will definitely reduce their capital.

Senator CONROY—So, there will be a reduction in shareholders' funds of \$1.5 billion, a one-off hit?

Mr Mason—Yes.

CHAIR—In fact, it is \$2.5 billion, isn't it?

Mr Mason—Yes.

CHAIR—The all-up cost is \$2.5 billion, according to this sheet you have circulated.

Mr Mason—Yes. That is \$1½ billion on the claims effect and \$1 billion on the unearned premium reserve, so it is \$2½ billion.

CHAIR—So that I understand this properly, you have said that in New Zealand, the United Kingdom and Singapore, according to this other supplementary document, these problems of transition were overcome in the introduction of their GST, VAT and other goods and services taxes. These are international precedents that the Australian government should follow when it deals with Australia and the unintended \$2.5 billion consequence that you have now highlighted. What is the cost to revenue of the Australian government meeting your claim? Is it \$2.5 billion?

Mr Mason—We do not think it is a cost to revenue on the basis that we do not believe this was factored into the government's anticipated revenue out of the GST package. It is one of the reasons that we believe it is an unintended consequence. All the modelling that has been done, to our knowledge, is based on the effects of a GST once it is introduced.

CHAIR—So you are saying that the government never thought they would get the \$2.5 billion, so it would be pretty easy for them to agree with you and not collect it now?

Mr Mason—We would hope so.

CHAIR—If they do collect it now, you will pass it on to your customers?

Mr Mason—Ultimately, yes.

CHAIR—The tax cuts that the government is dangling are not calculated to compensate ordinary Australians for this \$2.5 billion so, if they have to wear it, the compensation given by the tax cuts is inadequate, isn't it?

Mr Mason—That is the inference we draw, yes.

CHAIR—And it just means that people will not insure and will run a risk that they will suffer considerable damage through loss because they are uninsured in circumstances where they incur problems. That will affect their budgets or their businesses quite considerably, or they will just have to pay an extra premium over and above what the alleged compensation meets.

Mr Mason—Yes.

CHAIR—Why haven't you been making a bigger noise about this, Mr Mason? This is quite a serious issue, isn't it? It is an easy decision for the government to say, 'Yes, we agree with you, because we did not intend to collect that money in the first place.' But the Treasurer has told everyone, including us, that he is not going to vary his package. He repeats those remarks, and he is entitled to be believed. You have been trying to settle this with the government for some time, but you have not succeeded and you have a meeting tomorrow. Why haven't you made a bigger noise about this—\$2.5 billion is not a trice; it is quite a large sum of money?

Mr Mason—When you say a 'bigger noise', I believe that we have been talking to the appropriate people, including yourselves, in our submission. Whilst we have distilled it to the figures in front of you, the issue is incredibly complex. It has taken us a considerable

amount of time, using expert assistance, to in fact work out the effect of this by class of business, by type of insurance, and it is only quite recently that we have in fact come to some certainty on these numbers.

CHAIR—I know. But I am talking about it from our point of view. We have legislation coming at us like a freight train down the railway line at high speed. In fact, the government has got the legislation already through the House of Representatives. The members of the House of Representatives, I am sure, would have liked to have known that these figures were there and that these were unintended consequences before they were called to vote. But they have voted for it now and, if we pass it, it will not go back to them. So we are left with reviewing this on the basis of your negotiations.

I really think that for us to report honestly to the Senate about the nature of the submissions we have received, we would probably need to hear from you by about 10 April as to whether you have got satisfaction. Our report is due on 19 April, and if you have not got satisfaction, we need a bit of notice so that we can write it in our report.

Mr Mason—Thank you for that; we will certainly come back to you.

Senator FERGUSON—Senator Cook may change his vote. I think I detect some wavering.

CHAIR—No. I think it is outrageous that your government has not told these people that \$2.5 billion can be written off when it was never intended to be imposed.

Senator FERGUSON—You have already decided you are going to vote against it.

Senator SHERRY—And you will vote for it. Following on from the issue, I just want to clarify whether you are dealing with Treasury, the Treasurer's office or the Assistant Treasurer's office on this matter.

Mr Mason—With Treasury.

Mr Barnes—With Treasury and the Australian Taxation Office.

Senator SHERRY—Why are you dealing with them? The Treasurer boasts, and has said in writing to this committee, that the Treasury's views are irrelevant, that he put the package together, that this is his package. It is their political package, and there is not going to be any change.

Mr Mason—Can I correct our answer or add to it? We have also been talking to the Treasurer's office as well as Treasury, yes.

Senator SHERRY—In your submission you say:

ICA was an early and enthusiastic supporter of tax reform on the grounds that the new tax would replace a range of existing indirect taxes. In fact this has not eventuated, with the effect that fire services levies, stamp duties on insurance premiums and payroll tax still apply in most jurisdictions.

Is it your position that the GST should have replaced those taxes that are mentioned?

Mr Mason—Yes, that was part of our original submission to the government. We believe that those matters should remain on the agenda for future consideration.

Senator SHERRY—Let us just take payroll tax, as distinct from fire service levies and stamp duty. I do not know what the cost of getting rid of those would be. We would be looking at a GST of 12 or 13 per cent to get rid of payroll tax, wouldn't we?

Mr Mason—I do not have the numbers in front of me. I understand that is one of the reasons why the government settled on the package that it did—the level of cost that would need to be undertaken to remove all these taxes. It also depends on the future economic performance as to whether there is room in the future to change these things further.

Senator SHERRY—The tax cuts are overwhelmingly coming from budget surplus, which will be run down very significantly. The GST is largely replacing existing taxes but not payroll tax. All the other taxes you want replaced. The money has to come from somewhere. Effectively you are advocating a higher GST than 10 per cent. The loss of revenue either has to come from the tax cuts or a higher GST.

Mr Mason—In our original submission we felt that there was a higher optimal level, but the government has settled on the level that it has at the moment.

Senator SHERRY—What was the optimal level that you were advocating?

Mr Mason—I think it was a range. We did not have access to the modelling. I think we said there was a range between 10 and 12½ per cent.

Senator SHERRY—Obviously, it is going to be close to 12½ per cent to get rid of payroll tax, at the very least. You will continue to push that policy.

Mr Mason—One we have got some hope for though is the fire brigade levies. The approach taken in South Australia and Western Australia, we believe, could usefully be picked up by the state governments, particularly in New South Wales and Victoria.

Senator SHERRY—That is very small beer compared to payroll tax though, is it not?

Mr Mason—The combined effect of fire brigade levies and stamp duty on the insurance industry is about \$1.7 billion a year, I think.

Senator SHERRY—When I made reference to small beer, I meant in terms of government loss of revenue. Payroll tax is a mighty loss to state governments.

Mr Mason—Yes.

Senator SHERRY—Given the position that you have outlined, there is going to be continuing pressure to increase the GST as one of the options to get rid of these taxes.

Mr Mason—There may be, yes.

Senator SHERRY—That is correct, isn't it?

Mr Mason—We will continue to press for further reforms of state taxes, yes. Obviously, the cost effects of that is what government has to take into account in looking at it.

Senator SHERRY—You talked earlier about your general support for a goods and services tax and you outlined principles of equity and transparency. What happened to simplicity? Is this simpler for you?

Mr Mason—It is simpler for the whole community in our view, yes.

Senator SHERRY—No. Is this problem simpler for the insurance industry? Has it made your world easier?

Mr Mason—The concept of one central tax applying to consumer purchases is simpler.

Senator SHERRY—But you have not got that.

Mr Mason—Our problem remains the states and specifically with insurance.

Senator SHERRY—But you have not got the simpler world? You still have the state taxes that you want to get rid of. You have the GST and this problem. How is your world simpler? You are here before a Senate committee. You still have the state taxes and charges. You have the GST. You have a \$2.5 billion hit. The world is simpler, is it?

Senator CONROY—I would hate to see one more complicated.

Mr Mason—Our world is going to be significantly complicated by the transitional effects, if we do not satisfactorily resolve those. In terms of a broad based GST which applies universally to all insurance products, and one that has classed the insurance industry as taxable, we believe that that will be relatively simple and efficient on an ongoing basis. Our problems are all in the lead up.

Senator SHERRY—If you get what you want.

Mr Mason—Yes.

Senator HARRADINE—Has Treasury or the Treasurer's office suggested that they really consider that the \$2.5 billion was an oversight?

Senator CONROY—They have not done any modelling.

Senator HARRADINE—Quite seriously, the income expected to be derived from the GST is \$27.2 billion in the first year. Are they saying that the odd \$2.5 billion is not taken into account? It seems to me that that is what Treasury would not do and Taxation would surely know. They are professional officers. They would have known all about this.

Mr Mason—My colleague on my left has been involved directly with Treasury.

Mr Morgan—The correct answer to that is that Treasury certainly have not conceded the point. We believe that is the case though, that the \$2.5 billion was an oversight. We believe that it was an oversight.

Senator CONROY—So Treasury are arguing that it was a deliberate policy decision to impose \$2.5 billion on your industry?

Mr Morgan—They have not said that either.

Senator FERGUSON—Mr Conroy put words into your mouth.

Senator CONROY—We would not want to have that argument again.

Senator BARTLETT—In terms of this argument, are they not conceding that it was unintended or are they not saying that this \$2.5 billion is there? In terms of the costing, which is I think what Senator Harradine was getting to, does the \$27 billion, or whatever the GST is going to bring in, include this \$2.5 billion or are they saying the \$2.5 billion does not exist or are they saying it does exist and it was meant to be there?

Mr Morgan—I think the answer to that is that our analysis has led us to the view that the \$2.5 billion is there, that it is a cost that will be incurred as a result of the transitional provisions. That information has been provided to Treasury and we have had discussions with them about their views on the matter. It is fair to say that they have not expressed a definitive view on whether that amount was in the \$27.2 billion or whether it was an oversight or whether they had in fact taken into account—

Senator FERGUSON—Or whether they accept it.

Senator BARTLETT—So it may be \$30 billion rather than \$27.2 billion that is the total take.

Mr Morgan—That is a question that should be directed to Treasury, quite frankly.

Senator CONROY—They have not said to you that they concede that it is in the \$27 billion?

Mr Morgan—No.

Senator HARRADINE—They are out by 10 per cent and that is the GST.

CHAIR—What has the Treasurer said? You have had discussions with his office.

Mr Mason—The Treasurer has not to this point to my knowledge expressed any view at all.

CHAIR—Have you told your customers that if this is not agreed you will dump \$2.5 billion worth of extra charges on them?

Mr Mason—No.

CHAIR—Do you think that is fair to your customers?

Mr Mason—The question of certainty, which I touched on earlier, I think, is the real issue. We certainly would not feel in a position to tell our customers what is going to happen yet until we have some certainty as to what the actual final answer is going to be. But we will have to ultimately tell our customers what the final effect of the package will be.

Senator FERGUSON—What you are really saying is that there is no point in scaremongering? Is there?

CHAIR—Are you scaremongering by telling us that you think there will be \$2.5 billion? This is a public hearing.

Mr Mason—Yes, I am aware it is a public hearing. We are not scaremongering. I think we are here trying to provide you with a very informed and considered view—

CHAIR—Yes, exactly.

Mr Mason—because you gentlemen will ultimately take a decision.

Senator FERGUSON—Were you aware—

CHAIR—Order! Are there any further questions?

Senator FERGUSON—Yes. Mr Mason, while you are actually in discussions with the Treasurer, and you have the chairman suggesting that, have you told people that there is going to be an additional \$2.5 billion thrown onto them? That is scaremongering.

CHAIR—No, I did not say that.

Senator FERGUSON—You did.

CHAIR—I said if you do not get your way with the Treasurer there will be \$2.5 billion worth of transitional costs.

Senator FERGUSON—I will read the *Hansard* carefully.

CHAIR—Please read the *Hansard* carefully. That \$2.5 billion is not a trice; it is a serious amount. There is no compensation for it in this package, so if it is dumped on customers they have to find it or they do not insure. That is the bottom line.

Senator FERGUSON—If it is substantiated.

CHAIR—Are you saying that the Insurance Council is not telling us the truth?

Senator FERGUSON—Because they are still in discussion with the Treasury.

Senator CONROY—‘Substantiated’ and ‘in discussions’ are two different things.

CHAIR—I think we have come to the end of our questions to you. We are now beginning to debate among ourselves, Mr Mason, and we have plenty of time to do that in our own chamber. We do not need to delay you for that purpose. Thank you for aiding our inquiry. I do indicate to you, though, that it would help us if, by 10 April, there is an answer one way or another, you could tell us what it is.

Mr Mason—We will certainly do that.

CHAIR—Thank you very much.

Senator SHERRY—It is a \$2.5 billion question.

CHAIR—We now adjourn for morning tea, and we will resume promptly.

Proceedings suspended from 10.37 a.m. to 10.48 a.m.

DENOVAN, Mr Jon, Partner, Mortgage Industry Association of Australia

EDEMA, Mrs Victoria Anne Massey, President, Mortgage Industry Association of Australia, National Vice President, Mortgage Industry Association of Australia

SYMOND, Mr John, Managing Director and Founder, Aussie Home Loans

CHAIR—I now welcome the Mortgage Industry Association of Australia. We invite you to address us for a short time on your submission and then be open for questions.

Mr Denovan—Thank you, Senator. The Mortgage Industry Association of Australia represents intermediaries of all kinds in the lending of money process, whether they are brokers, originators or managers, and the membership spreads right across Australia.

I am a partner in the law firm Gadens Lawyers. I am here today representing and speaking on behalf of the Mortgage Industry Association of Australia, Aussie Home Loans, many other mortgage intermediaries and the thousands of businesses throughout Australia that supply the financial industry. During my very short presentation I will use the term ‘financier’ to mean lenders of all kinds whether they are banks, building societies or credit unions and the term ‘intermediary’ to mean all kinds of mortgage originators, managers and brokers—anybody who facilitates the transaction.

Our starting point is that all business should be treated equally. I think everybody recognises that significant problems arise from the partial or total exclusion of any business from the GST net because as soon as you take somebody outside the GST regime you have three important consequences. Firstly, the prime principle of the GST system that the consumer should pay the tax, is corrupted. Instead of the consumer paying the tax, the business is paying the tax. The second consequence is that there is a skewing of the tax system so that somebody in the business chain is disadvantaged because one of those businesses is paying the tax. Thirdly, as has been demonstrated around the world, tremendous scope for dispute arises as to whether the particular supply falls within the exemption or not. If you look at the court cases in other jurisdictions that have a GST regime, you will see that most of the money and time in courts are spent disputing whether something is input taxed or not.

The most desirable situation for a GST regime is one in, all in. For this reason the best solution would be for financial suppliers to be within the GST net. We accept that this model has not been followed overseas and we also accept that it is unlikely to be supported at this time in Australia for reasons of systems and methods to make it work. I think a lot of people have said that that might be desirable but it is just too damned hard. In our submission we seek other solutions to prevent the injustice.

What is the consequence of input taxing financial suppliers? It means that the supplier does not get a credit for the GST that business pays on supplies. It is absolutely fundamental to understand that this is not equivalent necessarily to saying that the business absorbs the tax. In the case of financial supply, one way or another the financier or the intermediary will have to pass that tax on to the consumer if his business is to continue. Inputting financial

supplies does not mean that the consumers of financial supplies are not paying GST. One way or another they are.

The skewing of the tax system by making financial supplies input taxed has very significant economic consequences, as shown in our submission. The first of those is the tremendous bias against outsourcing. As soon as the financial supplier outsources a supply, the cost increases by 10 per cent because of the GST. We say that this is quite inconsistent with the statement in the explanatory memorandum that there is no bias against outsourcing. The explanatory memorandum to the legislation goes into some detail to say that there will be no bias against outsourcing and then it goes on and creates the bias by not following through with appropriate legislative provision.

The next financial economic consequence is that all financiers, other than the major banks, and all intermediaries, are disadvantaged. Why? Because they are obliged to outsource. The major banks are advantaged because they do not have to outsource and because they can spread the charges over millions of accounts to recoup the GST.

Why does this matter to the financial industry? The financial industry is one of the largest industries in Australia. At present, the industry extensively outsources the supply of a vast array of services—for example, financiers outsource to lawyers; to valuers; to surveyors; to mortgage insurers; to landlords, by renting premises; to cleaners, by cleaning premises; to IT companies, and so on. Outsourcing has a tremendous benefit for competition. It is outsourcing that created companies like Aussie Home Loans and brought competition into the financial system in this country. Outsourcing keeps thousands of small Australian businesses in business. It provides competitive tension in the supply of these services.

Financing is a margin business. Our margins are always being squeezed. If outsource supplies cost 10 per cent more because of the imposition of GST, it is clear that there will be a substantial reduction in outsourcing and thousands of Australian businesses and Australian employees will suffer. Once it is decided that the financial supply will be input taxed, you have decided that a business is going to pay the GST, so the question is deciding where or which business will pay it. That is the problem with the current structure. There should be an opportunity for any business that provides financial supplies, directly or indirectly, to be input taxed. As soon as you allow any business which is directly or indirectly providing financial supply to be input taxed, you remove the bias against outsourcing.

That proposal simply places smaller financiers—all the credit unions, all the cooperatives, associations throughout Australia, all the intermediaries that the Mortgage Industry Association of Australia represents (Aussie is the largest) and the thousands of businesses that provide supplies to those businesses—on an equal footing with the four major banks. It enables those financiers and intermediaries to obtain services at the same cost as the major banks and it enables those businesses to maintain competition with the major banks.

Small financiers and intermediaries work on a small margin. The result of that small margin is that 80 per cent of their gross income may be in expenses, and all of those expenses are outsourced. So, as soon as you add a GST of 10 per cent, that is another eight per cent in cost; you have almost halved their profit. Our analysis of literally hundreds of

businesses has shown that not only does it halve the profit but in some cases it wipes the profit out altogether.

We say that the GST as currently proposed in relation to financial suppliers will result in the following. Firstly, there will be a reduction in competition because the major banks will be advantaged. The value and importance of competition has been graphically demonstrated in Australia by the growth of mortgage originators and, in particular, Aussie Home Loans.

Secondly, there will be a reduction in jobs as small businesses shrink or close. In the few weeks we had available to prepare this submission, the response from small businesses throughout Australia was staggering. Only some of the responses were put in the submission that was lodged. There was a recognition by small suppliers throughout the country that they rely on outsourcing from financial suppliers to continue in business. We could see country towns and suburbs left without lawyers, left without valuers, left without other resources. Thirdly, the resources of Australia will shrink because these businesses will shrink or close; not only the outsourced businesses but the small originators and the small banks.

Fourthly, and importantly, securitisation. Securitisation has, for many years, been strongly supported by the Commonwealth government and each state government. Special laws have been passed to facilitate securitisation. Securitisation is, of course, the pooling of assets and then the issuing of bonds to raise money to fund those assets. This process has provided cost-effective finance to millions of Australians. Securitisation will be substantially disadvantaged by GST as proposed because securitisation, by definition, outsources everything because the actual lender has to be bankruptcy remote, so every aspect of the securitisation activity is outsourced. Securitisation also works on particularly small margins and, with outsourcing being essential to it, it could see itself in real difficulties.

Finally, there is a substantial increase in risk to all financiers because banks will be inclined not to outsource. If big banks have a choice of using an external lawyer to do the next financing of the Sydney Harbour tunnel, instead of outsourcing it, they will do it internally to avoid the GST. Then will follow the next time when they are doing the financing for the Olympic stadium. This is just not an issue of consumers. This goes to the heart of prudential control of our financial system.

What about overseas experience? Overseas experience is not valid in relation to this issue because overseas financial markets are not as flexible and competitive. Australia has one of the healthiest and most competitive financial industries in the world. These concepts that I have been talking about of securitisation and intermediarisation are now being exported to the UK, New Zealand and South Africa. I had people from Sweden over to see me only a month or two ago. The concepts are going to the whole of Asia. Here we are world leaders and taking a step which will disadvantage an industry in which Australia is a world leader.

What are the solutions? There are four solutions. My association does not push any particular solution because we do not want to be in conflict with the other people who are making submissions to the Treasurer and to this committee. One solution is to include the financial suppliers in the GST net—one in, all in. The second solution is to make financial suppliers GST free so they can obtain the input credits. That is unlikely to find favour because GST free at the moment is confined to charities, education and exports.

The third and fourth solutions achieve the same result. One is to allow anybody who is in the financial supply chain to elect to be input taxed, so a valuer who is providing a valuation could elect to charge GST or elect for that business to be input taxed. The explanatory memorandum says that, if the bank does the valuation of your home, it will be GST free. If you get a valuation from Aussie Home Loans, it will not be GST free because the exception was not wide enough. That is the bias against outsourcing. That is the graphic demonstration of the damage to competition. That is the graphic demonstration of the damage to be done to small businesses.

The other way of structuring it rather than changing the input taxing concept, so the legislation can be left alone basically, is to allow Aussie Home Loans to make valuers, lawyers and mortgage insurers who are his suppliers part of his group as a department, a branch or a joint venture. The concept of branches and joint ventures is already in the legislation. By enabling a financial supplier to include specified businesses as their branch or their joint venture partner, they become the one entity, and you remove an artificial tax arising simply because you are operating through a separate corporate entity. Thank you for your attention.

CHAIR—Thank you, Mr Denovan. Is it your intention to invite any of your colleagues to provide a supplement or shall we go straight to the questions?

Mr Denovan—Straight to the questions, I feel.

Mr Symond—I make one point. I think the world going forward is clearly going to be a lot more dependent on technology. We all know that the big banks and big institutions are spending hundreds and hundreds of millions a year in systems. The outsourcing of our industry is going to become greater, not less, going forward particularly in technology. That is an area where, unless you are one of the bigger institutions, you cannot afford to undertake that technology yourself. You are forced, whether you like it or not, to outsource. I am very concerned. I think technology is going to be probably the biggest challenge in most organisations. We will be forced to outsource. I am fearful that the cost of this GST on outsourcing will dramatically increase, not decrease.

Senator GIBSON—Aren't some of the big banks doing exactly the same?

Mr Symond—In outsourcing?

Senator GIBSON—Yes.

Mr Symond—Certainly.

Senator GIBSON—For IT?

Mr Symond—They are outsourcing some of it. But when you have millions of customers and some of the outsourcing is to subsidiaries of them or joint ventures, clearly they are in a better position to wear the cost and pass the cost on in other forms of revenue, whereas organisations like ourselves are not open to recoupment in other areas.

CHAIR—I attach a fair bit of weight to this submission because one of the things that Australia does have is a competitive home mortgage market. It does, for example, for exactly the reason that we have mortgage providers keeping the banks honest and providing competition in this market. If we did not have that competition, bank charges and costs to mortgagees would be higher, and the Australian dream for most people would be a bit further away than it might currently be, so I think this is quite an important submission.

Senator O'CHEE—Mr Symond, you would probably agree that the Treasurer has also been quite a substantial aid to you too. Every time the banks do not cut their interest rates quickly enough, he says go and see Aussie Home Loans, doesn't he?

Mr Symond—He certainly does. I think, in fairness, that most previous Treasurers have taken the same line.

Senator O'CHEE—One of the things Mr Denovan said is that his view is the consumer always pays. Let us just look at option 1 and compare it with what the government is proposing. Option 1 is basically taxing people's mortgages, isn't it?

Mr Denovan—Yes. The costs of the GST will not be absorbed by any bank or any financial institution. I can just explain one thing which we have skimmed over a bit. In the proposal that we are putting forward, we do not see the big banks as the enemy, we see them as our competition. We feel that input taxing anybody in the supply chain is important for the big banks as well. It is good for the whole system. It is not a fillip for mortgage originators or small banks; it is a system wide remedy.

Coming back to your question, our analysis would be that the additional cost imposed by GST will be passed on to borrowers or customers in one way or another. As I understand it, the big banks propose to do it by increasing bank fees across a myriad of bank accounts. The actual cost to the individual consumer is comparatively quite small in their case because of the millions of accounts conducted by them.

A specialist mortgage lender does not have those millions of accounts over which to spread the charge and, therefore, its only answer is to increase the interest rate. In the case of most mortgage originators, they promise fee free loans, which is a term very hard to say but something very nice to have. Once you have your fee free loan, it is locked in there for ever. They have been promised that for the next 25 years their loans will be fee free. Therefore, fees cannot be added in to recoup the cost of this GST.

What will have to happen is that the interest rates will have to go up on existing loans. It is not just new loans; it is the \$8 billion worth of loans that Aussie Home Loans has already written. It is the many billions of loans that the industry has written. As soon as those interest rates go up, the interest rates on new loans will go up, and it will be a case of tag. That is what we are concerned about.

Senator O'CHEE—Yes, I understand all those points. What I am saying to you, Mr Denovan, is that your preferred option is to basically bring financial services into the GST net, which means taxing people's mortgages.

Mr Denovan—Yes, because I think that avoids a natural skewing that arises from taking anything out of the net. But I understand the problems.

Senator O'CHEE—You understand that most people would be actually quite upset if they thought there was GST attached to their mortgages.

Mr Denovan—Yes.

Senator O'CHEE—One of the points you have made is that some of the mortgage originators have promised in their contractual arrangements with the mortgagors that there will be no fees on the thing. That was a marketing ploy, wasn't it?

Mr Denovan—It is a marketing ploy, but it is also written into many of the contracts.

Senator O'CHEE—Yes, but I mean it was written into the contracts because it was part of the marketing drive that the mortgage originators live with it.

Mr Denovan—Yes, certainly.

Senator O'CHEE—It does not have to be in every contract. It is just that it is the way they chose to start their business—the way they chose to do it.

Mr Denovan—Correct.

Senator O'CHEE—So it is a tactical decision they made?

Mr Denovan—Yes, but they are now locked into it for the next 25 years with those loans.

Senator O'CHEE—Sure. Did you advise them to put it like that or did you suggest that maybe they should have been a bit more careful about the way they worded their contracts?

Senator CONROY—They probably believed the Prime Minister when he said that he would not introduce a GST.

Senator O'CHEE—Mr Denovan?

Mr Denovan—I think it was a matter that was decided in order to product differentiate their product.

