



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

SELECT COMMITTEE ON A NEW TAX SYSTEM

Reference: A new tax system

WEDNESDAY, 17 MARCH 1999

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SENATE
SELECT COMMITTEE ON A NEW TAX SYSTEM

Wednesday, 17 March 1999

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

Substitute members: Senator Chapman for Senator Ferguson

Participating members: Senators Brown, Colston, Harradine and Margetts

Senators in attendance: Senators Cook, Conroy, Chapman, Gibson, Harradine, Margetts, Murray, 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

ANDERSON, Mr Jason Leigh, Senior Economist, Australian Stock Exchange . . .	1979
BEAVON, Mr Norman Charles, Chief Executive Officer, Australian Duty Free Association	2008
BURN, Dr Peter, Secretary, Business Coalition for Tax Reform	1921
CARMODY, Mr Geoffrey Francis, Economic Consultant, Australian Food and Grocery Council	1938
CUTRESS, Mrs Brenda, Executive Director, New Zealand Grocery Marketers Association	1938
FAHRER, Dr Jerome Gregory, Principal, Allen Consulting Group	1969
HERSKOPE, Mr Michael Arthur, Senior Manager, Corporate Affairs, Philip Morris	1969
HOLDSWORTH, Mr Simon Nelson, President, New Zealand Employers Federation	1894
HOLT, Mr Philip Matthew, Managing Director, Australian Business Ltd	1992
HOOKE, Mr Mitchell Harry, Executive Director and Chief Executive Officer, Australian Food and Grocery Council	1938
LUCCHESE, Mr Adrian, Legal and Corporate Affairs Director, Rothmans of Pall Mall (Australia) Ltd	1969

MARTIN, Mr John Edwin Charles, Executive Director, Australian Chamber of Commerce and Industry	1894
ORTON, Mr Paul, Manager, Policy, Australian Business Ltd	1992
PATERSON, Mr Mark Ian, Chief Executive, Australian Chamber of Commerce and Industry	1894
ROCHE, Mr Michael Anthony, National Manager, Strategic Planning and Review, Australian Stock Exchange	1979
ROGERS, Mr Anthony John, Vice President, Finance, DFS Australia Pty Ltd ...	2008
RYAN, Mr Fergus Denis, Chair, Business Coalition for Tax Reform	1921
RYAN, Mr Warwick Michael, Ernst & Young, Indirect Tax Adviser to the Australian Duty Free Association	2008
SCHUBERT, Mr Jeffrey Brian, Economic Adviser, Australian Business Ltd	1992
SILVER, Mr Stuart, Manager, Public Affairs, W.D. & H.O. Wills (Australia) Pty Ltd	1969
STEWART, Mr Alan Grant, Member and Past President, New Zealand Grocery Marketers Association	1938
STRANG, Mr Christian, deputising for President, Australian Duty Free Association	2008
WALSH, Mr Damian John, Partner, National Indirect Taxes Practice Leader, Arthur Andersen	1955

Committee met at 9.04 a.m.

CHAIR—My colleagues who are not here, I understand, are snarled in traffic and will be here shortly. That is no reason why we should not make a start. I have the ritual opening message to read, and please bear with me when I do so.

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 1998. This hearing relates to the second stage of the inquiry. In this stage, the committee is examining the broad economic effects of the government's taxation legislation proposals. It will have 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.

The committee will report on the second stage of its inquiry by 19 April 1999. 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 almost 1,400.

This is the third public hearing to be held by the committee in Melbourne 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 made by those witnesses who are giving evidence today.

My question to the committee is: is it the wish of the committee that submissions 104A, 340A, 559, 645, 747, 864 and 870 be made public? I note assent and I therefore 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 attach to the parliament, or its members and others, necessary for the discharge of the functions of the 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.]

HOLDSWORTH, Mr Simon Nelson, President, New Zealand Employers Federation

MARTIN, Mr John Edwin Charles, Executive Director, Australian Chamber of Commerce and Industry

PATERSON, Mr Mark Ian, Chief Executive, Australian Chamber of Commerce and Industry

CHAIR—I welcome you to the proceedings. The normal procedure, as I am sure you have been briefed, is to address us on your written submission and then take questions from the committee.

Mr Paterson—Mr Holdsworth is the managing director of Thos Holdsworth and Sons in Rosebank, Auckland in New Zealand. He wrote a paper which we attached as an appendix to the submission that we made to the committee. He is also the president of the New Zealand Employers Federation and was operating a business at the time the GST was introduced in New Zealand and has been operating a business under that structure since that time. He made a number of observations in the paper that we presented to the committee and is in a position to respond to questions of the committee on the real life experience of introducing a GST in the New Zealand commercial environment.

It was not my intention to take the committee through all of the detail of our submission, but to highlight some of the major themes that we have drawn out in our submission. Firstly, I will make some introductory comments to ensure that all members of the committee are aware of ACCI and its constituent base. We are the peak business representative group in Australia. Through our constituents, we represent in excess of 350,00 businesses, every industry sector, every industry size, every state and territory and we cover about 85 per cent of non-farm employment throughout the Australian economy. It is with that background that we present our submission to the committee.

Members of the committee will also be aware that, in 1996 in pursuit of achieving fundamental tax reform, we took the step of introducing discussions on the need for tax reform widely within the community, not just within the business community. We engaged with the Australian Council of Social Service and hosted a tax reform summit in October 1996. Our submissions addressed the outcomes of that summit and I will come to those in some detail a little later.

We also established at that time what we described as the tax reform forum which was bringing together a range of business, community and welfare sector representatives and a number of specialist professionals and academics to focus on key areas of the existing tax system to examine the need for change across the full spectrum of taxation—taxation of income, taxation of consumption, taxation of business, taxation of assets and the federal-state financial relations—and examined a broad range of potential approaches to fundamental tax reform.

We were also instrumental, together with the Business Council of Australia, in forming what is now known as the Business Coalition for Tax Reform. The business coalition has appeared before the Senate and is appearing in its own right again, following us today. I do not propose to go into too much detail in relation to the business coalition. You are aware of its background. We are supportive of the submission that was made by the business coalition for tax reform and have been very active participants in its processes since before its formation. We continue to be active participants in the leadership of that group today.

The BCTR had a focus, as the committee would be aware, on improving international competitiveness of the Australian taxation system; improving fairness in the system; creating a climate leading to investment, job creation and savings; the elimination and/or reduction in a range of existing indirect taxes and the replacement of those indirect taxes with a single rate broad based goods and services tax; addressing the important issue of federal-state financial relations; pursuing a reduction in rates of income tax and pursuing a simplification and reduction of business taxes. I will not touch on all of those elements today but it is clear that the background to our submission and of the business coalition's submission needs to be seen in that context.

I would like to place on record a note of concern in relation to these proceedings and the involvement of some groups within these proceedings. One of our key members, the Queensland Chamber of Commerce and Industry, with a very active interest in the proceedings of this committee was denied an opportunity of appearing before the committee and I place on record our concern at that action. QCCI sought to actively participate in the committee's inquiry and was prevented from doing so. As an important or peak body in the state of Queensland, and one which has a very strong interest in achieving fundamental tax reform, it did not have an opportunity to present its material.

CHAIR—Mr Paterson, can I just interrupt you and I am sorry to do so. You have flummoxed me and that is usually fairly hard to do. I was unaware that we had denied the Queensland branch of your organisation an opportunity to appear. We had a one-day hearing in Brisbane and we will certainly check how that happened, if it did, but your word is of course accepted by me. If it did and we have acted that way to not enable them to come forward, that is indeed something that I would regret and if there is some way in which that could be corrected I would be very pleased to look at it. I do not think it is something that we have consciously done, but we will investigate it. I am pleased you have raised it.

Mr Paterson—Thank you, Mr Chairman. It is important to raise it because as part of our submission we made reference to two very detailed surveys that had been undertaken in relation to compliance costs of the existing tax regime. Those surveys were undertaken independently. One was undertaken by the Queensland Chamber of Commerce and Industry looking at the compliance burden of the existing tax regime; the other was a survey undertaken by the Chamber of Commerce and Industry in Western Australia, looking at the compliance with the existing tax regime in that state. As I think members of the committee acknowledge, these are two quite different economies in two essentially different states with different levels and different approaches to the tax structure within those states. Interestingly, as is highlighted in our submission, the results of those two surveys highlighted compliance with the existing indirect tax regime at something in excess of \$23,000 per annum. Different

methodologies were adopted in those two surveys but they both independently came up with very similar results in terms of the compliance burden of the existing regime.

I think it is important that members of the committee keep that in the back of their minds when examining any assertions in relation to compliance costs of the alternative regime because it is the alternative regime that needs to be compared with the existing regime in terms of the compliance cost issue. I would like to come back to that if I may, Mr Chairman.

As I have highlighted, we have put before the committee the real life experience in New Zealand. I think there have been a lot of myths that have grown up about New Zealand and the introduction of a broad based consumption tax in that economy. Mr Holdsworth is here and in a position to respond to questions of the committee and hopefully address some of the myths that have been presented by others to this committee.

I think it is also important to highlight that, notwithstanding many differences between those who have appeared before this committee and appeared elsewhere and made public observations, there is much greater agreement in relation to the proposed new tax package than is immediately obvious. I think some of the observations that I make later will reinforce that.

I commented earlier on our approach to pursuing fundamental tax reform in 1996 and joining with ACOSS and other community representatives to increase the quality of the debate and the communication within the community. We undertook a pre-election survey prior to the 1996 election and asked our constituency what were the most important areas that that constituency sought for change from the next government—that is, the government elected in March 1996. On a list of 71 issues, the top three were tax reform issues. We again surveyed our members in a pre-election survey in the lead-up to the 1998 election, asking them again to identify, from a very broad list of issues, what were the most important areas of reform that were required by the business community. Once again, the top three issues identified by the business community were tax related issues. Five of the top 10 identified in the pre-election survey leading up to 1998 were tax related issues.

It is clear from all of the evidence that we have before us that the business community seeks reform of the way we tax assets, the way we tax income, the way we tax consumption and the way we tax businesses and federal-state financial relations—seen in the context of the earlier criteria that I identified coming out of the Business Coalition for Tax Reform of maintaining international competitiveness, of improving fairness and of having a climate that leads to investment, job creation and savings.

I mentioned earlier the 1996 tax summit. We entered that summit in the context of seeking to have an open debate and discussion about tax reform, not in an expectation that we would reach agreement on all elements of tax reform between the business and welfare communities. But I think it is fair to say that there was much greater agreement achieved at that summit than many might have expected. The outcomes of the summit were agreement on the core principles for pursuing fundamental reform. Those core principles identified at that time, and included within our submission, were equity, economic efficiency, the adequacy of the tax base, simplicity and comprehensibility, transparency, a minimum of

compliance and collection costs, and a structure that avoided tax avoidance that goes on very broadly in relation to the existing system.

I would make particular reference to two of those outcomes, the first being that of equity and the second being that of adequacy. There was an acceptance by the business community that we had to have a tax system that was equitable. This was not about the business community saying, 'Look after us and have somebody else pay for it.' There was a genuine recognition that the tax system that replaced the existing system had to be equitable. There was recognition that the existing system is not equitable. There was also recognition that whatever the tax collection base adopted was it had to be adequate to provide the goods and services that people demand of a civilised society. I think that identified a step forward in terms of the process of debate about fundamental reform.

Members of this committee do not need to be reminded, but I will do so for the purposes of this presentation, that we have had a pretty sorry history in relation to pursuing fundamental tax reform in Australia. In 1985 there was an attempt to pursue comprehensive reform, which was rejected. In fact, the business community, in part, rejected the elements of fundamental tax reform that were proposed in 1985.

That did not mean that we did not get it. Capital gains tax and the fringe benefits tax were all introduced within 12 months of the 1985 tax summit. The tax laws doubled in volume in a period of 10 years following that summit. So saying 'No' to it did not mean we did not get it. It just meant that no-one had any control over the general structure and the thrust of reforms.

In 1993 a package of comprehensive proposals was put forward and was again rejected. That did not mean that we did not get changes in relation to our tax laws and structure. The l-a-w tax cuts that were offered at the time were subsequently forgone. The wholesale sales tax rates were increased across the board. So standing back and looking at the history of tax reform in this country does not say that by rejecting particular approaches we do not get it. It just means that we have a haphazard approach that does not deal with reform across the board.

In pursuing tax reform, we have tried to keep what has been described as Einstein's maxim in the back of our mind, that is, make everything as simple as possible but not a bit more. We recognise that there is a trade-off between simplicity and some of the other criteria. But, in our view, to achieve a world class tax system, we should make everything as simple as possible but not a bit more.

It appears to us that the major area of difference on the issues associated with the broad based consumption tax that is being contemplated by this committee is the area of coverage. The most important area of coverage that is being examined by the committee is the application of the GST to food. There are some other issues which we are happy to respond to in questions, but I would like to keep focused on the area of most substantive difference between those who have appeared before the committee—that is, should this tax apply to food, however described?

In our submission, we would urge the committee to recommend adoption of the broadest base possible. That is evident in our submission to the committee. It is evident in all representations that we have made in terms of the introduction of a broad based consumption tax. If we are going to look at overseas experience, our view is that we should look to the best experience overseas, not the worst. The best experience overseas is to include food within the goods and services tax base and deal with the impacts of that by other means.

We understand the arguments that are put forward by those who would have food excluded from the tax base, but we believe it invites greater complexity, greater compliance costs and a whole range of boundary disputes that will lead to complexity and cost for all associated with the tax system. Whatever definition is adopted in relation to food, it will lead to arbitrary and anomalous distinctions, and I am sure the committee has heard of the many bizarre approaches that have been taken overseas where they have had different approaches in relation to the tax treatment of food. I do not propose to go through all of those.

Members of the committee would be aware that, in looking at the application of the wholesale sales tax in Australia to a particular food product, it took over three years and an approach to the High Court to determine whether frozen yoghurt was ice-cream for the purposes of the wholesale sales tax. We ought not seek to replace the existing tax system with a tax system that is equally complex, equally arbitrary and equally uncertain.

There are also issues associated with matters peripheral to the treatment of food but very important: the issue of packaging; the issue of when does food become food—when is food food and when is it not food? Many of the jurisdictions overseas that have tried to grapple with this issue have had to make incredibly arbitrary distinctions between hot food and cold food with the ambient temperature of the food determining the application of the tax; whether the product is eaten on the premises or taken outside the premises, and that determines the application of the tax; the nature of the outlet that sells it determines the application of the tax; the quantity of the products sold—the doughnuts sold in Canada—determines the application of the tax.

We want to urge the committee to avoid the adoption of a similar system in Australia. We remind the committee that for each dollar of benefit that would go to the poorest 20 per cent of households, the rest of the community would get \$7.60 in benefit from exempting food from the application of the GST. The top 20 per cent receive double the benefit of the bottom 20 per cent from exempting food. So we would urge the committee in its examination of the proposed tax package that it support the inclusion of food within that tax base.

There are 412,000 companies in Australia in the food industry, and in excess of 135,000 companies sell food and non-food products. To treat food differently in that environment is to create a compliance nightmare for those businesses. I put that forward notwithstanding some of the observations that may have been made before the committee yesterday. I did not have the benefit of attending the hearing yesterday, but I have read some substantially conflicting reports of what was said yesterday. If you will bear with me—

CHAIR—If you have read it in the media, you probably have read substantially conflicting reports.

Mr Paterson—I have before me a release that I received yesterday afternoon from Senator Murray which says that:

The Senate Tax Inquiry has today been told that there is no international evidence that taking food out of the GST adds to compliance costs.

That is the opening sentence of Senator Murray's release yesterday. That relies, I think, on evidence provided by Mr Michael Walpole to the committee.

I then have an AAP wire service story which opens—and this refers to the evidence given by Mr Walpole:

Excluding food from a GST would increase compliance costs and stifle innovation, particularly on small business, a tax expert said today.

They are diametrically opposed positions, Mr Chairman. I would seek the opportunity to at least take on notice the issues that were raised by Mr Walpole in his evidence, to examine the evidence that has been put before the committee and come back to that issue if there are matters that we can adequately address.

I believe that there were some assertions made in relation to the compliance impact in New Zealand, and we would like to examine the assertions that were made. Certainly our experience and that of Mr Holdsworth is not supportive of major compliance burdens introduced in New Zealand, and we have got access to some material that has been published in New Zealand that might seek to address that issue.

Our view is that there are major compliance costs associated with exempting food. It depends on where you draw the line on what is described as food and what is not described as food. I have heard no-one who has argued for special treatment in relation to food adequately define it; nor have they considered the implications of when food and packaging for food become treated as food and food packaging in the production chain and, therefore, how you would deal with compliance, not just at the sale of the food product at the final retail sale, but when does food become food? When does the tin that goes into packaging for a tin of tomatoes become treated as packaging for food and when is it treated otherwise? We believe that there are major compliance implications of removing food from the application of the GST which need to be addressed by the committee.

In any definition of food there will be arbitrary distinctions. There are arbitrary distinctions in every regime around the world that has sought to specially treat food. There are arbitrary distinctions within the existing wholesale sales tax system of which the committee is aware. The special treatment in relation to food or anything else will create boundary disputes that will have an impact on prices. It will have an impact on the prices surveillance responsibility that may be introduced. It will have an impact on the cash flow for businesses that have special treatment in relation to part of the goods that they sell. It will have increased compliance costs. And it is not something that can be easily done by just shaving the tax cuts to compensate for the amount that would otherwise be lost from GST revenues, because we look at the ANTS package as a package as a whole which tries to address the removal of a whole range of state and territory indirect taxes, hence a growth tax

in the form of all of the revenues from a goods and services tax to the states and territories enabling the removal of those state taxes.

Hence, in our view, the proper responsibility for the funding of local government to states and territories will reduce the administration costs on business of introducing the new tax regime and will also reduce the costs associated with the Australian Taxation Office, the ACCC and the courts, if that distinction is not drawn. The revenue implications also need to be taken into account.

Mr Chairman, they are the opening observations that I wanted to make. I think that they summarise fairly the position that we have put to the committee in our submission, and we are happy to respond to questions.

CHAIR—Thank you, Mr Paterson. Is it your intention to ask Mr Martin and Mr Holdsworth at this point to supplement your remarks, or shall we go straight to questions?

Mr Paterson—It was my intention to go straight to questions, Mr Chairman.

CHAIR—You raise the question of the QCCI. We are doing this on the trot. I raised a question with the secretariat and I am advised that we have not received a submission from the QCCI and nor have we been approached for a hearing. It sounds to me that this is a matter we should deal with off-stage. I want to register for the record that, if there has been some administrative problem, we ought to resolve it, because it is not our intention as a committee, and certainly not mine as chairman, to deny such central organisations as yours and the QCCI in Queensland from exercising a view before this committee.

Mr Paterson—I am happy to deal with that out of session, Mr Chairman. I was directly advised that the response that they received was, ‘We keep hearing the same message from business; we do not need to hear it again,’ and they were not provided the opportunity of appearing. But we will deal with it separately, Mr Chairman.

CHAIR—Just on a small matter which betrays my penchant for being a pedant, you did say that the l-a-w tax cuts were forgone. If we go back and examine it, the first step of the l-a-w tax cuts was brought forward, and the second step of those was put back but then converted to a superannuation guarantee levy commitment. Whether that is the same thing as what you are saying I do not know, but there is a tendency in political-speak to characterise those as being forgone. I just wanted to set the record straight, from my point of view, on that point.

There are 16 bills before us, 16 bills that constitute the government’s package of bills for this legislation. You have addressed us, I think usefully, on overview and concept. We have to report on those bills as well, though, and do so in fairly quick time. Do you have any remarks about the detail of those bills or do we assume your broad endorsement of the government’s position involves an endorsement as well of each of the clauses, subclauses and placitums of those bills?

Mr Paterson—We certainly did not appear before the committee today with an expectation that we would take the committee through every line item of those 16 bills, nor

were we provided with a time frame to appear before the committee that would enable us to do that. We have sought to approach this issue on the basis of general principle. We examined the alternative packages that were presented in the last election and concluded that the package in the ANTS package most closely addressed the criteria that we as an organisation had identified in terms of seeking change and that most accurately reflected the principles that came out of the tax summit in 1996 and the Business Coalition for Tax Reform's principles of achieving change.

It is clear to members of this committee that not every element of change that we would have liked to have seen in the package was introduced, and in some cases that was as a result of matters beyond our control. We are formally on the record as having indicated that we would have preferred that payroll tax was one of the taxes that was reduced in the trade-off between state and federal taxes. That was not something that was put forward by the states in terms of their priorities for removing taxes. The removal of payroll tax is one of the areas that we will continue to pursue.

So I do not say that we sign off on every line item of every piece of legislation. But we do support the introduction of the comprehensive package that ties together; we do not believe it is appropriate to try and cut and paste, in an arbitrary way, individual elements of the package without thinking about the implications for the rest of the package as a whole.

CHAIR—In many respects the task of this inquiry is an impossible job, and I guess that is why it has been given to the Senate. You are aware that the procedure in parliament is that second reading speeches are directed to the concept and overview; the committee stages are directed to each line. Our report, to be thorough, would need to address the first part of it, and, to the extent that there is interest from key organisations in the community, the second part of it as well.

My question is not a loaded question. It is really a question to ascertain whether or not the ACCI has done an analysis of those 16 bills and, granted your submission, whether you accept the concept and agree that the concept's application in those 16 bills has been carried through so that if we were to vote on it, if your eloquence were to persuade us to recommend and vote on it as a job lot, your members would not complain about the regime that would then be adopted in terms of its compliance ability or its administration. My question is: have you done that next part of the work; or do you intend to do that next part of the work and, if you do, will you tell us what your outcomes are?

Mr Paterson—We have not at this stage been through every line item of the bills that are presently before the Senate to undertake an examination of the nature you propose. Given the nature of our organisation and the resources available to it, we have examined the issue in terms of broad principle. Do we believe that every business in Australia will accept every measure without complaint, criticism or concern? I would be very surprised if that were the case.

CHAIR—I am not asking you that, Mr Paterson. I am asking: as an organisation that represents Australian business—and as the pre-eminent organisation, as you rightly pointed out to begin with—are you satisfied that these bills do represent a direct translation into legislation of a concept that you support?

Mr Paterson—Yes.

CHAIR—You are satisfied?

Mr Paterson—Yes.

CHAIR—Despite the fact that you have not done an analysis of the bills?

Mr Paterson—We have done an analysis of the bills. I said that as an organisation we have not done a line by line analysis of every element and that with the resources available to us we have not been able to do that. But we are satisfied that the direction and the thrust of those bills reflect the policy construct that was identified in the ANTS package and endorsed by our constituency.

CHAIR—If you do not have the resources to do the examination, I am not sure who in Australia does, Mr Paterson. I note for the record that the House of Representatives had to vote on this before Christmas as if all of these issues were indeed easy to come to grips with. But a lot of evidence before us is that many prestigious organisations like your own are still dealing with whatever, to use their term, ‘devil’ is in the detail of these bills.

Let me pass on. I am very pleased to acknowledge the presence here of Mr Simon Holdsworth from New Zealand. Please, Mr Holdsworth, do not take these remarks as anything other than an Australian expression, as I warmly acknowledge and welcome your presence, but why just New Zealand? Why are you not concerned to bring evidence before this committee from, say, Canada or indeed, in contemporary experience, Japan?

Mr Paterson—Because we urge this committee to adopt what we regard as world’s best practice in terms of the application of a broad based consumption tax, and that is New Zealand. We would not assert or urge this committee to adopt the Canadian model, which overloaded a goods and services tax onto an existing sales tax regime and did not seek to address the complexity and compliance burden introduced. There is real life, long-term experience of businesses in an economy not dissimilar to our own, not far away, who have applied the tax in a way that we would be urging this committee to recommend the application of the tax, and we believed it was appropriate therefore to look to that experience.

CHAIR—From that answer, do I deduce that you regard the New Zealand tax structure as best practice?

Mr Paterson—We regard the application of the broad based consumption tax within New Zealand as best practice, yes.

CHAIR—And that we should look at the practical effects of that?

Mr Paterson—Yes.

CHAIR—I am sure we will. You said—and I think I took it down correctly—that your tax summit was about opening debate on reform, not necessarily seeking agreement, and how

committed you are as an organisation. I acknowledge that this is true, as you have consistently been in the field arguing for reform—although reform is a matter of judgment; it is not a matter of fact, and I often wonder whether one person's reform is another person's inequitable structure or the like. But, leaving that semantic argument aside, you also said that you are about opening a debate in Australia on tax reform in a constructive way with ACOSS. Is that correct?

Mr Paterson—Correct.

CHAIR—Why did you not invite the ACTU, representing a substantial number of Australian workers—I do not know what their membership is these days—to that process and have a truly embracing debate?

Mr Paterson—We did. We approached both the President and the Secretary of the ACTU—I and my then president did that personally—and we sought their active involvement in that summit. They rejected the approach. They indicated to us at that time that taxation was not an issue that they were concerned about and they declined our invitation to participate. And we did that well before the summit was held.

CHAIR—Was that invitation just for the summit or was it for the working parties that had been established with ACOSS prior to the summit?

Mr Paterson—There were no working parties established with ACOSS prior to the summit. We invited them to participate in it. We invited them to discuss their involvement and the nature of their involvement in the summit, and we invited individual representatives both of the ACTU and of individual state labour councils to attend the summit. All of those invitations were declined.

CHAIR—Okay. Thanks very much. You are a member of the Business Coalition for Tax Reform, as you have said. Are you also a party to the organisation Australians for a Fairer Tax System?

Mr Paterson—I personally was.

CHAIR—But you are here representing an organisation?

Mr Paterson—That is correct.

CHAIR—Your organisation was?

Mr Paterson—No. I personally was involved with Australians for Fairer Tax.

CHAIR—This is the organisation that conducted a media campaign prior to the last election calling for what I would term a conservative version of tax reform, is it not?

Mr Paterson—Yes, it is an organisation that was involved in an advertising campaign in support of tax reform.

CHAIR—And this was at arm's length from the Business Coalition for Tax Reform?

Mr Paterson—It was.

CHAIR—But nonetheless involved the key players from the Business Coalition for Tax Reform?

Mr Paterson—It did.

CHAIR—Why didn't it call itself what it truly was, Mr Paterson: the Business Coalition for Tax Reform, telling Australians what the business view of tax reform would be, rather than characterise itself as Australians for a Fairer Tax System?

Mr Paterson—Because it sought involvement from a broad cross-section of people to support the concept and the campaign to address fundamental tax reform. It did not seek to limit its constituency or seek to limit its support only to Business Coalition members or to business alone; it sought to invite the opportunity for anybody to contribute to its activities.

CHAIR—But looking down the list of who participated, it is an overwhelmingly business front organisation, isn't it?

Mr Paterson—I would never describe it as a business front organisation. We approached that campaign in a genuine and open way; we hid nothing in terms of the activities that we were undertaking. I believe that activity was entirely consistent with the broad thrust of activities that we have undertaken over the last three years in terms of openly publicly campaigning for tax reform.

CHAIR—Where did the \$4½ million to fund the campaign come from?

Mr Paterson—Contributions, by—

CHAIR—From whom?

Mr Paterson—From individuals. I cannot answer where the money came from. ACCI made a contribution to that campaign. Individual constituent organisations of mine made contributions to that campaign. Other business groups and individual businesses and individuals made contributions to that campaign. But I do not have first-hand knowledge of where all of the contributions came from.

CHAIR—And no electoral return on donations to that campaign has been filed, of course, it not being an electoral organisation?

Mr Paterson—Correct.

CHAIR—So we do not have transparency or full disclosure in terms of funding for that campaign?

Mr Paterson—As I understand it, that organisation was set up in accordance with the prevailing legal structure. Advice was taken on its structure. There is no political campaign issue associated with it, to the best of my knowledge.

CHAIR—Well then there is no objection to that organisation making public its donors, is there?

Mr Paterson—I cannot comment on behalf of the organisation. I am not authorised to do so.

CHAIR—But, as a member of it, do you have an opinion?

Mr Paterson—I believe that the structure that was put in place was an appropriate structure, that it met all legal obligations, and all disclosures that it is required to make have been made.

CHAIR—At law?

Mr Paterson—Yes.

CHAIR—But don't you think there is a question of transparency here in public debate?

Mr Paterson—I think everything that we have pursued in this has been transparent and open, and I would continue to put that view.

CHAIR—We may disagree on that.

Mr Paterson—We may do.

CHAIR—I have no further questions at this stage.

Senator GIBSON—First of all, Mr Paterson, congratulations to your organisation for starting the latest round in the last several years in this debate on tax reform. I think you really do need patting on the back for the initiative your organisation took in getting the tax forum going in 1996. I think we are able to look at the bills today as a consequence of that initiative.

Yesterday, we had conflicting evidence about the compliance cost for business for the GST. First of all we had Mr Walpole, a lecturer from ATAX at the University of New South Wales. He was quoting references from the literature and included in the references was one from New Zealand—a 1992 paper which claimed that the total compliance cost in New Zealand was 7.2 or 7.3 per cent of revenue collected, which seemed a strange number to me. We also had Mr Ray Regan from the NTAA make allegations that, for every business, the cost of complying with the GST for the business alone, not total cost, would be about \$7,000 on average and would require 228 hours of work to comply, and that the cost of computer systems would be very large, also for the training for implementing it, and just going on and on and on.

On the other hand, we also had the Institute of Chartered Accountants give evidence yesterday, and part of their evidence was that the compliance cost would be minimal and negligible. In fact, there was a quote from one of the group from the institute that computer programs were currently available in New Zealand, and have been working for quite some years and were currently available as an add-on to existing accounting packages, for about \$150 or thereabouts and that the cost of modifying programs and getting networking was basically negligible.

I am pleased you have got Mr Holdsworth from New Zealand here. We note his paper setting out what he believes are the facts that apply to the New Zealand system, which is basically what the Australian system is modelled on, apart from a few exclusions we have in health and education. Could you elaborate on compliance costs for us?

Mr Paterson—It was for those reasons that we asked Mr Holdsworth to be here. His paper, which is attached to our submission, addresses some of those assertions because some of the assertions in relation to compliance costs have been around for some time. The assertion of \$7,000 and the assertion of 228 hours were things that had been around for some time. Mr Holdsworth raised both of those issues in his paper and responded to them in his paper. I think it is best that I ask him to respond, in his own words, on both of those issues and then to pick up the issue in relation to available packages as well.

Mr Holdsworth—If I can just go back to 1985, when our system came in, the company I was running was on manual accounting at the time—we had no computer assistance—but we were operating under a wholesale sales tax regime. For us, a GST system in the way it came about was a simplified system because of the simplicity and the fact that the tax applied to everything: we no longer had to distinguish between products with differing rates of wholesale sales tax. The operation in fact probably halved the compliance work that we did. For any other company that perhaps was not subject to wholesale sales tax there would be some additional compliance costs.

I have never heard the 7.2 per cent figure quoted in the past. That sounds extraordinarily high to me. I note that a paper from Alan Bollard—who is with our Treasury—which was presented in 1992 to a conference over here, makes reference to compliance costs but at that stage, seven years after the introduction of the tax, it was not considered an issue in New Zealand. I would support that.

In terms of compliance in sheer time and the reference to the number of hours, I run two companies. It takes me half an hour every two months for each company to complete the tax requirement. I do not consider that that is an imposition. We are now, of course, on computerised systems in any event, but there is no additional compliance cost there.

As far as the tax packages are concerned, I can confirm that you can buy a package which will comply with all the requirements of our system in our market for under \$200. It not only meets all the requirements, but actually will print out the return. I think that answers the points you raised.

Senator GIBSON—Mr Paterson, would you expect that the software suppliers would have comparable products on the Australian market and able to do a similar job for Australian business?

Mr Holdsworth—They are here now.

Mr Paterson—Our expectation would be that that would be the case. In many cases, depending on the structure that the legislation finally ends up in, the packages on the market at the present time could probably adequately deal with it. There may need to be some minor modifications.

It is important that it is kept in mind that people are going to need to be able to comply with whatever tax regime is going to be place and, therefore, fair warning prior to entering the tax year will need to be given to those businesses to ensure that they have got adequate mechanisms in place.

As Mr Holdsworth has indicated, you can introduce it in a manual environment in New Zealand, such as at the time it was introduced, and add another column to the bookkeeping. It is not a dramatic impost, as long as the tax is kept reasonably simple.

Senator GIBSON—With regard to small businesses that are not computerised or about to go computerised, is it not true in Australia today that you can buy a very adequate accounting package such as MYOB for about \$400 or \$450?

Mr Paterson—It is certainly the case from our experience.

Senator GIBSON—One would expect those packages to be modified following the passage of the legislation and for very little additional cost?

Mr Paterson—There is no doubt that computer software is being developed and enhanced all the time and will be expected to meet whatever changes are made. If none of this package were being contemplated, but alternative changes were being introduced in a budgetary context, there would be implications for software treatment that would be taken up by the developers of those software packages and made available in the normal commercial course of events. We would expect people to respond quickly and to be able to provide cost effective solutions to whatever the challenges are.

Senator GIBSON—I will move onto food and consideration of possible exclusions. You said earlier that you believe there are about 135,000 businesses in Australia that are dealing with both food and non-food products. They are concerned about their compliance cost if food was excluded. I noticed in the media this morning that Senator Murray is quoted as favouring a wide definition of food. You did say earlier that you believed food should be left in, but if food were excluded, what would your recommendation be?

Mr Paterson—There are two issues. Firstly, we have strongly advocated the broadest base possible. In fact, the package that is proposed has zero rated some goods and services that we would have advocated should be in the net, as they were in New Zealand. We would be strongly urging retention of food within the net and therefore saying, ‘Do we have a view

on a narrow or broad definition of excluding something that we very strongly believe ought to be in there?’

However you describe it, whether you take a narrow definition or a broad definition, the broader the definition, the greater the financial impact on the package. But wherever you draw the line, there will be boundary issues and you will have to treat either the nature of the business that is selling the product or the nature of the product. Is water food? Is Coke food? Is bottled water food? If it is the take-away restaurant distinction, is the food that is eaten inside food, or is the food eaten outside food? In Canada if you buy one doughnut it is taxed; if you buy six doughnuts they are not taxed, because they are regarded as food for home consumption. Those arbitrary distinctions will create a compliance nightmare.

Our very strong view is that you do not exclude food from the net. The broader the definition, the greater the financial burden on the tax package; the broader the definition, the fewer the compliance costs. Notwithstanding that, there will be boundary issues for all of those small businesses and larger businesses that sell grocery products. Part of what is sold within a supermarket, a corner store, a Seven Eleven or a Food Plus is food product and part of it is not food product.

How do you treat the power, the light, the wages, the rates and taxes and all of the other costs associated with a business when part of its product is treated differently to the other part of the product that is being sold?

Senator O’CHEE—So it does not matter whether you take a wide definition or a narrow definition, you are roughly going to have the same number of businesses affected to the same degree.

Mr Paterson—We believe so. Not to the same degree, because the narrow definition of food will create many more boundary disputes than the wide definition. In the narrow definition of food, do you treat takeaway food differently from restaurant food? What is a restaurant? What is a takeaway store? Do you treat the nature of the outlet selling the product? Do you treat a pizza outlet differently from a supermarket that is selling a pizza that you take home to heat up?

You will have greater compliance costs with a narrow definition than a broad definition, but you cannot assert that having a very broad definition and excluding all food will not have compliance costs, because it will. There is a whole range of administration costs that would then be borne by government in terms of administering the system when you make those arbitrary distinctions.

Senator O’CHEE—And if you define food very broadly to include restaurants and so on, then gluttony becomes a major form of tax avoidance, doesn’t it?

Senator MURRAY—So far I have been quoted in the media as supporting a narrow definition of food and now a wide definition of food. I think we will find out where the Democrats are at the end of this process, not right now. I will lead in with regard to some of your opening remarks, Mr Paterson. It would be best if you picked up a copy of Mr Walpole’s submission, if you do not have it, and refer to the *Hansard* record and you can

come to your own judgment as to where the confusion lies in terms of the evidence that was given to us. I would like to lead off, if I could, with Mr Holdsworth. Welcome to Australia. What part of New Zealand are you from?

Mr Holdsworth—From Auckland.

Senator MURRAY—Were you a member or leader of the New Zealand Employers Federation in 1991?

Mr Holdsworth—I was a member of the board in 1991, but I have been president for the last three years.

Senator MURRAY—You will recall at the time that the GST was introduced in New Zealand a compensation package was offered to the community.

Mr Holdsworth—Yes.

Senator MURRAY—And it was then withdrawn in 1991. Did the Employers Federation oppose the cuts to that compensation package?

Mr Holdsworth—What you are dealing with here is the whole range of the tax system. While it was withdrawn in one form, it was replaced in another form. In fact, the family support measures that were put in place in 1985 were changed in 1991. The actual total level of family support is, in fact, greater now than it was at that time. So it has been replaced in a different form or delivered in a different way, but the family support base has in fact been increased.

Senator MURRAY—Do I understand that to mean you supported the cuts, but then you supported further changes?

Mr Holdsworth—Our organisation did not in fact take a position on that. It is considered a welfare matter and not normally something we would comment on. I am not sure of the specific items to which you refer. I recall the changes coming in, but they were replaced by a different form of assistance. They were not just taken away and removed entirely. I think that is the issue there.

Senator MURRAY—Is your organisation a member of the Business Round Table of New Zealand?

Mr Holdsworth—No, we are not.

Senator MURRAY—Mr Paterson, this issue of compensation and the attitude of business to it are quite important in this debate. Would you give the committee, in political terms, a rock solid, iron clad guarantee that the ACCI will never call for a net cut in the social security compensation package, the existing social security net, that exists for Australians?

Mr Paterson—I cannot give any such rock solid commitment or guarantee because that proposition has not been put before my general council, which is the governing body in terms of policy matters. Our approach to tax reform recognises the adequacy and equity issues that I identified earlier. We have not called for across-the-board cuts in welfare or other payments. We recognise that, for the purposes of the introduction of a broad based package of fundamental reforms, that the adequacy component needs to be addressed.

We have been at the forefront of the debate about addressing poverty traps associated with the interaction between the tax and the social security system. We have raised issues associated with the interaction between the tax and the wage system. We are not an organisation seeking the removal of all forms of welfare. We believe that welfare in Australia ought to be appropriately targeted and that it addresses the needs of those identified. We have a strong view in relation to developing economic policies that promote a growing economy that provides an opportunity for job creation and therefore relieving the burden in relation to welfare demand.

Senator MURRAY—Back to you, Mr Holdsworth. The evidence referred to on New Zealand compliance costs is in the Walpole paper. There is a very useful table on page 8. They have quoted the compliance costs of business taxes in New Zealand, a study by Sandford and Hasseldine for the Institute of Policy Studies in 1992, as their source. That might be a useful reference to you.