Senator O'CHEE—As you said, the consumer always pays. Surely one of the advantages of input taxing, as compared with your option 1—your preferred option—is that when you input tax the incidence to the final consumer is slightly less because you are not taxing the increase in value which is derived by Mr Symond or any of his other competitors.

Mr Denovan—You say option 1 is our preferred option, but option 1 is the theoretical preferred option in the sense of one in, all in. But in this association we do not push for that solution at all because it does result in taxing the consumer on the gross as opposed to the

net which you get out of the input taxing solution. The input taxing solution minimises the increased cost to finance and, therefore, in itself is fine. It is where the line is drawn that is our problem as to what is a financial supply. We do not understand why, as it says in the explanatory memorandum for item 12, if a bank gets a valuation, there is no GST but, if a mortgage originator or a credit union or a cooperative gets a valuation, there is GST.

Senator O'CHEE—There is also an advantage to an originator in outsourcing valuations, for example. If a bank does a valuation internally and the valuation is wrong, the bank has got nobody to sue or blame but itself. The originator gets an advantage in that he has recourse to somebody else to say, 'Look, you gave me this valuation. This valuation was dud. The valuation showed the property as twice what it was really worth. I am going to claim against you.'

Mr Denovan—I think the banks internally insure against their valuation sector or their legal section getting it wrong. Many originators would like to do their own valuations, but they are prohibited from doing so because of securitisation. This is the element of securitisation which requires that every step in the transaction is outsourced to maintain the credit quality.

Senator O'CHEE—But the insurance the banks take themselves does not receive this benefit.

Mr Denovan—I do not know. I cannot speak for them.

Senator O'CHEE—Because, again, the insurance industry is input taxed.

Mrs Edema—From the point of view of the banks, they are large institutions and, again, what the association sees are the smaller managers being disadvantaged. As a small mortgage manager myself, we do not have the capacity to take on the risk of a valuer being wrong because that would wipe the business out whereas, with a bank, they are obviously doing their risk analysis on any number of things and they can carry that risk.

Senator O'CHEE—That gets back to the fundamental problem that you really face in Australia as opposed to, say, in America, which is that here you have got four major banks. In America, the securitisation market was driven off a whole heap of very small banks and so those bank loans were bundled up across the states, across 10 or 15 different banks. That is the fundamental structural difference between Australia and the most mature securitisation market—

Senator CONROY—That is why we do not let you merge any more banks.

Senator O'CHEE—which is the United States. That is really a consequence of the structure of the banking industry in Australia, isn't it?

Mrs Edema—It may well be, but does that mean that we should be disadvantaged as a result? We have brought competition to the market and saved consumers a heap. We have been advantageous politically for both parties and yet this here is an injustice.

Senator O'CHEE—What I am saying to you is that some of us were arguing for a secondary mortgage market 11 years ago because we recognised the need to have it. But we also recognised 11 years ago that you did not have that stock to come into the securitisation process because the large banks did not get the advantage of securitisation that you would have if you were a small bank.

I was on record six years ago saying to the credit unions, 'You should securitise'—because it suits them. Because of the cost structure they can churn their loan portfolios. Big banks do not want to do that. If we are going to have a mortgage securitisation market in Australia, we have to understand that there is less stock to churn, don't we?

Senator CONROY—But now you have hit it on the head.

Mr Symond—But securitisation really helped us bring competition on to the banks, which forced interest rates down. Dismantling the securitisation structure, such as in-house valuers and the like, is going to affect the pricing of the bonds, which means higher rates and less competition. The big banks will laugh because this is exactly what they want.

Senator O'CHEE—The fundamental problem is maybe it is more a problem to do with the structure of the Australian market. That is what your real inflexibility is. Your real impediment is that you do not have dozens or hundreds of small banks that you can draw on. That is your real impediment.

Mr Symond—But that can never be changed. We have got four big banks that control the financial markets. They have been here long before and will be long after. You, as politicians, will come and go but the big banks will be here and will get bigger and bigger. Competition in niche markets like ours and the mortgage industry is the only hope of trying to keep them in line in some niche areas. This GST is going to clip our wings.

Senator O'CHEE—What I am saying to you is that there are a whole heap of limits that you have to deal with. What I am putting to you is that the more fundamental constraint on the growth of your industry is in fact the structure of the industry in Australia. You are still growing.

Mr Symond—But we are stuck with that. Whether you or I like it, we are stuck with it and it really is not going to change fundamentally and significantly for many years.

Senator O'CHEE—You are missing the point. What I am saying is that that is a more fundamental constraint than the constraints you are talking about.

Mr Denovan—I think we are missing the point. I am sorry, I don't quite understand the point. It seems to me that you talk of securitisation in America being aided because there were a whole lot of small institutions. Small institutions certainly do get a leg up by securitisation and you were 100 per cent correct in encouraging the credit unions to securitise when you did.

Just take securitisation for one moment. When one of the major banks decides to securitise, which Westpac has just done recently, the whole thing is developed internally.

The upgrades that are required to make sure the thing has a suitable rating is given by Westpac or a Westpac subsidiary. Westpac does not have to outsource who holds the title documents because Westpac says, 'I am holding them. I am big enough and you can trust me.' Westpac does not have to outsource the valuations because Westpac says, 'Trust me, I did the valuation.' Westpac does not have to mortgage insure the mortgages because Westpac says, 'I do not like that mortgage. If it goes into default I will put another mortgage into the pool.' None of these things are available to the Bank of Bendigo which has just done something good by taking over IOOF and is about to develop and do things in the country. None of this helps the credit unions. This absolutely disadvantages them to the extent of 10 per cent right across the board because the vast majority of their expenses are supply.

Senator O'CHEE—Having said that you believe that all businesses should be treated equally, you then propose an artificial system where in fact some businesses will be treated differently from others in the financial sector. Your argument though leads you to the very flaw you were trying to avoid, doesn't it? Surely if we say, 'Look, people in the financial sector can treat their outsourcing differently,' we will have a whole heap of people trying to get themselves into the financial sector and thereby trying to claim a benefit? How do you deal with that problem?

Mr Denovan—That was exactly the problem that the Treasurer raised with me when I discussed the matter with him. I have thought about it, and the way the legislation works every business has that problem. The legislation provides that if I make a financial supply in excess of \$50,000 in a year then I have to start pro rata-ing my input taxes. If we take my law firm, for example, and I put some money in the bank, earn some interest on it and the interest is more than \$50,000 in the year, then I do not get an input tax credit for all my rent. I have to start pro rata-ing it across my business inputs.

That means that the vast majority of businesses in Australia are already being placed in the situation where they have to apportion their GST input taxes. So all I am saying is that my business and all the other suppliers to the financial supply business will themselves have to pro rata and say, 'Yes, today I do not get an input credit because I had some money in the bank earning interest. Today, I do not get an input credit because I provided a financial supply to Aussie Home Loans.'

So the problem of apportionment is already there. It is embedded in the legislation. It is one of the great sleepers in my view that practically every business, all the supermarkets, everybody who is in trade, is not going to get a full input tax credit.

Senator O'CHEE—That was not my question. My question is: won't you find a whole lot of people trying to create the opportunity for themselves to be in the financial sector and therefore be in the same situation as Mr Symond? That was my question.

Mr Denovan—Yes, of course you would, and that was my opening remark. As soon as you do not have GST applying to all goods and services, you have the room for dispute. You have arguments about whether that is in the net or out of the net. For example, would a property developer who pays an estate agent's commission to a purchaser to assist him or

her to buy a home get an input credit? You are nodding—you have obviously read that case, too, recently.

We have that problem of allocation of credits as soon as everything is not in the net. It is an unfortunate problem and I do not find a solution for that. I do say that the solution is—having accepted the problem is there—to allow the allocation of those credits to find their natural level. It does not matter whether a firm of valuers, externally or internally, is providing the financial supply. If it is a financial supply it should be input taxed. Why, simply because it is a separate entity, should it be different?

Senator CONROY—Mr Denovan, I was just interested in your comments a little earlier to do with the impact on suppliers of services to financiers and intermediaries, valuers, et cetera, in regional areas. I was just wondering if you could expand on the comments you were making about that?

Mr Denovan—Amongst the letters and the submissions, you will see that there are a large number of letters from valuers and lawyers located in country and regional areas. Some of them have gone as far as to say that their businesses will close as a result of the reduction in outsourcing from the financial suppliers. My particular business is not a suburban business; it is a city law firm. But I receive 40 per cent, maybe 50 per cent—in that order—of our income from providing work for the financial suppliers. I am sure that will all go. This is a marginal business. I am absolutely sure it will all go.

Senator CONROY—So these people will pack up and leave country towns because of this?

Mr Denovan—I think the businesses will close and the resources available to country towns and suburban areas will be reduced.

Senator CONROY—You mentioned earlier the impact, Mr Symond, of not being able to input credit. For your existing loans—not new loans—you signed up to say no fees and charges.

Mr Symond—Yes, we have made that representation.

Senator CONROY—Therefore, the only way for you to recoup your margin as it stands at the moment is to increase interest rates on your existing home loans?

Mr Symond—Yes. That would be the unfortunate consequence in the way the GST is formulated in its present form.

Senator CONROY—Presumably then, for new loans, you either have a choice to increase your interest rate as it stands at the moment or to introduce fees and charges?

Mr Symond—Or both, because it may well be too lopsided either way. Then that takes away the differentiation and the competitive pressure where, all of a sudden, you do not have a clear point of differentiation with the big banks.

Senator CONROY—That is just a tactic according to the Senator O’Chee.

Mr Symond—I guess you have also got to believe what is a fair thing to do as well and what is a fair return. My personal belief there is that I do not believe you should be able to get a fair interest rate return and on top of that charge fees and charges. It has got to be one or the other. That is my personal belief.

Senator CONROY—You would argue very strongly that this package will skew the market back towards banks?

Mr Symond—In its current form there is no doubt that the competitive forces that we introduced, and others have followed, will be diluted significantly. At the end of the day the consumers will lose out because it will put the big banks in a better position to increase interest rates—they have already started with the fees and charges—dramatically higher than the GST component, to where they were before. Seven years ago when Aussie Home Loans kicked off, there was something like a 4½ per cent profit margin on home loans. Today it is less than two per cent. If you do not have competitors out there and they do not exist, it will creep right back up because of the structure of our financial system.

Senator CONROY—Could you expand on why it would actually be higher than just the GST? I did not quite follow you on that.

Mr Symond—I guess you charge whatever the market will stand and, if you do not have competition out there, you get away with whatever you can get away with for as long as you can. That is what happened in home lending in this country for 100 years. If your competitors start to disappear, then you are less sensitive, as a big bank, to pricing. As has been demonstrated, you will get away with as much as you can get away with for as long as you can get away with it. If you take the competitors out of the system, then it is open slather.

Senator CONROY—I think Mr Denovan suggested that expenses were outsourced—80 per cent—so you are really close to getting your profits wiped out and some of the smaller originators, perhaps even yourselves, would be forced to amalgamate or go out of the market?

Mr Symond—Certainly with Aussie Home Loans, we believe it will wipe out at least 60 per cent of our operating profits.

Senator CONROY—Sixty per cent?

Mr Symond—The smaller players would probably be totally wiped out. We are at least big enough. We are providing more new home loans than all, bar the four big banks. We would struggle tremendously with the GST in its present form. As for the smaller players, God help them.

CHAIR—You were saying, effectively, that there will be upward pressure on interest rates, and interest rates may rise if this package comes through.

Mr Symond—I think interest rates would rise. It will, I think, extinguish and force out a lot of the smaller lenders who are providing competition. The fewer competitors, the more, I think, the big banks will be able to roll out higher interest rates and fees and charges.

CHAIR—The knock-on effect would be that fewer Australians would own their own home?

Mr Symond—Certainly.

CHAIR—I do not think I have any more questions. As Julia Roberts said to Richard Gere in the movie *Pretty Woman*, ‘You don’t need to romance me anymore. I am a sure thing.’

Senator FERGUSON—We knew that, Senator Cook.

CHAIR—That argument makes me a sure thing, Mr Symond. Senator Harradine, any questions?

Senator HARRADINE—No. I think that the evidence is self-evident.

Senator GEORGE CAMPBELL—Senator O’Chee referred to the state of the market. Is it fair to say that the market in home lending at the moment is working fairly effectively in this country and has been since the commencement of mortgage originators?

Mr Symond—Not since the commencement but particularly in the last two years when the banks have been forced to nearly match on price and improve their services. Competition today in the home loan industry is red hot in favour of consumers and it is the best that consumers have ever experienced in this country.

Senator GEORGE CAMPBELL—So we have a very effective marketplace in terms of home loans at the moment?

Mr Symond—Yes, we do.

Senator GEORGE CAMPBELL—And your argument is that, if this package goes through, the impact of the package will, in fact, reverse that?

Mr Denovan—It goes through in its current form.

Senator GEORGE CAMPBELL—Essentially, I understand that your argument is it will cut substantially the profit margins of the non-bank lenders and will, in fact, probably widen the profit margins of the banks because of the application of the package.

Mr Denovan—Yes.

Senator GEORGE CAMPBELL—So here we have a set of circumstances where the actual legislation is going to, one could argue, lead to market failure?

Mr Symond—Or will play right into the big banks' hands.

Senator GEORGE CAMPBELL—In terms of the securitisation issue, it is done on the basis of parcelling assets. How will the package work in the way in which each of those individual assets is treated in terms of the cost impact? Will they be treated equally or will they be treated differently?

Mr Denovan—Securitisation is very unusually and peculiarly hit because it relies on the actual lender doing nothing but lending money or providing the financial supply. It cannot undertake any of the activities that relate to that lending because it needs to be bankruptcy remote. Securitisation is 100 per cent outsourcing by its very nature and, therefore, it is hit with GST left, right and centre under the legislation as currently proposed. I think that there is potential for the securitisation to be so heavily hit because of the number of differences of outsourcings that occur that it might cease to be a viable way of raising money.

Senator GEORGE CAMPBELL—That is the point I was trying to drive at, Mr Denovan. It is true to say that some assets will lie in the pool for the whole of the 25 years of the life of the loan. It is also true to say, I think, that on average most loans turn over in about a seven-year period—commercial loans, I think, in a lesser period than that—so some will turn over on a more regular basis. So the cost spread over the costs on the asset pool will be borne differentially by different asset holders—is that correct?

Mr Denovan—Yes. There could be a skewing. It is worth mentioning that today our submission is supported by the Securitisation Forum of Australia which is a forum established by the leading securitisation companies and their advisers throughout Australia. I think there is a letter of support from them in the submission.

Senator FERGUSON—Mr Symond, I am amazed that Senator Conroy and Senator Cook could raise the issue of a possible interest rate rise when, in fact, when they were in government they presided over 17½ per cent home loan rates. Currently this government has managed through prudent economic management to get it down to around six per cent. How much better off is a home buyer today under a six per cent interest rate than he or she was under 17½ per cent?

Mr Symond—Tremendously. There is a huge difference. If you are talking 11 per cent on an average home loan, you are talking probably \$1,000 a month better off.

Senator FERGUSON—That leads me to my next question: because of the concerns that you have raised in relation to input taxing, have you done research or worked out precisely just how much would be added to a home loan, factoring in the taxes that you say are going to cause you to increase your interest rates? Do you know how much a month it would increase the average home loan?

Mr Symond—Certainly our own organisation may have to increase rates by as much as half a per cent; however, the biggest impact is not that half a per cent. It would place us in the position of charging higher rates than the banking sector, which means a lot of the non-bank competitors would not survive and the banks could go out there and start increasing home loan rates by as much as two or three per cent.

Senator FERGUSON—Do you know the extra cost in dollar terms per month of an average home loan if the bill goes through in its current form?

Mr Symond—Yes. On an average home loan per month?

Senator FERGUSON—Yes.

Mr Denovan—I do not think you could actually answer it in that fashion. The actual impact of GST on a home loan is very marginal because it can be no more than 10 per cent of the costs in providing that home loan. Therefore, if the margin on a home loan is two per cent per annum, the increase in cost could be no more than 0.2 per cent per annum and in fact would probably be less than that.

The GST package itself is not what our submission objects to. The GST package itself does not increase the interest rates on home loans. The GST package disadvantages small banks and intermediaries. Once they are disadvantaged and removed from the loop, there is the potential for the reversal of the tremendous good things that have happened over the past few years. In the same way that it was ‘follow the mortgage originators down’, it will be ‘follow the mortgage originators up’. We cannot put a figure on the increase.

Mr Symond—It is more the consequence: there will be fewer players in the market, which means less competition, which means we get to the bad old days where you charged whatever you wanted to for as long as you wanted to in a deregulated environment. That is the consequence.

Senator FERGUSON—But you would still be in the market wouldn't you, Mr Symond?

Mr Symond—I certainly hope we would still be in the market.

Senator CONROY—Mr Symond, if the government introduced a measure that was going to wipe out 60 per cent of bank profits, do you think they would be continuing with a measure like that?

Mr Symond—I do not think they would.

Senator CONROY—You mentioned, Mr Denovan, that you had meetings and representations with the Treasurer?

Mr Denovan—Yes.

Senator CONROY—Were you all there?

Mr Symond—Yes, I was there.

Senator CONROY—Did the Treasurer acknowledge that this would be the impact?

Mr Symond—I think it is fair to say that we met with all parties and everybody, including the Treasurer, recognised that it is an unintended consequence but that nobody has

come up with a solution. It is something that everybody agrees is unfortunate and, as far as the Treasurer was concerned, they were going to have a look at it and get back to us.

CHAIR—When?

Mr Denovan—I think after the hearings of this Senate select committee. They suggested that we come along and explain our position, to garner public support and to try to find a good solution.

Senator CONROY—The Treasurer wants you to lobby against himself?

Mr Denovan—No, he wants us to find the solution. We all want to find a solution to this.

CHAIR—Order! We have to report by 19 April, you are in ongoing discussions with the Treasurer and we would like to know what the outcome of those discussions are so we can give an up-to-date report to the Senate. If we are not in a position to do that and there is no likely time by which there will be a clear answer, we will have to report the submission as it stands to the Senate as being the concerns that you express—and they are quite weighty concerns. My problem is really to try to get a time frame that meets our deadline. If what you are saying, though, is that the Treasury officers advised you to come and state your case here, it seems to me that they have delegated the responsibility to this committee to come up with a solution. If that is what they want to do, we will.

Mr Symond—We would be keen to get some feedback, and we are still waiting for the Treasurer's office to come up with some ideas.

CHAIR—But there is no deadline?

Mr Symond—No.

CHAIR—Okay. As there are no further questions, thank you very much. It has been a very useful submission. Thank you for aiding our inquiry. On a perhaps philosophical point, I must say you cannot be as good a batsman as Tubby Taylor, Mr Symond. I think the role of mortgage originators deserves an Order of Australia or some other sort of recognition because of the services to Australian home owners.

Senator FERGUSON—Perhaps you should recommend it to the government, Senator Cook.

CHAIR—Since we introduced competition that enabled mortgage originators to start, we can take some of the credit.

Senator FERGUSON—You should recommend it to the government.

[11.41 a.m.]

COOPER, Mr Gordon Stewart, Senior Vice President, Taxation Institute of Australia

PAYNE-MULCAHY, Mr Michael Lawrence, Senior Tax Manager and Acting Technical Director, Taxation Institute of Australia

WARTON, Mr Paul John, Chairman, Indirect Tax Committee, Taxation Institute of Australia

CHAIR—I welcome the Taxation Institute of Australia. Mr Cooper, if you are leading on behalf of your organisation, would you introduce your colleagues and make a presentation to us summarising your written submission? Then you can make yourselves available for questions.

Mr Cooper—Certainly. As far as our submission is concerned, the Taxation Institute of Australia welcomes the opportunity to appear before this inquiry into the GST and a new tax system. The institute is an opinion leader on taxation matters. It is the only professional body in Australia which has taxation as its sole focus. The institute is a national body of over 10,000 members drawn from all areas of the tax profession. The institute has always had a keen interest in tax reform. It has made numerous submissions to the government, Treasury and the Australian Taxation Office.

It is important for members of this inquiry to understand the perspective from which the institute prepared its submission on the proposed GST and the basis on which we will endeavour to answer any questions you put to us. When the institute comments on a tax proposal, whether it be a comment touching on policy, application or administration, the institute focuses primarily on the technical efficacy of the proposal under consideration. It is not the role of the institute to seek to analyse a tax proposal from an economic perspective. Bearing this in mind, the institute believes strongly that a comprehensive assessment of the impact of the GST is not possible in the context of overall tax reform until all of the government's tax reform proposals have been tabled in the parliament.

The current proposed GST regime is not simple either to implement or to administer. More specifically, the transitional provisions are unnecessarily complex. Whilst relief for existing consumer contracts which straddle the proposed implementation date of 1 July 2000 may well be appropriate, generally such relief is neither necessary nor appropriate for long-term commercial arrangements such as leases.

There should be a statutory right to charge and recover GST. Under the proposed transitional arrangements there is likely to be considerable unnecessary litigation to determine whether existing arrangements enable GST to be charged. The in-principle effect test in the GST anti-avoidance provision is far too broad. There should be statutory confirmation of the deductibility of professional fees incurred in implementing GST which would include the costs of the many valuations required as at the proposed implementation date of 1 July 2000. There must be clarification of the GST treatment of court awarded damages and compensation and also out of court settlements, and sufficient time must be allowed for the implementation of the GST.

Finally, the institute appreciates that perhaps the most contentious area of the proposed GST is its application to food. In its submission, the institute contends that, in order to avoid complexity, food and other essentials of life should remain within the GST net. However, if it were decided not to charge GST on food, then the institute considers that the supply of food should be GST free rather than input taxed. This would ensure that the cost of GST on inputs used in the supply of food is not borne indirectly by consumers. Moreover, although it would not eliminate definitional problems, at least it would avoid the need for apportionment of inputs by enterprises supplying a mix of food and other goods and services. In addition, it should minimise the additional administration and compliance costs. Thank you.

CHAIR—Thank you, Mr Cooper. Is it your intention to invite any of your colleagues to supplement or shall we go straight to questions?

Mr Cooper—Straight to questions, thank you.

CHAIR—Senator Ferguson.

Senator FERGUSON—Mr Cooper, food is not input tax free now.

Mr Cooper—There is wholesale sales tax on food, yes.

CHAIR—Some food.

Mr Cooper—Some food, yes.

Senator FERGUSON—There are wholesale sales tax implications for practically everything. A colleague said that, if you wanted to be free of tax, you had to walk through a virgin forest naked and eat a berry—it was the only way you could have any food that was currently not taxed.

Mr Cooper—No, there is some food that is free of tax. But, as I understand it, one of the advantages of moving to a GST regime is that you remove the hidden taxes in the form of wholesale sales tax.

Senator FERGUSON—What food is GST free now?

Mr Warton—Sales tax free?

Senator FERGUSON—Yes.

Mr Warton—Most food is sales tax free. Basically, the only foods that are subject to sales tax are snack foods and soft drinks.

Senator FERGUSON—What about the input costs? What about the lorry that carts the grain to the mill? It is taxed all the way through.

Mr Warton—That is correct. We do not want to get into political arguments, but for the first couple of years those lorries will still be taxed under the GST regime as well. The issue

is that, if food is exempt, it is exempt. If you look at the flowthrough add-ons, even under the GST there will be input taxes on certain businesses, so for finance businesses that supply the food industry there will be a flow-on of GST through that as well. It will not be as much, but it will be there. There is no pure tax system in the world—it is as simple as that.

Senator FERGUSON—I guess that was really a bit of a sideline to start with. In that last comment you made you were talking about food that is GST free when in fact we do not believe that any food is not subject to some form of tax under the current arrangements.

Mr Cooper—The only point we seek to make, though, is that if it were decided not to levy GST, the way that should be done is to have it GST free rather than input taxed so that the supplier would be able to recover the GST on their inputs.

Senator FERGUSON—But, in fact, you do not support the exemption of food, do you?

Mr Cooper—No, we think that in order to avoid complexity and in order to avoid difficult definitional issues it would be better for GST to be applied to food.

Senator FERGUSON—If it were to be applied to food, do you have a preferred definition of what ‘food’ should be?

Mr Cooper—Are you are saying if GST is applied to food?

Senator FERGUSON—If food were to be exempt from a GST.

Mr Cooper—I am sorry.

Senator FERGUSON—Sorry. If food were to be exempt, what would be your preferred definition of ‘food’?

Mr Cooper—Frankly, it would be an extremely difficult definition to frame. I think our view would be that we should seek to avoid the types of problems we have had under wholesale sales tax where you are endeavouring to distinguish between food that is perhaps regarded as fresh food and takeaway food. There have been a number of cases on wholesale sales tax on that very issue as to whether something is takeaway food—whether it is subject to wholesale sales tax or not. But, frankly, it is difficult to define food. At the margin there will always be issues as to whether something is in or out.

Senator FERGUSON—So, in fact, would it be the view of your institute that, for equity purposes, it is far better to target low income earners and welfare recipients through the social security system than to try and exempt food?

Mr Cooper—That is certainly the point that we have made in our submission. But, yes, we think that is a preferable way to go. It is extremely difficult to define food. An example under wholesales sales tax is a case we have had endeavouring to decide whether frozen yoghurt should or should not be subject to wholesale sales tax.

Senator FERGUSON—I have not got the page in front of me just at present, but I remember reading in your report something where I think you are ‘picking’ at various parts of the legislation, for want of a better term.

Mr Cooper—I think we would prefer to say we are seeking to highlight areas that could be improved.

Senator FERGUSON—Okay. You talk about transparency: what did you have to say about transparency?

Mr Cooper—I am glad you asked that. It is an area that is of great concern to us. Under the proposed legislation, when a GST invoice is rendered there is no obligation on the supplier to indicate how much GST is included in the amount or the supply. In many instances, that will not be a problem—it will simply be a case of taking one-eleventh of the amount and treating that as being the GST component.

However, there are circumstances where the supply may come from someone who is not registered. The recipient will not know that they are unregistered and may inadvertently claim GST to which they are not entitled. In addition, there is a system called the margin system where only part of the supply may be subject to GST. On the face of an invoice there will be no obligation on the supplier to indicate how much GST there is. It is our very strong view that invoices should be required to show the amount of the GST.

Senator FERGUSON—It is going to increase compliance costs, isn't it?

Mr Cooper—I do not think it will increase compliance costs as far as the suppliers are concerned. It is simply a matter where most of them will be rendering computer invoices. They will know what the one-eleventh is in the straightforward cases and when the margin scheme has applied they are in a much better position to know what the GST is than the poor recipient who has to make inquiries to determine what is the amount of input GST.

Senator FERGUSON—But, in the case of a cottage industry that may not register because their turnover is less than \$50,000, you are unlikely to have a computer invoice.

Mr Cooper—In that case, if their turnover is under \$50,000 and they are not registered, they will not have any GST. It should be made explicit on the invoice that there is no GST component.

Mr Warton—The problem that you have which also exists in sales tax at the moment, and it has just happened with the anti-evasion laws for the computer industry, is that if you make an exception then business takes the simplest approach to cure their problem. If you take the cottage industry, what will happen is that most businesses which are registered will refuse to deal with businesses which are not registered or which do not show the sales tax on their invoice because they will not have the benefit of instructing their staff to interpret the GST law invoice by invoice to apportion the amounts of GST. So the simple answer for business will be that, if they do not show it, do not deal with them. That causes some legal problems. It would be much better settled with a piece of legislation saying that if you issue an invoice the GST must be shown.

Mr Cooper—Let me make it clear that we totally support the decision that has been taken to make prices inclusive of GST. We are not suggesting it should be an add-on. We are merely suggesting that when a GST invoice is provided the amount of the GST should be shown on the face of the invoice. There are a number of other requirements as to what has to go on an invoice. We are simply saying that the number, the GST amount, also ought to be there.

Senator FERGUSON—Let me clarify that. The problem that you see is that a business may purchase from a non-registered business and in fact inadvertently claim the GST.

Mr Cooper—Yes, because they will simply process that invoice and they will assume that one-eleventh of the price is GST in respect of which they can claim input tax.

Mr Warton—It is not only there. Let us look at, for instance, a local council which bills some rates. They may also bill some expenses for garbage collection to a business. The garbage collection will probably be subject to a GST; the council rates will not. Unless the GST is shown separately on the invoice, you are leaving it up to the business to try to decipher how much is GST credit. It is an impossible situation. Most countries that I know of in the world insist on it.

Senator FERGUSON—It is also true that most experience overseas would suggest that even cottage industries in many cases—that is, people with turnovers of less than \$50,000—do actually register because they want to claim their input costs.

Mr Cooper—Yes, that is absolutely true.

Senator FERGUSON—There are likely to be very few people who in fact are not submitting an invoice which does have GST on it.

Mr Warton—There is no force to make—

Senator FERGUSON—I understand.

Mr Cooper—The problem still remains with the margin scheme where you are talking about significant dollars. For example, if you are talking about the transfer of an existing commercial building where the margin scheme applies after the introduction of GST, the dollars involved if someone takes one-eleventh of the price as being GST could run into millions of dollars whereas in fact the amount of GST payable may only be hundreds of thousands.

Senator GIBSON—Mr Cooper, to get back to general issues, your institute has been in favour of tax reform in Australia for quite a long time, hasn't it?

Mr Cooper—It certainly has.

Senator GIBSON—Do you currently support the government's ANTS package? I need this for the record, so that is why I am asking.

Mr Cooper—We certainly welcome many of the initiatives that are in there. We note that some of them have bipartisan support.

Senator GIBSON—I am surprised you did not say that in your submission.

Mr Cooper—We endeavoured to confine our submission simply to the GST and made the point that the GST was but one element of overall tax reform.

Senator GIBSON—Sure, I know that. You also said you supported the GST.

Mr Cooper—Yes.

Senator GIBSON—I just wanted to make sure that everyone else understands where you are coming from and that you have been in favour of tax reform for a long time.

Mr Cooper—We certainly have.

Senator GIBSON—You would also have to agree that this is the best chance that Australia faces of actually getting substantial tax reform through the parliament.

Mr Cooper—It seems to be the only chance at the moment, yes.

Senator GIBSON—That is the main point I wanted to make.

CHAIR—Of course, tax reform is very much a matter for judgment. Tax changes come along all the time. Mr Cooper, has your institute consulted with the government about the details you have put forward to us today?

Mr Cooper—Over the years we have had good relationships with governments of any political persuasion. Yes, we do consult with ministers. We consult with Treasury officials and more usually when it comes down to detail we would be involved in discussions with Treasury and the tax office on the precise form of legislation.

CHAIR—So you often get involved in actually working out what the bugs might be in the drawing up of legislation?

Mr Cooper—Yes. We consider that to be a very important part of our role. Certainly, the initiative that has come from Ralph to more formally entrench the involvement of external bodies such as ours is very welcome by us.

CHAIR—Were you consulted on these 16 bills?

Mr Cooper—No. Like everyone else, we have not had the opportunity. The problem, as you would be aware, that governments face is that until there is legislation confidentiality is a big issue. So it has certainly been the case in the past that generally it is only after a bill is tabled that we get involved. There have been some exceptions when we have been involved at an earlier stage, and I think the legislation has benefited from it.

CHAIR—Yes, fair enough. Have you been consulted by the government since the 16 bills have been released?

Mr Cooper—No, we have simply made our submission. We have not had any detailed discussion with anyone on the form of the bills as yet.

CHAIR—Given that they are such far-reaching changes and your previous role about being consulted, do you think that is unusual?

Mr Cooper—No, I do not think it is. I suspect that were it not for this inquiry we might well now be involved in detailed discussions with people regarding the form of the legislation.

CHAIR—That worries me because it seems that we are the means by which the government is consulting. Have you been and talked to the government recently about all the things that you are recommending? If you have, is there some sort of time line by which you would expect to get an answer on those consultations?

Mr Cooper—We have had some discussions with the Assistant Treasurer. Unfortunately, I was not able to go. My president attended those discussions. We have also had fairly detailed discussions with members of the Ralph committee on the proposals that they are bringing forward.

CHAIR—The Ralph committee is not before us; we only have before us *Tax reform: not a new tax, a new tax system*.

Senator CONROY—Minus business tax.

Senator HARRADINE—Except that the publication *Tax reform: not a new tax, a new tax system* does deal with business taxes. How is Ralph going these days?

Mr Cooper—Like everyone else, we are endeavouring to digest and we will be responding to the 843 pages that have come out in the second paper that the Ralph committee has released which outlines a number of options. We have a team of people working on a detailed response to that.

Senator HARRADINE—Has the government given any indication as to when it might be ready to respond to the suggestions or recommendations that might come forward at some later date?

Mr Cooper—No. As far as I am aware, the only deadline is that the Ralph report has to be in by 30 June. The government will respond obviously when it has given due consideration to that report.

Senator HARRADINE—We are being asked and pressed by the government to take a decision before 30 June.

Mr Cooper—On the GST?

Senator HARRADINE—On the GST, on ANTS. I noticed in your introduction that you emphasised what you have already got in your submission. It says on page 4:

It is submitted that a comprehensive assessment of the impact of the GST is not really possible in the context of overall tax reform until all the Government's tax reform proposals have been tabled in the parliament.

What do you mean by that? What are you saying to us?

Mr Cooper—The GST clearly has impacts on different sectors of the public. There are to be compensatory income tax cuts and changes, for example, to business tax measures. An important one that will perhaps impact on individuals is the intention that in the future excess franking credits will be refundable.

All those have been put forward as proposals and if they go through then it may well be that the package overall is a fair package and gives us a better tax system. But, as ever, the devil is in the detail. As I indicated in my opening remarks, unfortunately we find that the legislation that is setting out the GST is far more complex than we had anticipated would be the case. And I suppose we have the concern that, with the other tax reform measures that are proposed, the detail may contain unintended consequences.

Senator HARRADINE—You say in your submission in regard to the Senate:

The GST regime will be required to interface with other tax reform legislation and existing taxation laws on a number of levels. To some extent, therefore, the Senate should be mindful that it is considering the GST legislation in isolation.

Do you consider that it would have been better had we had the whole taxation reform package before us, including the business tax?

Mr Cooper—Certainly in an ideal world, yes. If the whole package had been before us, it would have been preferable.

Senator BARTLETT—Firstly, I have a general question. Obviously, the institute spends a fair bit of time focusing on taxation and tax issues. What is the institute's view about the purpose of taxation?

Mr Cooper—As far as we are concerned, the purpose of taxation is to raise the revenue that the government of the day considers necessary to provide the services that it feels appropriate.

Senator BARTLETT—In your submission you point out some important aspects that a GST should contain, such as lower compliance costs, ease of administration, minimisation of tax avoidance, et cetera, all of which are obviously important. I recognise the direction you are coming from but I am interested in how much importance you put on the need for a tax system to be fair, to be progressive, and to operate in a way that does not impact more heavily on low income people—those sorts of issues.

Mr Cooper—As far as the institute is concerned, we regard issues such as progressive tax to be a matter of policy rather than a matter of design for a tax system. We are concerned that whatever system is there should be as simple and as equitable as possible.

Senator BARTLETT—What do you mean by ‘equitable’?

Mr Cooper—Equitable in the sense that it can clearly be understood by people as to how the tax system applies, that there should not be unintended consequences in the tax system that give inappropriate tax outcomes to particular groups.

Senator BARTLETT—What would be an inappropriate tax outcome? If you are saying that it is matters of policy then surely it is a matter for the government or parliament to decide whether something is inappropriate or not.

Mr Cooper—It has unfortunately been the case over many years that measures that come in with one particular purpose can have unintended consequences for other areas. Certainly, we have seen our role over the years as being to try and draw attention to those so that the parliament can be clear that that is indeed the consequence that they intended, or if it was not, then steps be taken to correct them.

Senator BARTLETT—I very much agree. Hopefully we know what we are doing as much as possible when we are passing a law and what changes are going to occur as a consequence. But, in terms of assessing whether or not a change is a desirable or an undesirable one, you are saying that is an issue of policy that you do not get into?

Mr Cooper—For example, we would not comment on what were appropriate rates of tax, whether at the corporate level or at the individual level, other than in the context perhaps of looking at the international competitiveness of the Australian economy. But whatever level the government of the day chooses to set for tax rates is, we consider, a matter of mechanics and policy and not something we would buy into.

Senator BARTLETT—Sure. Going back to the answers you were giving before on the issue of food, you supported food being in the GST net for simplicity purposes and, following a question from Senator Ferguson, you said also for equity purposes. Do you mean equity in terms of everyone knowing what the outcome is, or equity in terms of one of those social policy considerations?

Mr Cooper—Predominantly, our concern is in the definitional issues of what would or would not be in if you seek to not apply GST to food. That is our main thrust.

Senator BARTLETT—So that is for simplicity and ease of management rather than fairness?

Mr Cooper—At the end of the day, yes, it is a policy decision as to whether GST should or should not be applied to a whole range of services.

Senator BARTLETT—There are a number of other areas that are exempt from GST under this legislation such as health services, education, and various business activities.

Mr Cooper—With respect, could I correct you on that. I think that is one of the problems that a lot of the debate has. They are not actually exempt; they are zero rated. The difference between zero rated and input taxed is extremely important.

Senator BARTLETT—But you still have those definitional issues. That is your concern with food.

Mr Cooper—Yes, and we ran a GST symposium in Canberra recently over a couple of days and a lot of time was spent debating, for example, what does come within the definition of health services. You do get difficult definitional issues, yes.

Senator BARTLETT—Certainly, yes. I will not go into this in great detail because issues of health and charities, et cetera, are being looked at in more depth by some of the other committees. Have you made a submission on any of those issues in any more detail to those committees?

Mr Cooper—No, we have not.

Senator BARTLETT—Do you have any general comment on some of those?

Mr Cooper—As a result of the two-day symposium we held, certainly a number of issues have emerged and it may well be that, if we are not too late, we could give the other Senate committees our views on what some of those issues may be.

Senator BARTLETT—And again, those would be coming predominantly from the issue of the management and operation of the system and those principles rather than a good or bad policy, the social impacts.

Mr Cooper—Yes, completely. We do not see it as our role to comment on those social issues. It is simply that if that policy decision has been taken it will be implemented, and the issues that arise from its implementation and operation—

Mr Warton—Could I just give an example of that? If you take a typical college sending out school fees at the moment, the school fees generally include fees, library fees, sports fees, bus fees—all sorts of things. One of the issues of the symposium was that all of those other fees would be subject to GST. There is going to be tremendous pressure by parents to get the schools to bring all of those back into the global amount.

What you are going to then ask is: how is the tax office going to handle discussing with every school, including public schools and government schools, as to what is a fair proportion of their money going to the library? The school can say, 'No, we make sure that we provide the library fee for free and all of the government compensation that we get goes to run that library for free so there is no charge, so there is no GST on that.' They are the types of concerns that we have. They are the day-to-day concerns of the system that are going to come up.

Senator BARTLETT—You would be suggesting, for example, that that aspect of education should be moved out of its zero rated status?

Mr Warton—What we would say is it needs to be made simpler. The system that is sitting there trying to tax one aspect and then trying to GST free other aspects makes it very difficult for schools that have no experience in this area. It is going to be very difficult for them to police it and change it. They are going to have significant pressure from all parents to change their methods to, if you like, avoid GST.

Mr Cooper—Our view would be that if there were no zero rated items it would be a simpler system to administer. Given that the policy decision has already been taken that those areas will be GST free, then all we are doing is commenting on the issues that flow from that.

Senator BARTLETT—I appreciate that. The main thing I am trying to get at is just an understanding of how much weight we should give to the importance of simplicity versus some of the other issues that are involved that have led to the decision to zero rate health services, for example. Obviously, you like simplicity in terms of operational things, but you do believe that there is a legitimate role for taking on board some of the other social aspects and consequences.

Mr Cooper—Quite clearly that is a matter for the parliament to decide what it feels should or should not be subject to GST.

Senator BARTLETT—So this is an area you would like to stay out of?

Mr Cooper—We do not regard it as our role to comment on what should or should not be in.

CHAIR—In short, you blokes are saying, ‘The devil is in the detail and we are experts in the detail.’ That is why you have this appendix A commenting on sections of one of the bills.

Mr Cooper—Appendix A on the transitional bill and appendix B on the main bill.

Senator O’CHEE—From the point of view of efficiency, leaving public policy issues aside, there is a difference between making an industry GST free and making a range of products GST free, isn’t there?

Mr Cooper—I do not know that I could agree with you that the existing areas that have been carved out as being GST free are an industry. You may well have, as has already been indicated, a school that is predominantly providing educational services which are GST free but maybe providing in addition services which are not GST free. In the financial services sector, it is not the case that all financial institutions are input taxed. It is simply that the financial services they provide are input taxed. Financial institutions, in addition, may provide a number of services that will be subject to GST.

Senator O’CHEE—But I am saying that it is different looking at a school compared with looking at a corner store which sells food and other items. The administrative difficulties of selecting a couple of products are substantially greater and have much more impact, don’t they, because a whole range of people may deal with food?

Mr Cooper—A whole range of people may deal with food but, as I have indicated, if you are looking at a school it may not be simply providing educational supplies. It may still have GST obligations.

Senator O'CHEE—The problem with exempting a range of products though is that you end up with a lot of arguments as to how you deal with the product, isn't it?

Mr Cooper—Certainly. If you have a number of products, whether they are GST free or GST exempt, you have the problem that we perceive of definition at the margin. But, unfortunately, the same probably goes, as we have already indicated, for educational supplies, health care and so on. At the margin there will be difficult definitional issues.

Senator O'CHEE—If you accepted a public policy purpose of attempting to protect low income earners and you had to choose between making food GST free or giving them some income tax or other compensation measure, which one would you plug for?

Mr Cooper—As we have indicated in our submission, we have a preference for food to be subject to GST and for there to be appropriately compensatory measures for low income earners. That is our preference.

Senator O'CHEE—There are two ways you can deal with food. If you choose to make it GST free, you can either make it all GST free, theoretically, or you could make some of it GST free, couldn't you?

Mr Cooper—Yes.

Senator O'CHEE—We accept that there are real definitional differences and difficulties in even working out what constitutes food—for example, baking soda, alcohol and so on. Which would be more administratively difficult: saying that all food is going to be GST free or that some food will be GST free but restaurant food, say, will not be GST free?

Mr Cooper—Our view would be that, from an administrative and compliance cost point of view, the broader the definition of food the better. To try and distinguish between, say, fresh food and takeaway food is extremely difficult. As I mentioned earlier on, in recent years there have been several cases from a wholesale sales tax point of view on just that issue. If food were to be GST free, then we would favour a broad definition covering all food, however you would seek to define food.

Mr Warton—If, just from your question, you were toying with an idea of taxing restaurants and not taxing food—the GST freeing of food or the input taxing of it—that does not necessarily mean that you could not tax a restaurant. You would only need to either deny credits for the GST on the food or, if the GST was free, you would still ensure that a restaurant was subject to GST in relation to its bill for food and services. You could still have food free, going through the chain, but when it got to a restaurant and they provided the service to their customer, the global amount would be subject to GST, with not part of it being apportioned out. That could be done. There are always ways to handle things. Every time you put an exemption or something in, you complicate it, and you have to bring in another rule to fix it. Those rules open up other areas.

Senator HARRADINE—The Treasurer indicates that, by the year 2000, 36 per cent of taxpayers will face a tax rate greater than 40 per cent compared to nine per cent of taxpayers in 1970. By the year 2000, almost 20 per cent of taxpayers will face the top marginal rate compared to less than one per cent in 1970. Has your institute done any studies about the effect of bracket creep on that outcome?

Mr Cooper—No, we have not—other than to be aware that over the time that has been an effective bracket creep.

Senator HARRADINE—And principally as a result of bracket creep? The other question that I have is on the issue of anti-avoidance, section 165-55 in the legislation, which states:

For the purposes of making a declaration under this Subdivision, the Commissioner may:

(a) treat a particular event that actually happened as not having happened . . .

It is in the taxation legislation. Has the institute considered this, or considered the section in the act as it is, and come up with any more felicitous wording than that?

Mr Cooper—No, Senator, we have not come up with more felicitous wording, but we certainly are very concerned about this whole division and its ability to impact on arrangements that have no tax avoidance purpose whatsoever. Indeed, the legislation itself contemplates situations where, from an economic or commercial viewpoint, there would have been no other way to do it; nonetheless, there is perceived to be a tax benefit. As a result, that so-called tax benefit is negated. We think that introduces a great deal of uncertainty and raises the potential for substantial penalties to be levied on perfectly innocent taxpayers.

Senator HARRADINE—To a layman, to provide a power to, as the act says:

(a) treat a particular event that actually happened as not having happened; and

(b) treat a particular event that did not actually happen as having happened and, if appropriate, treat the event as:

(i) having happened at a particular time—

and furthermore—

(c) treat a particular event that actually happened as:

(i) having happened at a time different from the time that it actually happened; or

(ii) having involved particular action by a particular entity (whether or not the event actually involved any action by that entity).

seems to me to provide the Taxation Commissioner with power that even God does not have. God cannot act in the contradictory manner, can he?

Mr Cooper—Our conclusion is that the draftsman at the time must have just finished reading *Alice in Wonderland*.

Senator CONROY—Senator Harradine is auditioning for the Australian version of *Yes, Minister*. I see in your submission that you are a national body of over 10,000 members. You list as members tax agents, lawyers, accountants, members of the judiciary and members within the ranks of the Commonwealth, state and territory public services. You did not mention any economists. Have you got economists? It is just that you did not mention them, that is all. I was just wondering.

Mr Cooper—I would have to confess I am a lapsed economist myself. Those members of the institute who are economists would normally be there for their interest in the tax system as a whole; they would not be bringing their special economic skills to bear.

CHAIR—You make it sound like being an economist is a sinful occupation, Mr Cooper.

Mr Cooper—I sometimes feel like that, too.

Senator CONROY—I am just interested in the argument about simplicity versus the economic efficiency of a tax, and whether or not you have considered the economic efficiencies of a tax against the simplicity of a tax. You seem to be saying, ‘You have just got to have the one rate. That makes it simple.’ It does not necessarily make it economically efficient, though, under tax theory, does it?

Mr Cooper—The perspective that we bring to bear on it is, I suppose, how it is going to operate in practice as far as businesses that are required to cope with these issues, as far as people who are required to advise on them, are concerned. I accept that, at the higher policy level, there may be different considerations. As I indicated in my opening remarks, we do not see it as our role to look at the major economic effects, other than in very broad terms at times looking at issues such as international competitiveness.

Senator CONROY—The reason I asked the question is that on your page 3 it says you do not support the full range of exemptions contained in chapter 3 of the new tax system. I presume from that that you would not support the exemption for food—and I think you already said so to Senator Bolkus. I am just trying to get a balance. Even though you say you are only looking at one aspect, why does the institute seem to just give the argument of simplicity over the economic efficiency of a tax system?

Mr Cooper—I suppose that, as I tried to indicate earlier on, the policy decisions that have already been taken to make things like education and health GST free do raise a whole lot of issues as far as the actual operation of the tax is concerned. We are not seeking to buy into the argument as to whether it is a matter of policy that food or anything else should be GST free or not; we are simply pointing out that, once the decision is taken to make something GST free, there are consequences that flow from that. But at the end of the day—

Senator CONROY—But there could be economic efficiency consequences.

Mr Cooper—That may be the view the parliament comes to.

Senator CONROY—No, I am trying to ascertain the thoughts of the membership of your institute. It would seem to me that they would just say, ‘We won’t talk about the

relative inverse elasticities in demand and whether or not one item should be taxed at a greater rate than another rate.' That is the tax theory which I am sure you have dealt with over the years. The simple argument says that the exemptions complicate the GST, whereas it could be more economically efficient if you went in that direction. I am just interested in how you formed the view that complication was the only thing that you would look at.

Mr Cooper—I must say I do have some difficulties seeing how there would be economic efficiencies arising from zero rating items.

Mr Warton—If you look at the make-up of the members, for instance we have small accountants who have 1,000 small businesses out there and they have to advise them. At the moment, if you just think of FBT, small businesses do not know how to do their FBT. That accountant has to run around to all those businesses before April and get their returns lodged. That is a requirement. A lot of those accountants are very scared about a GST coming in because their small businesses will not understand it. They will have to go around and educate them. What they are interested in is their efficiency: making it simple so that they can get around to their customers, let them comply with the law, and finish it. Whether there may be a higher economic efficiency for the economy is not in their regime. They just need to know what they have to do to keep the job going and to keep the customers complying with the tax office.

Senator CONROY—I absolutely accept that. The reason I am asking is that in Brisbane it was put to us by a doctor of economics that simplicity is an accountant's view of how it should work. An accountant will tell you it is more efficient. An economist will not necessarily tell you it is more efficient just because you have one rate on all items. I am looking to see how you balance. I accept absolutely the complexity argument, and I am going to come to that. In relation to an institute like yours, which is, as you say, an independent body with 10,000 members, who made the decision within the institute that that was the primary concern, other than the weight of numbers?

Mr Cooper—I think it is simply the weight of numbers. I suppose that we perhaps—

Senator CONROY—So we have to try to get a few more tax economists.

Mr Cooper—I suppose the difficulty we have with economists is that economics proceeds on the basis that people behave rationally. I have always had difficulty with that as a starting point for any subject.

Senator CONROY—That is a fair comment.

CHAIR—What do they say: you lay all the economists in the world end on end and you still never arrive at a conclusion?

Mr Cooper—Yes.

Senator CONROY—I apologise if you mentioned this while I was out of the room, but I refer to the question of the implementation period. You are arguing that 12 months is too short. That was certainly experienced with a less complicated system in New Zealand.

Mr Cooper—Yes.

Senator CONROY—Do you have a suggestion of how long? Is 18 months long enough? We are more complicated than New Zealand. Is it two years that you need?

Mr Cooper—It may well be that we do need two years if the system that we go for is as complex as is currently outlined. The experience as we indicated in the submission was that in New Zealand it was anticipated it would take 12 months and it actually took 18 months. Canada took 18 months to introduce the GST. We just think that, looking at world experience, we probably need longer to introduce it.

One added factor that we have that none of those regimes encountered is simply the fact that the start date of 1 July 2000 is only six months after the millennium and there is a lot of concern about Y2K. A lot of the resources that might be going into reprogramming and redesigning systems to cope with GST will still, right up until 31 December, probably be sitting there with their fingers crossed hoping they had picked it all up.

Senator CONROY—Cynics would probably say that the Treasurer is counting on it. In terms of the New Zealand experience on disclosure or, in this case, non-disclosure, you have made the point:

The present New Zealand Government is having to revisit the issue of non-disclosure of GST as a result of industry pressure.

You are very strong on the need for the disclosure.

Mr Cooper—Yes.

Senator CONROY—You would be convinced that, given the New Zealand experience, they will have to revisit this?

Mr Cooper—As I understand it, they are having a comprehensive look at a number of GST issues. As far as I understand, this is one of them that they are looking at because there has been ongoing pressure that, in a number of circumstances, it causes problems in that the amount of GST is not shown on the face of the invoice.

Senator CONROY—Would you support disclosure at the retail end as well?

Mr Cooper—Yes, because the retailer does not necessarily know whether someone coming in is buying for personal consumption; they may be coming in to buy to use in the business. You still may need to know the amount of the GST.

Senator CONROY—So it is actually simpler to have it transparent at every point but that ought also include that it be simpler at the retail end?

Mr Cooper—Yes. Frankly, we would not have thought with a very large number, if not the majority, of businesses now having relatively sophisticated teller machines that can produce this information.

Senator CONROY—It is minor computing programming, really, at the end of the day.

Mr Cooper—Yes.

Senator CONROY—It is just one extra line.

Mr Cooper—Yes.

Senator CONROY—I was interested in page 8 of your submission where you say in relation to the telecommunications industry:

... it is feasible for an offshore service provider to structure its transactions so as to avoid Australian GST by ensuring that it provides no services in Australia within the GST regime, yet is still able to provide Australian consumers with access to a telecommunications network. This may well place the Australian telecommunications industry at a pricing disadvantage to an offshore provider.