You made the very clear point that computerisation lowers compliance costs and makes the whole process much easier. You say that the computerisation increase in New Zealand from 1985 to now has seen a significant change in the ability of businesses to deal with this issue. That would, of course, be true of Australia. It is much more computerised now than it was 10 or 15 years ago. I will quote from page 10 of your supplementary submission:

With the growth of computerisation, this is now not necessary and we would have less than 1% of manual invoices in the course of business these days. In any event, computers are programmed to calculate the GST at the appropriate rate on data entry . . .

So, whatever the rate a GST is the computer handles it easily, as you remark. Then you go on to say:

As far as our export invoicing is concerned, these are all zero rated and done automatically by computer, and as we are able to claim any input tax there is no added cost associated with exports.

You have indicated the zero rating items on page 4, included in which are export sales, financial services and life insurance. It is your submission that any difference in zero rates and other rates in New Zealand is easily coped with by the computer systems. Is that correct?

Mr Holdsworth—What has to be distinguished between are those sales which are zero rated, such as export sales, and those other types of transactions which are exempted. The distinction is important because if the export item is zero rated, the manufacturer or producer can claim the input taxes all the way up the chain. At the end the final sale attracts no tax. However, if an item is exempted under our system it means that the organisation which is

dealing in those exempted goods cannot claim any of their inputs as they come in up the chain.

One of the interesting examples is the insurance industry where life insurance is exempted from the act but other products that they sell, such as fire and general insurance, attract the GST in the normal way. For the companies concerned it becomes an accounting nightmare because they have to apportion the costs of their inputs between the efforts put into the exempted products and the efforts put into the non-exempted products, and they are not able to claim all the inputs in a normal business way right through the supply chain.

Senator MURRAY—So, what you are saying is that making an item GST free is much easier than exempting it. Is that correct?

Mr Holdsworth—Zero rating it is certainly easier than exempting it from the operation of the act altogether, and much more efficient for business.

Senator MURRAY—For any item which is zero rated, if you are computerised it makes it a piece of cake. Is that correct?

Mr Holdsworth—Yes, even if you are working a manual system. In the simplest form of system that applies in our country, the simplest form of return system is a person adding up their debits and their credits from their bank statement, taking the appropriate fraction of each and paying, or receiving a refund for the difference. That is the very basic small business corner shop type operation.

The next step would be those still on manual systems where it puts one more column in a cashbook. Then we get into the age of PCs and simple programs. A large number of businesses—I am talking small enterprises—operate their own simple systems. Obviously, if there is a machine which will do the calculation for you there is some simplicity involved in that.

Senator MURRAY—So anything which is zero rated is easy to deal with, but anything in the exempted area is more difficult. Is that the conclusion?

Mr Holdsworth—It is more difficult, but the person dealing with it must be aware of the distinction between the two.

Senator MURRAY—Thank you, Mr Holdsworth. Mr Paterson, on page 9 of your submission you refer to a number of principles. That is at the bottom with the dot points. Amongst those principles you mention improving the overall progressivity of the system. I have not heard anyone say that the GST is not a regressive tax. I have heard many people say that the income tax cuts are regressive because of the way they fall on the community.

I have two questions. Firstly, why would you think that this package advances that principle of overall progressivity? Secondly, you have spelled out another principle of sustainable revenue and yet there are substantial revenue implications of the tax mix switch. Perhaps you could deal with those two issues in a response.

Mr Paterson—In relation to the progressivity of the system, we have looked at the whole of the system. The broad based consumption tax is not being introduced in isolation, it is being introduced at a time when a series of existing regressive indirect taxes are being proposed to be removed. That is why maintaining the integrity of the GST base is critically important, because it removes the wholesale sales tax and existing indirect tax.

It is proposed also to remove a range of state and territory based taxes, taxes that are equally regressive. I am referring to FIDs, BADs, stamp duties on transactions, and bed taxes and the like in New South Wales and elsewhere. It is not just about introducing a new tax but about the removal of a series of existing regressive indirect taxes with a much more efficient, much more robust tax base.

As for progressivity, I have not heard the argument put forward that the proposed changes in relation to income tax cuts are in some way regressive and not increasing the greater progressivity of the system.

Senator MURRAY—The argument on regressivity is that they favour the higher income people to a far greater degree than they do lower income people. That is the essential argument.

Mr Paterson—Proportionately, the evidence as I understand it, Senator, does not support that because the higher income earners and those on the top tax bracket end up with a greater burden under the proposed regime than they do under the existing regime. I do not believe that the evidence supports that proposition. We cannot look at this at a static point in time. Having reflected on it, in the year that I was born, the top marginal tax rate cut in at 19 times average weekly earnings.

Senator CONROY—What was the top marginal rate?

Mr Paterson—It was approximately 60 per cent and if we reflect on that and look at what the tax rate is at the present time—

Senator MURRAY—Mr Paterson, can you give us the reference here?

Mr Paterson—It was 1954. Yesterday was my birthday, Senator. I spent last night by myself in a hotel room in Sydney preparing for these proceedings. It is 1.3 times at the present time and it is anticipated to cut in at about average weekly earnings if we do not change the system.

Picking up Senator Conroy's point in relation to the actual rate, we need to look at the existing top marginal tax rate, the Medicare levy and the superannuation guarantee levy, which is imposed across-the-board, in making the comparison between the top marginal tax rate that applied at that time and the present.

Senator MURRAY—Yesterday we heard from Mr Michael Walpole. He is a senior lecturer with the Australian Taxation Studies Program, ATAX, the Faculty of Law, University of New South Wales. Our information, unless somebody else can correct it, is that they are the foremost authority on compliance costs, but they are not extravagant in their

claims. They are very careful, in fact, as you will see from the evidence as to what they do and do not say. You have claimed in page 14, Mr Paterson, that there is evidence from overseas countries that exempting food adds greatly to the complexity of the tax. Everybody intuitively accepts that. The problem is that there is no international evidence to that effect according to Mr Walpole, both in his paper and in his evidence.

The table I drew your attention to earlier shows that the overall compliance costs in Canada are lower than in New Zealand and the overall compliance costs in the United Kingdom are lower than in New Zealand, both of which exempt food. I accept without question that making food zero rated increases complexity. That is obvious. You cannot refute such a thing. My question to you is: what statistical evidence, what empirical research is there available which shows that that is the case in overseas jurisdictions?

I would point out to you as well that Professor Warren in his paper—both Warren and Walpole incidentally support taxing food—made the same point: that it is not apparent that there is evidence that you can put your finger on that the compliance costs increase when you zero rate food.

Mr Paterson—I do not want to get caught up in the distinction between exemption and zero rating.

Senator MURRAY—Let me use the zero rating approach.

Mr Paterson—In my opening remarks I indicated that there was conflicting reporting on the evidence that was presented yesterday and reference to a New Zealand paper which I undertook to examine and come back to the committee on.

Senator MURRAY—Do you have evidence that we have not seen yet on this issue?

Mr Paterson—It is certainly reported to us that the compliance costs associated with differential treatment in relation to food increase the cost of undertaking business in those environments. The paper by Mr Bollard that Mr Holdsworth referred to, talking about New Zealand's experience with consumption tax—we can make this available to the committee at an appropriate time—was published in February of 1992. Mr Bollard was then with the New Zealand Institute of Economic Research and now works with the New Zealand Treasury. The paper looked at the administration costs and average collection costs of a GST.

At that time, it was estimated that the average collection costs for GST were around 1.1 cent per dollar of revenue collected—which is a dramatically different position from that which is asserted in the paper that you referred to—comparing favourably with the overall average costs of tax collection of around 1.4 cents per dollar per income tax, and 1.7 cents per dollar for excise tax.

Senator MURRAY—If I could interrupt for clarification, Mr Walpole made a clear difference between administration costs and compliance costs, the administration cost being the cost to the Treasury—I do not know what they call them in New Zealand—and compliance costs being the cost to business.

Mr Paterson—The paper that I am referring to looked at not that distinction between administration and compliance but collection costs overall.

Senator CONROY—Yes, administration is collection costs, unless you are saying that you are adding the business costs together with the tax costs. The figures you are quoting sound like your tax office's collection costs.

Senator MURRAY—Mr Chairman, I am concerned that I am taking up too much time. I think I should ask on notice whether Mr Paterson has any international research or any available empirical research which clearly spells out all the various costs in different regimes, where food or other things are zero rated and regimes where they are not, and make that available to the committee. That would be very helpful. As far as I know, Mr Walpole's material is the only material we have which attempts to draw academic conclusions.

Mr Paterson—Senator, could I also reinforce the point I made at the outset in reference to the examination of the compliance cost regime of the existing tax system, because there are assertions of \$7,000, or seven per cent, or the like, in terms of the GST, but the compliance costs estimate by QCCI and CCI WA, which were included in our submission, says that the compliance cost with the existing indirect tax regime is \$23,000 per annum. So we need to take into account any assertions made in relation to the compliance cost of the alternative regime and compare that with the compliance burden of the existing regime which it seeks to replace.

Senator MURRAY—Which is why I am particularly interested not in people who are projecting costs, but in looking at countries which have experienced those costs and actually talking about reality, not otherwise. I would appreciate it if you could take that on notice.

Mr Paterson—Mr Holdsworth was going to add something to that.

Mr Holdsworth—Concerning the reference you gave me before on Sandford and Hasseldine, I meant to comment before. That is a paper, I took it from the title, that refers to business taxes generally. I have never, in my experience since we had our GST regime, encountered compliance arguments with that particular part of the tax system. Certainly in terms of business taxes, we have lots of other taxes where the compliance issues are huge, and I am talking about areas such as entertainment tax, fringe benefit tax, company tax, et cetera. So it may well be that 7.2 per cent is the figure in terms of compliance, but I would have thought from my experience that the GST component of that would be minute, as it is a very simple system to work.

Senator HARRADINE—I notice the time, Mr Chairman, so I will be very brief and add my welcome to Mr Holdsworth to Australia. Mr Holdsworth, on page 11 of your paper, you note that in your own business, most of the goods were subject to a 20 per cent sales tax prior to the introduction of the GST. Then you say:

For 95%, therefore, of our goods after GST, the retailers had the ability to make reductions in the retail prices.

Mr Holdsworth—Yes.

Senator HARRADINE—What were the procedures in place in New Zealand at the time of the introduction of the GST to ensure that the savings in these particular cases flowed through to the consumers?

Mr Holdsworth—There were no procedures in place to ensure that. Some items which were in the marketplace which had sales tax regimes of up to 40 per cent obviously showed reductions. At the same time, some retailers, to be frank, increased their margins at the changeover time. So the goods became cheaper at retail level but possibly not as cheap as they may have been. It was simply left to the market to work it out. Those people that did not pass on the full benefits of the reduced sales taxes vis-a-vis the imposition of the GST soon had to reduce their prices. In my experience, it was a very short time—I am talking months—before the prices settled down to the correct levels. But there was nothing formal in place to ensure that the retailers were going to pass on any benefits of any reduction.

Senator HARRADINE—Has an analysis been done on the balance sheets of a range of companies in various areas of those goods that were previously subject to sales tax and those businesses whose goods largely were not? Has any analysis been done of their balance sheets as to the profitability which resulted from the legislation? In other words, has business flourished under the GST in New Zealand?

Mr Holdsworth—It certainly was not impacted by it. There were some hiccups both before and after the introduction in that you had buying in specific areas where people were aware there was no wholesale sales tax regime so they bought pre-GST and stocked up on those things. Similarly—and cosmetics is a very good example—the cosmetic industry had quite a boom after the introduction because they had been on a 45 per cent sales tax regime and the price of the goods came down substantially. So there were some distortions around the changeover time but, within three to four months, they worked themselves through and the market settled down again. But there has been no analysis done in the way you asked the question, to my knowledge.

Senator HARRADINE—Mr Paterson, with respect to your comments about the family payments being made to families in respect of the number of children that depend on a particular income, you are not saying that that is welfare, are you, at whatever level of income?

Mr Paterson—It is not something that my organisation has contemplated in terms of making a judgment about whether or not they would regard that as welfare. So I am not in a position to respond.

Senator HARRADINE—That is a very important question because you mentioned the word ‘welfare’, that your organisation was concerned about the level of welfare being paid to persons who were not in a particular targeted group. I raise it quite seriously because I have heard it in circles that you move in that this sort of family payment is middle-class welfare. Aren’t family payments really, in that case, a recognition of the number of dependants and a particular income? Wasn’t there a case where these families could previously claim concessional deductions for each child—and they were abolished, and then they were able to claim rebates for each child, and then they were abolished? Aren’t family payments not inadequate but at least some sort of substitute for that social justice right?

Mr Paterson—Two things: first, I have already responded that, from an organisational perspective, my organisation has not contemplated that issue and therefore I am not in a position to respond on behalf of the organisation; secondly, if there is an assertion by the comment ‘in circles that you move’, that comment has been heard. If there is anybody who has asserted that I have made that observation, that is an inaccurate assertion.

Senator HARRADINE—I am sorry. Business circles and some chamber circles call that welfare. You mentioned welfare and I think it was legitimate for me to try to follow up what you meant by ‘welfare’. In fact, if you did mean to reflect on those payments, I would be interested to know.

Mr Paterson—I have answered it as best I can. Senator Cook, I just raise one issue because it does flow from the issue that Senator Murray raised earlier about the empirical evidence on compliance costs. In the paper that I made reference to, which is the paper by Mr Bollard where I was drawing out the estimates of collection costs, the paragraph that immediately followed that, which I should have continued to read, says:

What of compliance costs? There is no conclusive evidence here—

that is, in New Zealand—

but due to the few exemptions and simple rate structure, compliance should be less costly than for most European VAT systems (where estimates are that compliance costs may be four times as large as administration costs).

Senator MURRAY—That is not the evidence of Walpole. That is the difficulty we face.

Mr Paterson—That is why I said that we need to have a look at the Walpole issue, particularly the reference to the Sandford and Hasseldine paper that talked about the compliance costs of business taxes, to try to work out what the reconciliation is between those two. We will undertake to do that.

Senator CONROY—Do you support VECCI’s call of a few weeks ago for further federal government cutbacks of \$3 billion.

Mr Paterson—Sorry?

Senator CONROY—VECCI put out a press statement a couple of weeks ago calling for a further \$3 billion worth of government expenditure cuts. Do you support that?

Mr Paterson—I do not know the detail of that call, Senator.

Senator CHAPMAN—Mr Regan, who gave evidence to the committee yesterday, argued that the compliance costs, especially for small business, will be much higher, Mr Holdsworth, than you have indicated has been the experience in New Zealand. One of the arguments he put was that small businesses would be scared because there would be an army of tax investigators out there waiting to jump on them if they made a mistake in their GST calculations or returns, and therefore they would be putting in place much more complex systems and devoting much more time to their administration of GST than perhaps you have indicated. I am just wondering if you could enlighten us on the New Zealand experience as

far as that compliance aspect is concerned. Has there been an army of tax investigators out there ready to jump on small business or has it been a fairly simple process?

Mr Holdsworth—No, there has not been, Senator. There was indeed quite an educative process that went on beforehand. The beauty of our system is that it is so simple that it is difficult to make mistakes. The department also undertook to try to get round every person affected by the regime within the first six to 12 months—just as a courtesy, just to make sure that everything was going properly. Penalties were not applied where mistakes were discovered unless they were considered deliberate. But, because of the simplicity of the system, it did not really create a problem. It comes back once again to the fundamental thing: how simple a system can be designed. It then reduces the compliance issues for small business—and indeed any extra time. I find some of those comments by Mr Regan, whose statement I saw, to be quite extravagant, in my experience.

Senator CHAPMAN—Were any studies or analyses done in relation to the expected effect of the GST on the cost of living—whether that was going to be measured by a CPI increase or whatever—prior to its introduction in New Zealand? Now that it has been there for some years, what has the actual experience been in terms of its effect on the cost of living, or CPI?

Mr Holdsworth—I am not sure about the before situation, but the paper that was referred to by Dr Bollard actually contains a chapter on that which we are going to put before the committee. He actually details what happened to the cost of living and how long the GST adjustment took to come out through the system.

Senator CHAPMAN—Perhaps you can answer this in the context of a before and after situation. What was the general acceptance in the community in New Zealand of the GST, both in the lead-up to its introduction and now with some years experience of its operation and, in particular, the acceptance of the inclusion of food in the GST, again in the lead-up to its introduction and given now some years of operation?

Mr Holdsworth—I would have to say that there were considerable misgivings about the whole of a new system being introduced not only at small business level but also at consumer level before the system came in. By the time the system came in, businesses at least were happy to embrace it because of the simplicity of it. It took the public some time longer, but general acceptance happened very quickly.

Senator CHAPMAN—Are there any groups in the New Zealand community who would want to go back to the old structure, the wholesale sales tax structure?

Mr Holdsworth—No, definitely not. I have heard no calls for abolition of the GST other than that people would like the rates reduced.

Senator CHAPMAN—In regard to one element of the cost of compliance and that is, the cost of collection, Mr Paterson, Mr Matthews from the tax office indicated that the tax office expects that, in Australia, it will cost 0.88 per cent of revenue compared with the cost in New Zealand of 1.47 per cent and 2.55 per cent in Canada. Have you got any views on that analysis? Have you done any analysis yourself of the cost of collection?

Mr Paterson—Certainly in regard to the collection costs, if we followed through the article that was just referred to, it suggests a difference in experience in New Zealand from that which was put before the committee. I think we would need to take that question on notice.

Senator MARGETTS—In your organisation's submission on page 13, you say:

Economic efficiency is achieved if the tax system does not distort consumer or producer behaviour in ways which reduce welfare. A broad-based tax maintains relevant prices of goods minimising the distortion of consumption behaviour.

Perhaps I could remind you that amongst this package is a measure which is considered to be fairly distorting of consumer behaviour—that is, the reduction in diesel excise. What is the chamber's view in relation to externalities and how they should be handled? If, as has been given in evidence by doctors and environment groups to the other committee, there is a considerable health and environmental externality that may result from that—and perhaps we will consider it an unintended consequence—what is the chamber's view of how that kind of externality should be treated?

Mr Paterson—Our view is that that style of externality, if there is one, ought not be addressed through the tax system. If there is a particular good, service or product that impacts on the community in a harmful way, you ought to deal with that good, service or product. You ought not seek to create a distortion within the tax system to achieve some other outcome.

Senator MARGETTS—But the distortion is coming through the change of tax, it is being argued.

Mr Paterson—That might presume that the existing tax regime was an inappropriate one that sought to address, through the tax system, the impact of some goods, service or product. Our view is that the changes in relation to diesel fuel, in the context of the whole package and in the context of Australia, are appropriate.

Senator MARGETTS—Can I get this right? It is the consistent view of the chamber that the right price signals should not reflect externalities in goods and services.

Mr Paterson—We are saying that we do not believe that you should use the tax system.

Senator MARGETTS—If you cannot use the tax system, are you suggesting that we should use stronger regulations and legislation to deal with issues of externalities?

Mr Paterson—I have not come here prepared for a debate in relation to externalities and the real impact, or perceived impact, of a particular product.

Senator MARGETTS—It is in your submission though, about equities and price signals. I am just trying to work it out. I am sure you have got a policy somewhere about how governments should handle issues where there is a proven health impact of a particular government tax decision—in this particular case.

We have all seen the increased ads on television for diesel vehicles leading up to this decision. What is the chamber's view in relation to the true cost of production or the true cost of consumption? How should that be reflected if this kind of change increases the health problems for the community?

Mr Paterson—I cannot do anything but repeat the view that I expressed earlier and that is that we should not be using the tax system in this way. If there is a particular impact of a good or service, then that impact ought to be considered in context. If a particular product is determined to be harmful, then you ought to address the harmful aspects of that product, not seek to have a distortive tax regime.

Senator MARGETTS—No. I am saying the excise has been removed from it, which many people are saying is going to distort the price signals of that.