We had some evidence yesterday in Brisbane of a similar type of problem in terms of Amazon.com books coming in. Could you expand on that?

Mr Warton—Yes. With the way the legislation is presently written, a significant provider of telephone services, say, in America can run an advertising campaign in Australia saying, ‘Dial this number for all your international telephone calls.’ They would bill from America. You would pay on your Amex card, your Visa card or whatever. There is no requirement for them to pay GST. The service is provided between Australia and wherever in the world through satellites. On the other hand, Telstra, because they are providing the service in Australia and they are resident in Australia, et cetera, would be liable to put the 10 per cent on the GST. Clearly, we cannot have that.

Senator CONROY—But the government is telling everybody that this is going to help end the black economy.

Mr Warton—That is not the black economy.

Senator CONROY—It is creating a new black economy.

Mr Warton—I do not believe that is a black economy. I think the black economy is straight fraud; this is just a business taking advantage of where it is in the world to use leverage.

Mr Cooper—It just reduces Australian competitiveness, which is not a desirable outcome I would have thought. I might be saying that as a lapsed economist rather than as a tax specialist!

Mr Warton—I think the big thing that needs to be stated here—and I am sure you are aware of it—is that there are a massive number of amendments to this legislation already being prepared by the government.

Senator CONROY—We are completely unaware but, please, feel free to talk to us about it.

Mr Warton—From our understanding in talking with the government, there are many issues in this legislation that will not work.

Senator CONROY—Is this one that you believe will be addressed on your indication—

Mr Warton—It will be addressed. I have been told by Treasury that they are looking at addressing it. This is one, but there are many problems with the legislation and, if this is passed, there will be streams of amendments to the legislation to make it work.

Senator CONROY—So we can look forward to them in the Senate?

Mr Warton—I imagine they will all go through the Senate to be amended. So the legislation, if you could talk to Treasury—and we know from talking to people—

Senator CONROY—Treasury are particularly not forthcoming to this committee.

Mr Warton—Okay. There is a process going on now where, if I am with a customer or a client and I have a particular problem, I can ring people in Treasury or in the Australian Taxation Office and bring that up. If it is looked at and identified as a problem then Treasury addresses how they are going to amend the law to fix the problem.

Senator CONROY—And you are saying that there are hundreds and hundreds of examples?

Mr Warton—I cannot say that there are hundreds and hundreds; I know that there are many.

Mr Cooper—Which is not uncommon in our experience.

Senator CONROY—No, legislation gets amended all the time—for example, Wik set the record for hundreds and hundreds of amendments. I am not trying to draw anything from that other than there is some ongoing dialogue. I am just interested that there is ongoing dialogue on those amendments.

Mr Cooper—Yes, and as I indicated earlier on, we would anticipate that we will get involved in more detailed consultation on the nuts and bolts of the legislation.

Senator CONROY—I am interested in the question of compensation to low income individuals. I am just surprised to see that the Taxation Institute of Australia has included that in its submission. It seems to be more of a value judgment thing rather than in the strict sense of rest of your submission.

Mr Cooper—I suppose the bulk of our members, whilst they may be pursuing their own business interests, nonetheless do have some social conscience. Even if some of them are lawyers, they still do!

Senator CONROY—I am glad you said that. I hope you are a lawyer so you can say that; I am not.

CHAIR—Isn't that a contradiction in terms?

Mr Cooper—An oxymoron.

CHAIR—Do you realise if you were a politician, Mr Cooper, you would have offended both lawyers and economists by now?

Senator CONROY—And three-quarters of the Liberal Party's parliamentary representatives.

Mr Cooper—It probably explains why I never will be a politician. I think it is clear from our members that they are well aware of social issues and certainly do perceive that there does need to be an appropriate compensation package in there and, as we tried to indicate earlier on, that they see this as part of an overall tax reform package. It is a very important element, but it is not the only element.

Senator CONROY—One of the arguments that you are putting forward is in terms of simplicity—a broadest possible base, no exemptions, neutrality type of argument. Do you think that for simplicity that should apply in income, whether it is derived from PAYE or capital gains?

Mr Cooper—If you look at it purely from a simplicity point of view then the short answer to that is yes. One of the difficulties observed in having been involved in looking at this particular area and in having had discussions with people involved in the Ralph committee is that from an international competitive point of view the current regime, as it applies to capital gains, renders us uncompetitive and acts as a fetter on Australia getting the capital that it needs. That is perhaps an example where the greater economic good overrules the simplistic.

Senator CONROY—That is the first time you have thrown in the greater economic good.

Mr Cooper—I was just picking up on your language.

Senator CONROY—So you would be comfortable saying that we should widen the gap between the top marginal rate and the business rate which, from history, has seen a lot of people incorporate.

Mr Cooper—No, we would not. We would actually prefer to see the top marginal rate and the corporate rate the same so that you do not have this tax arbitrage which leads people to—

Senator CONROY—But you accept that that is the logical consequence. It is not tax fraud; it is simply tax minimisation.

Mr Cooper—It is simply tax arbitrage, that if people have a choice between different entities through which to conduct activities, they will tend to favour the lower tax entity in

many instances. Obviously, the flow through is that it comes out of the lower entity and ultimately does get taxed at the top marginal rate.

Senator CONROY—Thank you.

Senator GIBSON—Back to the question of timing, in answer to Senator Conroy's question you said that the institute favoured a longer time than the 12 months that the government has signalled from the passing of the legislation by the middle of this year, and you mentioned the example of New Zealand. Is it not true that tax reform of indirect taxes has been on the agenda here for a very long time? Most people in business were given a lot of detail before the 1993 election; they were given a lot of detail during the last 18 months of tax debate in this country—

CHAIR—And in 1985.

Senator GIBSON—In 1985, even earlier, that is quite true, thank you, Mr Chairman, and earlier with Asprey. But today's businessman is much more attuned to what needs to be done and what is coming up than what happened in New Zealand. There the tax reform program was sprung on the community because the government was basically in crisis and so the business community did have very little time to think about it before it was actually implemented. Isn't that true?

Mr Cooper—That is certainly true. But our concern remains that whilst people may be aware that a change is to take place, until the form of that change is finalised they cannot actually take any steps. We would still have a concern that within that 12-month period, perhaps particularly because it does cover the year 2000, it may be difficult for people to actually implement. And we have made the point that we are not seeking to have the goodies and defer the baddies. We would suggest that the whole process be deferred by another six months to an 18-month period, or possibly by 12 months.

Senator GIBSON—Is it not also true that a lot of businesses today are actually doing their homework now about the implementation.

Mr Cooper—Yes, it is certainly true that there are a number of businesses that are doing it but I have to say that my experience in recent months has been that the implications of the GST have come as a very rude shock to a number of very significant businesses that do perceive that the implementation will be a difficult exercise for them. They are simply looking at it and saying, 'There is perhaps more involved in our implementing this than we realised.' I am talking about businesses that might well be perceived as being very much in favour of GST but nonetheless see the implementation as being an issue.

CHAIR—Thank you very much. Mr Warton talked about international tax arbitrage, about a foreign owned technology company getting Australians to ring them. You may wish to take this question on notice. What sort of size of activity are you talking about? Is there any indication of how large that is? I suppose it relates to what the tax regime in Australia is and the level of tax take in Australia compared to other countries. Do you have any idea of the size of that activity?

Mr Warton—The size now?

CHAIR—Yes.

Mr Warton—That is better for Gordon to answer in regard to income tax arbitrage.

Mr Cooper—The only statistic that comes to my mind is in looking at tax on the Internet, a study done by a senior official of the OECD estimated that the amount of trade on the Internet currently was under one per cent but that within five years it would be as high as five per cent, so the potential is there for very significant growth. So these sorts of arbitrage opportunities, not just telcos but as you indicated earlier on, the mail order delivery of goods, could be very significant.

CHAIR—On behalf of the committee I would welcome any further comments on the detail of the legislation that you are going to be making between now and when we have to deal with it. Do I understand that what you are saying to us is that, because of Y2K and other complications, you guys, as the experts on the detail—and the devil is in the detail—have uncovered a range of little devils in there? Do I understand that you would be saying to the Senate that even if you supported this package then deferral of its implementation by six or 12 months would be a necessary breathing space for Australian business?

Mr Cooper—That is precisely what we have said, yes.

CHAIR—On behalf of the committee I thank you very much for aiding our inquiry in the very constructive manner in which you have.

Proceedings suspended from 12.41 p.m. to 1.32 p.m.

GOLDBERG, Dr John, Hon. Associate, Department of Architectural and Design Science, University of Sydney

CHAIR—I welcome Dr Goldberg from the Department of Architectural and Design Science at the University of Sydney. I am sure you have been briefed by now that what we are looking forward to from you is a short overview of your written paper and then if you would be kind enough to be available to answer questions from the committee. Please proceed.

Dr Goldberg—I did this work on behalf of the Department of Architectural and Design Science at the University of Sydney. The work arose from academic interest in the privatisation of road infrastructure and concern over the misuse of superannuation funds in this area. With your leave, I would like to read a short prepared statement.

To effect reform in the area of tax concessions for infrastructure projects there is a need to understand what has happened in the past. In the mid 1980s the Roads and Traffic Authority engaged Michael Perry and Associates, now the Infrastructure Development Corporation, to advise on financial arrangements. Perry modelled toll roads separately or in combination. All models were based on non-discounted cash flows from which were derived spurious internal rates of return to equity investors. Perry however did not falsify traffic forecasts in his models, but later his IDC, Infrastructure Development Corporation, worked closely with the Macquarie Bank. The RTA was encouraged to pursue this approach by Nicholas Francis Greiner, who came to power on the ‘we are a road-building government’ platform.

In 1993, after the environmental impact determination for the M2 Motorway was issued, Macquarie Bank joined forces with Gutteridge Haskins and Davey to concoct the so-called base case model. The key feature was that the traffic forecasts were derived by an interactive work back from the desired financial outcome. The exact process used is described in annexure A, part 1. The forecasts are therefore essentially fraudulent and failure to attain them in operation will be falsely attributed to ‘traffic risk’. But even if achieved, the M2 and similar toll roads are shown to be not financially viable.

This fraud was masterminded by Nicholas William Moore and Nicholas James, two Macquarie Bank directors, and others, working under John R. Caldon. Moore, James and seven others of the Hills Motorway Group receive directors fees of \$400,000 each. The stripping of \$3.6 million from a group that is essentially insolvent and the taxation avoidance and bond interest associated with the scheme does show how rewarding corruption can be. I have shown in table 1 of the submission how a Macquarie Bank director paid \$2 million per annum has been able to reduce his tax to 10.6 per cent of that amount and reduce his provisional tax by 75 per cent through the use of infrastructure bonds. Whereas an adult worker on average weekly earnings amounting to \$38,397 per annum has to pay 25 per cent.

The base case model became part of the M2 project deed, which was the document required by the Development Allowance Authority to enable certification for tax concessions. The project deed was signed by Bruce George Baird, the former Minister for Transport and

Roads, and Maxwell Moore-Wilton, the former Chief Executive Officer of the RTA. Both Baird and Moore-Wilton therefore underwrote the fraud. The Chief Executive of Abigroup, John Marcus Cassidy, was the third signatory and is in an invidious position as a signatory also of the M2 Prospectus.

The 1992 Development Allowance Authority Act is explicit in section 93ZA(c) as to the penalty for false or misleading information. It is the withdrawal of the certification. Why did the DAA not act?

In operation, a tax avoidance scheme has been arranged to augment the inevitable deficiency in toll revenue. In other words, the taxation system props up a non-viable project in operation which should never have been certified in the first place.

The raising of equity funds was facilitated by placing Peter C. Byers, Chairman of the Investment Committee of the Superannuation Scheme for Australian Universities, SSAU, and a Director of Unisuper Ltd, on the board of the Hills Motorway Ltd. Byers also received due diligence fees of \$42,000 for his involvement with Transurban City Link Ltd. Byers was thus effectively bribed to commit superannuation money to these fraudulent schemes. His due diligence did not apparently extend to checking the financial models to see if the long-term internal rate of return would ever be achieved.

Byers should face action by the Insurance and Superannuation Commission. It has the power to impose fines, to commence actions for restitution or to seek imprisonment of offenders.

What can be done in the face of this corruption? A royal commission is needed to investigate this corruption.

Senator FERGUSON—Mr Chairman, I want to raise a point of order. We have a witness who is accusing various other people of fraud and corruption and a number of other things under the protection of parliamentary privilege. I would also like to know how on earth the matters that have been raised by Dr Goldberg relate to our terms of reference? I raise those two issues: firstly, using parliamentary privilege to accuse people of fraud and corruption; secondly, this is a matter of relevance because I actually do not believe that any of the matters that have been raised so far are covered by any of the terms of reference that the Senate has asked us to question.

CHAIR—I will take that point of order.

Dr Goldberg—Can I answer that?

CHAIR—No, Dr Goldberg. It is a point of order for me from the committee. I should answer it. I think it is right that it is inappropriate for a witness to make allegations of the character that you have referred to, Senator Ferguson. To the extent that they have been made, it may well be that the matter would need to go to the Privileges Committee if there is retaliatory complaint from the people who have been named. I do not think it is an appropriate occasion in this hearing to make those allegations. So I would ask you, Dr Goldberg, not to name individuals and not to proceed to accuse them.

The second part of it is: where is this relevant to our terms of reference? I understand it to be relevant to the extent that it is arguing tax avoidance and a loss to revenue, which is an argument not particularly related necessarily to the tax package but to taxation generally. However, anti-avoidance and anti-evasion matters are matters that fall within our purview and we can deal with that submission in those terms.

Senator FERGUSON—I accept that ruling.

CHAIR—There is a provision here about tax avoidance. Other senators in our inquiry have asked questions about trusts and so forth and we have accepted them under that heading.

Senator FERGUSON—I accept that.

CHAIR—Now I can address you, Dr Goldberg. You have heard my ruling on the point of order. Would you please abide by it in the presentation of your submission?

Dr Goldberg—Certainly. I have no choice. May I say that you will not begin to understand this complex issue unless you know the background. If you took the names out, what has happened would still be there. Would you agree with that?

CHAIR—Perhaps what you should address us on is what has happened in your view and why you think there is a loss to revenue by avoidance and evasion, because that is the particular matter that this inquiry is concerned about. If there is an allegation of wrongdoing, that is better taken up outside of the terms of this inquiry. I do think the point that has been raised by Senator Ferguson is right, that is, that it is inappropriate to use parliamentary privilege in the way in which allegations can be made of an unsubstantiated kind, irrespective of your conviction about those allegations. For us, it may well end up in a question of reference to our parliamentary Privileges Committee anyway and be ruled out at that level.

Dr Goldberg—Okay. What has happened is that road infrastructure projects which were certified by the Development Allowance Authority should not have been certified because of a failure to demonstrate commercial viability. Furthermore, these infrastructure projects have been used in tax avoidance pretty seriously. In table 1 of the submission I show just how infrastructure bonds can be made to almost eliminate the tax of people on very high incomes. It is a question of equity. What is happening is that ordinary adult workers on average weekly earnings are paying 25 per cent of their tax as income and these people on very high incomes with investment in infrastructure bonds are only paying 10.6 per cent.

Senator CONROY—What page is that at?

Dr Goldberg—That is at page 19. Also they gain by a 75 per cent reduction in provisional tax. The other feature of this tax avoidance scheme which I have described is that they do not have to have the capital funds to even implement it—this is Macquarie Bank. Because of the trust company structure, they can conceal most of the goings on within the structure.

I am aware that the Development Allowance Authority is now part of the Taxation Office, but there still remains the question of two major projects—probably three if you include the Eastern Distributor—being commercially non-viable in terms of the Economic Planning Advisory Commission criteria. They have got substantial tax avoidance schemes built into them. The Taxation Commissioner, Mr Carmody, I understand did very recently signal that he was going to put this matter to rest to some extent by a certain process.

The other problem is that most of these infrastructure projects—the Eastern Distributor, the M2 Motorway and the Transurban City Link—were certified by the DAA. I tried to get through freedom of information the details of how this was done, but Mr Ian Maxwell said that I could not get the stuff. He is the Director of the DAA. But he says that at the time these were certified there was no provision in the act for them to be viable. This flies in the face of the fact that the DAA Act, which I mentioned, has a particular section 93ZA(c) which prescribes withdrawal of certification as a penalty for false or misleading information.

The other question that should be faced here is that the ASIC has a statutory obligation to put these prospectuses through surveillance, but my experience with them—and I have given them a lot of information; in fact, they asked me to look at the Transurban for them—is that they just do not really twig to what is going on. I do not think their performance has been really very good and I think that the complexity of the things is too great. The Taxation Office on the other hand is probably better focused to examine the taxation implications of these things. The ASIC has not necessarily got a brief to do it.

So one of my suggestions was that certain sections of the ASIC be removed to work in close collaboration with the Taxation Office to try to get a better steer on what is happening. You see, for example, in this particular one—and in the M2 one, but this one in particular—there is a tax avoidance scheme built into this which no person reading it, unless they understood what is really going on behind the scenes, would understand. Consequently, the Taxation Office has to act reactively to a situation whereas it could act proactively and cut this business off at the source. It is the same with the M2 and the same with this Infrastructure Trust of Australia.

That is perhaps one of the principal suggestions I wish to make in relation to the future of tax concessions. The other one being that I do not believe it need be the case that they get tax concessions. Why not give them a bounty right at the outset? If they did their sums correctly and were convinced that the infrastructure project was commercially viable, they would go ahead and be confident. What they are doing at the moment is leaning on the tax system, the tax base, to put forward this stuff. We have got the most peculiar situation where they are using the tax system to prop up a non-viable project which should never have been certified in the first place. I cannot say any more than that. Really that is the essence of what I have put together.

CHAIR—Thank you, Dr Goldberg. Are there any questions from the committee?

Senator FERGUSON—Dr Goldberg, I have listened to what you have had to say to the committee today and I repeat the earlier point that I made in taking a point of order with the chairman—that is, this select committee was set up to look into a new tax system. Nowhere in your submission—and I have read it briefly—can I see any reference to the proposals that

we have put forward by way of legislation to the new tax system. You are talking about an entirely different matter, a matter which obviously is of some concern to you. It would appear as though you have used this committee, for want of a better term, to push your own barrow rather than to look at the legislation that is before the parliament currently in relation to the government's proposals for a new tax system.

Dr Goldberg—So you do not think that the tax concessions for infrastructure projects come within the ambit of this?

Senator FERGUSON—No, it is not mentioned anywhere in the legislation that is currently before the parliament. We are talking about a new tax system. Have you seen the legislation?

Dr Goldberg—I have seen part of it, yes. I have seen some of the stuff on the Internet.

Senator FERGUSON—To the best of my knowledge—and I cannot claim to have read every word of the legislation because there is a significant amount of it—nowhere does the inquiry into a new tax system or the proposals by the government for a new tax system refer to infrastructure borrowings.

Dr Goldberg—Okay.

Senator FERGUSON—So I would concede that the evidence you have put before the committee may be relevant in another forum and you may wish to take your evidence to a different forum, but in the case of this particular inquiry the evidence that you have given before us is not particularly relevant to the actual legislation that we are putting forward. Mr Chairman, that is all.

CHAIR—Are there any other questions? There being no further questions from the committee, thank you, Dr Goldberg. The hearing will adjourn now for a private meeting of the committee.

[2.04 p.m.]

JOHNSTON, Mr Steven, Managing Director, Bulmer Australia Ltd

CHAIR—Welcome. Can you please address us briefly on your submission and then the committee will proceed with questions.

Mr Johnston—I would like to start by thanking you for the opportunity to appear before the committee. Bulmer Australia believes that the government's tax reform plan is an integral part of the policy framework for securing Australia's economic future. We applaud and fully support the positive approach being taken to ensure a viable and vibrant economic future for our community and business. Bulmer's submission to the Senate is focused on one particular anomaly in the tax package that would have an inevitable and unsustainable impact on the cider market in Australia.

Let me first start by introducing Bulmer Australia. Bulmer Australia has been operating in Australia, developing the cider market, for 30 years now. It has been a long, hard slog and, in fact, for the first 15 years the only reason we stayed in business was that the brother of the current chairman of the company, David Bulmer, set up the company. It was the family's commitment to this operation and to cider in Australia which sees the industry that we have today.

For the last 15 years, I am pleased to say, we have been operating profitably. We now employ over 100 people. We have production facilities in Campbelltown in New South Wales and in Canningvale in Perth, and we are very strong supporters of the apple growing industry based in Orange in New South Wales, supplying the eastern seaboard, and the district based around the Margaret River-Capel area in Western Australia supplying Western Australia, the Northern Territory and South Australia.

CHAIR—And Donnybrook, surely?

Mr Johnston—Absolutely. We have also been historically strong supporters of the Tasmanian industry.

As Bulmer as a worldwide group has developed, the group's ambition has gone from being much more than just a strong player in cider in the UK and Australia into trying to take cider global. This represents a tremendous opportunity for Bulmer Australia in that we have gone from being a subsidiary on the other side of the world into, hopefully, the spearhead for Asia-Pacific expansion. As part of this we have purchased the leading cider manufacturer in New Zealand and we have already started some small scale exports. That is briefly the background of the company.

I would like to explain now the anomaly relating to cider that has been created by the tax reform package. One thing we all accept in the industry is that the absolute revenue to government from tax on alcohol cannot be diminished as a result of the GST package. Therefore, some form of top-up mechanism is required to gap the 10 per cent GST and the current 41 per cent wholesale sales tax on wine and cider, the 37 per cent sales tax, and various levels of excise on beer and spirits.

Cider has always been classified as a wine. This has happened both in food standards and for taxation purposes. The reason for that is very simple and very clear, that cider has most of the cost structures of wine. It is produced in exactly the same way as wine, that is, via the fermentation of the sugar from fruit. In the case of wine, that sugar comes from grapes; in the case of cider, it comes from apples. Quite simply, if we do not ferment our alcohol from apple sugar it is not a cider.

However, we have seen in recent years the emergence of what many people call designer drinks or other people call ready-to-drinks, products where the source of alcohol is absolutely irrelevant because flavour is added and because the packaging is very highly impactful and very fashionable. We have had until now the situation where producers of ready-to-drinks or designer drinks could select their source of alcohol, whether it is spirits or whether it is fermented sugar, on the basis of the tax that they would then pay and not the flavour of the product. We have not got that freedom, as I said before. If it is not fermented apple juice it is not cider. So we are locked into the cost structure of wine.

At the same time, however, whilst it is an expensive product to make, it cannot reflect that same margin in retail pricing in the same way that wine can. This is because the frame of reference for the average cider drinker is beer.

There are very few people in Australia who drink just cider. Most cider is consumed by people who typically like to drink a beer or two. When they decide on a particular drinking occasion to not have a beer, to have instead something else, that is the opportunity for us to sell a cider. So you can see that, if beer is such a strong reference point for what the consumer is drinking, it is just as strong a reference point for what they are willing to pay.

After 30 years in Australia the cider industry is now one per cent the size of the beer industry, and one of the reasons it is so low, despite our concentrated efforts, especially over the last 10 years, is that we already live with a 10 per cent retail price premium over beer. In fact, the government quite rightly is seeking to close the loophole by which manufacturers can choose what base they use in their alcohol to determine whether or not they pay 41 per cent wholesale sales tax or 37 per cent wholesale sales tax plus circa \$38 per litre alcohol excise. Closing that is an admirable ambition. Closing it and including cider as a ready-to-drink is disastrous because that will take the total tax take on cider from 41 per cent to circa 91 per cent to 93 per cent. At the same time, it will take the price premium of cider from 10 per cent to 25 per cent over beer. Were we to absorb the impact of that excise, that absorption would be greater than the operating profit before interest and tax of Bulmer Australia Ltd.

So this for us is not a matter of finessing around the edges, it is not a matter of trying to gain a marginal advantage, it is not a matter of trying to make us more competitive against other products; it is about survival of the cider industry. However, the mechanism in place in the GST package very readily can accommodate Bulmer's needs. The wine equalisation tax which has been put forward is designed to bridge the gap between the 10 per cent GST as proposed and the 41 per cent wholesale sales tax as currency paid plus circa 1.9 per cent imputed CPI impact. So the wine equalisation tax exists as a device to maintain price relativities for wine pre and post GST. Our request is simple: that we simply continue to be treated as a wine for taxation purposes. Thank you.

CHAIR—Thank you, Mr Johnston. You say in the last paragraph of your conclusion that, if the tax package were modified to take account of your objections, there would be a minimal revenue impact. What do you think that revenue impact would be?

Mr Johnston—There has been no firm number put forward, as I understand it, for the wine equalisation tax, although the figure that is widely bandied about is, I believe, 31.7 per cent. Were that applied to cider then the price increase on cider would be 3.2 per cent against the target for wine of 1.9 per cent.

CHAIR—Can you reduce that to figures? What would be the impact on revenue to the federal Treasury?

Mr Johnston—Of a wine equalisation tax?

CHAIR—Of making the changes that you are asking us to make.

Mr Johnston—The impact would be positive to the Treasury. The reason I say that is that the GST plus wine equalisation tax, if that were 31.7 per cent, would raise a higher total tax on cider than the 41 per cent wholesale sales tax currently raises.

CHAIR—Have you put this to the government?

Mr Johnston—I have.

CHAIR—What have they told you?

Mr Johnston—It was a very enlightening process. The phrase ‘unintended consequence’ is bandied about quite often, and in this case it was generally the case that, when we spoke to people in Treasury and Excise, they clearly had no understanding of the economic background of cider as an industry. They were very comfortable in classifying cider and ready-to-drinks or designer drinks in the one category simply because that is where they thought they would fit. Once I explained the difference, then I must say I was impressed and reassured by the bureaucracy’s response to that information.

CHAIR—Does that mean we can expect the government to amend the legislation to take account of your concerns?

Mr Johnston—If I knew that were the case, I would be regarding this session as a waste of your time.

CHAIR—While you were reassured, you have got no ‘yes’ to your proposition?

Mr Johnston—I am reassured by the bureaucracy’s willingness to accept our information to fill a knowledge hole. We have had no feedback whatsoever on what the government’s decision might be, and I do not expect any indication of that until mid-March.

CHAIR—We have to report by 19 April. If by mid this month you receive a reply, would you notify the committee of the outcome of that?

Mr Johnston—I would be delighted to do that.

CHAIR—If the reply is in the negative, does that change your view about the tax package?

Mr Johnston—If the reply is negative, and that results in our paying beer levels of excise, then our reply is irrelevant because we are out of business.

CHAIR—Yes, but in your conclusions you start with a very nice supportive statement of the government. You support the tax system that they are proposing, but you are asking for a change to that, and if the change to it is not made, you are now giving us evidence that you are out of business—

Mr Johnston—Correct.

CHAIR—My question is: if the change is not agreed to, do you continue to support the tax package or do you not?

Mr Johnston—We believe the package is good for Australia. However, if you say to me, ‘I have the decision in this’, and it is either GST for Australia and Bulmer out of business, or it is the current system and Bulmer stays in business, then I feel very closely linked to the 110 people who are relying on our price relativity to be maintained.

CHAIR—Is that a no, that you do not support the package if they do not agree?

Mr Johnston—I could not support a specific tax which put this business out of business.

CHAIR—That is understandable. Thank you, Mr Johnston.

Senator O’CHEE—I am not a great beer or cider drinker myself, I have to admit. In the UK, where your parent company is based, is there a price difference between beer and cider?

Mr Johnston—Yes, though that has changed over the years. Traditionally, cider was a cheaper drink than beer, but in the mid-eighties excise was introduced to cider at a lower level than beer. The effect of that was to stall the cider industry and put it into decline and it took approximately ten years to recover from that.

Senator O’CHEE—So what is the price arrangement now?

Mr Johnston—There is a couple of pence premium; it is close.

Senator O’CHEE—Is cider more expensive or less?

Mr Johnston—More expensive in the UK.

Senator O’CHEE—Right. That is a couple of pence per what?

Mr Johnston—Per pint.

Senator O'CHEE—In percentage terms?

Mr Johnston—It would be less than five per cent.

Senator O'CHEE—I understand your laudable attachment to your company, but basically you are saying there should be a different regime in place for cider than applies to other alcoholic beverages under ten per cent by volume. Why should that be the case?

Mr Johnston—I am not suggesting a different regime. The GST package suggests a different regime. I am asking for the maintenance of the status quo under which expensive products to produce do not also carry the tax burden of cheap products to produce. For example, beer on a litre basis is approximately five times cheaper to make than cider.

Senator O'CHEE—If we have a regime which treats cider as a different case, won't we get a whole heap of cider based synthetics that are high in alcohol content? Won't that just create another series of anomalies?

Mr Johnston—That is a very good question, Senator, and it is one which taxes my thinking considerably. We have Strongbow Lemon White. That is a cider which conforms to the definition of a cider and the current definition of cider lets that through. I would be prepared to pay excise on Strongbow Lemon White in return for a tightening up of the definition of cider in a way which protects my base business.

Senator O'CHEE—What is the alcoholic content of Strongbow Lemon White?

Mr Johnston—Strongbow Lemon White is 7.4 per cent.

Senator O'CHEE—That is quite high by volume, isn't it?

Mr Johnston—Yes, it is.

Senator O'CHEE—I have been concerned for years about synthetics and the potential to create products more as a result of a tax arrangement than by genuine demand for product. From my point of view, I have difficulty with the proposal that alcoholic cider below 10 per cent should be treated as a case on its own, because that just creates the possibility for people to create other products that are based on apples.

Mr Johnston—The tightening up of the definition of cider that ANSFA suggests, and which we support, is so tight that no ready to drink product could use cider as its alcohol base. It is so tight that Strongbow Lemon White would no longer be a cider. In fact, the simple removal of one sentence from the current P2 food standards would make it so tight that no synthetic product could use cider as a base. If you add an alcohol source other than fermented apple to cider, it is no longer cider.

Senator O'CHEE—But you could ferment apple to much higher alcoholic contents, couldn't you?

Mr Johnston—Not significantly more.

Senator O'CHEE—How high a content of alcohol could you get through the fermentation of apples?

Mr Johnston—We could get that to about 9½ per cent.

Senator O'CHEE—Which is pretty potent.

Mr Johnston—I could never see us selling a product that strong.

Senator O'CHEE—No, but you could get it that high and then add a mixer to it.

Mr Johnston—You could add water to it to bring it back.

Senator O'CHEE—Or you could add some other flavouring to it.

Mr Johnston—You could not do that and still call it cider. If it is not called cider, it is then a product under 10 per cent alcohol by volume and, therefore, subject to beer levels of excise under the GST package. I am not seeking the flexibility to make cider taste like anything so it can compete with the designer drinks. That is not my intention. It is my intention to save the cider industry and to save Bulmer Australia. I am prepared to see the definition of cider tightened to our economic disadvantage to see that happen to ensure we have a future.

Senator O'CHEE—It just seems to me that alcohol is alcohol. If you have the opportunity, due to anomalies, to ferment a high alcohol volume drink, which is still cider, I do not see why we should treat it differently. That is my problem.

Mr Johnston—Senator, that is easily fixed by putting in a ceiling on how strong a cider can be and still be called a cider. That is very simple. The other point is that it is, if you like, the dollars per hit which is a driver, so just saying to pay tax based on alcohol streams ignores the underlying economics of making different sources of alcohol.

Senator O'CHEE—I would have been more sympathetic to what you said before you said that, to be perfectly honest, because I just see that as distortionary in the system—distortionary of investment decisions. If you are going to say, 'Look, some investment decisions are more expensive, therefore we are going to give them a different regime,' that, for me, is not a terribly persuasive argument.

Mr Johnston—I understand your point but as a cider business—a company which has always been a cider business—it is our choice to compete in the cider market. Our choice is weakened if we are taxed by something other than cider which does not have the same cost constraints as we.

Senator O'CHEE—A volunteer should not always complain of their injuries either. Thank you.

Senator SHERRY—I read in your submission that the Australian consumption of cider is 17 million litres per annum.

Mr Johnston—That is correct, Senator.

Senator SHERRY—Is that all produced in Australia or is there some imported?

Mr Johnston—Yes, it is all produced in Australia. We are a 100 per cent local manufacturer. We have seen two New Zealand brands try to launch into the market over the last 10 years. We have seen some imported cider from the UK but not enough to get you merry on a Saturday night out.

Senator SHERRY—Who are the other major producers of cider in Australia besides Bulmers?

Mr Johnston—Bulmers has approximately 95 per cent of the market. We do truly dominate the market. I guess you could also say we are the only dedicated commercial cider maker. The other two producers of note are CUB, who owns the Tasmanian Mercury brand, via its purchase a couple of years ago of the Cascade brewery—

Senator SHERRY—Formerly Cascade.

Mr Johnston—That is correct. The other producer is Orlando Wyndham, a major Australian wine producer who has the e33 brand.

Senator SHERRY—Have you had any discussions with those two companies?

Mr Johnston—No, I have not, Senator, because quite frankly, whilst we all have a cider business, if I do not sell cider, I do not eat. If CUB does not sell cider, it sells more beer. If Orlando Wyndham does not sell cider, it sells more sparkling wine. I do not think we have a common interest in this.

Senator SHERRY—You are not aware of what their position is on the issue of cider?

Mr Johnston—I have heard nothing from them.

Senator SHERRY—I am surprised that you say that about CUB because certainly from my knowledge of Tasmania—I am a Tasmanian senator—cider production might not be significant in the context of CUB's total beer production, but it would be not insignificant in a pretty sick Tasmanian economy at the present time.

Mr Johnston—I would agree with that. The Mercury brand of cider in Tasmania enjoys a level of market share in Tasmania that we enjoy on the mainland. We look at their loyal drinker base in Tasmania with envy.

Senator SHERRY—Do you export any product at all?

Mr Johnston—We are on the cusp of making decisions in the area of export which this particular issue causes us to put on hold. If we are able to continue to conduct business in Australia, then we see Bulmer Australia rapidly developing into Bulmer Asia Pacific. To flesh that out, our UK parent company currently sells and exports product into Hong Kong,

Singapore, Malaysia and Japan. Our intention is that, starting next year, we start Australian production for supply of those markets and that we develop the skill set over a five-year period, so that we go into the five years just producing and come out of the five years actually managing the Asia-Pacific markets.

Senator SHERRY—You have said that, in your case, this change to the tax regime of alcohol would close your operation. Do you have any view about what the impact would be on CUB's Mercury cider and Orlando's production of cider?

Mr Johnston—That would depend on how they cost their product and their promotional choices. Let me explain: Bulmer Australia is the only company in Australia to have developed the cider market, and over the last nine years we have seen 10 competitors come into the market who have not spent a penny on developing the market in real terms; they have simply reduced their price. So, on the one hand, we have been investing to develop the market and, on the other hand, we have been fighting off price competitors. If we are out of business, the other manufacturers have the choice of saying, 'Do we continue to just put it out on price and get what we can, or do we decide to spend significantly in a market which Bulmer, after 30 years of working in it, have decided they cannot get a return from?'

Senator SHERRY—I have one final point. The wine industry has appeared before us, and I think it is fair to say that there is a split view in the wine industry about the way in which the tax should apply to alcohol. I take it, from what you are saying, that you would not support a volumetric taxation of alcoholic beverages, based on a volumetric approach, as it is known?

Mr Johnston—That is correct. I would not support a volumetric tax.

Senator SHERRY—Thank you.

Senator CONROY—Bulmer produces one of the higher alcohol content alcoholic ciders, with Strongbow Lemon White at 8.4 per cent; that is right, isn't it?

Mr Johnston—That is correct.

Senator CONROY—Can you give us any reason why this product should not pay the same amount of tax as similar ready to drink products of similar alcohol content?

Mr Johnston—I thought I had explained, Senator, that the cost structure of cider production is such that it is an expensive product to make and, in a sense, the differential tax rate eases the burden and maintains relativities, using Senator O'Chee's paradigm.

Senator CONROY—Is it the government's role to make a judgment on who has an expensive cost structure and compensate them for it?

Mr Johnston—The government has historically said that wine will be treated in a different way to beer and spirits, and there has been widespread community support for that. We are simply asking that you continue that.

Senator CONROY—That is not quite what I asked. I asked: do you believe it is the role of government to go around the country looking at different companies, products and industries, saying, ‘This one has a more costly structure than that one and, therefore, that is the basis on which tax concessions are given’?

Mr Johnston—If ready-to-drinks were not on the market, I do not believe we would be having this discussion. Ready-to-drinks are a hybrid product which can, and do, successfully exploit loopholes in the tax system. Cider has always been a wine, with the cost structure of a wine, competing in a tough market. We are simply asking that we continue to be allowed to do that.

Senator CONROY—That is still not answering the question that I actually asked you about the role of government.

Mr Johnston—The role of the government, I believe, is to provide a sustainable, predictable environment in which business and society therefrom can prosper.

Senator CONROY—That is probably the first time in my memory of my time in the Senate that Senator O’Chee and I have been in agreement on an issue; it is quite frightening.

Senator O’CHEE—It worries me, too.

Senator CONROY—Yes. I am beginning to think we are both wrong.

CHAIR—Can I say that it worries me even more than either of you.

Senator CONROY—There is a reasonable argument, as Senator O’Chee has already put, about why a product that contains, say, 8.4 per cent distilled spirits, 8.4 per cent fermented sugar or 8.4 per cent wine based designer drink should pay more tax than an 8.4 per cent alcoholic drink.

Mr Johnston—Pay less tax.

Senator CONROY—Yes, sorry—less tax.

Mr Johnston—I do not understand, Senator, why you are focusing on such a small part of our portfolio. The overwhelming majority of our business is produced at the same strength as beer and sells at a premium to beer. I do not want to go out of business because of an anomaly. If you like, 8.4 per cent cider versus ready to drinks or spirits of the same strength is an anomaly.

Senator CONROY—There are 1.2 million businesses that are going to be dragged into a more expensive cost structure through the ANTS package, and I am sure yours will have an extra added burden from compliance costs. The government is offering some small compensation. Many would argue that it is not enough to cover the true impact and, more importantly, the true impact of the compliance costs is not even known yet. I am just looking for a reason; I am relatively new to the game. I have not had a lot of exposure to the arguments. At the same time as we are arguing that food should be in, that we should have a

consistent tax over all these different products and that we do not want to make it more complicated with all these anomalies here and there—and that is a strong line from the government—almost every organisation from the business sector that has come forward to us has said, ‘Yes, that’s right: we don’t want these anomalies. We want a comprehensive base; we want it to be as broad as possible; we don’t want any exemptions and we don’t want any anomalies.’ I am just looking for a reason as to why a government, whether it was our own previous one—as I think Senator Ferguson has made the point and Senator Gibson over time—or the existing government on the one hand want to argue for purity, and then other organisations come forward and say, ‘Purity, but not just yet.’

Mr Johnston—I am arguing for purity and consistency. The government has put forward a proposal which says, ‘There is a GST across all alcohol. There is the wine equalisation tax on wine, there is a beer level of excise on beer and a spirits level of excise on spirits and, at the same time, we will close a ready to drink loophole, and, in closing the ready to drink loophole, we will now be inconsistent by calling cider a ready to drink instead of a wine.’ We are simply saying that this is the environment you are asking us to play in—a wine equalisation tax, a beer excise and a spirits tax. We are happy to do that. Even though the wine equalisation tax does negatively impact us, please just continue to treat us as a wine. We are not arguing for a special case. I am just saying that, in the detail of slotting cider somewhere, it has been slotted on the wrong side.

Senator CONROY—The wine industry put to us very strongly that wine and beer are not substitutes; they are not in competition. In actual fact, the wine industry’s competitors were other leisure activities. So, I am standing there, thinking: ‘What am I going to do tonight? I’ll have a glass of wine or I’ll rent a video or I’ll go out and buy a CD instead of having a glass of wine.’ They were the competitors. Do you support that argument? Do you see yourself as a competitor to beer, or not?

Mr Johnston—We do not see ourselves as a competitor to beer. I think that the competition for the leisure dollar is very broad today. It is getting increasingly broader every day, where we see, for example, pubs turning into casinos. So, yes, competition for the dollar is broadening every day. But I very emphatically said that cider is not a competitor to beer. To repeat what I said earlier: beer provides the context where cider can be drunk when somebody specifically does not want to drink a beer right then. So when they do not want to drink a beer, they might consider a cider. They will only consider a cider if it is not too much dearer than beer. Currently, not too much dearer than beer is about 10 per cent, not the 25 per cent that the GST package would impose on us.

Senator CONROY—I have to declare a non-vested interest in that I am actually teetotaler, so I am uninfluenceable by any side of this particular argument, but I also worked in a liquor store for four years while I was at university.

Senator FERGUSON—Was that four years as a teetotaler?

Senator CONROY—The boss apparently reckoned I was a safe investment because I would never drink the profits. I spent a lot of time on Saturday mornings and Friday nights setting up display stalls. I would set up the slabs of beer on special right next to the casks of wine, right next to the boxes of cider. I would often watch customers stand there, looking at

the three. They were not asking me to set up a CD stand to choose what they wanted to do. So, my personal anecdotal evidence in terms of substitutability and competition, gained from four years working in a liquor store, is that it is drawing a bit of a long bow to say that they are not actually in competition. There is a function of price involved, no question, and, yes, this is quite some years ago and, as you said, the leisure industry has changed a lot since then, but when I had to set the specials up, it was all in.

Mr Johnston—I can appreciate that point of view. I think that, if somebody were considering a CD purchase, they would not be thinking about it in a bottle shop. To that degree, the level to which it is a predetermined purchase means they are not going to be standing looking for a CD display next to CUB. But whilst I say that cider does not compete with beer, that does not mean that the same people do not drink beer, cider, spirits and wine. I think very few people will just drink wine or just drink beer. In going into your bottle shop when you are at university and seeing cider next to beer, next to cask wine, that person can buy something from each of those three displays for each to be drunk at a separate drinking occasion. I am not saying they are different people; they are different drinking occasions.

Senator CONROY—That is a valid point. I always enjoyed your ads, though, can I say. They are some of the better ads on television. It is a big national advertising campaign. It must be fairly expensive. How much do you put into your advertising budget a year?

Mr Johnston—We are a significant spender but the short answer is every penny we can find, because we do have to stand out against very strong advertisers like the brewers. We would spend approximately \$2½ million a year on Strongbow mainstream, approximately \$750 on Strongbow white and a bit less than that on Scrumpy Jack.

Senator CONROY—Scrumpy Jack is a name from my past. My apologies if you have already given this figure, but what do you estimate is the likely increase if it goes through as it stands at the moment for your products?

Mr Johnston—If it goes through as it stands, talking about our mainstream business which is Strongbow, the stubby—the advertising you remember—our 4.7 per cent alcohol product, that would take the price premium versus beer in the six pack from 10 per cent to 25 per cent.

Senator CONROY—Do you have handy any calculations on what is the amount of tax paid per standard drink by Strongbow alcoholic ciders at the moment?

Mr Johnston—Yes, I do and I am happy to provide those.

Senator CONROY—Thank you. Now we have relived my university past.

CHAIR—I suppose, since we are into true confessions this afternoon, I have never spent four years in a liquor store and I am not a teetotaler.

Senator FERGUSON—Neither am I.

Senator HARRADINE—No comment.

CHAIR—Senator O’Chee, were you looking searchingly at me for the call?

Senator O’CHEE—Yes, please.

CHAIR—You have it.

Senator O’CHEE—Suppose I wanted to produce mead at a slightly lower volume per litre than is normally produced so as to bring it in under 10 per cent—we are watering it down—given that the cost of producing mead is very expensive, do you believe that a mead producer should get a different tax regime as well because his or her costs might be even higher than yours?

Mr Johnston—I must declare an interest here. We produce mead in New Zealand. Mead under the food standards is another non-grape wine. Naturally, I say yes, of course, it should be subject to the wine equalisation tax in the same way that cider, as another non-grape wine should be subject to the wine equalisation tax. I am very clear on that.

Senator O’CHEE—If it was a sub-10 per cent mead, you would want it to be treated differently from other sub-10 per cent alcoholic beverages?

Mr Johnston—Yes, but I do not accept the basis of your question. I am not asking for it to be treated differently from other sub-10 per cent products. You are introducing alcohol strength as a new way of defining alcohol taxation, and the current system—and the proposed taxation system—recognises differential taxation rates for different alcoholic products. I would say that mead should continue to be treated as a wine, in the same way as cider should continue to be treated as a wine, which is consistent with the last 30 years of history and not unrealistic. It is a different reality.

CHAIR—Any further questions from the committee? Thank you, Mr Johnston. I have always wondered how you can whistle and break a bottle of cider at a distance but you are not here to give us evidence on doing that today so I will not pressure you. Thank you very much for your evidence and for the support you have given to the committee in its inquiry. We will, of course, take note of what you have said. If you do get an answer from Treasury, will you let us know what the answer is?

Mr Johnston—Specifically, yes.

Proceedings suspended from 2.45 p.m. to 3.03 p.m.

ELLIOTT, Mr Rob, Manager, Research and Policy, Australian Institute of Company Directors

MARKS-ISAACS, Mr Simon, Deputy Chairman, Tax and Economics Committee, Australian Institute of Company Directors

CHAIR—I welcome representatives of the Australian Institute of Company Directors to the witness table. We have been through this procedure before with you, Mr Marks-Isaacs. Mr Elliott, welcome to the inquiry. The normal process is that we invite you to address us briefly in overview of your written submission and then make yourselves available for questions, if you would. I notice that the initial list you registered with us included five people. You have been kind enough to make yourself available earlier than the appointed time and for that we thank you, but does the fact that you are three short mean that you are significantly underpowered and therefore would want to wait for a while?

Mr Elliott—No, Mr Chairman.

CHAIR—You are happy to proceed in these conditions?

Mr Elliott—Yes, we are. There are, as you have pointed out, apologies from our Chief Executive Officer, Mr Ian Dunlop, who is unfortunately in South Korea on OECD business helping Australia with regard to global corporate governance guidelines—

CHAIR—Unfortunate for him or for us?

Mr Elliott—Unfortunate for the Australian Institute of Company Directors in that our CEO is unable to appear. Also, there are late apologies from two of our technical experts from our tax and economics committee, Glenda Nixon and Suit Fun Tham—and we make those apologies right up front. Perhaps it would be worth while my explaining that it is not normal for us to be moving our experts, such as Simon, from one part of the country to another from week to week but it is lucky, again for the Institute of Company Directors, that there is a Business Coalition for Tax Reform meeting in Melbourne tomorrow, as you are no doubt aware.

Senator CONROY—We were not invited.

Senator SHERRY—We were not aware.

Mr Elliott—I actually did point that out to the secretariat.

Senator SHERRY—The GST invitation list—

CHAIR—Order! This barney or discussion across the table is out of order. Mr Elliott, please proceed.

Mr Elliott—When we trying to get a time before the committee in our dealings with your secretariat, whom we found extremely helpful, we pointed out that the 4th and 5th in

Sydney did clash with the BCTRs meeting in Melbourne on the 5th. Therefore we are before you today and we are very thankful for the time today because tomorrow would have been very difficult in terms of underpowering. Thank you again for hearing us today, and if you do not mind I will read a statement.

I will start with a general overview of the Australian Institute of Company Directors, or the AICD, for those of you who are not aware of who we are and what we stand for. Then I will make some general comments on a broad policy level and then I will hand over to Simon Marks-Isaacs who will make some more specific comments. I know that some people of the committee are well aware of the AICD but for those who are not I think it is important to realise that the AICD is a body that represents individual company directors, not companies. Our membership is that of individual people involved with boards of directors. We have over 13,500 members.

CHAIR—Would it be fair to say that you are the trade union for company directors?

Mr Elliott—Yes. We actually do very similar things. We educate, we have a role in maintaining standards, representing, as today.

Senator FERGUSON—Perhaps you could teach the trade unions a thing or two.

Mr Elliott—I am sure we could both learn from each other.

CHAIR—I should stop interrupting because the banter seems to have set the committee in a desire to engage in smart repartee. We will resume with you, Mr Elliott.

Mr Elliott—Thank you. As I said, our membership comprises individuals, not their companies. The membership represents and sits on the boards of more than 70,000 of Australia's companies. Those companies are of every size, from Australia's very largest companies down to some of Australia's very smallest companies—companies in every state and territory of the country. They participate in every industry that the country has to offer. They are of every type of corporate form of company from private companies, publicly listed, not listed, charitable, not for profits, no liability companies, government bodies, GDEs—the works.

Whilst the membership of the AICD covers boards that represent more than 98 per cent of the top 200 listed companies in Australia by size, I think it would be very unfair to represent the AICD as representing, if you like, the big end of town. That would really be quite a wrong impression to give of the AICD. Over 75 per cent of the AICD's membership is of individual directors from the small, very small and medium-sized sector of the business community.

The AICD itself as an organisation is split into divisions in each Australian state and territory and has a national office in Sydney where I am based. The AICD has an extremely extensive consultative and committee structure. This structure enables the AICD, we believe, to take a national perspective on major issues whilst remaining responsive to local needs across Australia in the key areas of education, professional development and, especially, policy.

The primary objective of AICD's policy is the achievement of international competitiveness—and I stress 'international' competitiveness. In the contemporary debate on national direction and the appropriate balance between economic and social imperatives, the importance of international competitiveness is often overlooked. It would be fair to say that all of the desirable objectives to which Australia as a nation might aspire—such as high employment, quality health, education and welfare, improved environmental standards and social cohesion—are entirely dependent upon the ability of this country to create wealth. In turn, this ability to create wealth is determined by the level of international competitiveness and innovation that we achieve in all the sectors of the national economy in totality, which itself is a function of the speed and the success of our reform process.

Reform must be approached in a holistic manner in which each proposal is assessed both individually and collectively in terms of its ability to contribute to international competitiveness and hence the wealth creating ability of the economy. Optimum outcomes will not, we believe, be achieved with a fragmented or ad hoc approach to any policy reform.

Turning to tax reform, we believe it must be assessed in exactly this context as the tax regime is a significant determinant of the competitiveness of the Australian economy. It can either inhibit or encourage international competitiveness and thus has a major influence on critical outcomes such as the level of unemployment. The tax system should not be designed just to facilitate revenue collection to meet necessary outgoings. Rather, it should seek to be consistent with delivering maximum economic performance and generating the greatest number of wealth creating jobs in the community.

The AICD is concerned that tax issues are frequently discussed with a short-term focus. In order to achieve international competitiveness it is imperative that a long-term view be adopted. Australia's present tax system has grown through a process of ad hoc incremental change over many years with little thought being given to its overall objectives or to its anti-competitive impact on the economy. Indeed, it is generally accepted that the present tax system is a major competitive disadvantage to Australia. The AICD believes that a fundamental overhaul of the tax system is overdue and obviously very required. The AICD has been pursuing fundamental tax reform for many years and was one of the founder members of the Business Coalition for Tax Reform, the BCTR, which now comprises some 40 business organisations.

The AICD's philosophy on tax reform is very simple. International competitiveness is, as I have said, particularly relevant to the Australian taxation system which has been in urgent need of reform for many years. The AICD agrees with the view that Australia's current system of taxation is inefficient and cumbersome. In brief, it is a system characterised by complexity.

The current taxation system represents a major competitive disadvantage for Australia in an increasingly globalised economy and at a time of unparalleled regional opportunity for our country. It is imperative that party political considerations not be permitted to interrupt the introduction of bold new ideas that would dramatically improve the efficiency of the Australian tax environment to the benefit of all Australians.

Within the context of achieving international competitiveness, the AICD sees the key objectives being delivery of a tax system characterised by: equity across the community; efficiency, simplicity, transparency, stability and certainty; encouragement of innovation; incentives to create wealth and thus jobs; equity of treatment between structures; low compliance costs; non-impedance of transactions; and, very importantly, encouragement of venture capital availability. In essence, the AICD believes we need a straightforward system which is easy to understand, which dramatically lowers compliance costs and which reduces the incentive to establish artificial minimisation arrangements.