Mr Paterson—But I am not sure, when it was argued that the excise be imposed upon it, that it was done for the reasons of externality. It was done for the reasons of revenue.

Senator MARGETTS—I am sure it was not.

Mr Paterson—I cannot see how the argument follows that removing something that was put on not for externality reasons suddenly has to be addressed in the context of externalities.

Senator MARGETTS—I can see we are not on the same wavelength on that. I might go onto my other question. You have talked about the issue of compliance costs and the emphasis on simplicity. Can you comment on the range of community and other groups who have given evidence that they are going to be involved with tax collection that they have never been involved with before? What is your view on this in terms of their need for compensation? Some of those groups say that they will find it very difficult to survive.

Mr Paterson—There are very few organisations that will be affected by these changes that are not presently tax collectors. They are not all covered by the wholesale sales tax, but the vast majority of organisations within Australia are, in some way, affected by the tax system either by way of the impact of the fringe benefits tax, the collection of PAYE income taxes, the prescribed payments tax regime, the payment of taxes under FIDs and BADs and/or payroll taxes at a state level. Most businesses have an obligation to comply with one or more of the existing tax regimes. This is not about changing the tax compliance burden and suddenly making hundreds of thousands of businesses new tax collectors. If it makes new tax collectors, it makes that at the margin. The vast majority of businesses have to comply and collect tax on behalf of government across a broad array of taxes at the present time. As I am advised, there is nothing in this legislation which requires record keeping that is not otherwise required for compliance with existing tax obligations.

Senator MARGETTS—So all of the evidence that has been given to the committee in relation to compliance concerns, from a wide range of community groups, is all wrong?

Mr Paterson—I think they are looking at a comparison between the potential impact of a goods and services tax and whether they had an obligation under the wholesale sales tax.

Senator MARGETTS—So you would disagree with the Arthur Andersen evidence in relation to charities and community organisations?

Mr Paterson—I have not seen the Arthur Andersen evidence.

Senator MARGETTS—Okay. Thank you very much.

CHAIR—I must draw the line here. We are almost 20 minutes over time, although we did start about five minutes late. It just shows how popular you are, Mr Paterson. On behalf of the committee I thank the ACCI, yourself, Mr Paterson, Mr Martin and, in particular, our thanks to you, Mr Holdsworth, for coming all the way that you have. The committee is now adjourned for morning tea.

Proceedings suspended from 10.38 a.m. to 10.46 a.m.

BURN, Dr Peter, Secretary, Business Coalition for Tax Reform

RYAN, Mr Fergus Denis, Chair, Business Coalition for Tax Reform

CHAIR—Welcome to the inquiry. You have been here before and I am sure you know the format. We ask you to address us briefly on your submission and be available for questions.

Mr F. Ryan—Thank you. We have a brief opening statement which I would suggest we table. It goes over what we have said before. I could just add, as a formality, that the 40 or so members have been joined now by the Restaurant and Catering Association. I think that is the only thing that is new since we last spoke. I will hand it back to you for questions. We will table the opening comments later on.

CHAIR—That is very useful in the cause of helping us get through our program.

Senator MURRAY—One of the issues raised earlier today is, firstly, an issue of policy and, secondly, an issue of priority. An important part of the new tax system is the question of fuel excises. I have not heard anyone dispute the fact that there is a difference between clean fuels and dirty fuels or fuels which are dirty and those which are dirtier. The previous government and this government—and all governments, as far as I know—do use taxation measures for influencing health and social and environmental outcomes, as well as economic outcomes. Alcohol is a typical example, with low priced beer, medium priced beer and high priced beer, but there are other examples.

Is it your view, as a business coalition, that it is appropriate for the government to introduce and ensure there are effective tax incentives to encourage price distortion which would encourage consumption of cleaner fuels such as gas over diesel? In other words, is there a price disparity sufficient to encourage a switch between the two?

Dr Burn—The Business Coalition for Tax Reform does not have a formal position on that. As a general principle, I think that the business community would support measures that would have socially beneficial outcomes. Whether they are organised through the tax system or through other mechanisms would depend on the effectiveness and collateral costs of those particular measures. While not disputing the desirable outcome, it becomes a technical question about the selection of the desirable tool and the most effective way of delivering and achieving that social outcome.

Senator MURRAY—But isn't it true that, within fuel usage, taxation is a very major component of the price and, therefore, you can materially influence price incentives or price motivations through the tax system?

Dr Burn—My understanding is that the demand for fuel is very unresponsive to changes in price. The evidence for this comes from the experience of the last several years where we have had dramatic drops in the price of fuel not related to taxation, but drops in price nevertheless. They have not been associated with increases in the usage of fuel. Quite the opposite, fuel usage has decreased in per capita terms at the same time as the price has

fallen. This suggests that taxation aimed at influencing the price of fuel is not an effective way to change the consumption of fuel if that is the desired result.

Senator MURRAY—But, as a tax expert, you would appreciate that you have to distinguish between substitution and an increase in consumption. For instance, in the case of beer, there has consistently been a decrease in per capita consumption in Australia, but within that decrease there has been a massive increase in the consumption of low priced and medium priced beers partly—I would not attribute it wholly—because of the price incentive.

Dr Burn—I think you are certainly right in not attributing it totally because there has at the same time been a lot of action, for example, on drink-driving campaigns that would take people away from drinking full strength beer to low strength beer unrelated to prices. What I am trying to get at is that there are a lot of things that could influence those consumption behaviours and substitutions between different alcohols, for example, or different fuels that create too much noise to create any reason to doubt the general point that I am making about fuel and taxes on fuel. The demand for fuel is not very responsive to changes in price and, therefore, changes in fuel excise are an ineffective way of addressing the externalities that can be connected with fuel use.

Senator MURRAY—The assumption I would make from what you have said is that, to make an effective price incentive, you would need to make the gap between, say, a clean fuel and a dirtier fuel wide and also accompany it with very strong education campaigns or regulatory incentives such as the ones you indicated with the drink-driving approach.

Dr Burn—There are two parts to my answer. One is that I think that what I am saying is that measures to influence the price of fuel are not effective. Trying to differentiate between fuels and influence consumer behaviour by the changes in prices of fuels is not an effective way, given particularly the collateral damage that you can cause in transport costs and the like and the regional impacts that might have. I think that you would be better off concentrating on the second set of alternatives that you identify and giving up on the ineffective tool of attempting to change behaviour by changes in price, which the evidence suggests is not effective.

Senator MURRAY—I would have to have a look at that evidence, but I accept what you are saying on its face value at this time. With regard to priorities on the same issue, there is around a \$3½ billion cost dedicated to the fuel excise change. We have had numerous submissions—not only to this committee but in the past—by business wanting payroll tax to be taken off. The simple question to put to the business coalition is: where do you rank, as a priority, payroll tax being taken off and fuel being cut, given that the evidence is that the economic impact and the employment impact of taking payroll tax off is greater than the economic impact and the employment impact of reducing fuel excise in the manner outlined?

Dr Burn—The business coalition's position is that we should reduce as many of the present indirect taxes as possible. As to choosing between different indirect taxes, the questions are very complicated. You have identified some of the elements that need to be taken into account. Other elements that need to be taken into account that are relevant to the particular substitution that you are referring to would be the regional, distributional and

overall price impacts. One cannot assume that a dollar removed from all indirect taxes will have the same impact on overall prices.

There are strong reasons to suggest that a dollar reduced in payroll tax—and it is certainly the case in the modelling work that we had done—would be less effective in reducing prices than a dollar reduced in excises on fuel. That has very serious implications for the nature of the overall price impacts on the community from total packages. It also has impacts on the distribution questions. My hunch would be—and we have talked about this before—that payroll tax would fall relatively heavily on mass produced goods and services which feature prominently in the consumption baskets of low income people whereas boutique services and goods produced in small firms would not experience payroll tax. So reducing payroll tax may have perverse effects whereas fuel, for example, will have effects which I think will end up being roughly deleterious to low income earners.

In other words, the equity questions need to be considered alongside the other questions that you have identified. It is a very complicated question to try and assess, in this forum, the overall impacts of the substitution that you are suggesting. For that reason, the business coalition went for an umbrella approach to indirect taxes rather than to try and pick and choose between them.

Mr F. Ryan—I would reaffirm that in the longer term payroll tax would remain in the sights of the business coalition as an objective—but in the longer term.

Senator MURRAY—The option that faces this committee is to recommend alternative priorities to the government—for instance, do not cut excise by as much, knock off payroll tax or do not cut excise at all and knock off payroll tax, or reduce income tax cuts and knock off payroll tax and so on. If they were ever to consider those kinds of recommendations, it would be within the knowledge that there is a finite amount of money available so you have to choose priorities, which is something your business group have clearly recognised. I was just looking for an indication as to whether payroll tax ranks for you as a business group ahead of the issue, for instance, of excise and of income tax cuts. I do not mean it rudely, but your answer strikes me as equivocal—namely, that you think there is so much to balance you cannot really give an answer.

Mr F. Ryan—That is in part right. I would characterise it as meaning that, broadly speaking, we think that the existing recommendations in the ANTS package are balanced. We recognise, however, that there will be differences of opinion even within the business coalition, and we are proceeding on that assumption. Hence our wish to leave the payroll tax on the longer term agenda.

Senator MURRAY—I have a final question, going back to my former line of questioning. It was noted earlier by Senator Margetts, who will descend upon you from the skies shortly, that there has been an increase already in advertising for new diesel equipment which would indicate that price does indeed have an effect on buying behaviour. Secondly, I have been reminded that in New Zealand when they altered diesel excise the gas fuel vehicle industry virtually collapsed, which may mean that for them, as opposed to the other side, it was a major consideration. Could you, probably on notice, send me some better evidence of

the fact that diesel versus gas price differentials are unlikely to result in a change of purchasing behaviour? It would help me considerably.

Dr Burn—I am very happy to do that, Senator. The evidence came from a recent study, from memory, by ABARE. On the advertising for new diesel fuel equipment, I point out that advertising is a non-price incentive for substitution between different things.

Senator GIBSON—Again, congratulations to Mr Ryan and Dr Burn on behalf of the Business Coalition for Tax Reform for the work you have done in helping us get this far in looking at these particular bills of the ANTS package which are currently before the parliament.

As an alternative to this reform package, the Labor Party have basically been saying that the current system of tax is adequate. Remember, in 1993 they put up the excise and wholesale sales tax rates, and increased the total tax revenue from the community by 30 per cent then without any compensation, I might add. In your view is the current system sustainable?

CHAIR—I think you should know, Mr Ryan, that the Labor Party is not saying that the current system is adequate.

Mr F. Ryan—From the business coalition perspective we have, from the beginning, approached this on a non-partisan basis. As I think I might have said last time, pretty much at every meeting as chairman I have been reminded of that—to go out there and, however one can, to keep it non-partisan. So all of the academic work we have done has been zero based, if you wish, in terms of its origins and who introduced what and when.

All of the research starts from a zero base as to where it came from, who brought it in and what its origins are. If I may, I would distinguish the group of experts that we use at the BCTR as distinct from the membership. Those experts have been from right across the body of knowledge that you are trying to address now. In a broad sense I think that their answer would be, bearing in mind Senator Cook's comment there, that none of them is comfortable with the existing system. That is perhaps self-evident and oversimplistic. Dr Burn, would you like to comment?

Dr Burn—Yes. As you know, about a month ago we forwarded to your committee a copy of a study undertaken by Access Economics for the Business Coalition for Tax Reform. That study demonstrates the expected decline in indirect tax revenue that we could expect to find if—

Senator CONROY—What was that figure on the WST's decline?

Dr Burn—The study that we had commissioned looked at the full variety of existing indirect taxes both federal and state and showed, under conservative assumptions, that if the existing indirect tax system was kept, without increases in rates, there would be a substantial revenue shortfall going forward. This arises for a number of reasons.

Senator CONROY—Wasn't it \$100 million for the WST?

CHAIR—Order!

Dr Burn—I am answering a question about the—

CHAIR—Dr Burn, you are answering a question that has been put to you by Senator Gibson. You should answer the question.

Dr Burn—The reasons for the expected shortcomings in the indirect tax system come from improved fuel efficiency and the trend to smaller cars, a falling impact on the penalty duty of leaded petrol as more cars move to unleaded fuels, falls in tobacco usage and modest growth in the consumption of spirits, tariff rate reductions in the pipeline, the relative decline in cars as a proportion of total consumer spending—cars representing a very large proportion of the total wholesale sales tax take—and a growth in the value of services relative to those goods. That goes for the federal system.

In relation to indirect taxes levied at the state level, there are a variety of issues that are relevant. Some relate to issues previously mentioned, such as the reliance of states on the arrangements replacing the former franchise fees on fuel, tobacco and alcohol, which are also expected to decline relatively; the changes in the pattern of growth in Australia in a regional sense because Western Australia and Queensland, which are low taxing states, are growing relatively faster and the implications therefore over all revenue are slight; and the cyclical nature of stamp duties. The combined picture provided to us in the study by Access Economics of all these state and federal indirect taxes is a substantial decline in indirect tax revenue relative to the current system. This would continue a decline that has been experienced since the mid- to late 1980s and which was offset, as you point out, Senator, only by the changes announced in the 1993-94 budget which instituted a program of increased rates of wholesale sales tax and also increased excises. It was only because of those measures that the long-running trend in decline in indirect taxes as a share of GDP was temporarily reversed in the early to mid-1990s. The downward trend has again resurfaced.

Senator GIBSON—One could therefore assume that if the indirect tax system is not reformed basically as proposed then some of those indirect taxes, such as wholesale sales tax, will have to go up, down the track, in order to sustain the revenue base.

Dr Burn—That is one option. There are a number of other options.

Senator CONROY—What was the fall in WST, given that Senator Gibson raised the question?

Dr Burn—As I understand it the question relates to total indirect taxation.

Senator CONROY—He asked about WST. You specifically mentioned an increase in WST rates. That was your specific question.

CHAIR—Order! Please proceed, Dr Burn.

Dr Burn—The general issue is the decline of indirect taxation. Let us look only at federal indirect taxation because that is where the large decline is expected. What would

have to happen to compensate for the revenue? Either taxes somewhere else in the system would have to rise at the federal level or spending by the federal government would be reduced—they are the alternatives—or an increased budget deficit.

Senator GIBSON—Thank you, Dr Burn.

Senator CHAPMAN—There was discussion somewhat earlier on the issue of fuel tax. Is it a fact that the cost of transport makes up a significantly higher proportion of the final cost of goods in Australia than it does in many other countries?

Dr Burn—Yes. It is true. That arises from two factors: first, that the inland transport costs are higher because our inland is bigger and, second, from where we are in the world itself.

Senator CHAPMAN—The cost of fuel and vehicles, of which taxes in both cases make up a significant component under the existing tax structure, would therefore be a significant cost in the final cost of goods?

Dr Burn—That follows from the previous point, yes.

Senator CHAPMAN—So that, in terms of making our economy more competitive and the final cost of our goods more competitive, there is a very strong argument for both reducing fuel taxes and eliminating the effect of wholesale sales tax on transport input?

Dr Burn—That follows.

Senator CONROY—Could you give us the figure on the decline in WST, break it down into the different categories of federal indirect taxation and compare the larger falls to the smallest fall?

Dr Burn—I would like to flick through the document for a minute, if you would bear with me. We have tabled this document and I refer you to a table on page 3 of the document, 'Table 1—Past and prospects for federal indirect taxes as a percentage of GDP'. There is an expected relative decline in all of the taxes listed and a breakdown of that. In proportional terms the wholesale sales tax will fall roughly the same as excise on non-petroleum products—

Senator CONROY—What is that in dollar terms?

Dr Burn—and also much the same as customs duty. Petrol excise is expected to fall relatively greater than those and total excise is a function of those.

Senator CONROY—Isn't it a fact, on those figures, that the WST fall is the smallest of all of them in terms of dollar figures or a percentage, whatever you want? But, any way you want to draw it, the WST decline is actually the smallest of those categories?

Dr Burn—The fall in WST of \$1.1 billion is smaller than the fall in other—

Senator CONROY—Over how many years was that?

Dr Burn—That is after 10 years.

Senator CONROY—It is \$100 million a year. You want to introduce a \$30 billion tax to make up for a \$100 million fall in WST? That is the haemorrhaging of the tax base on WST—\$100 million a year.

Dr Burn—My answer to that question will take about five minutes. It is that the proposal to replace the range of indirect taxes that we currently have with the GST is much more extensive—

Senator CONROY—We are talking about Commonwealth indirect taxes.

Dr Burn—than the simple replacement—

Senator CONROY—Excuse me, I am asking you about Commonwealth indirect taxes.

Dr Burn—But the point I am making is that the GST is not limited to the replacement of federal taxes. The WST is limited to the replacement of a raft of other indirect taxes levied at state level. If you will just excuse me for one moment, I will list those taxes that are at the state level.

Senator CONROY—The committee is familiar with them. What I am asking you about is the argument that the current Commonwealth tax base is declining because of the collapse in the WST revenue, which has been an argument touted by the supporters of this tax, the GST, extensively.

Dr Burn—The argument that we have put forward is that the indirect tax system is at risk, and is demonstrably at risk, due to a variety of circumstances. What other people say is their business, but I point out that wholesale sales tax is one tax scheduled for elimination with the introduction of the GST. Other taxes are the financial institutions duty; debits tax—

Senator CONROY—The committee is familiar with the state taxes.

Dr Burn—stamp duty on marketable securities; conveyancing duty on business property; stamp duties on credit arrangements, instalment purchase transactions and rental agreements; stamp duties on leases—

Senator CONROY—Are you here to answer questions or just to give speeches.

CHAIR—Order!

Senator CONROY—I am trying to ask questions and I am being given speeches.

CHAIR—Order! The committee will come to order. Did you have a point of order to raise, Senator Chapman?

Senator CHAPMAN—Yes, I do not think it is appropriate for members of the committee to hector a witness when he is trying to answer.

Senator CONROY—He is not answering the question I asked at all. I asked him about the WST and he is giving me a list of state taxes. I am not quite sure how they are related. Maybe you understand.

CHAIR—Can you complete your point of order, Senator Chapman.

Senator CHAPMAN—He is answering the question as he regards as appropriate. If at the conclusion of that answer you want further information then it may be appropriate for you to ask a further question.

Senator CONROY—Do I have to sit here for five minutes while he gives me a speech that is not answering my question?

CHAIR—Do you wish to address the point of order, Senator Conroy?

Senator CONROY—The witness is not answering the question that I asked him. He has chosen to give, on his own indications, a five-minute speech. If Senator Chapman thinks the committee has the time to sit and listen to a five-minute speech which is not even in relation to the question that was asked, then Senator Chapman is entitled to his opinion.

Senator CHAPMAN—The witness has also indicated that you put to him a proposition that does not apply to the organisation which he represents.

CHAIR—Order!

Mr F. Ryan—Might I suggest, Mr Chairman, in the interests of being helpful, that the overall point here is that the GST, as Peter has said, removes a whole raft of taxes, without going into the numbers that you already have. I think the senator's specific question on wholesale sales tax is one on which we have a huge amount of data available. We would be very happy to respond very promptly with the specific answer to his question.

Senator CONROY—The answer to the question I asked is yes, but I will repeat the question for you.

CHAIR—Order! Hang on.

Senator CONROY—Is the fall in revenue from the WST smaller than the other indirect taxes?

CHAIR—Senator Conroy, please. On the point of order, yesterday when it was argued that Senator O'Chee was badgering a witness unfairly, I expressed a view to the committee which I will express again. It is proper to treat witnesses with fair courtesy. I do think witnesses can withstand a bit of direct questioning, and ought to be able to hold their end up in discussion, as indeed I thought the witness yesterday was, and as Dr Burn is now.