That is all I have to say. I will hand over to Simon Marks-Isaacs to briefly discuss three or four specific reform issues which we believe are vital to achieving the above objectives. Thank you.

Mr Marks-Isaacs—I will be brief so that we can move on to questions. In essence, in looking at tax reform, we need to look at the current system. We must not forget the problems with the current system. They revolve around the fact that the current tax bases, both direct and indirect, are too narrow. The rates are either too high or, in some cases, simply too low. The system is internationally uncompetitive, particularly in relation to those rates, but also Australian exporters are disadvantaged vis-a-vis importers by our current sales tax system.

There is far too much tax avoidance and evasion in the system. Employment and investment are both discouraged. In terms of the indirect tax system, we have a whole raft of taxes which are either nuisance taxes or impediments to generating wealth and growing the whole economy. Tax reform is all about producing a system that allows the economy to grow as rapidly as possible, while still providing sufficient revenue to fund into the future the revenue requirements from sensible modern government. The need is there for a holistic approach, not simply, 'Let's have a new tax here; let's get rid of an existing tax there,' but looking at the whole thing with the objective in mind of a system that is more effective in allowing the economy to grow. That is all.

CHAIR—Thank you, Mr Marks-Isaacs and Mr Elliott. I am just looking at your submission. You have attached to it a BCTR submission which is a preliminary submission to our committee. Am I to take it that it is part of your submission as well?

Mr Elliott—Correct.

CHAIR—One of the organisations listed on the BCTR submission is the Australasian Railway Association, which I understand is part of the BCTR organisation. Are any of your directors members of corporations for statutory authorities which would be delivering rail services in Australia?

Mr Elliott—Whilst I am not certain off the top of my head about the 13,500, I would be quite surprised if that was not the case. Our directors represent every industry—large and small—and government and non-government. I cannot say yes or no, but I would be surprised if they were not.

CHAIR—On that list as well is the Insurance Council of Australia. I presume that you would have members of your association who are directors of insurance companies.

Mr Elliott—Again, I would assume so.

CHAIR—On that list is the Master Builders Association and, ergo, the above?

Mr Elliott—I would, again, assume so.

CHAIR—And the West Australian Chamber of Commerce and Industry?

Mr Elliott—There would no doubt be overlaps between those organisations and members of ours who sit on boards of those companies. I stress that our members are individuals. Those organisations, on the whole, are representing companies or groups within those specific industries.

CHAIR—Just what point of view are you representing? The Australasian Railway Association appeared before us and argued that rail, under the package that is in front of us, is being used to cross-subsidise road transport, so the expenditure that they need to improve the national track is being neglected, and we should not proceed with the package unless there were a change made there.

This morning, the Insurance Council of Australia told us there is a \$2.5 billion transitional cost which they calculate will be imposed on Australian insurance companies if this package goes ahead and they are asking the government for relief from that. They have not yet got a straight answer. If they do not get relief, they will dump the \$2.5 billion onto their customers. Since this was an unintended consequence, they go on and say that, of course, the compensation provided by tax cuts has not allowed their customers to be compensated for this extra charge.

The Master Builders Association have told us there is a whole raft of changes that they want from the government. They are not yet in a position to notify us as to whether, if they do not get them, they would want the Senate to amend the bills. But they say, according to modelling done by Mr Chris Murphy, that the Australian house will be smaller and that the quality of fitting out will be at a lower standard should this package go ahead.

The West Australian Chamber of Commerce and Industry said to us on that fateful day in Perth last week, when we had the pleasure of Marks-Isaacs's company again, that they explicitly request that dockets show how much the GST is costing, so the customers fronting up to the counter can know what they are paying for the good or the service and how much they are paying the government in tax. All of these things add up to something less than agreement to the enthusiastic and open endorsement of this entire package that your organisation is putting forward. Do you support those other organisations in their interests or do you ask us to overlook them?

Mr Elliott—Perhaps I could just quickly answer one of the questions that you posed with regard to what our organisation represents? Our organisation represents individual directors, not necessarily their companies because, as is apparent from the numbers of over

13,500 members and over 70,000 companies on which they sit, most of our members have multiple directorships, a thing which we encourage in Australia—and worldwide in government terms—to spread director talent across. I envisage that we could have a member who would sit on a company in each of those different groups.

The role of the director is to consider the best interests of that company whose board they sit on at that moment and also the good of the entire economy which, all things being equal and taking the whole of the economy in context, should lead to a greater flow of money and a more vibrant economy—dollars in people's pocket which would, in turn, be good for their particular company. There can be clashes between individual directors when they are sitting on different boards.

CHAIR—I saw you start when I made the point of the \$2.5 billion transitional cost that the Insurance Council of Australia had submitted to us this morning.

Mr Elliott—I just was not aware of that figure.

CHAIR—Do you modify your support for the government's package now that you are aware of the concerns of the railway industry? Just before afternoon tea, we had before us Bulmer, the company that manufactures and markets Stongbow Cider. They said to us, in the equivalent of what is under oath, that they would go out of business if the package were endorsed. For all I know, a director of Bulmer may be a member of your organisation.

You support this package and you support it without qualification. Now that information is available to you, do you still support it without qualification? If you do, what do you say to any director that is a member of your organisation from Bulmer when they go out of business? What do you say to the Insurance Council of Australia et al?

Mr Marks-Isaacs—Senators, and I guess this is addressed to all of you, you sit in a pivotal position in Australia. You are above all the sectoral interests and, to an extent, so are we, as the Australian Institute of Company Directors. What you are referring to is over a whole range of specific sectoral interests. What we talked about in our introduction was the importance of holistic reform. No package is going to make everybody better off in Australia. A package is going to make life more—

Senator CONROY—That is not what the Prime Minister said.

Mr Marks-Isaacs—I am not the Prime Minister; I am Simon Marks-Isaacs, and I am saying it. I am very happy to debate it with the Prime Minister.

CHAIR—I am very interested in your answer, Mr Marks-Isaacs.

Mr Marks-Isaacs—The point is that no package is going to make everybody better off in terms of the amount of tax they pay, in terms of compliance costs. There will be some people—inevitably, there always are some people—whose tax is increased slightly or who have a slightly higher compliance burden. It is all about making a better system for Australia, for Australian business and for Australians.

Mr Elliott—I want to add to that in terms of policy at the institute. My role at the institute is policy manager. I am not an expert in any particular field. I am responsible to the secretary for a raft of policy committees. They cover everything from law to accounting, tax, economics, environment and technology—you name it. This question comes up daily before us as an institute: how do we try to juggle the best interests of our members in the economy? Clearly, there are people who in any system are going to be better off than others. Our objective is, as far as possible, to improve it for the majority and, hopefully, for everybody, acknowledging that there will be some who will, hopefully, be better off than they were before, but who will still be worse off than others. This is an inevitability of life. As directors we have to face this every day.

CHAIR—I must say I am curious to know how you make that judgment, because I only scratched the tip of the iceberg. I can keep going with a whole train of witnesses we have had from various industry organisations, various businesses and, indeed, from other groups—even ACOSS, which argued for significant change to the package—like the ACTU, which represents a large group of Australian workers, which argued the tax package is unfair because it does not recognise bracket creep and deal with wage justice, particularly for low income earners. Since you did not know about the \$2.6 billion unintended consequence—

Senator FERGUSON—It is increasing.

CHAIR—\$2.5 billion—thank you for the correction. I do wish to be accurate. This appeared new and fresh to us today, I might say. Would you support a package that imposed that as an unintended consequence on consumers or do you take refuge in the remarks of Mr Marks-Isaacs that there will be winners and losers? The only conclusion I can gain from that is, ‘Well, it’s tough on those who are the losers,’ because there is some broader national interest which no-one has yet been able to identify; some ethereal border of national interest that we should have regard to. What do you say to the insurance companies?

Mr Elliott—I am not quite sure of the question. It was not just Simon, I think.

CHAIR—Let me then rephrase the question and make it more pointed. We have adduced from a lot of evidence that there are a considerable number of problems with this package. You embrace this package without qualification and say it should proceed in the national interest. That is what your submission said.

Mr Elliott—The institute actually has for many years before the package came out been calling for fundamental tax reform, and in many respects we would actually like to see more done. We say that in our submission and in many other submissions with regard to tax, but also with regard to many other reform initiatives that the country is considering. We think it is a good step. We think it is a step in the right direction. We are not saying that we would not like to see other things embodied in it. And I do not think it would be fair to say that it is only Simon who believes that there will be winners and losers. I personally agree with that.

CHAIR—I am not singling out Mr Marks-Isaacs, but he put those views.

Mr Elliott—I think it would be fair to say that, in a personal capacity—not that I am appearing in such a capacity—I would agree with that. But I think also the Institute of Company Directors would agree that in life there will be people who will inevitably be better off than others. The objective that we are trying to achieve is a better standard for all than they currently have. I am not saying that it will be equally better for everybody. But we believe that if we go down the track of fundamental holistic reform—and we take the view of looking at the whole package, taking up the point of sectorial interests—you are right, it is a very tough call to make. This is but one of many. I know this is in the terms of reference here.

I have been dealing this week with accounting standards harmonisation globally. There are many in Australia who will find that an enormous benefit. There are others that will find it very difficult. Corporations Law amendments will be more beneficial to some than to others. As an institute we try to look at the total picture and raise the standard for the entire community.

CHAIR—Our problem is that as a Senate we have to vote on these bills and we have to vote on what is before us. What would you say to the customers of the Insurance Council who get dumped with \$2.5 billion of extra costs that were not intended? Do you say, ‘You are a loser; that is tough. In the national interest you should wear it.’ Or, do you say that the government should correct the package to remove the impost?

Mr Marks-Isaacs—We have not seen how the \$2.5 billion is worked out. Could you explain how it is calculated?

CHAIR—I can provide you with their submission, but they gave it to us this morning and they were, as you are, in the equivalent of under oath and I think that they are entitled to be believed. As an organisation in good standing and one mentioned in your own submission, Mr Marks-Isaacs, I think you should accept their view that that is the case.

Mr Marks-Isaacs—I have accepted it. I have just asked if you could explain how it is calculated.

CHAIR—It is too lengthy for me to explain briefly. That is the figure, irrespective of how they calculate it, given to us under oath by an organisation attached to your submission, and I think you are entitled to believe them. What do you say?

Mr Marks-Isaacs—What we say is that the critical issue here is the net compliance costs. We are not talking about one tax here, one tax there; we are talking about a tax package. That tax package involves getting rid of a number of existing taxes which business currently has to comply with. Yes, for the Insurance Council the burden may be slightly greater after the new package is introduced than before.

Senator CONROY—It is 10 per cent of the entire revenue forecast.

Mr Marks-Isaacs—I am well aware of what \$2.5 billion means. I am accepting it. At the same time I am also asking for some greater explanation of it. I note that, in fact, there was no immediate response from you on that.

CHAIR—I am not here to debate you, nor am here to inform you, but I am here to ask you questions. If you want to go off and question what the Insurance Council says, please do that. The conclusion is that it will cost them \$2.5 billion. My question to you is, and I would like an answer to it, thank you: what do you then tell them? Do you tell them that it is an unintended consequences and they must bear it, and that there is no compensation or that the package should be amended? That is the question.

Mr Marks-Isaacs—Most companies are having to work out how they are going to comply with the new tax package. I can say from my company that, whilst we will have to put work into complying with the GST, we will have savings in other areas of compliance. The critical thing for the nation is the net compliance cost across a range of industries. If all the savings and the additional costs are passed on because there is a net saving there will be a benefit for the consumer to flow it through.

CHAIR—But they are saying this was not calculated. I would be grateful if you would not dodge the question. I would be pleased if you would try and answer it.

Mr Marks-Isaacs—I do not believe the government has calculated into its package compensation for consumers for the additional cost of companies complying—no. The market will keep companies honest to the extent that if one insurance company tries to pass on excessive costs then I am sure the others will not. The market forces and the ACCC's role will dictate that the result is reasonably fair to the consumer.

CHAIR—Are you saying that you do not believe the Insurance Council.

Mr Marks-Isaacs—Certainly not.

CHAIR—You do believe them?

Mr Elliott—I think it is important to put on the record that there is absolutely no intent from the Australian Institute of Company Directors to doubt the submissions of other organisations or individuals that appear before the committee. I think we were just trying to get some indication of how they calculated that because I think in the terms of the break-up and whether it is a one-off hit or it is over time that could actually assist in getting some understanding of perhaps how we could answer the question better. Whilst they are going to see this as a one-off hit, perhaps there are going to be gains in growth over the economy over time. I think that is really all we were trying—

CHAIR—This is a discrete one-off hit—\$2.5 billion.

Mr Elliott—I stress that there is no intent to question the truthfulness of anybody who appears—or ourselves.

CHAIR—If you do not question their truthfulness, you accept their figure and if you accept their figure this is not figured into the compensation via tax cuts that the government is offering the community. They say if they do not get relief their customers will have to bear this extra charge.

Mr Marks-Isaacs—You said to us that \$2.5 billion represented compliance costs.

CHAIR—No, I said a transitional cost to the industry. You introduced a compliance, not me. The *Hansard* record will show that as the case.

Senator FERGUSON—Could I have a point of order, Mr Chairman?

CHAIR—You may.

Senator FERGUSON—You are asking the gentlemen at the witness table to comment on a figure that was first brought to the public attention at about 10 o'clock this morning. It was first brought to our attention then and it is the first time that Mr Simon Marks-Isaacs or Mr Elliott would have ever heard of that figure because it is the first time that any of us had ever heard of it. And you are asking them to decide right here and now whether they believe that is a true figure or whether they do not believe it is a true figure. Even the Insurance Council said that they would supply the modelling. You yourself said that they contended that there was a \$2.5 billion transitional cost. Nobody has proved that that is the case and you are asking them to make a comment on an issue that they have just heard about for the first time.

Mr Marks-Isaacs—I ask to take this question on notice because as it is explained here it is now quite clear to us where it emanates from.

CHAIR—I have been asked to rule on a point of order and I must do so first. There is no point of order.

Senator FERGUSON—Thank you.

CHAIR—Then to you Mr Marks-Isaacs, there was an interjection masquerading as a point of order, but there was no point of order.

Senator FERGUSON—Which you have never done, of course, Mr Chairman.

CHAIR—And I have always been ruled out so you should accept the ruling out in the same way. The point is this—to spring off what Senator Ferguson has just said—we heard about this at 10 o'clock this morning, that is true, but you embraced this package and you have heard about it at 3 o'clock this afternoon. One hopes that you have got the intellectual rigour and honesty to change your position in the face of new information. Does this new information change your position or do you still say that there will be winners and losers and it is tough luck for the losers?

Mr Elliott—I think it is important to realise that, of course, we would hope as representing Australia's company directors we would be able to take new information on board and relook at things. Quite clearly the answer to that part of the question is, yes. The answer to the next part of the question as to whether this particular information means that we will, I think we will have to take on notice and consider that and come back to you on that.

Mr Marks-Isaacs—This is clearly a transitional issue, and the whole point about the tax reform package is to look at what is good for Australia in the long run. Of course there will be transitional problems with any new tax system and there is always a date from which things have to take effect.

Senator CONROY—But that is 10 per cent of revenue.

CHAIR—Order! Senator Ferguson you may have a question.

Senator FERGUSON—Thank you, Mr Chairman. I was hoping I would get one sooner or later. Let me say, Mr Mark-Isaacs, I will not be asking you to comment on any figures that have been presented to us only five minutes ago, which have not been verified and, in fact, are only a contention—

CHAIR—You are not questioning the Insurance Council, are you?

Senator FERGUSON—Yes, because they said they would supply the modelling to us which actually caused them to come to those conclusions. When, in fact, they do supply that—

Senator CONROY—We asked Treasury for modelling—

Senator FERGUSON—Steady, Senator Conroy, don't go too far again.

Senator CONROY—Make sure you call a point of order next time.

CHAIR—Order!

Senator FERGUSON—Your fame has spread across the continent, Senator Conroy. Let me say that they have said that they will supply the modelling which causes them to come up with that figure which has yet to be verified, and when it does I am sure we can supply you with that modelling so you can then make a further comment. The chairman also said—and I think misquoted and I would like to check on a submission—that the Master Builders said that people were being forced to buy smaller houses as a result—

CHAIR—No, the consequence would be smaller houses based on the Murphy model. That is what I said.

Senator CONROY—Concerning Mr Chris Murphy's report from Econtech, the Master Builders said that people were choosing smaller houses. He did not say anything about it at all. It is in the submission. I have read the submission because I very carefully took note of the comments that were made before about people being caught. They are actually choosing smaller houses by choice, not because they are forced, and it is in the submission which I have not got in front of me.

Let me ask you a question in relation to evidence that Senator Cook quoted from the Western Australian Chamber of Commerce about putting the price of the GST as an item on a receipt. We currently have seven different wholesale sales taxes none of which are

displayed on any price of any good that is sold in the community today. Do you know whether the Western Australian Chamber of Commerce believes that each of those seven wholesale sales taxes should have also been, over the past 20 years or more, put on the price ticket of goods that are sold?

Mr Marks-Isaacs—I am afraid we cannot comment on the WA Chamber of Commerce and Industry's position.

Mr Elliott—I have absolutely no idea on that.

Senator CONROY—Criticising, Senator Ferguson—

Senator FERGUSON—Order! I cannot hear the witness, Senator Conroy.

CHAIR—Could you please repeat the answer, Mr Elliott?

Mr Elliott—To be quite honest, we have no idea of the answer to that.

Senator FERGUSON—I just did not know whether you may have heard—

Mr Elliott—But the observation with regard to sales tax is, I think, an important one which raises the issues of transparency, simplicity and understandability. I think it is only fair for the Australian taxpayer to understand exactly where the taxes lie. In fact, you would have noticed that in other parts of our submission we have suggested that levies be regarded as and called taxes where they are currently not.

Senator SHERRY—Does that include surcharges?

Senator FERGUSON—Do I have the call?

CHAIR—Yes, you have the call.

Senator FERGUSON—Thank you. I just wondered. I want to talk about your philosophy on tax reform because I think it is important we talk about the new tax system rather than about some of the other things that have been raised already. You list a number of items that in your philosophy you think are important.

Do you think that the current tax package which has been passed by the House of Representatives and is now before the Senate satisfies your objectives in the various areas that you have spoken about—efficiency, simplicity, transparency, stability, low compliance costs and alignment with the personal taxation system? Do you believe the current tax package satisfies those criteria?

Mr Marks-Isaacs—Yes, to a great extent it is a move in the right direction—and a big move.

Mr Elliott—That is not to say that if someone comes up with a fantastic new idea or new information we would not embrace that if we believed that that would be even better. But, yes, we think it is a big step in the correct direction to the benefit of the community.

Senator CONROY—Benefit of—

Mr Elliott—Who else would it be in the benefit of?

CHAIR—Order!

Mr Elliott—I again refer to the fact that the membership of the Institute of Company Directors does not in any way, even remotely, resemble a ‘small minority’.

CHAIR—You should not have answered the interjection.

Mr Elliott—Sorry, Mr Chairman.

Senator FERGUSON—It is going to be very difficult, Mr Elliott, because Senator Conroy is pretty persistent—as you are no doubt aware.

The other issues that I want to raise are issues that you have raised in your submission—current national tax issues, tax bases being too narrow, et cetera. Is it fair to say that in your submission the only criticism that you have of the current proposal is that it does not address the issue of payroll tax?

Mr Marks-Isaacs—That is a major issue, but we recognise that that is not something that can be dealt with in the short term. That is something that needs to follow on later.

Senator FERGUSON—So, other than the issue of payroll tax, you believe that the tax package adequately covers all of those areas that you believe are the most important in tax reform?

Mr Marks-Isaacs—We believe it does, yes.

Senator FERGUSON—Thank you, Mr Chairman.

Senator GIBSON—Perhaps I should declare an interest: I am a fellow of the Institute of Company Directors. With regard to the appended BCTR submission and following on from the chairman’s questioning of you earlier, isn’t it true that basically those 40 business organisations came together to put forward a common view supporting tax reform for the Australian community in the interests of long-term economy, equity and fairness for everybody?

Mr Elliott—Yes, quite clearly, and in coming together they recognised that there would be some short-term sectoral pain. But the very fact that these various diverse sectors—big, small and in every industry you can think of—did come together and have stuck together is exactly for that reason: they are looking long term to the benefit of the community because

their view is that if the community is healthy then the individuals within it will be able to support more jobs.

Senator GIBSON—And are you surprised that some of those members have appeared before this committee and have also made approaches directly to the government with particular sectoral interests—if you like, subsidiary sectoral interests—underneath the overall umbrella of the ANTS package?

Mr Elliott—I am not at all surprised. I would be surprised if anyone were surprised. That is their role—to do the best they can for their particular sector. Our role is to look at the directors of all companies. So, no, it does not surprise us at all. But what is perhaps even more surprising than that is that, in the big picture, in the long term, they are still sticking together, and they all still agree with the fundamentals of what we are saying.

Senator CONROY—I am looking forward to your identical submission on Ralph.

Senator HARRADINE—Let me ask the institute's point of view—you have put a submission to the Ralph committee?

Mr Elliott—We have put a submission to the Strong Foundations paper which was the first paper we have.

Senator HARRADINE—Yes. That is on the Internet.

Mr Elliott—Correct. We are still considering the nearly 900 pages of the latest paper and, also, the international comparison paper which came out between the two—that is correct, Senator.

Senator HARRADINE—Mr Ralph has to report to the government by 13 June and we are being asked by the government, indeed, perhaps required by the government, to vote on this package before 13 June. Do you think that the Senate is or is not presently in a position to be able to assess the GST regime as it impacts on other business taxation reforms to be announced by the government?

Mr Marks-Isaacs—The government has in its wisdom separated the personal tax package from the business tax review. We believe that the measures in the personal tax package, as announced, make sense whatever the outcome of the Ralph committee. We do not see any likely outcome from the business tax review that would make any of the reform measures planned, and a new tax system, negate any of the benefits from those.

Mr Elliott—We would hope that there would be additional benefits that could flow but we do not expect anything to be coming from it which would negate or reduce the benefits in the personal side—your terms of reference here.

Senator HARRADINE—Would you think it would be desirable for the parliament to have all of the tax reforms before it?

Senator CONROY—A true holistic approach perhaps?

Senator HARRADINE—At the one time? I mean this is a revolutionary change and there are associated changes, or there are to be other changes for business.

Mr Marks-Isaacs—We have just seen some very severe balance of payments figures come out. They demonstrate how urgent is the need to address tax reform, to do everything we possibly can to boost exports and reduce imports. The government's tax package is a small step in that direction—

Senator HARRADINE—Even Howard and Costello have abandoned that—

CHAIR—Order!

Mr Marks-Isaacs—as quickly as possible.

Senator CONROY—Even the government has given up trying to pretend it affects the balance of payments.

CHAIR—Order! Senator Harradine has the call.

Senator HARRADINE—It is interesting to hear that.

Senator O'CHEE—Some people have said that it is not possible to calculate the benefit of a more efficient tax system to the economy. Other people have said that they do not believe that efficiency in the tax system is important. What is your view about efficiency of the tax system and do you believe this package provides a more efficient tax system? If so, what are the consequences for the economy as a whole of a more efficient tax system?

Mr Elliott—I am surprised to hear that anyone would say that an inefficient—and this is turning the words around slightly—tax system is good for a country. I am bewildered by anyone thinking that. So, yes, we believe that a more efficient tax system, whatever it may be, would be beneficial for an economy globally, competitively, and that if you have a thriving economy that is good for companies, individuals, jobs, wealth creation and basically everything—social security, social cohesion, education and all the services that the community expects from its taxes.

The disadvantages of having an inefficient system are many, and they are not just legal and they are not just fiscal. There is no doubt that they go to the very heart of the community's psyche towards the government and paying taxes. You do not need to listen to too much talkback radio to hear people's disenchantment with the current system—the systems and schemes that are being propagated to avoid taxation. I do not believe, and I do not think the Australian Institute of Company Directors believes, the current system is particularly well regarded by the population. It is leading to people having a negative attitude to their obligations to provide for the services that the government is expected to provide back to them.

Senator O'CHEE—Do you believe the current tax arrangements we have in Australia are well regarded internationally vis-a-vis potential competitors for investment in this region?

Mr Marks-Isaacs—Far from it. Australia's tax system is regarded as particularly complex. Our tax act of 4,000-odd pages, as I believe it is, is regarded as one of the most complex and difficult in the world to understand, and our capital gains tax is a real negative to investment and perceived as just that by other countries.

Senator CONROY—How many pages are being withdrawn?

CHAIR—Order!

Senator CONROY—How many of those 4,000 pages are being ripped out?

CHAIR—Order!

Senator CONROY—Any? One?

CHAIR—Senator O'Chee, please proceed.

Senator O'CHEE—One of the arguments being used by some people is that we should worry about trust arrangements, that we should crack down on those and that that should be the real focus of tax reform rather than reforming the indirect tax—

Senator CONROY—Are you supporting that, Bill?

Senator FERGUSON—Mr Chairman, can I take a point of order. Senator Conroy persists in interjecting whenever we have a witness he does not agree with. We sit through and listen to his questions from time to time. If you want this inquiry to descend into a farce then I think you should allow him to continue to interject, but if you want the inquiry to have some standing then I think you ought to order him not to badger the witnesses when Senator O'Chee is asking a question.

CHAIR—There is no point of order, but I do ask all senators to observe the proper decorum and when I give a call to a senator I expect that senator to be able to pursue their line of questioning in the appropriate manner. We will now take a deep breath and pause for a second and, having done so, Senator O'Chee may proceed.

Senator O'CHEE—As I was saying before I was interrupted, there have been some people who have said that the focus of tax reform should be looking at trusts and trust arrangements and not worrying about a GST and sorting out some of the other taxes that companies and business have to pay. How would you respond to that point of view?

Mr Marks-Isaacs—We believe the need to tighten up on avoidance and evasion is definitely there. We have been saying that all along. We need to make the tax bases broader and the rates lower. Tightening up on different types of avoidance and evasion is all part of the same objective.