But this is an inquiry for the purposes of informing the Senate and I would ask you, Dr Burn, to be sensitive to the questions that are being put to you and try and answer those. I think, frankly, reading out a list of taxes which are well known to us is not directly an answer to the question. Senator Conroy, please continue.

Senator CONROY—Just returning to those figures, and Mr Ryan says the information is available, is \$100 million the smallest of the falls in the four categories or five categories—I have not got the document in front of me, but I have seen it—of indirect taxes?

Dr Burn—It is roughly the same as the fall in other excises, marginally below. Yes, it is the smallest of those listed at the federal level.

Senator CONROY—Thank you. What is the fall due to reductions in tariffs in the Commonwealth indirect taxes?

Dr Burn—The fall due to the reduction in tariffs is, in your terms, \$50 million a year greater than the fall in sales tax.

Senator CONROY—I think it has been worked out at about \$4.5 billion over time since the discretionary decisions were made to reduce tariffs. But, as you say, that may equate to \$150 million. Is that what you are saying?

Dr Burn—It is actually \$1.3 billion.

Senator CONROY—Over what time period is your \$1.3 billion?

Dr Burn—A 10-year period.

Senator CONROY—That is a forecast. I was talking about what has happened over the last few years. I apologise for not making that clear. My point is that a fall in the total indirect tax cut is substantially accounted for—not all—by the discretionary decision which your organisation possibly would have supported if it was around at the time—certainly the business community has advocated support for it—and that is the reduction in the rates of tariffs in terms of the decline over the last few years of the indirect tax base. Is that a fair comment to make, that the \$4.5 billion makes up a substantial part of that falling rate, that it makes up a substantial reason for the fall?

Dr Burn—I am a little bit unclear of where your \$4.5 billion comes from.

Senator CONROY—I think from Treasury figures. Looking at the decline in revenue from the indirect tax base has indicated that there are declines in X, Y and Z, but the largest and most substantial amount is a \$4.5 billion decline in the indirect tax base because of discretionary decisions by the government to reduce tariffs. Are you aware of that?

Dr Burn—I do not have the information in front of me, but what I do have relates to exactly the same point. The decline in customs duty in the Access Economics study we commissioned is scheduled to be about \$1.3 billion over the next 10 years. I think that is getting to the same point.

Senator CONROY—I am talking about the last five or six years and you are looking at projections into the future, about which I am not questioning the accuracy of at all.

The point I am making is that in terms of the argument which Senator Gibson commenced with, that there is a problem with the sustainability of the revenue base of the Commonwealth, there are those who want to advocate, ‘Look at the past, there has been this big decrease.’ If anyone is being fair dinkum about the discussion, look at the segments of it, and the overwhelming proportion of that decrease is due to discretionary decisions taken by government—not some long-term systemic problem—to reduce tariffs, which have equated, on Treasury figures, to \$4.5 billion. That is the point I am trying to make. I apologise for the longwindedness of the point I make.

Dr Burn—The point I make is that that is not right. We have here a forecast of a reduction in federal indirect taxes over the next 10 years of \$5.3 billion. The tariff reductions are expected to contribute—

Senator SHERRY—Is that \$5.3 billion the total?

Dr Burn—That is of federal indirect taxes.

Senator SHERRY—Is the total over 10 years a \$5.3 billion decline?

Dr Burn—In 10 years that will be the revenue shortfall.

Senator SHERRY—I just wanted to clarify that.

Dr Burn—That will be the annual revenue shortfall.

Senator SHERRY—Annual? That was not clear in what you said.

Dr Burn—So the answer to the question is no, the reduction in tariffs is not the substantial proportion of that, but that there are four—

Senator CONROY—Maybe we just misunderstood. I am talking about the past, not the future. You are talking about a forecast; I am talking about the last five or six years. Maybe we are at cross-purposes.

Mr F. Ryan—We do not have those figures.

Senator CONROY—I accept that. When you said no, I was talking about a past set of figures that have been published by Treasury.

Dr Burn—I understand the reasoning. The reasoning for us supporting a tax change now is the projected revenue situation, not the historic revenue situation.

Mr F. Ryan—We acknowledge your point is historic and we are unable to deal with it because we do not have the facts.

Senator CONROY—I was just confused when you said no. Thank you for clearing that up. The Victorian Employers Chamber of Commerce and Industry is a member of your coalition, according to the list.

Mr F. Ryan—Yes.

Senator CONROY—Do you support their call a few weeks ago for a \$3 billion further reduction in Commonwealth expenditure?

Mr F. Ryan—The Business Coalition for Tax Reform has not got a position on that statement by VECCI. Virtually all of our 40 members take positions from time to time. Not all of those positions come to us for consideration. That one certainly has not.

Senator CONROY—Are you aware of that call?

Mr F. Ryan—Yes, I recall it.

Senator CONROY—It is just that Mr Paterson from ACCI was not aware of that call.

Mr F. Ryan—I am hazy on the detail, but I am aware of it.

Senator CONROY—It was a public press statement; it was not a secret. So you have no view in support of one of your members?

Mr F. Ryan—No, the Business Coalition for Tax Reform does not have a view.

Senator SHERRY—Dr Burn or Mr Ryan, do you have the ANTS package there?

Dr Burn—Yes, Senator.

Senator SHERRY—Could I take you to page 35 which lists the taxes—state, territories and local government—to be abolished or reduced as a consequence. Isn't it true that, at least on revenue projections to 2002-03 of the state taxes to be abolished or reduced, all of the revenue—except the accommodation tax which is peanuts in terms of total revenue—from those state taxes is increasing to 2002-03?

Dr Burn—Yes.

Senator SHERRY—The problem is not with the state taxes in terms of revenue security, is it?

Dr Burn—It is easy for potential misunderstanding. These figures are dollar numbers and our declines are measured in terms of percentage of GDP.

Senator SHERRY—On page 35?

Dr Burn—No, the figures on page 35 are in dollar terms. Our declines in state taxes are measured as a proportion of GDP which is, of course, the relevant number.

Senator SHERRY—Yes. Isn't the relevant number the percentage of gross domestic product?

Dr Burn—That is what I am saying.

Senator SHERRY—Let us look at the money increase in these state revenues of the taxes that are being abolished. If you look at those, except for the accommodation tax, the money collected from those taxes is rising faster than projected gross domestic product up to the year 2002-03, isn't it?

Dr Burn—I do not see the projection for the gross domestic product.

Senator SHERRY—My point is: is there any weakening in the indirect taxes that are being replaced at state level in terms of revenue as a percentage of gross domestic product?

Dr Burn—Our evidence is that there is a weakening of state indirect taxes forecast over the next 10 years. I do not see, in the numbers on page 35, any reference to GDP so I cannot make the computations you are making.

Senator SHERRY—If you look at those figures, it seems to me that they are growing faster than gross domestic product at least to the year 2002-03.

Dr Burn—I need to know what your projections of gross domestic product are to have any useful input into that—

Senator SHERRY—You do not agree?

Dr Burn—As I say, our evidence in the paper tabled to your committee mid-February is that, as a proportion of GDP, state indirect taxes are forecast to fall. I just cannot do the sums very quickly without the projections of GDP available before me on these particular indirect taxes. I am trying to put forward useful evidence to the committee.

Mr F. Ryan—We would be happy to do that comparative exercise, Senator.

Senator SHERRY—If you can, yes. The point I am getting at is that, at least to the year 2002-03—and that is the only revenue projections we have from Treasury—there is no reduction in state indirect tax levels. It is the same with most of the other indirect taxes, including wholesale sales tax.

Mr F. Ryan—I think it depends on the basis you use to measure decline. We are simply stating that we have used a different basis.

Senator SHERRY—Whether you use money or percentage growth, as compared to the growth in the economy—and I think that is probably the most relevant—they are growing taxes at least until the year 2002-03.

Dr Burn—Yes, it is a question of relativity. I agree the comparison would be interesting. Our paper, as Peter said, deals with the percentage of GDP.

Senator SHERRY—I have a final question. If you follow the logic of your argument, Dr Burn, if we assume the tax base in respect of federal indirect taxes is declining—I do not accept that logic, but let us assume that is the case—why wouldn't the GST replace the other federal indirect taxes? Why wouldn't you get rid of those as well as the WST and replace it with a GST?

Dr Burn—And the remaining federal indirect taxes would be tobacco excise, liquor excise and fuel excise? Are you proposing to get rid of them?

Senator SHERRY—No, I am not proposing anything. You are saying that federal indirect taxes are going to decline significantly over the next 10 years, including WST. Is that right?

Dr Burn—Yes.

Senator SHERRY—This package gets rid of WST with a GST.

Dr Burn—Yes.

Senator SHERRY—And a whole range of state indirect taxes. Why wouldn't you get rid of the other federal indirect taxes as well?

Dr Burn—For the very simple reason that the need to do so would be removed because you would have a growth tax.

Senator SHERRY—So, following on from that, are you saying that the GST will, as a percentage of revenue to be raised, raise more money and have a faster growth rate than federal indirect taxes?

Dr Burn—Yes, because we forecast in the study that federal indirect taxes will decline as a proportion of GDP, whereas we would expect the GST to roughly hold its weight in terms of GDP, unless the proportion of consumption rises. But you would not expect a very big change there. So the growth in the GST would be expected to be much more substantial than the growth in the current indirect tax system, given the failings in the current indirect tax base.

Senator SHERRY—But, given your previous points that the GST taxes the service sector—and I do not necessarily accept that in whole—wouldn't you expect a GST to raise an increasing amount of money faster than the rate of economic growth, given the changing structure of the economy on the basis of your argument?

Dr Burn—Yes. The point that we make is that the GST will raise more than the present indirect tax system and, as you point out, the present indirect tax system is biased against, say, manufacturing versus—

Senator SHERRY—No, I do not necessarily agree with that argument. That is the argument that you have put.

Dr Burn—But the logic underlying that conclusion is that the current indirect tax system would not raise as much as the GST because of the projected decline in the share of GDP that would be raised under the existing indirect tax system.

Senator SHERRY—You are saying we have got a GST attached to services more than it is at the present time—more than the current indirect tax system. Given the switch in the economy as a percentage of gross domestic product, there will be more services—service industries are growing. Wouldn't we therefore expect the revenue from a GST compared to economic growth year on, year by year, to be greater than year-on-year economic growth?

Dr Burn—No. The GST will raise more than the existing indirect tax system. The existing indirect tax system would not capture the switch to services but the GST would capture the switch to services from year one, so that, relative to the existing indirect tax system, there would be a shift, but the GST would be a tax on all consumption at a single rate—as proposed—and the shifts between different consumption items would not affect the total take. It would just be more of one relative to the other. The comparison that you make, however, is very valid. Compared to the existing indirect tax system with its weak base, the GST would prove a much more sustainable source of revenue.

Senator HARRADINE—I have a number of questions and maybe I can follow them up at a later stage. On page 69 of the second Ralph business paper, volume 1, there is a proposal to abolish concessional tax treatment for public benevolent institutions such as hospitals and non-profit organisations to gain \$300 million to reduce the company tax rate to 30 per cent. Does your council support taxing charities, schools and non-profit organisations in order to cut the company rate?

Dr Burn—As I understand it, that figure refers to a change in the treatment of fringe benefits tax. Is that right? I do not have the number before me; I want to make sure I am answering the right question.

Senator HARRADINE—Yes, that is the point, I think.

Dr Burn—The business community is currently going through a process of looking at a full range of options as included in those papers. Our position formally is that we would not want to rule anything out. We have to consider everything in there. Revenue-raising things would be put forward as trade-offs for various things, including changes to fringe benefits, potential changes to capital gains tax, changes to business tax, et cetera. So I would feel uncomfortable ruling anything in or out from that paper. But I understand the point you are making.

Senator HARRADINE—That really is going to the FBT matter.

Dr Burn—Yes. I guess the question is that, if there is a deleterious effect on public benevolent institutions arising from changes to fringe benefits tax, perhaps the most effective way to address that would be not via the tax system but by some other mechanism.

Senator HARRADINE—Perhaps you could take this on notice. On page 24 of your submission, you talk about the reworking of the interface between tax and social security

systems, particularly relating to the family. On horizontal tax equity grounds, do you think that a family of whatever income, with children, should be taxed at the same rate as an income earner without family responsibilities?

Dr Burn—I appreciate the opportunity to take the question on notice. Perhaps I can give you a preliminary answer here. On horizontal equity grounds, you would look at the total relationship of that family with the tax and income support system. So that horizontal equity would depend on the final outcome, rather than just the tax side of the equation. For instance, you would take into account payments received in relation to children. You would look at the effect on their total disposable income. I point out that there are proposals to increase the benefits available to children and to decrease the rates of withdrawal of those benefits that would benefit families with children, relative to those without. I think the horizontal equity question has to take into account not just the tax side of it but also the transfer side of it.

Senator HARRADINE—I will not go into that. You must have a different understanding to me about the matter. Are you going to take that on notice?

Dr Burn—Yes.

Senator HARRADINE—Thank you. Perhaps you could take this on notice as well. Has the council considered the effect of the tax package on regional Australia, in particular, on a state like Tasmania which, on the evidence that has thus far come before us, is going to suffer a considerable loss of employment? Bear in mind that last Friday the figures showed that the number of persons in Tasmania in full-time jobs is the lowest since statistics in that area started to be taken in 1978. It is an absolute crisis. I would have thought that your organisation might have been interested in that particular area—no doubt it is interested.

Mr F. Ryan—As we said at the beginning, we have about 40 members. I believe the Tasmanian chamber is one of those members. At a general level, certainly, yes, we are very conscious of that as you would hope we would be. I think that the business coalition, over its 18-month existence, has learnt an enormous amount on some of the broad issues surrounding regional Australia. We have not formulated a single view but, for example, on issues surrounding compensation, in our discussions with ACOSS, we have said and continue to say that we are very open to learning more and finding out better facts, getting a better mix in the compensation where it makes sense. I would not like to make a comparison of any of those issues because it is not within my competence or capacity. So we do not have a single view, but we are very conscious of it. We are very open to advice from other parts of the community.

CHAIR—The time is now 11.41 a.m. I know Senator Margetts has some questions. I draw the attention of the committee to the hour. Our next witness, the Australian Food and Grocery Council, anticipated needing 75 minutes. It is now down to about 50 minutes. Out of respect for them, can we please keep our questions tight.

Senator MARGETTS—We can.

CHAIR—Thank you, Senator Margetts.

Senator MARGETTS—I want to revisit the questions that Senator Murray was asking. We have been given evidence both here and in one of the other committees in relation to how competitive the transport sector is in Australia. The evidence was that the transport sector is actually very responsive to cost signals. I am just trying to see whether you can defend your position in relation to transport elasticity. Was there evidence that you were using from ABARE talking about modal elasticity, fuel choice elasticity, or was it about general transport elasticity to price signals?

Dr Burn—The evidence from ABARE related to elasticities of demand for fuel.

Senator MARGETTS—So it was basically transport fuel as a lump but not a particular transport fuel?

Dr Burn—That is right.

Senator MARGETTS—So you have not actually proven or disproved the case that was being put to you, I would say. We have evidence in Perth that the Perth bus choices are being affected by price, amongst other things. In Sydney, there was evidence given to the committee that Sydney bus choices may be going down from 300 to 150, plus we have the evidence from New Zealand. Have you got any evidence to counter those figures of actual choices being made from one mode, that is, from the gas vehicle sector to the diesel sector, based on this highly competitive nature of the transport sector and its design to save money?

Dr Burn—No.

Senator MARGETTS—Is what you are saying that you are prepared to ignore any unintended consequence on the environment or health? If it can be proved that there will in fact be a move towards change in people's consumer behaviour—there certainly is already—to mean more diesel will be used especially in the urban areas, would you not say that is an unintended consequence? If that were the case, what would you recommend should be done about it?

Dr Burn—If I can clarify the nature of my comments earlier, I was answering a question in relation to what I understood to be the relative effectiveness of different instruments in policy affecting decision making. My general point was that, in relation to fuel, price is not a terribly effective way of influencing behaviours whereas the range of other tools that can influence behaviour in relation to externalities would probably be much more effective.

Senator MARGETTS—I find that quite extraordinary, considering the volume of literature that exists in relation to the price signals on consumer behaviour. So you are actually saying that all of that volume of documentation over the years in relation to price signals for consumer behaviour is off the point?

Dr Burn—No, it is a question of relative effectiveness. I think the literature supports the argument that emissions control measures, for example, are much more effective than price signals. So it is a question of relative effectiveness.

Senator MARGETTS—So would you recommend, to achieve cleaner air, to counter any market difference and to counter the concern that has been raised with new information about particulate damage to health, that the government take a position of controlling emissions?

Dr Burn—I would not put myself forward as an expert to recommend to the government such a change. What I am pointing out is that, in an evaluation of this, you would want to make sure that you were using the most effective policy tools available. The most effective policy tool available is not in relation to price and therefore taxes on fuel, but other mechanisms. Could I leave it to people with much more expertise to give advice to the government.

Senator MARGETTS—Can I suggest that what we are getting from the business community seems to be shifting goalposts. When there have been suggestions about increased environmental standards, they have said, ‘Let the market deal with it,’ and I have seen lots of evidence, even from conservative economists, saying, ‘The price mechanism should reflect the real cost and you can build in externalities.’ In a way, the business community are really leaving us with nowhere to go. Perhaps the business community are saying we should not deal with environmental and external costs of the decisions government make.

Mr F. Ryan—Firstly, I think opinions will vary within the business community. Secondly, where unintended consequences can be demonstrated, the business coalition would certainly be happy to take those on board, as it does with the other issues. But I think it is very difficult to generalise as to what position business has on this issue. There is a wide variety.

Senator MARGETTS—Thank you very much.

Senator GIBSON—Mr Ryan, can I return to the criteria of simplicity of our tax system. I know that Senator Meg Lees, the leader of the Democrats, has said publicly that the importance of simplicity has been overstated. Do you have a comment to make about that?

Mr F. Ryan—Other than that it remains, if you like, the core value within the whole business coalition effort. I am not quite sure of the context in which you made that statement, but on its face I would certainly have to disagree with it because from the beginning it has formed part of the objectives of pretty much anybody that has been in the debate, including ACOSS and others.

Senator GIBSON—Thank you.

CHAIR—We are finally done. Thank you very much, gentlemen, for your appearance before us. I am sorry it has taken so long, but our thanks for aiding our inquiry in the manner that you have.

[11.47 a.m.]

CARMODY, Mr Geoffrey Francis, Economic Consultant, Australian Food and Grocery Council

HOOKE, Mr Mitchell Harry, Executive Director and Chief Executive Officer, Australian Food and Grocery Council

CUTRESS, Mrs Brenda, Executive Director, New Zealand Grocery Marketers Association

STEWART, Mr Alan Grant, Member and Past President, New Zealand Grocery Marketers Association

CHAIR—As you are settling in, Mr Hooke, can I say I am sorry that we have kept you waiting as long as we have. I am aware that you wanted to make a long presentation. Our format does not accommodate that, but could you please make a presentation and bear in mind that we would like to leave as much possible time for the committee to ask questions as we could. We are now crunching you unfairly and we will have to extend a few minutes beyond our finishing time for lunch, but can I say—in the somewhat hopeful belief that we may be finished on time—I have a luncheon engagement at 12.30, so I may have to depart before you have concluded, and my apologies in advance for that. Please proceed.

Mr Hooke—Thank you, Chairman. I appreciate the courtesy. As you know, I am the Executive Director and the Chief Executive of the Australian Food and Grocery Council. We have previously appeared before this committee in presenting our modelling results which form the basis of our policy. We again appear in this respect to present the views of Australia's largest manufacturing industry, a major employer, a significant exporter of elaborately transformed manufactures and a major contributor to this country's economic and social welfare. We are also a globally competing industry, vigorously competing onshore and offshore without assistance; therefore getting taxation reform right is a key part of the efficiency and competitiveness equation in growing the industry's businesses. We cannot continue to rely on our comparative advantages in the production of agricultural commodities to underpin our competitive strengths in the value added end of the food production chain.

Notwithstanding the emotion that surrounds the taxing of food or the necessities of life, our industry has rejected a special pleading or a sectional interest case. We have no desire to support a piecemeal approach to tax reform. Indeed, the worst outcome for our industry would be differential taxes on food and drink products—that is, the zero rating of food confined to some food and beverage products only, akin perhaps to a Fightback mark II scenario—for the reasons that we have previously stipulated to this committee and which are contained in our submissions.

The committee knows our position on tax reform and the conditions of our support for the introduction of a GST. We consider the ANTS package of proposed reforms meets the fundamental criteria of good tax design. It will, in the main, deliver against the key tax reform objectives of the Australian Food and Grocery Council and, indeed, as you have heard, the Business Coalition for Tax Reform, of which we are active members.

But the package falls short in providing enduring adequate compensation to the poor and socially disadvantaged and fails as a policy initiative to remove payroll tax, deferring to competitive federalism and the market for its potential eventual removal, thus in the interim retaining a discriminatory and inefficient double-up on value added taxes. The tax mix switch of around \$5 to \$6 billion exacerbates the first round effects on prices, including our products, and therefore limits—to Senator Murray's line of questioning earlier on—the capability to remove other indirect taxes, particularly payroll tax, and therefore the scope to reduce the levels of compensation required to offset the mildly regressive impact of the GST. That is a very important point.

Our submissions propose for this committee's consideration remedies to the package which are consistent with our objectives for comprehensive reform. Our consideration that the critical and economical objectives do not and need not be mutually exclusive or in conflict with the social objectives of fairness, progressiveness and responsibility for the poor and disadvantaged go to a key plank of our policy, that is, that there should be effective compensation for lower income and socially disadvantaged people.

In doing so, we have addressed the fundamentals. We consider the proposals to exempt food to be symptomatic of a lack of confidence in the adequacy of fiscal compensation measures and their political durability for lower income people. As a welfare measure, as we said at the last hearing, we regard excluding food as a very poorly targeted and thus inefficient means of compensating the poor. I guess you have heard the line of \$1 for every \$5 for the 20 in the top 80 time and time again. We consider a better course is tax transfer compensation that is adequate and durable and consistent with the way welfare compensation is currently provided.

As I said earlier, we consider the proposed arrangements, the adjustments to pensions and other benefits rates will be eroded over time. To remedy this, we recommend that the ANTS package be amended such that the pension increases and other benefits proposed—that is, the four per cent plus 1½ per cent above CPI—are re-expressed in terms of a percentage increase relative to male total average weekly earnings and that the increment be added to the 25 per cent male total average weekly earnings legal minimum. In that way we consider the compensation would be adequate and permanent and affordable, given that the additional budget costs of the proposed changes would emerge slowly over time.

However, as I said at the last presentation to this Senate select committee, at the end of the day, if it is parliament's consideration that food is to be excluded from the goods and services tax, then we implore this committee to recommend that it be all food that is out, again for the reasons I have stipulated on numerous occasions. You know our position.

As a further remedy to the package, we remain committed to the abolition of payroll tax. As you know, we think there is around two per cent in the price of our products as a consequence of payroll tax. From the introduction of a 10 per cent GST, reducing the price impact of the GST reduces the amount of compensation required for its mildly regressive effects on the poor. Commitment to its abolition by state and territory governments should be an added precondition of the radical reforms to federal and state financial relations. The case for removing payroll tax is very strong.

We also strongly recommend that companies are not constrained in their ability to fully forward shift or fully price recover the net impact of the GST on their products. After my discussions with Allan Fels and others, we are optimistic that the new price control powers that have been provided to the ACCC through the amendments to the Trade Practices Act and the states' referral of pricing controls as part of this package will be a reserve capability. It begs the question that if there is not sufficient competition out there in the market to militate against super normal profits perhaps Professor Fels has some work to do in that area.

We also support the application of the GST included in the price of the product on the shelf. Professor Fels has made it very clear that he would consider it to be misleading and deceptive conduct not to convey the full net effect of price to consumers on the shelf. We support the transitional arrangements for there to be an input tax credit for the wholesale sales tax component of inventory.

In summary, we remain supportive of the government's package. We recommend that it be amended to correct for the inadequacies in the provision of compensation to the poor and socially disadvantaged and contain a commitment to the removal of payroll tax.

Chairman, if I may, I will introduce Mr Geoff Carmody who will go through some of the more technical aspects. He appeared with us before. Then, with your permission, I have brought two of our colleagues from New Zealand who will present to you briefly a case study of their experiences in New Zealand. Mr Alan Stewart is a former president of the New Zealand Grocery Marketers Association and Mrs Brenda Cutress is the Executive Director of the New Zealand Grocery Marketers Association.

CHAIR—We will hear from Mr Carmody. I acknowledge and welcome your colleagues from New Zealand to these proceedings. The purpose of these proceedings is for this committee to inquire into your submission which we have before us. It is not necessarily the case that you need to dwell overlong on what your submission contains for this committee. My consideration in managing this inquiry has been to try to allow as much time as possible for each of the slots allocated to the organisations appearing before us for the committee to ask questions. I ask you to bear that in mind when you are making your presentation.

Mr Carmody—Thank you, Mr Chairman. The committee has a copy of my power point presentation. I intend to focus only on the salient points. What I want to try and do is very briefly address the merits of zero rating food as against other alternative ways of delivering compensation as part of tax reform. The case for zero rating food rests firmly on the proposition that the tax system and the social welfare system combined should be fair. The argument is all about fairness. Taking food out is argued to be a fairer way of handling indirect taxes.

Overhead transparencies were then shown—

Mr Carmody—Fairness is obviously an important ingredient in any sensible tax social welfare system. How much fairness should there be? As H.G. Nelson would say, 'Too much fairness is barely enough.' There are some objective things that could be said about this that might throw some light on the merits of the case for zero rating food.

The first proposition that supports the case for zero rating food rests on household expenditure survey data which show that, as a proportion of disposable income, spending on food tends to decline as income rises. As this chart shows, the bottom 20 per cent of Australian households spend something like 39 per cent of their disposable income on food. The top 20 per cent of households spend something like 13 per cent of their disposable income on food. Clearly, zero rating food, therefore, would deliver a larger proportion of benefit to lower income groups than to higher income groups and, in that sense, does promote vertical equity.

The question is, however, whether that is the most efficient way to go. Given that budgets have scarce resources, all programs that budgets are trying to meet need to be delivered as effectively as possible. There is one objective piece of information that can be obtained from the household expenditure survey which throws some light on that consideration.

This chart shows that, generally speaking, the dollars per annum spent on food tend to rise with income. If you look at this chart, the bottom 20 per cent of Australian households spend a bit below \$5,000 per annum on food and the top 20 per cent spend over \$7,000 per annum on food.

This causes problems if you are zero rating food as a vertical equity measure because zero rating food targets the assistance to products and not people. The benefits that people get from those products will be a function of how much they spend on them. This is not to say that you are not promoting vertical equity, but you are doing so in a way that sprays the assistance dollars much more widely than you would hope. There are ways of looking at this to make the point. This chart shows that, if you spend \$1 of assistance on the bottom 20 per cent of the people through zero rating food, you will spend nearly \$1.50 on the top 20 per cent.

Perhaps a starker measure of the wastefulness of this approach is this: the yellow segment of this pie chart shows the amount of the total assistance obtained from zero rating food that goes to the bottom 20 per cent of households. It amounts to one-sixth of the total assistance delivered in the economy. The top 80 per cent of households end up getting another five-sixths of that assistance. You can help the poor by zero rating food but it is not the best way to go. There are basically three ways of helping the poor: you can do it by spending more dollars on the rich than the poor; you can do it by spending the same dollars on the rich as the poor—by increasing the tax free threshold, for example—or you can target measures directly to those most in need. That latter approach seems to me to be the most efficient way to go.

Food does not come out of it all that well because only one-sixth of assistance goes to the bottom 20 per cent of households. In effect, you are imposing on this assistance an inverse means test where the highest income people get a bigger dollar benefit than the lowest income people. There are better ways to do the job.

Having said all that, the compensation package in the ANTS documentation is inadequate. There are arguments about whether it is adequate on day one in terms of compensation for the price effects. They go to whether you are talking about a CPI average

or individual CPI effects on individual households. In terms of averages, it is probably still adequate, although you could probably argue that there are outriders in various income groups that need more assistance to be fully compensated. There is a clear-cut case of inadequacy in the durability of the compensation package that is being offered.

We should remember that, before the ANTS package was delivered, this government legislated that pensions and other related benefits would not be allowed to fall below 25 per cent of male total average weekly earnings. That was a pre-existing legislative commitment that had absolutely nothing to do with the tax reform document. It takes but a moment's reflection to realise that, if male total average weekly earnings rise faster than the CPI, it is only a matter of time before the real value of the compensation offered in the ANTS package will be eroded to zero. On some of the numbers I have done, that erosion could occur in as little as two to three years. In other words, the compensation package is simply inadequate over time.

There is an easy way around that problem. That is to respecify the compensation as an increment to the male total average weekly earnings benchmark that already exists. For example, if you wanted to lock in the four per cent increase in pensions and other benefits forever, you would increase the 25 per cent benchmark to 26 per cent. If you wanted, on top of that, to add another 1½ per cent above CPI you would increase it by another half a percentage point. All sorts of variations are possible, but the basic point is that, if you want that compensation to be permanent, you have to link it, as an increment, to the 25 per cent MTAW benchmark, otherwise it will be eroded over time.

Finally, there is a win-win proposal there. Leave food in but respecify compensation so that it is durable, not so that it will erode away over time. If you leave food out and leave the compensation package the way it is now, you will not provide permanent compensation for anybody. If I had my druthers, I would suggest a couple of other things too. Firstly, I would reduce the extent of the tax cuts by the amount of the tax mix switch, and use the revenue gained from that to get rid of payroll tax. Secondly, to make sure that the income tax cuts are permanent, to be honest, I would index the tax brackets to make sure that they do not get eroded over time as a result of inflation.

Mrs Cutress—I would just like to give the New Zealand perspective on this. I am going to table most of the things I would normally say. The surveys that I wish to refer to are all outlined in these documents. Interestingly, when GST or the concept was introduced into New Zealand, it received very little opposition. A white paper took 1,400 submissions and there was little opposition to the tax. Similarly, when the bill was eventually introduced in 1985, there was little opposition because it was made very clear at the outset that, at the time GST was introduced, personal income tax would be reduced, wholesale sales tax would be eliminated and, to help the low income earners who would be affected by the regression of the tax, there would be income support given. As a result of that, the tax met very little opposition.

The bill went through. During its passage—and this is what I want to dwell on in a little bit more detail—the then National Party that was in opposition did suggest an exemption for food. Interestingly, that was very strongly opposed and did not carry much weight because it was proved in a couple of surveys that I have tabled here that, for the reasons we have just

seen so cogently up here on the screen, when you do this it is the upper income earners who benefit more if you exempt food.

For that reason, it was decided it would be far more efficient to give the income support rather than exempt food. Similar surveys were done in respect of clothing, transport and medical bills and the same thing was found. For those reasons, the bill was carried and has been supported ever since. It has proven to be a very efficient tax because there are no exemptions. It was decided it was far better to have no exemptions and keep the paperwork and the compliance costs to a minimum, which has happened. For those reasons, it has proven to be a very successful tax.

Mr Stewart—In addition to my involvement with the New Zealand GMA, I have been a managing director of New Zealand's largest privately owned food manufacturing company, Hansells New Zealand. I was also involved in the Australian food industry with Lanes Biscuits when that took over the Nabisco factory from Arnotts, and I was managing director of that company for a year. Since then, I have continued an involvement in a number of small manufacturing food industries in New Zealand.

Prior to the introduction of the GST in New Zealand there was the wholesale sales tax regime, similar to what is currently operating in Australia. There were many examples of anomalies in that system with different rates of tax for the same product—a pencil sharpener which was ornamental, rates from exempt to 40 per cent depending on at which port it came into the country. So there were problems with the sales tax system. They also had similar problems in the food industry—fruit juice was exempt from sales tax; fruit drink had sales tax on it. Unless it was a very low level of juice, then fruit juice ended up more expensive than fruit drink. The problem there was that the lower income people bought the fruit drink and paid the sales tax; the higher income people bought the fruit juice and did not pay the sales tax. What that leads on to is the problem with inequalities, with different rates of tax for different products.

When a GST was introduced into New Zealand there was large scale educational activity. I was involved as an accountant at that time. Certainly it became an advantage to educate small businesses in the benefits of GST, and there have been considerable benefits. Those small businesses have been able to very quickly get used to GST, and that has been a great help in their own record keeping and in their ability to prepare annual accounts and that sort of thing.

The GST system also brought into the tax system a number of people who had previously not paid any tax whatsoever. The small operators, painters, tradesmen, casual businesses which paid no tax now have to pay GST on their expenses, their operating costs and also on their own income. Previously they were able to get totally tax free income by not declaring it. Many of those people then wanting to get back the GST input also registered for GST. When you have a GST on all turnover without exemptions, there is a very easy cross-check between GST and income tax to ensure that people are paying the correct income tax.

Exemption of foodstuff from GST perpetuates the anomalies that currently exist in the Australian wholesale sales tax system. I am aware of such examples as different sales tax

rates that apply for the same product—milkshake flavourings where chocolate is classed as a chocolate preparation and exempt and other food milkshake flavourings are 12 per cent sales taxed. This causes confusion—different retail prices. There also have been problems with classification of products. I am aware of the same biscuit that was labelled a cracker and had sales tax on it; when it changed to be a crispbread it became exempt sales tax.

Any effort to exempt some food products is going to add to those problems. Even if all food products were exempted from GST, there would be many cases where it is difficult to decide whether a product is a food or whether it is a confectionary—such things as health bars, whether they are confectionary, whether they are food. There would be ongoing problems. This can be avoided if GST applies to all sales as GST records would be prepared from the total turnover of a business.

In summary, the major benefits to the New Zealand food industry with the introduction of GST were the removal of sales tax rate anomalies, the creation of a level playing field with all taxpayers paying their fair share of the tax, and improved and more accurate record keeping for accounting which led to better and more efficient business management. The country benefited with a more even tax take while encouraging personal saving, with consumers paying their tax on consumption and less tax on their income—therefore, not paying tax on the money they saved. Tax is also collected from visitors to the country with GST inclusive prices. Similar benefits would apply in Australia, provided the system of GST is kept simple with all consumer products being taxed at the same GST rate.

ACTING CHAIR (Senator Gibson)—Thank you, Mr Hooke. I guess the first thing is to say that I think you have previously made plain to us your strong views about food and the GST, and you have also told us previously of your preference about payroll tax and the tax mix switch. However, in the executive summary of your submission, you make the claim:

The package falls short in providing enduring adequate compensation to the poor and the socially disadvantaged.

I have really got to ask what evidence is there to say that that is correct? After all, we as a committee have had the original Treasury information, plus evidence from Treasury, plus the HECS data, and then we have had ACOSS evidence basically showing that all groups would be adequately compensated with the four per cent plus the 1½ per cent guarantee by CPI adjustment.

Mr Hooke—It comes back to what you mean by ‘adequate’. As Geoff Carmody has just said, on day one you could argue that the compensation would be adequate at four per cent plus the 1½ per cent. But, as he also explained, as we have explained in our submission, if you relate that to the establishment of a legal principle whereby pensions and other benefits would not fall below 25 per cent of male total average weekly earnings, one could presume that that is going to increase. Male total average weekly earnings are going to increase at a faster rate than will the compensation arrangements in the package. Therefore, if you presume that, or if you conclude that the word ‘adequate’ means that it must also be enduring and does not erode over time, then you have to say that it is not equitable.

So the point is simply that the structure of the arrangements as they are will not, in our view, endure over time. They will be eroded and, therefore, we have proposed a rather

simple suggestion which will not have a major impact on the budget in the first instance but, more likely over time, be commensurate with the prospect of it eroding over time.

Mr Carmody—You only need two points to establish the case. The first point is—fact: 25 per cent of male total average weekly earnings is a legislative benchmark of benefit adequacy that was introduced before 13 August 1998. Fact: average earnings grow in real terms over time. Put those two together, and the legislative benchmark erodes the compensation as currently specified.

Senator SHERRY—Spot on.

Mr Carmody—All you need to do to fix that is re-express the compensation as an increment to male total average weekly earnings and you are there.

ACTING CHAIR—Again, it gets back to what is meant. If the CPI adjustment is providing adequate compensation—and the evidence from, as I said, ACOSS and the Melbourne Institute is that it is adequate with the four per cent adjustment—regardless of how long it takes, and I take your point about the average weekly earnings, for some years, CPI adjustments would continue to lift those adjustments. The average weekly earnings is a completely different adjuster.

Mr Carmody—You have already promised the community, before the tax package was introduced, that 25 per cent of male total average weekly earnings is a standard below which you will not fall.

Senator GIBSON—Yes.

Mr Carmody—That benchmark will, over a matter of a few years, eat away to zero the compensation package offered in the tax package, and to claim the 25 per cent as part of your compensation package is to claim that something was introduced before it was introduced. If you are honest you would have to say that, if that was the benchmark before the package was introduced, we need to add to that benchmark to provide to those on social welfare benefits compensation that lasts. If you do not do that, everyone who says that the compensation package will not endure is dead right.

Senator CHAPMAN—I can understand your saying that the relative value of the compensation package would erode, because the MTAWWE earnings will rise faster than the CPI. But, provided the compensation package maintains pace with the CPI, I cannot see how you can say that the real value of the compensation package will erode.

Mr Carmody—No-one is saying that I said that. All I am saying is that you have promised by law to maintain a relative standard.

Senator CHAPMAN—No, our promise in relation to compensation was that we would maintain the real value of that compensation.

Mr Carmody—Which is cheap compensation, because the cost is zero after a couple of years.

Senator CHAPMAN—Nevertheless, if the compensation is being maintained, it does not have to—

Mr Carmody—I think that is semantic, Senator.

Mr Hooke—The political point, if I may—

Senator SHERRY—Sorry, I missed that, Mr Carmody. What did you say then?

Mr Carmody—I said I think that is semantic, Senator.

Senator CHAPMAN—I ask our New Zealand guests: in relation to the introduction of the GST in New Zealand, were any estimates made prior to the introduction of the GST in New Zealand as to the effect it would have on the cost of living, either by CPI or some other measure? Was any compensation introduced in New Zealand? And, since the introduction—now some years down the track—has there been any analysis of the effect of the GST on the cost of living, as measured by the CPI or some other factor, and how does that jell with any prediction prior to its introduction, if such early analysis was done?

Mrs Cutress—As I said, I think, when I commented earlier, work was done to estimate what effect it would have on prices, and it was estimated that it would affect prices by about five per cent. As it happened, I think it was lower than that because the sales tax that came off a lot of products actually lowered that price. That is why the income support package that was introduced at the same time was linked to that lower income. We did a lot of work; there were a lot of surveys done on population income. It was estimated that those income groups in the lower two decile groups would need an income support system by way of compensation, and that was set in place. That has subsequently been reviewed by the government.