Senator O'CHEE—So in fact the introduction of a broadly based goods and services tax assists that goal of cracking down on avoidance?

Mr Marks-Isaacs—That is a small step, but reforming the tax system so that it is simpler, clearer and across direct and indirect taxes, has a lower number of broader taxes, will altogether make a big difference.

Senator O'CHEE—I think one of the witnesses we had in the last week or two told us that 1,304 transnational companies in Australia paid no tax and that this was the real flaw in the tax system. Do you have any comment to make about transnational companies and tax and tax arrangements?

Mr Marks-Isaacs—We are not experts in that field, and it is an extraordinarily complex field which I think we would prefer to leave to individuals who are particularly skilled at it.

Senator O'CHEE—But you think basically we should pay attention to people who are particularly skilled in that area, rather than just off-the-street commentators?

Mr Marks-Isaacs—Very much so.

Senator O'CHEE—Can I just ask you also about suggestions that food should be zero rated. What would be the consequences for business and the tax system were the government to adopt that suggestion?

Mr Marks-Isaacs—I think we would find firstly that the support for the package would drop off enormously. We certainly do not support a GST unless it is on food, because the additional cost that you would introduce into the system and the additional hurdles that would be put up involving transitional costs and everything else simply do not make it worth while going through unless it is fairly broad based.

If we do not have that revenue from the GST on food, we then have to look at what to chop out of the package. Do you chop more of the welfare compensation? Do you chop more of the tax cuts? Do you chop the money going to the states? You cannot then reform the state-federal relations in the same way, so that does not work. You have more compliance costs, because you have all the issues that witness after witness has been telling you about what comes up in Canada and in the UK with the question, 'Is it food or isn't it food?' and the compliance costs are far higher.

If you find through the work you have commissioned in relation to the question, 'Is a GST on food fair for everybody?' that there are some groups who are going to be worse off through it, then arrange for more compensation to be provided to those groups.

CHAIR—Any further questions?

Senator CONROY—You indicated in Perth in your previous evidence that you supported the package as it stood. You had not looked at the legislation, but you supported it as it stood.

Mr Marks-Isaacs—That is right.

Senator CONROY—It was indicated to us this morning by the Taxation Institute—which is one I mentioned to you last week as well and you can take their submission away with you today—that unfortunately for you the government are proposing up to 100-odd amendments. Would you be pretty disappointed with that?

Mr Marks-Isaacs—Far from it, because, as I said to you last week, we have not read the legislation. Our position is not, in fact, to go through the legislation in great detail, but to comment in general on what is required from tax reform and the direction that has been taken. I invited you to please point out discrepancies. Clearly, discrepancies have been identified and continue to be identified by the Senate select committee among others, and, as those discrepancies are identified, they need to be dealt with by amendments to the legislation. It is due and proper process.

Mr Elliott—The Institute of Company Directors would be delighted to see as many amendments as are required to make the package better.

Senator CONROY—But you have no idea what those are, and you are not interested in finding out in doing your own analysis?

Mr Marks-Isaacs—You tell us about them.

CHAIR—It is not for us to provide information. You are giving a submission to us. Senator Conroy, is that your question?

Senator CONROY—It was my question.

Senator SHERRY—You have both stressed the issue and used the words ‘dramatically lower compliance costs’ as a result of the ANTS package. Where is your study evidence—and I certainly cannot find it here in your submission—regarding the costs of collection of a GST, administration, 4,000 tax inspectors, new officers working for the tax office and well over one million tax collectors, because businesses become tax collectors? Where is your evidence and study that this is in fact going to result in dramatically lower compliance costs in the taxes that it replaces?

Mr Marks-Isaacs—Dr Jeff Pope of Curtin University was commissioned by the Business Coalition for Tax Reform to produce just such a study and it showed a net reduction in compliance costs.

Senator SHERRY—Could you provide that for us, please?

Mr Marks-Isaacs—Certainly.

Mr Elliott—I am sorry if it has not been supplied already by the Business Coalition for Tax Reform, because I know it was referred to in their submission to you on 3 February.

Senator FERGUSON—I think it has.

Mr Elliott—It was referred to in their submission on 3 February.

Senator SHERRY—It was referred to, but we have not seen the details. It may be one of those submissions we have not got evidence from.

Senator CONROY—We have thousands of pieces of paper flying around. Are you happy to continue questioning?

Mr Elliott—We would be delighted to continue to field questions, if there was time and there was nobody else coming. We think this is an absolutely crucial debate for Australia to have and the more questioning, the more openness, the better. If there is anybody on the Senate committee who disagrees with the fundamental principles which the institute is proposing, we would be very pleased to field questions from them.

CHAIR—Maybe you should invite us to come and address you at some time so we can articulate our views on that in considerable detail, Mr Elliott.

Mr Elliott—Those offers have already been made.

Senator CONROY—I am available any time.

CHAIR—We do have other witnesses behind you, and as much as we would like to no doubt extend this session, because I do apprehend an eagerness by some of my colleagues on this committee to ask further questions, in deference to those who are coming behind you, we will have to close this session now. I now do so, and thank you and Mr Simon Marks-Isaacs for the assistance you have rendered our inquiry.

Mr Elliott—Thank you for the opportunity to appear. Mr Beazley has already addressed us on some of these issues in the past and is invited at any time in the future, or any other of his shadow ministers.

Senator CONROY—When did you speak? Was it before or after the release of the package?

Mr Marks-Isaacs—I will take that on notice. Do you want the actual date?

Senator CONROY—My rough guess is that it has got to be before, by definition.

Mr Marks-Isaacs—I will take that on notice and notify you when we are sure that you have a copy.

CHAIR—It was at the time of the summit held by the Business Coalition for Tax Reform, and his paper was a submission to that summit, as I understand it.

[4.03 p.m.]

SAUNDERS, Professor Peter Gordon, Social Policy Research Centre, University of New South Wales

CHAIR—Professor Saunders, while you are making yourself comfortable, I will take the opportunity to welcome you and your colleague to the hearing. You have submitted a paper which is before us, and the normal course is to invite you to, if you would be kind enough, give a brief overview of what you have presented and then open yourself for questions.

Prof. Saunders—Yes. I am the Director of the Social Policy Research Centre at the University of New South Wales. Alongside me is my colleague, Ms Jenny Chalmers who was involved in the research I am going to talk about and has done a lot of the work that we will describe later.

Perhaps I should say at the outset that the submission is not an official submission on behalf of the Social Policy Research Centre itself. It comes from a research team working within the centre who recently completed some research that we feel has relevance to some aspects of your consideration. Having said that, perhaps I could read out some introductory comments and then take questions.

CHAIR—Please do.

Prof. Saunders—My submission is intended to draw the committee's attention to recent research on budget standards undertaken within the Social Policy Research Centre of which I am the director, and to explore the role that research can play in estimating the impact of a GST on household living standards.

A budget standard represents what is needed by a household living in a particular place at a particular time in order to attain a particular standard of living in terms of material consumption of goods, services and activities. Its development involves identifying all of the items required to obtain a particular standard of living and then costing them using market prices.

Our 46 household budgets each consist of over 400 individual items. They include major items of expense such as the house and the car down to minor things such as salt, pepper, toothpaste and toilet paper. Because the budgets are costed using market prices, they are dependent on the level of indirect taxes, at least to the extent that these are passed on as higher prices. A switch away from personal income tax towards an indirect tax such as a GST has the effect of lowering the gross income needed to sustain a given household budget whilst at the same time increasing the cost of purchasing a given consumption bundle.

Budgets were developed for two separate standards of living—a modest but adequate standard and a low cost standard. The modest but adequate standard is one which affords full opportunity to participate in contemporary Australian society and the basic options it offers and describes the situation of a household whose living standard falls somewhere around the median standard of living experienced in the Australian community as a whole. The low cost standard represents a level of living which may require frugal and careful management of

resources but would still allow social and economic participation consistent with community standards and enable the individual to fulfil community expectations in the workplace, at home and in the community. It describes a level below which it becomes increasingly difficult to maintain acceptable living standards because of the increasing risk of deprivation and disadvantage.

In developing these two standards, our research built upon the most informed judgments about needs in different budget areas and the best available data on household consumption oriented behaviour. Data from a range of sources were used to inform the budgets, including from the household expenditure survey, HES, and other ABS collections, as well as from the Australian living standards survey conducted by the Australian Institute of Family Studies. Our food budget, for example, is based on the dietary intake requirements recommended by the National Health and Medical Research Council adapted to conform to the actual eating habits of Australians. The assumption of a nutritional diet also influenced several other areas of the budgets. Thus, we made no allowance for expenditure on tobacco, and individuals were assumed to maintain a good state of overall health by engaging in regular exercise which in turn affected the clothing, leisure, transport and health budgets we estimated.

A budget standard contains a mixture of normative and behavioural elements. The former reflects judgments about what people should do while the latter encompasses aspects of what people actually do do. The judgments were made after consulting with experts in each field and also reflect the comments we received from a series of focus groups. It can be argued that because a budget standard does not reflect actual spending patterns it does not provide a basis for estimating the actual effect of a tax change on real families. It may thus be preferable to regard the budget standard estimates as illustrative rather than definitive. However, there are also many conceptual and practical problems associated with using actual expenditure data as recorded in the HES for this kind of purpose.

Several assumptions are required to draw conclusions about the standard of living of a household from income or expenditure data as recorded in the HES. My point is not to argue which of the two methods is superior but rather to claim that each has a role to play in addressing compensation and related issues. Furthermore, while a budget standard does not correspond to the expenditure patterns of actual households, it does correspond to a particular standard of living and thus can be used to estimate whether tax or other changes make households better or worse off. We have undertaken some calculations to illustrate this point. They are based on the GST price effects provided to us by the Melbourne Institute, which we have applied to our budget standards to assess what difference they make. Our results are summarised in the overhead.

An overhead transparency was then shown—

Prof. Saunders—The overview shows three columns of figures for the two standards—the low cost standard on the left and the modest but adequate standard on the right. The left-hand column in each case provides the dollar value of our budget standards. The next column provides our estimate of how much those budget standards increase by as a result of the price effects induced by the GST. The final column, which is not in the submission I provided earlier, re-estimates that middle column, taking out the food effects. Again, we have relied on the Melbourne Institute price effects to calculate these figures.

The estimates reveal that the impact of the tax change differs as between the low cost and modest but adequate standards and, within each standard, differs according to household type. The magnitude of these differences, particularly those that operate at a given standard of living, make it clear that the GST will have different effects on different households. These would need to be reflected in the structure of any compensation package if it is to be distributionally neutral.

The overhead shows that the effects vary at the low cost standard by between three per cent and 3.6 per cent for non-aged households and by somewhat less for aged households. The effect increases with the number of children in the household. Overall, the effects are somewhat smaller at the modest but adequate standard. An across-the-board rise in income of four per cent as proposed in the government's compensation package, while it might protect the absolute standard of living of households that receive it, would still leave significant changes in relative living standards, even among households that start out at the same standard of living.

As I said, the overhead also shows in that third column what would happen if food were exempt from the GST. Again, we have relied on the Melbourne Institute for the price effects. At the low cost standard the increases now range between 1.5 per cent and 2.3 per cent for non-aged households and no longer increases with the number of children. The effects are now just over one per cent for the aged. The modest but adequate effects are again somewhat lower for all households.

The main point to emphasise about the estimated effects is that they vary across different households. Providing the same compensation to each will not, therefore, offset the distributional effects of a GST on households with a low standard of living. Furthermore, the estimates refer to the change in the budgets of households which will often exceed their incomes. A four per cent increase in income may thus be sufficient to maintain their after-tax income but not necessarily their standard of living. Thank you.

CHAIR—Thank you, Professor Saunders. Is it your intention to ask your colleague to supplement or shall we go straight to questions?

Prof. Saunders—Straight to questions.

Senator FERGUSON—I was very interested in looking at the overhead that you have because, in fact, what you are saying to us is that, in dollar terms, every single household, regardless of whether or not food is exempt, will be better off under the tax package than they currently are.

Prof. Saunders—I think that does raise the question of exactly the basis on which one decides whether a household is better off or not.

Senator FERGUSON—I am sorry to interrupt, but I will explain why I said that. I think the figures you have used here, if we compare them to other figures that have been supplied in evidence to this committee by people who have done modelling, are probably the worst case scenarios. I think you are using the household expenditure survey figures, which is what the Melbourne Institute used. Of those households that you have mentioned regarding the

increase caused by the tax package using the household expenditure survey, not one group is going to have an increase of four per cent. They are all under four per cent and the compensation that this package is offering is four per cent.

Prof. Saunders—Yes. What I would like to say is that the compensation increases the income of households by four per cent. This slide suggests that the percentage increase in the budgets of the households in all cases is less than four per cent. I totally agree with that statement. If one is then prepared to equate the income of households with the budget, then I think it follows that households are better off. But I am raising a question mark, if you like, over that final step in the logic of the argument. We know it is possible—and the household expenditure survey certainly demonstrates this—that for many low income households their expenditure exceeds their income. Therefore, providing a four per cent increase in their income may not compensate for a smaller than four per cent increase in their expenditure.

Senator FERGUSON—It may not, but the point I am saying is that they are all going to be better off than they are today. If they are going to get four per cent extra and the effect of the tax package is going to increase their costs by less than four per cent, then in fact they are all better off than they are today, regardless of whether you think they are well off today or not—that is another question. They will all be better off than they are today in dollar terms.

Prof. Saunders—Yes, I think I would agree with that.

Senator FERGUSON—Thank you. I think it is important that we have that on the record because there are some people who have suggested that the compensation is not adequate. Also, you talk about the impact of the GST, saying that the Melbourne Institute research does not accommodate consumer response to price changes resulting from the tax change. Of course, people will always respond differently to price increases, won't they?

Prof. Saunders—Yes, I think that is right. Economists generally tend in their discussion of issues like tax reform to put a lot of emphasis on these kinds of behavioural changes in response to tax and other effects. But the fact of the matter is that we do not have a very good feel for how large those behavioural changes are; and often, in practice, we tend to ignore them and concentrate on what is referred to as the income effects and ignore the substitution effects.

Senator FERGUSON—Professor Saunders, do you support the tax package or the tax reform program?

Prof. Saunders—That is not something I have addressed in my submission—

Senator FERGUSON—I understand that. That is why—

Prof. Saunders—so I am talking outside of my submission. On balance, I am not convinced by the arguments for taxing food. My view would be that further consideration ought to be given to whether or not food should be exempt from the GST. I can expand on that if you wish, on why I take that view.

Senator FERGUSON—If I can just explain that the reason economic modellers have suggested that food should not be exempt is that, if we wish to target people on low incomes and those who are welfare recipients, the correct way to do it is through the social security system, where the compensation can be accurately targeted, rather than exempting food, where many of the benefits go to those that are not on the lower end of the income scale. That is what the modellers have told us.

Prof. Saunders—And I think in the short run that is probably right. Our earlier exchange, which was referring to the slide, looks at the short-run impact—what happens immediately on the introduction of the tax and the provision of the compensation package. However, the previous witnesses were placing great emphasis on the long-run effects of the tax system and I think that is the appropriate time frame within which to analyse a change of this importance. The concern is whether or not the compensation that is provided, and that may be seen as adequate in the short run, will be there in the long run.

Senator FERGUSON—In order for it to be changed the change has to go through the parliament. I cannot imagine the Democrats or the Labor Party voting to reduce the compensation and we have guaranteed that we will not.

Prof. Saunders—I am thinking more of a long-run scenario in which the rate of GST itself may change. I am not arguing about the compensation as it applies to the package at the point of introduction.

Senator FERGUSON—It is very difficult for us to look at it as anything other than the rate at which it is applied, isn't it?

Prof. Saunders—Yes, I think that is true. But I think it is also true that there are concerns that what may be guaranteed in the short run may not be so secure in the long run.

Senator FERGUSON—The government has done the best it can to put some safeguards into that, unless other parties wish to increase it—and I do not know that they would—once it is in.

Senator BARTLETT—Can I just clarify a bit more about the table that you have addressed in the overhead. With the budget standard benchmark that you are putting in, is it a typical household Australia wide, is it specific to Sydney, or is it averaged across city and country?

Prof. Saunders—The budgets we have were costed in Sydney. That, as you would be aware, makes quite a large difference to some components, particularly the housing costs. We have done some work trying to see what sort of magnitude of difference that might make, and in my submission I did include a paper of mine in which I tried to give some preliminary estimates of what kind of difference it might make if one tried to replace the Sydney housing costs with housing costs in the other capital cities, using the same methodology that we have used.

Senator BARTLETT—The issue of housing costs and housing related issues is covered a bit more specifically in the terms of reference of the Senate Community Affairs References

Committee, which I am normally on—I am just moonlighting here this week. You have picked private renting here in most cases, except for the aged households. Is that because that is where the potential for housing costs to impact on living standards is most focal?

Prof. Saunders—No. The reason we focus on private renters in most of the public presentations of our budget standards is that we do want the budget standards although they refer to very specifically defined households—as you can see, we define the age of each individual in the household. We have to be very precise in order to calculate the needs.

We realised during the research that it was impossible to provide anything like a representative housing cost figure for someone who was purchasing a house because the mortgage arrangements would vary so greatly, depending upon the time of purchase, how they had responded to interest rates in the intervening period, the length of the mortgage and so on. So in the budget standards report we have a matrix, if you like, of possible housing costs for purchasers, but they cover a very broad range.

We took the view that private rents at least have some kind of test against the market and therefore we felt that they did reflect the market valuation of a particular standard of housing. In fact, what we did in the budget standards report was come backwards at the housing costs for purchasers and we arrived at figures that were broadly similar to the rent figures we had introduced, on the argument that if the standard of housing was the same then the housing costs ought to be the same.

Senator BARTLETT—How fundamental an issue is housing cost as part of people's overall ability to have a decent standard of living?

Prof. Saunders—The housing costs are quite a substantial proportion of our budgets. They vary dramatically. They are much lower, of course, for the people who are assumed to own their houses outright, who are the aged. But for the non-aged households, housing costs—and we are talking here of all housing costs, not just rent but insurance and rates and so on—vary between around 20 and 25 per cent of the total budget, so they are quite a large item.

Senator BARTLETT—Just briefly on the issue of food that was raised earlier, is the main reason you believe, on balance, that food should be exempt because it is a safer or a more effective way of ensuring minimal impact on lower income people of any price variations with the tax changes?

Prof. Saunders—I do not find the arguments for including food strongly convincing. There are three arguments, as I understand it. One is revenue—it raises a lot of revenue. That is certainly true, but this is a very big package and it is possible to make other changes elsewhere that could offset the revenue effects. The second argument is a sort of level playing field argument; that if we tax everything at the same rate that will minimise the extent to which the tax system interferes with price signals and therefore minimise the disincentive effects of the tax system and make the tax system as efficient as possible. I do not think there is any economic argument that supports that proposition. The economic analysis of designing a tax system to minimise efficiency effects, in the conventional

economic meaning of the term, suggests that you should have a rather complicated structure of rates, not a level, constant rate.

The third argument is of course the practical one that if we tax food at a different rate to everything else then we get into these terrible boundary problems of what is food and what is not and so on. That I think is a serious argument but I do not think it is one that cannot be overcome. There will be boundary problems in any case with the GST defining some of the other zero rated exempt items. My view is that it would be a reasonable price to pay to have some possibly grey areas on the boundary or some decisions that might be seen as somewhat arbitrary in order to exempt food which is a very large proportion of the budgets of most low income households.

Senator BARTLETT—In effect, having a tax on food is more regressive than most other indirect taxes.

Prof. Saunders—Yes, by itself. I do not think there is any doubt that, when you look at a tax on food in isolation from any other changes, it is regressive. I do not think anyone has argued against that.

Senator HARRADINE—Why have the particular households been selected?

Prof. Saunders—The research itself was commissioned by the then department of social security back in 1985. The structure of the households was agreed at through a rather lengthy process of negotiation with the department and it was designed to try to cover most of the household types that were most prominent in the Australian population in terms of numbers, but also households that were of particular interest to the concerns of the department. We have not, of course, presented all of the households in this table. I tried in the table here to give a flavour for what the magnitude of the effects is. The range of the effects that are shown on the overhead encompasses the range for other households so there is nothing that is not on the overhead that causes the general story to be different from the one I have told.

Senator HARRADINE—I am looking at a couple plus girls aged three and six and a boy aged 14. I am going to the question of why you are saying that food is different from other necessities of life. For example, if you take that household type of a couple plus girls aged three and six and a boy of 14, you have got food there as \$172 out of \$659—I am talking about page 11—

Prof. Saunders—Page 11 of the submission?

Senator HARRADINE—Yes, of your attachment.

Prof. Saunders—I am unable to find the table that you are referring to. I am sorry. I may be able to answer the question.

Senator HARRADINE—I think I have the right document. Look at housing, energy, clothing and footwear which are all necessities of life—even leaving aside household goods and services. I will go from other figures that we have been given previously for the low income group. From memory the figures that we were provided on another day were

something like 23 per cent of expenditure was on food whereas about 40 per cent was expenditure on other necessities of life. Why are you suggesting that a GST on food is more regressive than a GST on other necessities of life? You can get around with barely anything on sometimes in Sydney but certainly you could not do so in some parts of Tasmania.

Prof. Saunders—The argument I was putting forward is not something that can be supported with hard facts. These are questions of rather difficult judgments about equity and trade-offs between the different objectives. If one develops your line of argument it seems to me that one ends up without a GST at all on the grounds that most goods are required by people in order to live in society. The logic that you are putting forward suggests that one should not have a GST. That is not really a position I was adopting. I was arguing that—

Senator HARRADINE—I am just asking you what is the difference between one necessity of life and another necessity of life.

Prof. Saunders—I think the answer to that is there is not a lot of difference. To live and participate in Australian society today requires many different goods.

Senator HARRADINE—It requires you to wear clothing; it requires you to have some shelter; it requires you to get warmth; it requires you to drink water and it requires you to travel to work for example. I am just interested to know what is special about food when it comes to a question of necessities of life. Some of the other necessities of life are more of a burden on the household expenditure of low income groups and, indeed, of middle income groups than food is.

Prof. Saunders—I say two things. One is that I agree with your basic proposition and I think that the budget standards research demonstrates that in order to achieve those standards of living that I articulated a few minutes ago one needs to consume a very wide range of goods and one cannot, in any sense, say that this particular good or group of goods is any more necessary than another. The fact of the matter is that it requires a package of goods and services and activities to participate and achieve a standard of living in a country like Australia.

I think that where we might disagree is on the evidence on the degree to which the different items are regressive across different households. I would have thought that the evidence does show that food across the distribution of households as a whole is more regressive than housing and clothing and so on, and that is because there is a sense in which food does meet a more basic need and that it is always possible to cut back on other expenses more easily than food.

Senator HARRADINE—But is it not a fact that in actual monetary terms the richer the household, the more food they eat?

Prof. Saunders—It is true in monetary terms, and it is also true that the richer the household the more they spend on food, but for questions of distribution what matters is how that money amount varies with income. If you express expenditure on food as a proportion of income, then that declines with increasing income.

Senator HARRADINE—Yes, I understand that. Under the item ‘Leisure,’ does that include cigarettes and alcohol?

Prof. Saunders—We did not have any cigarettes. None of the individuals was allowed to smoke but they have a modest amount of alcohol consistent with the NHMRC guidelines, which is something like a couple of middies a beer a week. It is that order of magnitude, and possibly a glass of wine every now and again.

Senator HARRADINE—Sorry, how much was that?

Prof. Saunders—It was a couple of glasses a week, and maybe a wine here and there, and cask wine of a low cost standard, of course, so rather frugal.

Senator HARRADINE—You might be interested in reading some of the submissions that we have had from the wine industry and from distillers and various other people. Thank you.

CHAIR—I think the headline answer that you gave to Senator Ferguson, in answer to his question, ‘Are people better off under this tax package than before?’, was yes, and I think he is delighted that you did so. But the evidence you have given since raises some questions in my mind as to whether in fact that is what you actually meant, and I want to come back to that point before I conclude.

Looking at your chart on the screen, the figures in the column ‘Before tax package (\$/week)’ are figures which, if I heard you correctly, you have worked out according to dietary need, Australian eating habit and the circumstances of each of those categories. This is not what they receive, this is what they need to live.

Prof. Saunders—Yes.

CHAIR—This is an important distinction because, just doing some quick calculations, in the column ‘Aged households. Single female age 70,’ she needs \$193 a week to live, which calculates out at \$10,036 per year, but the age pension is \$9,000 or thereabouts. So what you are saying, in that column, is that this is what a single female aged 70 would need, but that is not the same as what she gets, and she gets less than what she needs according to that table.

Prof. Saunders—Yes, and I should thank you for giving me the opportunity to clarify that earlier comment. I do not have the mathematics in front of me to be able to work out the yes or no of this—

CHAIR—I used my fingers and toes to calculate the figure!

Prof. Saunders—But if we take, for example, a single female who was at our low cost standard with an annual budget of \$10,000 a year and who was on the pension with an annual income of \$9,000 a year, then it is possible that a four per cent increase in her income could be less than a 2.7 per cent increase in her budget, and therefore she could be

worse off. So I should correct the answer I gave to Senator Ferguson earlier, or qualify it. I think we would have to do those calculations to check that.

But I was trying to make the point that if one is talking about compensation, one is talking about whether people are better or worse off, and that does raise the question of how you are measuring the extent to which they are well off. Household expenditure analysis has tended to use the income. Some people have argued that expenditure is a better measure. Here we are using a normative budget, which is neither their income nor their expenditure as recorded in the HES.

CHAIR—I understand that. The important thing, therefore, about your figures is that they do not show what the income of low income people might be, they show, according to your calculations—and I do not dispute them—what people need as a minimum to live.

Prof. Saunders—Yes.

CHAIR—And where their income is less than what those figures show, that means they are either using up savings, or they are borrowing money if they can, or they are selling a capital good, like a house, to survive, or they are living off their families in some other way. They are, in fact, dissavers. Have you done any calculations to see how typical of the income levels those basic figures are and how many people fall below those figures in actual incomes?

Prof. Saunders—First of all I will talk about the ‘Low cost’ figures, which is the first column on that table, because I think that is the main interest here. These figures are, as you have already said, certainly for the single female, above the age pension and they are above the social security payments that any of these households would get. They are substantially above those payments in some cases—20 to 25 per cent higher. They are also higher than the Henderson poverty line by 15 per cent or thereabouts, it varies a bit. So, they are above what most low income Australian households would actually be receiving as an income.

I have done some calculations using the household expenditure survey to try and get a feel for how many people fall below that ‘Low cost’ standard and how many fall between it and the ‘Modest but adequate’ standard. They are contained in the paper which is attached to my submission.

I can give you a figure. This is for all private renter households. Just over one-third of the population—36 per cent—had recorded expenditures that were below our low cost budgets. If you exclude housing costs, and the earlier discussion suggested—and I think that was right—that Sydney housing costs are not very representative of housing costs outside of Sydney, that figure falls to about 29 per cent.

The first figure I gave you, the 36 per cent, was for private renter households only. If one includes owners and purchasers it falls to 29 per cent. If one has the broader population and then excludes housing costs it goes down to about 20 per cent. So, about one-fifth of the population actually have incomes that are below our low cost budgets. This is where, of course, the issue of the tax package is compensating people’s incomes.

When household expenditure is different from its income, or when the budget standard is different again, one in principle has three different ways of measuring their standard of living and, therefore, three different ways of deciding whether they are made better or worse off or whether they are compensated adequately or not.

Senator FERGUSON—Can I just clarify the answer you gave me earlier. Am I now to believe that if a single female aged 70 needs \$193 a week according to your ‘Before tax package’ column there, and if the tax package where food is still included is going to increase her costs by 2.7 per cent and we compensate that person by four per cent, you are now saying that she could be worse off?

Prof. Saunders—I am saying that she could be worse off because the income she receives may be below the value of the budget standards.

Senator FERGUSON—We are giving her four per cent above what she is actually getting today—another four per cent. Her costs, on what she receives today, are only going to increase by 2.7 per cent and you are telling me that she could be worse off after we give her a four per cent increase.

Prof. Saunders—Could I think about that for a second and consult?

Senator FERGUSON—Please do.

Prof. Saunders—That was a very pointed question and I was put on the spot by it before.

Senator FERGUSON—The only subject I was ever really good at was arithmetic. Could I suggest that perhaps you present this to us as another paper rather than try to work it out now. Could you present it to us as a tabled document?

Prof. Saunders—Yes, I would like to do that. Probably the best thing to do is to go away with this table and do some illustrative calculations and submit those.

Senator FERGUSON—Thank you.

CHAIR—I had not actually turned to the headline statement of whether they are better off or not yet in my examination of you but I am running out of time and will have to yield to my colleague, Senator Sherry, in a minute. Whether they are or not depends on all of the assumptions that the government has made in its ANTS package, does it not? That is your working basis.

Senator FERGUSON—This is the HES data.

Prof. Saunders—You will not find those figures in the HES. These are our budget standards which you will find in this report.

Senator FERGUSON—They are not ANTS package figures.

Prof. Saunders—No, they are not HES package figures but these are figures that we have produced, as I tried to explain to Senator Harradine, by starting from the needs of households and identifying what the households need in the different areas to get a particular standard of living, translating that into a series of goods and costing the goods. In the process of developing the budgets, we did check that our budgets were not way out of line with the household expenditure survey figures so that they do, to some extent, represent the selective lifestyles of Australian households, but they are not HES figures.

CHAIR—The questions from my colleagues have derailed my question. What I am asking you is whether the calculations of increase caused by the tax package and your projected calculation—with food exempt—are based on the ANTS package and what the government says will be the level of value to a consumer of their tax package.

Prof. Saunders—All that we have used to calculate those figures for food exempt are our budget standards and the price effects that the Melbourne Institute has calculated from the government's ANTS package.

CHAIR—Yes. So, in essence, if the government is right and has told us the truth, then those figures have validity. If any of the assumptions upon which the government has based its calculations are wrong, and those figures are out of whack, to that extent your figures are wrong too, aren't they?

Prof. Saunders—Yes.

CHAIR—I do not want to delay the process now but we have had a lot of evidence about what the costs to low income earners really are, as opposed to what the costs are alleged to be by the government. Whether the modelling at low income levels is right or wrong and, I think, on the evidence—I am making a comment now—we have adduced that there is an open question whether you should trust the figures that you have been given in the ANTS package—

Senator FERGUSON—That is not the collective 'we'—

CHAIR—I am speaking for myself. That is how I discern the evidence. The other thing is—and I will be quick on this final point—these are averages, are they not? Each of those figures there is what you would regard as the average—the first one, the single female aged 35, is an average of that category?

Prof. Saunders—No. That first figure refers to one individual, not anything like a HES where there is a sample. We have calculated a budget for a 35-year-old woman living in a particular house in a particular place in Sydney.

CHAIR—Okay. We talked about richer households a moment ago. Under the HES richer households have more people in them, don't they?

Prof. Saunders—Yes.

CHAIR—And therefore more consumers?

Prof. Saunders—Yes.

CHAIR—Right. So the fact that they are richer is, in part, a feature of the fact that there are more contributors or wage earners in that household than otherwise? It is probably the case, too, that wealthier people buy more expensive food. It may be the case that middle class people buy a better diet of food than poor people do, and that poor people, by buying cheaper food, may not buy the ideal dietary requirement—that would be true as a statement, would it?

Prof. Saunders—That is true, yes.

CHAIR—And finally, you have selected these categories from 1985 as requested by the Department of Social Security—

Prof. Saunders—1995, Senator.

CHAIR—I see. You have just ruined by question because if it was 1985 it would have been related to the Department of Social Security's modelling of the then options paper on tax reform brought down by the then treasurer, Paul Keating.

Prof. Saunders—Right.

CHAIR—Were you asked by the Department of Social Security in 1995 to do this modelling?

Prof. Saunders—We were not directly asked. There was a public tender to undertake the research and we submitted—

CHAIR—And you tendered?

Prof. Saunders—We tendered, yes.

CHAIR—Okay. Senator Sherry.

Senator SHERRY—Thanks. I was interested in your statement to Senator Harradine earlier about necessities of life and you said it is easier—talking about food compared to other necessities of life which you accepted were necessities—to cut back on other necessities. They were the words you used, and I am not using them out of context. Let us take clothing and footwear. Certainly many of the low income families with children that I have contact with in Tasmania, would find it very hard to cut back on clothing and footwear, for example. Many of them pass down clothing and footwear from one child to another and many of them buy second-hand clothing. It would seem to me that—I put it to you and ask for a response—the capacity to cut back on clothing and footwear would be as limited as it is for food for many low income families with children.

Prof. Saunders—I would not dispute that statement; I would agree with that statement. But let me qualify that part of the discussion. I do not think it is particularly useful to try to identify which goods are necessities and which are not. I think that the budget standards

work basically shows that you need a lot of things to live a normal or even a low cost lifestyle in Australia today.

One can define necessities, it seems to me, in two ways. Firstly, there is what you might call a technical way, which is the way economists tend to do it, which is to look at the extent to which you buy more or less of an item as your income increases.

Secondly, you can try to define necessities in what I would call a judgmental way. I might well agree with your judgment on this particular matter as you have just expressed it, but there will be others who will make different judgments. To try to define necessities on that second basis is not a particularly useful way forward. I think it is better to take a harder look at the figures and ask the sorts of questions about how expenditure on these items varies across the income distribution of all households.

We know that economists have used the proportion of budget spent on food as a measure of the standard of living for over 200 years. The higher your standard of living, the lower the proportion of the budget devoted to food, because you have more discretionary money to spend on other things. That is not to say that people do not need clothes, a house, transport, leisure, energy and so on to live. Of course that is part of the overall picture.

I did not want to imply in the remarks I made to Senator Harradine that it was possible for low income people to cut back on consumption of all items other than food. I certainly did not mean to imply that, and if that implication was drawn, I am sorry. I did not mean that.

Senator SHERRY—Let us take people above AWE, which is about \$36,000, and their expenditure on food, clothing, footwear and transport. Higher income earners would have a greater discretion to switch purchases. In respect to clothing, it is different brand types; in respect to food, it may be that you are able to replace chocolate biscuits with plain biscuits, or a restaurant meal once a fortnight with McDonald's once a fortnight. When I say a restaurant meal, I mean that a non-McDonald's meal is a more expensive type of operation.

I suppose that is one of the approaches that I would contend would certainly lead the party I represent to believe that the only way to guarantee protection for lower middle income earners is not to have a GST at all.

ACTING CHAIR (Senator Ferguson)—Is that a question or a statement?

Senator SHERRY—I am asking for a response.

Prof. Saunders—We have indirect taxes at the moment. The argument for a GST, as I see it, is that it does bring services into the tax net, and services are largely untaxed currently. That is why I think that a GST will be modified in some way. But anyway a GST can be argued for. It would definitely broaden the tax base. We do have a tax system where, whilst the overall level of taxation is low, we rely very heavily on personal income tax to raise the money that we do. I think the argument that there is a fair amount of tax resistance to further increases in income tax, particularly marginal tax rates, does suggest that over the long run one may need to look for supplementary taxes.

Senator SHERRY—On that issue, though, one of the considerations is an equity consideration. If we take a single income couple with two dependent children aged between five and 13, if you look at the ANTS package, the GST is accompanied by income tax cuts. A person in that category I have mentioned on \$15,000 a year receives a 2.9 per cent reduction in income tax—\$14.70 a week. But a person on \$75,000 a year receives a tax cut of 10.9 per cent or a \$106.55 a week.

Now, there is a similar pattern right through the income tax cuts. I do not know what your view on equity is, but I would submit to you that that is fundamentally unfair for lower and lower middle income earners. Again, I would ask you to respond.

Prof. Saunders—I could not agree more. Over the last two decades or so, there has been an increase in inequality of income in Australia, as there has been in many other countries. In Australia we know that the driving force behind that inequality is inequality of market incomes. We also know that the effect of the government's tax and social security policies have been to offset much of that increase in inequality, not reverse it, but certainly hold the line. I think the Australian tax and social security system has done a pretty good job in that regard. This tax package would have the effect of the government policy, far from offsetting what is happening in the market, reinforcing it. My own values would be to oppose that change, so I totally agree with you.

ACTING CHAIR—Can I just correct one thing, Senator Sherry? You were talking about a single income couple with two children aged between five and 13?

Senator SHERRY—I have closed the book, unfortunately.

ACTING CHAIR—Because it is fair to say that, on a single income, no Australian gets more than \$85.77 in income tax cuts. I think Senator Sherry was referring to the total package, which includes family benefits as well. But it is a fact that, regardless of income, no Australian gets more than \$85.77 a week in actual income tax cuts.

Senator SHERRY—Yes, what the total package is worth to me.

ACTING CHAIR—If someone earns \$½ million a year, their tax cut is still only \$85.77 a week. That is the maximum.

Prof. Saunders—Yes.

ACTING CHAIR—Senator Sherry referred to people wearing hand-me-down clothes. As the third son in line, I know a lot about hand-me-down clothes. Senator Sherry is probably right when he says that in lower income families clothes are handed down. Thank you for appearing before us today and giving us your evidence.

[5.04 p.m.]

CHARLES, Ms Therese Anne, Chief Executive, Association of Consulting Engineers Australia

STEWART, Mr Donald Grant, Finance Manager of Member Firm (Ove Arup and Partners), Association of Consulting Engineers Australia

ACTING CHAIR—I welcome Ms Charles and Mr Stewart. I invite you to make an opening statement and then we will follow with questions.

Ms Charles—Thank you. The Association of Consulting Engineers Australia represents consulting engineering companies in Australia. We cover most of the consulting engineering companies in Australia—that is, we cover engineers as businesses. We are the association that represents the business interests of engineers.

Our association covers large firms and very small firms, down to one-person operators, and we have members in all states of Australia and in most regions of Australia. Our companies work in Australia, obviously, but internationally in some 40 countries in the world, and the value of the work of our designers is something like \$10 billion at the last estimate, including significant overseas earnings. So in fact the work done by the members of our association contributes to both domestic and export income, and we obviously have an interest in the tax system as it impacts on both of those areas.

To give you a bit of a feel for the kinds of projects our members are involved in—just in case people are not really sure what consulting engineers do—members of our association are involved in, or have recently been involved in, the design of a lot of projects at the Olympic Games sites in Sydney; a big international project of a member firm, or of a number of member firms, recently was the development of Hong Kong airport; the M1 Motorway in Sydney is another recent one; and the Star City Casino is another. They are the big ones, but we also have small firms that get involved in hotel and resort development, down to very small jobs in the suburbs and domestically.

It would be fair to say that we, as an association representing our members, feel that the current tax system is broken and that we need a new system. I think that our interests in relation to tax reform are broad but also come down to internal business interests. If we could address the broad interests first, basically we want a healthy economy which promotes international competitiveness, because those are both issues that impact on the profitability and the productivity of our sector, working as we do significantly in the building and construction and infrastructure sector and also in the international area. The tax system, as it relates to those things, is important to us.

We also want a climate that promotes investment and a climate that promotes employment and savings, because all of those things feed into consumer confidence and the propensity for people to invest, all of which feeds down to the work that the members of our association get involved in.

We want the system to be fair. We do not want a system that addresses the economics and not the social side, and internally in our firms our interest is in a reduction of compliance costs. If I headlined a single issue here, it is the importance of the reduction of compliance costs through the introduction of as simple a tax system as possible.

I would expand on that by saying that we support a system that would look at the elimination of as many taxes as possible, which in turn comes through replacement with a broad based consumption tax with minimal exemptions, and this is what we are here to discuss today, amongst other things.

In summary, we would support comprehensive reform of the tax system. In terms of the implementation of the system, we have a number of interests. The first is the issue of transitional costs. The second thing is business education. It is important for businesses in our area—as in any area, I would propose—that they know what is coming and are made as ready as possible to minimise the impacts on the transitional costs.

Then we have a number of specific issues that have to do with our sector rather than with the general business environment, most of which are covered by my previous comments. They include things like the treatment of progress claims and retention claims under the GST and how we treat fixed price contracts which span the commencement date. Members of our association get involved with those sorts of things every day, and we are anxious that the implementation of those elements of the GST are looked at in sympathy with the way that it actually operates in our area.

We also have a range of business issues which have been looked at through the Ralph committee. The detail of all of the issues that we have an interest in have been put out in greater detail in a submission which we have made to this group. It is not my intention to go through them in depth. There are a number of pages there.

Finally, my comment would be that we think that it is important to consider the package as a whole when we look at what finally comes out of this process at the end. We do have an interest in reduction of compliance costs, which I mentioned previously. I might just close my opening comments and ask for questions.

CHAIR—Thank you, Ms Charles. I apologise for not being in the room at the beginning of your remarks. From what you have said, it is not appropriate that we ask your colleague to supplement you at this point. We will go straight to questions.

Senator GIBSON—Ms Charles, I assume from what you have said that your association has been pushing for tax reform in Australia for quite some lengthy period of time.

Ms Charles—Yes, that is correct.

Senator GIBSON—You would be aware, of course, of the several attempts that have been made by various governments to get tax reform on the agenda and through the parliament. Is your association supportive of the government's ANTS program as detailed before us, which is the legislation we are looking at now?

Ms Charles—In general, we support comprehensive tax reform, which is what we believe that package is about. In terms of the detail, we believe that there is probably a lot of debate to be had, and this process is part of that debate. I think in general we would say that a system which promotes comprehensive tax reform, which that one does, would receive our support, without my necessarily endorsing any specific element of it without more discussion on that element.

Senator GIBSON—Let me just go on from there. In essence, the program is essentially about lowering the cost of doing business in Australia and also lowering the costs of exports out of Australia.

Ms Charles—We would support both of those things.

Senator GIBSON—Fine. You have raised several technical issues here in your submission. You made a short mention of them a few minutes ago—progress claims, retention payments and also details about the contract spending and commencement date. You have rightly made reference to clauses in the bill about, for instance, the contract spending and commencement date. Have you made specific representations directly to the government—not to the Senate committee—about those specific issues?

Ms Charles—We have made representations to the Ralph committee and we have sent copies of our submission to the ATO and appropriate groups involved in this.

Senator GIBSON—I suggest that it would also be appropriate for your organisation to make direct representations to the Treasurer's office.

Ms Charles—Yes, we have sent a copy to the Treasurer.

Senator GIBSON—It is important that you should pursue those matters because they are about the implementation and detail of those issues.

Ms Charles—Yes.

Senator GIBSON—But it is also important that you make the case directly with the government on those issues. I am in no position to judge the ins and outs of those technical details which you have raised. Undoubtedly they are important issues and you should pursue them.

CHAIR—I have a couple of questions. Your submission raises—as has just been referred to and as you addressed in your oral presentation to us—a number of concerns that you have about the package as it is that you want us to take note of. It really follows on from what Senator Gibson was just asking you. We have to make a decision about what we do in the Senate chamber shortly and it is a decision that we vote this way or we vote that way. It would relieve us of a lot of the burden of having to discriminate between what we think is right or wrong if you did take those submissions up to the government. If there were an answer one way or the other from the government as to the changes that you sought before we had to make a decision about it, and if the government were to meet you at any point in terms of your concerns, would you regard that as satisfying those concerns or would your

concerns still be at large? I have to put it in such black and white terms because we will be faced with a stark choice when it comes to the occasion of the debate on each of the clauses on each of the 16 bills. Have you had a chance to troll through all of those bills?

Ms Charles—No. I would not like to say I was familiar with all of them.

CHAIR—It is a huge task and I am not expecting you to necessarily do it, but it would aid our inquiry, if there were any matters in any of those bills that you were particularly concerned about, if you were to notify us of them before we make our report, so we can properly reflect all of your concerns about the legislation we will have to vote on.

One of the things that Senator Gibson put to you was that a government objective in the ANTS package is to lower export costs. I think everyone in Australia can sign onto a measure that might do that so long as it does not disrupt and create significant equity problems elsewhere or some other major unforeseen circumstances. Are you aware that, on modelling provided to the federal Treasury and supplied to us in evidence by the Treasury, they expect that the exchange rate will increase by 3.5 per cent as a consequence of these tax changes?

Ms Charles—Mr Chair, I think the increase in the exchange rate probably means that externally we are considered to have a stronger economy and that, in turn, will have advantages for firms in Australia.

CHAIR—Do many of your members participate in the global economy and seek to sell their services overseas?

Ms Charles—Yes, they do.

CHAIR—One of the concerns they would have is to be price competitive, is it not?

Ms Charles—Yes.

CHAIR—The lower exchange rate at the present time enables them, all things otherwise being equal—professional competence, experience and so forth—to compete on price. If the price goes up their competitiveness is reduced, is it not?

Ms Charles—Yes. I think though that it needs to be seen in context. I think we would be looking at the package as a whole and that we would see significant advantages to costs that would come from other areas of the package, in particular the compliance areas. Having looked at the package across-the-board, we feel that although it is still very unclear what is going to happen in the end, there are advantages in the comprehensive reform process that this package is proposing.

CHAIR—Whether it is reform is a matter of judgment. It is a package of changes, but whether those changes add up to reform is a matter of judgment. The point I am making is, as an association representing consulting engineers, you are happy to wear any deterioration in price competitiveness for your exporters as a result of this package?

Ms Charles—I am not aware of the background that you are commenting on, Senator, so I am not doubting it. I guess what I am saying is that it is a broad package and what we would have to do is look at all of the elements. I guess the big issue for us has been the issue of internal costs that come from a very complex system. Of course we have a concern about the downsides of this but, across the board, we believe it has advantages.

CHAIR—Were you aware of the downside I have just referred to?

Ms Charles—No, I was not.

CHAIR—So your judgment about support was a judgment made without that piece of information?

Ms Charles—Our basic interest is to have a healthier economy and reducing compliance costs. We believe that that will have significant enough impacts.

CHAIR—I understand that, because that is what you have said in answers to earlier questions. Are you not aware of the modelling provided to the Treasury on the exchange rate implications of the tax change and how that will change price competitiveness of your exporters? It is a fact, is it not, that you made the judgment prior to being aware of that information?

Ms Charles—Mr Chair, I am still of the same view, but I am happy to take it away and take it on notice and give you a more considered opinion in the light of that.

CHAIR—You took me at my word, for which I thank you. The particular material was provided to us by the Department of the Treasury and, in the attachment, modelling done by Econtech on the exchange rate implications of the package. All I can say is that this is what they say. It is not what I say or what anyone says or whether separate modelling would come to different conclusions—this is what they say to us.

Senator SHERRY—Ms Charles, in your introductory remarks, you said the current system was broken. ‘Broken’ is a fairly strong term. What do you mean by ‘broken’?

Ms Charles—We think that it is so complicated and so complex and it is creating so many costs in our firms that we consider that we need something that looks like it is a new system rather than marginal changes to the current system, which we think are liable to create even more complexity.

Senator SHERRY—Something that looks like a new system is not necessarily a functioning whole replacing something that is broken. Have you done any analysis in your area of firms and current compliance costs vis-a-vis what the compliance costs will be under the GST?

Ms Charles—We have not done any analysis, but I am aware of analyses that have been done by other groups that indicate that, with the existing system, compliance costs with the range of indirect taxes that we have now, the costs for a small to medium business, are about \$30,000 a year. That is just compliance costs—it is not the costs of the taxation itself.

The evidence suggests that those compliance costs arise because there are so many taxes and they are all taxed at different rates and they all have different rules apply, and it is dealing with that complexity that creates the cost. We therefore believe the simpler system has got to be cheaper. It does not matter if it is a firm in this sector or another sector, but a simpler system has got to achieve that.

Senator SHERRY—Do you believe a GST is simpler?

Ms Charles—A simple GST levied across the board with minimal exemptions would be simpler, yes. We believe that.

Senator SHERRY—I am just interested because we get this sweeping comment all the time—‘It is broken’—but when we ask for hard data, and I am interested in how it affects consulting engineers, witnesses have a problem giving us the figures, the specific analysis and study. You are representing engineers, and that is certainly the area where I would have liked to have seen some specific survey data. You might take that on notice.

You also said in your introduction that a reform of the tax system must lead to improved employment and savings. How does this package in the view of the Association of Consulting Engineers improve savings?

Ms Charles—I will have to take that on notice.

Senator SHERRY—Why make the assertion in your introductory remarks if you cannot show us how it improves savings?

Ms Charles—It is a highly complicated question, so I would like to take it on notice.

Senator SHERRY—I make the point again that you make a sweeping assertion but you cannot sustain the assertion. I gather from conversations I have had with some consulting engineers there is a tendering process for business. Have you done any analysis about what you expect the price effect will be on the tenders that individual firms or individual engineers who are consultants put in when they tender for a particular project?

Ms Charles—I am sorry; could you explain it a little more?

Senator SHERRY—Okay. We have a GST replacing the 10 taxes. Have you done any analysis of what the price effect will be when a firm is putting in tendering for some particular business? Will the price go up?

Ms Charles—No, we have not. I think it would be difficult to do since we are not absolutely certain what the new system is going to look like.

Senator SHERRY—Again I must say I am surprised you have not attempted to do that. It is a pretty critical issue. The reason I ask that is that, in the conversations I have had with some consulting engineers, one of their concerns is that they believe they will not be able to pass the full costs on, that their margins will get squeezed. Do you have any comment to make about that as an issue?

Ms Charles—It is possible, yes.

Senator SHERRY—Why would you think that is possible?

Ms Charles—It could be that margins get squeezed higher up the line and it feeds down the line to consulting engineers. But, again, I guess I put it in context that there will be advantages in other areas.

Senator SHERRY—Such as?

Ms Charles—Reduction of compliance costs.

Senator SHERRY—Let us accept—I don't—for the purpose of argument that compliance costs are reduced. Isn't there a likelihood that, if margins are squeezed, some consulting engineers, firms or individuals are not going to be any better off as a result of this tax change?

Ms Charles—We believe that they will be because the economy will operate at a higher plane, that they will save on compliance costs and that they will be better off.

Senator SHERRY—Again, it is a sweeping assertion. You have not done any research on what the cost impact will be and the ability of consulting engineers to be able to withstand a squeeze on margins if costs go up. I would put it to you—certainly in the conversations I have had with a number of consulting engineers—that this is a concern.

Ms Charles—But I think, Senator, if you ask them about the current compliance problems that they have with the existing system they would probably say they have more concerns in that area.

Senator SHERRY—That may be true. Let us accept, for the purpose of the argument, that your position about compliance costs is correct—even though I do not accept it, but let us assume it is. I am surprised at your continuing arguments being based on assertion rather than hard research. I am surprised because, as I said earlier, the consulting engineers that I have had discussions with are very worried about that impact, that issue of a squeeze on margins, their ability to pass on costs and the overall impact that will have on their businesses, even if the issue of lower compliance costs is accepted. I am just surprised you have not done any particular research on that issue in terms of representing your industry.

Ms Charles—We have not. I still believe that it would be very difficult for us to do that kind of research when we are not absolutely certain what is going to happen. There is a mountain of other research around, and I guess that we are a small association.

Senator GIBSON—Can I follow up some of Senator Sherry's questioning? I bring to your attention, in the ANTS booklet, Treasury estimates of cost reductions for various industries, on page 168, for other construction. The estimate is that the cost reduction will be minus 4.6 per cent for other construction. I might add that, in the line above that, for residential construction, it is minus 4.9 per cent. So the Treasury estimates are that, in the long run, in your industry within Australia, there will be significant reductions in costs.

Ms Charles—Yes, which has been my point all along, Senator. It has to be seen in context of the advantages.

CHAIR—That assumes, of course, that those figures are right. I think you will not find anything in the ANTS package which says what the export values of this package are, but that is another matter. Thank you, Ms Charles and Mr Stewart, for appearing before us this afternoon and aiding our inquiry into the tax package.

Ms Charles—Thank you, Senator.

CHAIR—The hearing is now adjourned until nine o'clock tomorrow morning in this place.

Committee adjourned at 5.34 p.m.