Senator CHAPMAN—So what you are saying is that, in practice, as it turned out, the price effect of the GST prior to its introduction was actually overestimated—that the price effect was actually less than the estimate?

Mrs Cutress—Yes.

Mr Stewart—I would add that the income tax take went up considerably more than was expected. By picking up a lot of people who previously had not paid income tax, we ended up with a lot more taxpayers. There was a significant drop in income tax from around 60 cents in the dollar to 33 cents in the dollar, but we still had a much higher income tax take than was expected. The family support scheme that was brought in adequately supported the low income people so that, overall, I think everybody was happy with the GST when it came in.

Senator CHAPMAN—So it was a win-win-win situation.

Mr Stewart—It was, yes.

Senator O'CHEE—I have a brief question for our friends from New Zealand. I note the comment Mr Stewart just made about the income tax take going up. Was it the experience in New Zealand that many businesses registered because they wanted to get the rebate of taxes paid on input costs?

Mr Stewart—Yes.

Senator O'CHEE—Was there also another element where, if they could not be a registered business, then obviously somebody who was going to buy from them could not claim a credit on the input? Was that also a factor?

Mr Stewart—If you owned a commercial property and you got a painter in, you would expect him to give you a tax invoice and be able to claim back the tax. If you asked him for a tax invoice and he said, 'I'm not registered. I can't give you one,' that immediately pointed the finger at someone who was avoiding the tax system. Generally, people accepted that it was necessary to register. That picked up a lot more taxpayers.

Senator O'CHEE—So it wasn't just the desire to get the input tax credit that led to the high registration; it was also the necessity to be able to give a business number or business registration, to be able to do business with other people, that brought these people, albeit reluctantly, into the net.

Mr Stewart—Yes.

Senator MURRAY—I should follow by saying that the other element in New Zealand was the low registration level of \$30,000, which encouraged people to get on.

Mrs Cutress—Yes.

Senator MURRAY—One of the things we have to address is whether \$50,000 in Australia is too high. Mr Chair, I am going to take the call last, if I may, but I will make one comment in doing so, to compliment Mr Hooke and Mr Carmody on trying to address the core problem which this committee has had to grapple with; that is, the relationship between the three issues of efficiency, simplicity and equity and how we deliver a fairer tax system and deliver compensation.

Mr Hooke knows that I am a long-term admirer of his particular style and approach to these issues. I think that he and his organisation approach any Senate inquiry with a great deal of passion. We quite often do not agree, but I have always found the passion supported by integrity and thoughtfulness. We might not end up agreeing on this either, but I am very appreciative of you really making the effort to address a very fundamental problem.

I would also like to say that, of all the business organisations we have had before us, I know your organisation has consistently paid attention to the social consequences of our tax system and not given exclusive attention to the simplicity and efficiency areas. Thank you for making the effort. I know there is money and time attached to it.

Senator SHERRY—Mr Carmody, going back to a copy of the slides that you showed us earlier on, you say: is compensation locked in? Slide 1 says, ‘That still might support more generosity to cover non-average individuals.’ By that, do you mean that there are people who obviously do not conform to the average who are uncompensated or undercompensated?

Mr Carmody—What I meant there was that inevitably, no matter how fine a level of detail you go to in the household expenditure survey data, you will end up still dealing with groups of people rather than individual people and, indeed, the finer disaggregation you go to, the more unreliable, statistically, is the information you are working with. So, by definition, every aggregate of groups must give you an average picture. There are potentially people above and below that average.

That being the case, and particularly where those people can be identified and reached through the social welfare transfer system, I am perfectly happy with the proposition that, in the interests of picking up those people, you should risk a deal of overcompensation for the average to make sure that you minimise the damage that might be done in terms of undercompensation for individuals.

I think how you identify some of those people will be a practical issue but I would be the first to admit that when you are dealing with aggregates, no matter how fine the disaggregation of households you are talking about, then you must be dealing with averages to some extent and, by definition, averages have a range of people in circumstances around those averages. That is all I meant.

Senator SHERRY—So there are groups of people who may miss out on an adequate level of compensation, because of the averaging process?

Mr Carmody—If you target compensation tightly to averages and make it just adequate rather than overcompensate, then there will be that risk. That is right.

Senator SHERRY—You then go on and say, ‘There is a clear case for arguing that the compensation package is not adequate over time,’ and you went into the issue of indexation to male total average weekly earnings. I was not totally clear on this point. With the indexation to male total average weekly earnings, I understand the issue in relation to people on age pensions. Are you suggesting that all social security payments be indexed to male total average weekly earnings?

Mr Carmody—I am not across the precise arrangements for all social welfare benefits. I understand that a large number of them in some way, directly or indirectly, are geared to the pension, which is in turn geared to this benefit adequacy benchmark. All I am proposing is that, for all of the benefits that you want to adjust, to deliver compensation for people in receipt of those benefits you simply have to re-express the compensation package as an increment to the 25 per cent MTAW benchmark. Some benefits might be lower than that but, if they are geared to that with some sort of proportioning factor, you will guarantee that the level of compensation you deliver on day one stays there relative to pre-existing legislated commitments over time.

Senator SHERRY—I understand that principle, but the only one at the moment that is directly linked in that way, first by policy prescription and then by legislation, is the age pension, as I understand it.

Mr Carmody—That is not my understanding, Senator. My understanding is that other benefits are linked to the pension as well. So, by working on the pension, you do something for these other benefits as well. I might also say that that is not the only way compensation is being delivered. There are also adjustments to taper rates, and so forth, for a number of benefits—not all, regrettably, but most. They also provide useful amounts of compensation by reducing marginal effective tax rates for people on those benefits.

Senator SHERRY—We spent some time on the committee in Sydney yesterday in discussion, particularly in respect to pensioners and the erosion. You say in that slide, ‘Is compensation a better way? This erosion could occur quite rapidly on some forecasts for wages and prices in only a few years.’ Is that dependent on the growth in male total average weekly earnings over and above inflation?

Mr Carmody—That is correct.

Senator SHERRY—You said, I think in answer to Senator Chapman, ‘If you don’t do that,’ that is, this indexation arrangement ‘everyone who says the compensation won’t last is dead right.’

Mr Hooke—Presuming that the growth is greater than the CPI rate, which, as Geoff Carmody said, historically has been the fact. The real issue here—and it goes to what Senator Murray kindly said—is that proposals to exempt food from the GST base are symptomatic of a lack of confidence in the compensation arrangements in the package. As we have spelt out ad nauseam, taking food out of the system, sure, will provide some compensation, but it is not an effective or an efficient way of going about it. Therefore, we have concentrated on tackling those fundamentals to the package that we think go to the heart of the problem that people have about the compensation, and that is whether it is enduring.

Senator SHERRY—I do not disagree with your analysis. In fact, I congratulate you for at least dealing with certainly one of the fundamental concerns that I have about a GST. I do not believe it addresses all of my concerns, but, at least in this area, it attempts in a way to suggest what no-one else has at least been honest enough to do. So I congratulate you to that extent.

Mr Carmody, you talked about the average. There is a very significant group of people who are unemployed, who are not of pension age—and I am not sure you would be aware of the detail—who have lost their job and have little prospect of finding further work and are living on their superannuation, for example, prior to reaching pension age. There is a very significant number of these people. We have had a lot of correspondence from them. It seems to me that there is no compensation in this package for them at all.

Mr Carmody—I think it is a question of ends and means. I have no difficulty with vertical equity as a fundamental design issue. I have a lot of personal support for the

proposition that the tax system should do its primary job, which is raise revenue efficiently. The social welfare system needs that.

If people point out to me that there are particular groups in the community that are falling between the stools, that is, they are not entitled to adequate social welfare compensation and they do not get enough income to benefit from income tax cuts, I am quite happy with the proposition that, where such groups are found and are genuinely in need, the social welfare system, the targeted transfer system on the outlays side of the budget, should be adjusted to address those problems.

But the fundamental design point that we are trying to make here is: let the GST do its job properly by having a uniform, comprehensive approach to taxation. Then, to avoid this problem of spraying compensation all over the place—in fact, giving five-sixths of it to people who do not need it, arguably—make sure that you deliver social welfare benefits through a targeted approach, preferably on the outlays side of the budget. If people can point out groups that are going to miss out as a result of this package, my response would be: design the social welfare system to pick them up.

There is another thing you could do as well. You could improve the whole character of the compensation package by getting rid of the tax mix switch. That is just a pea and thimble trick anyway. You would virtually eliminate the overall CPI effect if you were to just say, ‘Take that part of the income tax cuts that are funded by the GST and use that GST revenue to get rid of payroll tax, for example.’ You would then have virtually no CPI effect. That alone would dramatically change the magnitude of the compensation problem you would be left with.

Senator SHERRY—When you say to reduce some of the income tax cuts, would you reweight those income tax cuts? At the moment the percentage reduction for higher income earners is greater than it is for lower and middle income earners, in the main, although there are some exceptions. Would you go that far?

Mr Carmody—As H.G. Nelson says, ‘Too much vertical equity is never enough.’ That is an area where different people can have different views. Value judgments about the progressivity of the income tax rate scale can differ between different people. I am trying to present material based on objective fact here.

If you got rid of the tax mix switch, the bottom end compensation dollars that you would need would be substantially reduced. If you left the income tax cuts structure the way it was, you may end up actually giving more in real terms to lower income groups than not. But I do not have a view personally on that. I would prefer to see lower income tax rates across the board because I think they have adverse incentive effects on saving, incentives to work and so on.

Mr Hooke—By definition you will have to reconfigure them and find the brass to pay for the payroll taxes.

Senator SHERRY—To return to that quote earlier, and this is in reference to your compensation:

If you do not that, everyone who says the compensation package won't last is dead right.

Notwithstanding that I have other concerns about the package, could you blame us for voting against the package if the government did not pick up your suggestion?

Mr Carmody—Frankly, having been involved in the tax reform debate now since 1975, I think it would be much better for you to vote in favour of adjusting the compensation package to make it last, and put in place an indirect tax system that would stand the test of time and help provide the revenue that you will need to fund your policies when you eventually get back into power.

Senator CHAPMAN—I hope that is many years into the future, of course.

ACTING CHAIR (Senator Gibson)—Any further questions, Senator Sherry?

Senator SHERRY—No.

ACTING CHAIR—Senator Harradine?

Senator HARRADINE—I want to follow up what Senator Sherry has been asking in respect of certain groups that may miss out because of the averaging. Householders with disabilities, for example, have still got to eat. They have still got to have shelter, clothing, and heating and what have you. Is not a GST on services more onerous for them than for other householders? For example, they have to get somebody in to clean the house, do the gardening, do the digging and chop the wood. Surely, this is a serious problem.

I would like to ask our colleagues from New Zealand—and welcome to Australia—how was that particular specific question approached in New Zealand? Have you any information about it? If not, I would be interested to have an answer on notice.

Mrs Cutress—You will notice some of the surveys that were done in the papers I have tabled. They will show you that the impact it had was far less than was thought. Because the GST picked up so much more revenue than was anticipated—it was a 50 per cent higher revenue than they anticipated—it was decided that that money would be used to help those people that fell within the gap that you are thinking about.

There are benefits. The social welfare system was seen as the most efficient way of addressing that. Because the GST was seen to be so effective for the reason that it lowered personal income tax and was beneficial overall, it was felt that it was much more efficient to help the sorts of people that you are concerned about through a social welfare package, which was implemented.

Senator HARRADINE—Thank you for the general answer. However, could I have an indication specifically in respect of a householder not on a social security benefit, but a householder who has disabilities and who has to bring people in to clean the house and do the digging in the garden, et cetera, those sorts of jobs that those householders, if they were able-bodied people, would do themselves, and enjoy doing themselves.

It seems to me that this package discriminates against those people. Can you comment on that particular householder in New Zealand? I am referring to a person who is not on social security but for whom the GST applied to services so that it increased that person's liability. There appears to be no compensation for that person in this package.

Mr Stewart—That person who had a disability you are saying does not have social security; therefore that person must have an income.

Senator HARRADINE—That's right.

Mr Stewart—Therefore, from that income the reduction in income tax on the low level is quite significant. So they were compensated—

Senator HARRADINE—That reduction of income tax applies whether the person is able-bodied or not. Can't you see the point I am making?

Mr Stewart—The person with a disability on low income, as an individual, got back as much compensation as extra cost. Compared with another person, they might not have had an advantage, but compared with their previous situation they were not disadvantaged. Their income tax went down and they paid more GST.

Senator HARRADINE—Except they have to pay a GST. They have to pay a GST on the services whereas previously they did not.

Mr Stewart—But they got a lower income tax. They ended up on an equal situation. And, if you are talking about cleaning, there was sales tax on cleaning materials which came off.

Mr Hooke—It goes to the heart of the issue, whether you provide assistance to those people through the welfare system or a blunt instrument across the whole board. Do you want to pick up on that?

Mr Carmody—I can see where Senator Harradine is coming from. This is not meant to be a flippant answer, but I am trying to explore the range of possibilities. If you wanted to make sure that there were absolutely no losers and no gainers and everyone was absolutely square, you would never do anything. You would not change wholesale sales taxes or anything because it is just impossible to replicate the impact, benefit or cost, of an indirect tax system with a direct tax social welfare transfer system. You are going to have approximations if you change one for the other; that is inevitable.

That said, I think I would respond as follows: it is certainly true that different people in different circumstances have different bundles of expenditure and therefore they face different net price effects from the GST package. The argument is that the government only adjusts pensions in line with CPI, et cetera. My response to that is this: the price effects we are talking about here are all policy induced and therefore a more discriminating approach is appropriate; therefore I would look at the one-off price effects affecting different groups in the community and try to judge whether the compensation package, social welfare benefits, plus income tax cuts and the like, are adequate.

For that you are probably going to have to overcompensate some to make sure that others do not lose out or do not lose out significantly. I cannot say to you, however, that every single individual in every single circumstance as a result of any sort of tax reform is going to be absolutely okay. The only way you can guarantee that there will be no losers is to have no winners and have no change.

ACTING CHAIR—Mr Hooke, can I just ask one last question? The Restaurant and Catering Association predicted losses of about 20,000 jobs based directly on using the Canadian experience and applying it here. Would your organisation care to comment on that evidence?

Mr Hooke—I am aware of the Canadian experience. I am also aware of the Restaurant and Catering Association's position. I have no evidence to support or refute their claims about job losses, but I would certainly make the point, and it is made in our submission, that if you start drawing the line between, say, food and beverage products in grocery stores and other root trade outlets as distinct from food service and restaurants and caterers, then you will certainly confer on the producers of those products a competitive advantage—what some like to call in the vernacular 'the share of the stomach'. To the extent that that flows on in terms of competitive disadvantage to the restaurants and caterers then one could certainly presume that that will impact on their businesses.

That is the reason why we have said all along that, if you are going to take food out, you need to take it out totally, and the revenue implications of that are about \$6 to \$7 billion. The revenue implication from stopping at the food service line is about \$4½ billion, and if you go back to a Fightback mark II scenario of light and processed and staples and what have you, you are about \$2½ billion.

ACTING CHAIR—Senator Margetts, can you hear me? It sounds as though she has gone.

Senator SHERRY—Mrs Cutress, you referred earlier to how good the GST was at raising revenue. Why was it necessary to increase the GST in New Zealand from 10 to 12½ per cent after two years?

Mrs Cutress—The government made a decision that it needed further revenue and it was seen preferable to go the GST route than to up personal income tax, and at the same time a commitment was given that income taxes would be reduced.

Senator SHERRY—Yes, but if it was so good at raising revenue, why should it be increased shortly after it was introduced?

Mrs Cutress—It was not shortly after. It was—how many years after? It was quite a while.

Mr Stewart—It was some years after.

Senator SHERRY—It was four or five years, but that is a pretty short time.

Mrs Cutress—Yes, yes. I think the decision was that it was an effective way of raising revenue, and then at the same time this undertaking was given that income taxes would be further—

Senator SHERRY—Yes. But my point was that earlier in your evidence you were talking about GST being good to raise revenue, et cetera, when it was introduced. When it was so good, why did you have to increase the rate shortly thereafter? Why was it not sufficient on introduction?

Mrs Cutress—It is why government chooses to raise taxes all the time. At times governments see there is a need somewhere—

Senator SHERRY—Just like the government here could increase the GST if it wanted to.

Mr Hooke—No; different systems.

Senator SHERRY—No. Provided it passes it through federal parliament. The states and territories do not have to agree. They can just pass an act, can't they?

Mr Hooke—Is that right?

Senator SHERRY—Yes, of course. Federal parliament can pass an act to change that act of parliament any time it likes.

ACTING CHAIR—The committee will come to order. We have run out of tape with *Hansard*. We will have to stop. Thank you very much for your attendance and evidence.

Proceedings suspended from 12.45 p.m. to 1.43 p.m.

WALSH, Mr Damian John, Partner, National Indirect Taxes Practice Leader, Arthur Andersen

ACTING CHAIR—The committee will resume its public hearing today and we welcome Mr Damian Walsh from Arthur Andersen as our next witness. You are aware of the standard procedure. We have your submission before us. You have the opportunity to speak to that submission, if you so desire, and then we will go to questions.

Mr Walsh—At the outset, I would like to reaffirm our support for and commitment to the tax reform process and, of course, the GST in concept. You will note from our written submission that the direction of the submission is actually to point to a number of design and transitional issues that we are particularly concerned with for our clients at large. I will briefly touch on the key issues and then turn over to questions.

On the design side, the legislation itself is unnecessarily complex. The interaction of the business to business transactions tax and the cascading impact of certain aspects of the tax does create a degree of complexity. In addition, we would submit that the compliance costs are substantial for our clients, recognising that, in the mainstream of GST—if I could just add an early clarification to that point—like wholesale sales tax, there is a degree of simplicity. Once you are in the system and you are selling widgets and paying the tax at a particular rate, once your systems are established, the process is fairly simple. The complexities are really in all of the other areas outside the mainstream. Financial services is probably the most obvious area of the incredible complexities in the GST legislation.

We would point out that relatively few taxpayers—I would submit, without providing any obvious support for it, less than 500—would pay far and away probably 85 per cent of the GST revenue. But there are about 1.6 million taxpayers that will be caught in the GST net, required to be registered and—

Senator CONROY—Tax collectors, you mean?

Mr Walsh—Taxpayers.

Senator CONROY—Taxpayers or tax collectors do you mean?

Mr Walsh—One point six million entities will be registered for GST purposes and will be charged with collecting and paying GST. Most of those taxpayers will, of course, contribute absolutely nothing to the net revenue, and that is because business to business transactions net each other out. What one business will charge in GST to another business will be taken as a credit by that business at about the same time. There is clearly a cash flow issue but, as long as the timing is right, in fact, there is no revenue to the government. And that is clearly the majority of the taxpayers.

Input taxing financial supplies does give us some serious concern. It does create a cascading tax on tax business input cost. It will flow through in consumer prices and it will ultimately flow through to exports and, particularly, the impact on in-house Treasury functions. Financial supplies that are made by an in-house Treasury function, where that Treasury function is, in fact, part of an otherwise fully taxable business, creates the most

obvious burden of double taxation for a business, and an area that would give us and our clients very serious concern.

Away from the design issues, the price expectations that have been delivered in the ANTS package—in the original August proposal for the tax reform package—we feel have been overemphasised. There is an immediate impact for some, a pre-GST or a pre-1 July 2000 impact of GST, and that is quite clearly the case in relation to insurance. It goes well beyond that though. All warranties, indemnities—motor vehicle warranties, extended warranties and such indemnities—leases, subscriptions, travel passes, and so on that are actually acquired prior to 1 July 2000, but overlap the introduction of GST, will give quite a number of our clients both costs in the form of GST before 1 July 2000 and, of course, for quite a number of our clients, it imposes a burden of identification, calculation and collection; there has been clearly some publicity in the insurance sector on that point already. We would submit that this is a matter of a lack of adequate transitional provisions, and I will talk a bit more about that in just a second.

There is also the denial of input tax credits, again in a transitional sense for motor vehicles but, more generally, financial supplies, as I mentioned earlier, and also the denial of input tax credits on certain categories of expenditure which would otherwise be business inputs, most particularly entertainment and related hospitality and such expenditure.

The anti-avoidance provisions are simply over the top, and we would seriously submit that they should be reviewed and rewritten. We do not think it is appropriate that you can have a general anti-avoidance provision drafted in such a way as to expressly apply, even where there is no commercial alternative to the transaction that is targeted as being offensive. The definition of export services is too restrictive. Again, that will create a compounding effect for quite a number of businesses in Australia.

On the transitional side, I have already mentioned the problem with pre-purchased insurance, indemnities, warranties and so on that have the potential to create very substantial unfunded GST liabilities for quite a number of businesses if they cannot work out the impact in advance. In the next few weeks, insurance policies start to be recalculated and renewal notices go out and so on. It goes well beyond that. As I said before, any warranty, indemnity or lease may well fall into that category.

There is double taxation of leases. If one buys a piece of equipment—let us say a motor vehicle—or acquires a motor vehicle by way of lease pre-GST such that sales tax is paid on the vehicle post-GST, the lease payments will also be subject to GST. So, if one acquires a vehicle in May 2000 on a lease arrangement, the vehicle will be subject to sales tax when acquired. That sales tax will be capitalised in the cost and that will be part of the lease package to which GST will apply again. Again, it is a transitional issue which we submit can be dealt with.

There is a much broader issue for capital equipment generally that is acquired sales tax paid prior to 1 July 2000 and that is really a demand issue, I would submit—the computer industry, the transport industry to some extent and some other industries where there is a very substantial amount of sales tax inherent in goods that are then acquired pre-GST, but post-GST are generating taxable services for the GST regime. Of course, there is no credit

allowed for the sales tax that is paid. What is going to happen, of course, is that the demand for computers will simply shrink as we get closer and closer to GST. Most computer equipment is subject to sales tax, of course.

There are some other aspects of the transitional provisions as we have pointed out in our report that we would submit need to be addressed. I would submit that in the interests of simplicity and equity, the legislation should be reviewed in detail for all of these issues before it is finally passed.

I would like to reiterate that we do not have a problem in concept with GST. I have stated that position very clearly. We stated it in our written submission and we have made that position clear on our firm's behalf on other occasions. We are supporters of tax reform. We are supporters of the concept of the GST. It is the detailed impact on our clients' businesses that we are most particularly concerned with.

ACTING CHAIR—Thank you, Mr Walsh, for the submission you have made to us. Have you also made submissions to the government and to the Treasurer's office about these details?

Mr Walsh—Yes, we are making submissions to the government on a regular basis as a firm and on behalf of our clients.

ACTING CHAIR—Fine.

Senator MURRAY—Mr Walsh, I have read your firm's report that you did with the Ralph committee on international taxation. I think this submission of yours continues a tradition of providing objective and very helpful advice and views. As a working member of the committee, I welcome it and thank you for it.

I notice from the BCTR submission earlier today that participants in the BCTR research effort included Mr Philip Anderson of Arthur Andersen, Mr Brett Rix of Arthur Andersen, Mr Tony Rumble of Arthur Andersen and Mr Tony Stolarek of Arthur Andersen. Were all these observations you have put to us put by Arthur Andersen's representatives to BCTR? Have they been accepted as broad objective suggestions for the improvement of the tax package?

Mr Walsh—The work that the BCTR has been doing in relation to the Ralph committee has clearly been directed at the business tax reform process, rather than the broader tax reform process. The GST has not been a factor of that but the BCTR is aware of our submissions and our concerns about the design and transitional issues that I have pointed to today.

Senator MURRAY—As a general comment, I would summarise your views that it would have been far more helpful if the government had circulated draft legislation for public comment, as it does with the CLERP and CLERB process and indeed as it is doing with the republic process, before digging its heels in and saying there should be no change because what you are recommending are some fairly material changes to the package.

Mr Walsh—We would have preferred to have seen the legislation circulated as a draft. I understand that it was intended to be released as a draft for comment but because of time constraints that did not happen.

Senator MURRAY—I draw attention in your executive summary to this following remark:

Further, we do not express any comment on the political issues associated with the introduction of GST nor the debate as to whether food or other supplies should or should not be taxed.

That is on page 1 of the submission. Would you agree that the issue of food is not so much a political issue but a concern as to the equity principle and whether the equity principle should best be served by food being taxed or not taxed or by those less fortunate in our community being compensated for the effect of that tax on a necessity of life?

Mr Walsh—I would agree that that is perhaps a better description for it than the one that I have used there. What we as a firm were intending to say is that this submission makes no comment on the place of GST in the tax reform package. Let me make it clear that we are supporters—very active supporters, very aggressive supporters—of tax reform. We deal with our clients on a daily basis. We know the problems that are in the system now because we see them on a daily basis. Whether GST belongs as part of the tax reform package depends on the whole package and, in the package that has been delivered, it has a clear role—or a broad based consumption tax has a clear role. This is the model of the broad based consumption tax that we have got—the GST—and it is about that particular model that we are making our comments.

We offer no comments in this submission in this forum on the issue of whether food should be in or out of the GST base. Perhaps I could venture a comment now on that point that we would believe that taking food out would add a very serious level of complexity in the sense of how our clients would be required to manage the GST process. But on the equity principle I offer no comment.

Senator MURRAY—I certainly accept that your firm and you will take a very practical approach to the issue of tax, based both on your experience and your interaction with clients. Therefore it is interesting to see what I would regard as commonsense judgments. Again in your summary on page 2, you have the remark:

There is no question that it will take years for the effects of the abolition of the WST and other tax changes to fully impact costs and prices. It is also true that the cost of GST as a new business input impost will take many years to be realised.

I assume that that is a judgment based on your international experience as a firm and your expectation of the practical consequences of the tax package?

Mr Walsh—Yes, that is the case. It was acknowledged in the ANTS package that the PRISM model that Treasury has used does not take into effect the time delays of the abolition of wholesale taxes, FID and BAD and so on. The price expectations that are put forward here are not 1 July 2000 price expectations. They are probably not 1 August 2000 price expectations. They are much longer term price expectations.

As an example, sales tax has no doubt been paid on the desks we sit at and the audiovisual equipment that we are using in this convention centre we are in at the moment. It will only be when that equipment and this furniture is actually replaced that the advantage of the abolition of sales tax actually comes home.

Senator MURRAY—So with capital equipment there are some write-offs, for instance, on depreciation terms which go as far as 15 years on some kinds of capital equipment?

Mr Walsh—That is correct. It is effectively the economic life.

Senator MURRAY—So notionally it could take 15 years for some of those to wash through?

Mr Walsh—Yes, indeed it could. I will offer a further clarification there, though. How much is still left after five, 10 years? It might be that there are very small amounts of tax still embedded. If I keep driving my car for 15 years I guess tax would be embedded.

Senator MURRAY—But it is unrealistic to expect it all to wash through in year one or year two, isn't it?

Mr Walsh—That is right.

Senator MURRAY—I think both Senator Sherry and Senator Conroy have previously indicated to witnesses in questioning that in many respects this GST is in fact a multi-rate tax intention, because you have exempt goods, you have zero rated goods and you have new taxes introduced for luxury cars and for alcohol. You have confirmed that view, if I have paraphrased them correctly, by saying on page 3 of your executive summary:

Simplicity should dictate that a multi-rate GST would be preferred.

In other words, if you are going to differentially tax within the package, it should be encompassed within the same philosophical entity in which the GST exists. Is that a correct summary of your position?

Mr Walsh—Yes, it is, and that is what we have stated in our executive summary on page 3: the single rate of 10 per cent has been delivered notionally in the context of GST, except to the extent, as you point out, that there is quite a range of exemptions or GST-free suppliers—education, charities, health care, child care and so on. But we believe the problem is compounded by the introduction of two new taxes to sidestep the multi-rate GST issue that the wholesale sales tax is now being replaced, effectively, by three new taxes—the GST, the luxury car tax and the wine equalisation tax. We would have a concern—again, as stated on page 3 of our report—that over time we will find that more goods will find their way into the luxury tax rate or into the equalisation tax rate, if I can change the terminology perhaps, and that would be a serious concern.

Senator MURRAY—My last question—although, as you could guess, I have many more because of the detail you have—relates to the remark you made that the ATO has publicly

acknowledged that in order to collect \$30 billion in net revenue it will collect \$40 billion gross. That \$10 billion obviously gets repaid in due course, I assume?

Mr Walsh—Yes.

Senator MURRAY—Can you indicate the time period over which, in your experience, that \$10 billion would be repaid and who is primarily going to bear the cash flow negativity of more being collected that is going to be retained?

Mr Walsh—I cannot give you an answer to that question in any calculated sense, Senator. I have not tried to extrapolate from that tax office statement as to the time over which that cash will be outstanding. But they are saying that in any financial year to collect their \$30 billion of GST revenue they will manage \$40 billion in cash. The cash flow, of course, comes about because we have a value added tax system, a multistage system: one person will pay the tax and the next person will take the credit at about the same time but not at the same time. So the tax that will be paid in one month may not be taken as a credit until the following month, and that is the cash flow differential. There are also much greater timing differences.

There are timing advantages for some businesses as a result of GST, and there are timing disadvantages for others. It is really a case-by-case analysis. You have to look on the one hand at the time difference between receiving cash from your customers and actually paying your GST liability on the output side and, on the input side, actually paying your suppliers the cash-out in GST terms, and actually getting the credit for the GST that you have borne.

Senator MURRAY—I have seen evidence which indicates that large business will get a cash flow positivity out of this process, but that small business will in fact experience the bulk of this negativity. Is that likely to be so?

Mr Walsh—Not necessarily. Again, it will depend on a case-by-case analysis. Large supermarkets will clearly get a cash flow advantage. They collect cash at the cash register and they will not pay their GST liability until the 21st of the following month—although we would say also that that is too early; it should really be at least 30 days for most businesses—and they may delay settling up with their suppliers. In that case, there is a very significant cash flow advantage. There may be other very big businesses who suffer some deferral in cash collections that would see them paying their GST liabilities before they collect the cash from their customers. And, of course, the smaller the business is, the more likely it is they will have less market power to collect their cash early. So it is likely to be exacerbated at the small business level.

Senator HARRADINE—Mr Walsh, in relation to your Tasmanian clients, have you been able to advise them of the total effect on employment and growth in Tasmania as a result of this ANTS package?

Mr Walsh—No. I cannot give you any specific information as to advice we have given to any particular Tasmanian business.

Senator HARRADINE—In regard to the Ralph review, your international management partner, Alf Capito—is that his title?

Mr Walsh—Alf Capito is the head of our international tax practice.

Senator HARRADINE—He is a partner in your firm. He made some very interesting comments in a couple of articles in your very valuable *International Tax Bulletin* review of December 1998 in which he said:

If the government proceeds with some of the measures announced prior to the last election—for example, an ill-considered Deferred Company Tax (DCT) regime, or an ill-considered Group Consolidation Regime (coupled, as can be expected, with interest allocation rules)—there is little doubt that many Australian multinationals will re-domicile.

Are you satisfied that the processes that are taking place both in respect of the ANTS package and the business taxation areas are proceeding in a way that ultimately will result in a fair deal for all? I ask that question because, on page 7 of your submission to us, you indicated that:

The review must prioritise all economic growth principles, especially international competitiveness.

I will just finalise this with a quote two pages on where Mr Capito said:

We need urgent tax reform in this area and should not allow it to be side-stepped or ignored in what has become a narrow minded tax reform debate centred on whether or not we should have a GST.

Maybe I am interpreting the term ‘narrow minded’ in a way that was not meant.

Mr Walsh—I think, Senator—and clearly I will defer to my colleagues’ comments there—that we are concerned for tax reform, we are aggressively working for tax reform, and we are generally very pleased for the degree of consultation that is available to us as a firm and through the Business Council, the Business Coalition for Tax Reform, the Ralph committee process and so on.

We would be concerned if the debate got down to GST itself. GST, in the context of tax reform, is very different to saying, ‘Let us just have a new tax and let’s call it GST.’ We would see that GST as a new tax is a very, very substantial tax. Anywhere between \$30 billion and \$40 billion in revenue is a very, very substantial amount of revenue, particularly compared to corporate tax at about \$18 billion at the moment and sales tax at about \$13 billion. They sort of phase away. Therefore, as I say, we are very concerned to make sure that the GST is debated in the context of total tax reform and not in isolation.

Senator HARRADINE—You have mentioned between \$30 billion and \$40 billion as the expected income from a GST. Did you indicate that was what the figure was? We have been working on the figure of about \$27½ billion as far as I know. Is that right?

ACTING CHAIR—In the first year, Senator.

Mr Walsh—And clearly over time that will grow. I think there is some added revenue from some aspects of the transitional provisions, particularly the denial of input tax credits

on motor vehicles over the first two years or 100 per cent in the first year and 50 per cent in the second year, which will have a very substantial cost to business. And that will flow through. It will cascade through the business cycle and end up in consumer prices. And at every stage, of course, it will add to GST revenue because it has the effect of creating tax on tax as you go through. Over time I think we will wait and see how much revenue comes from the GST.

Senator CONROY—I just want to go back over some of the evidence you gave a little earlier in regard to those that will incur pre 1 July 2000 costs for your clients. I think you suggested insurance, warranties. Could you just expand on what you mean by warranties?

Mr Walsh—A warranty that is given. A very simple example is a motor vehicle. A three-year, 100,000-kilometre unlimited warranty is in effect no different from an insurance policy. It is an indemnity that the motor vehicle manufacturer or the distributor will give to indemnify the user against any faults in the car for that long.

There is some uncertainty about the ultimate scope of the GST legislation—some of the terminology is very vague—but we would submit that those extended warranties will be subject to GST to the extent that they overlap or span the introduction of GST. Warranties on brown goods—washing machines, television sets or anything like that—will have the same effect, particularly in the case where you have extended warranties being offered by the credit card companies or being offered by the retailers on their own account. Manufacturers' warranties, statutory warranties, may well not constitute a separate supply for GST purposes. As I said before, there is some uncertainty in interpretation there.

Senator CONROY—Leases, you said?

Mr Walsh—Leases, yes.

Senator CONROY—Subscriptions?

Mr Walsh—Yes.

Senator CONROY—And travel—I was not sure whether I heard you right when you said travel. I was making notes trying to get—

Mr Walsh—I specifically mentioned travel. It was the concept of prepaid travel—a yearly train ticket or a yearly travel pass. A monthly travel pass that is bought two weeks before the introduction of GST will overlap the GST period to some extent. The legislation is quite clear that, where you have periodic supplies that overlap or span the introduction of GST, the GST will apply to that part of the supply that is post 1 July 2000. These require some cost analysis right now. We have clients in the insurance sector who will be sending out insurance renewals in the next few weeks for policies that are effective from July of this year. There has been a lot of publicity about that already.

Senator CONROY—The insurance council and NRMA, in particular, have been before us already on that issue. Funeral services have also got a bit of publicity in terms of prepaid funeral services.

Mr Walsh—Yes.

Senator CONROY—Off the top of your head, are there any other sectors where you have clients?

Mr Walsh—I should say that we come across new situations every day where there is some as yet unforeseen impact of the GST on our clients.

Senator CONROY—Liability. In terms of how your clients are coping, as you have indicated you have insurance companies about to do mail-outs. Presumably they have one of two choices: they can absorb it into their shareholders funds in some cases or increase their prices. In your experience, are they leaning one way or the other or are most just increasing package prices?

Mr Walsh—I think the insurance companies are saying quite publicly that they will seek to determine the impact and increase their prices to recover the tax.

Senator CONROY—It might be the only place that the 100 per cent of flowthrough actually works.

Mr Walsh—Yes.

Senator CONROY—You made some suggestions that there is a lack of adequate transitional arrangements on these issues. Is there anything that you could suggest to the committee at this point?

Mr Walsh—I would think that there are a number of ways of handling it. You could just draw a line in the sand and say that an insurance policy that is purchased pre 1 July 2000 is just outside the scope of the GST.

Senator CONROY—Wouldn't that lead to a mass rush of people buying insurance policies before 1 July?

Mr Walsh—I do not think it is going to lead to any more of a rush of people to do that than it will to do house renovations, quite frankly. You can renovate your house in May 2000 and enjoy it for the next 20 years, but you do not pay any GST on it. If you take out an insurance policy in August 1999 that has two months overlapping the GST period, it will no doubt create some market rethinking and repositioning but that is going on anyway. As soon as the rate of sales tax drops from 32 per cent to 22 per cent on televisions and stereos and things, the retailers will be out there marketing it very aggressively. The reason they are not marketing it now perhaps is because they do not want people to hold off buying that equipment for another three or four months.

There are market demand issues. Motor vehicles are in the same situation. I know from what I have read in the newspapers that the motor vehicle industry has made it pretty clear that it is very concerned about the demand issues associated with the transition to GST.

Senator CONROY—You make reference on the first page of your executive summary to the fact that the GST tax collectors will be saddled with a substantial compliance burden. Could you expand on that?

Mr Walsh—GST is an inherently complex tax. It is the multistaged nature of the tax. As I noted earlier in my comments, once the systems are set up to manage GST, those businesses that are in the mainstream of GST that have their cash flow managed effectively should be able to manage GST with relatively little burden. It will become a fairly automatic thing, as is wholesale sales tax for people who are in the mainstream of wholesale sales tax. Their systems are established. They have been in the system for many years and it works for them.

The problems lie outside of that area. We are asked to look now at some of the most complex contractual arrangements that our clients will need to deal with many years after GST is introduced. An example is where an operator of a site is offering exclusive access to a vendor of products: ‘If you come on to my site, none of your competitors will come on here, in return for you, the product vendor, including a little marketing blurb on your products. In other words, you put our logo on your packaging. We will also give you some signage and some administration space on site and so on.’

What you get there is a taxable supply being made in return for consideration, which is another taxable supply, where there is no value attached to it. There are no invoices; there is no cash changing hands, but the GST legislation requires that each side of that contract be broken down, the supplies be identified and valued, and the GST be paid on those supplies by the one party and the other party. If the value to each party matches—which you would expect that it would—and the value that is being supplied on this side meets the value that is being supplied on that side, then for the GST that is paid each party will give the other party a tax invoice and they take a credit equal to the amount that they have just paid and there is absolutely no net GST advantage to the government. Yet we have to go through that process and break down the contract. This is an issue that we will do over and over and over again for every major business contract that is created.

Senator CONROY—I would like to get some idea of what you mean by mainstream. When you say companies in the mainstream will not have an overall big change or big problem, what sort of company are we talking about there that is outside the mainstream? Is it a small business person who does not have a computerised system? Is that what you mean by outside the mainstream? I am trying to get some perception of what you mean.

Mr Walsh—No, when I talk about mainstream, I am really talking about a company that buys and sells commodities—for example, like the glass I am holding in my hand. For them, GST at 10 per cent on their sales is an easy thing to manage. They are currently paying 12 per cent sales tax on their sales and they will now pay 10 per cent GST. The systems require very little modification and the whole process is very simple for them.

On the other hand, if the company that sells these glasses is a major commodity trader and has in-house functions and some activities that are going to be input taxed, that is where the complexity arises. How do you start the identification process of what credits I am going to be entitled to and what credits I am not going to be entitled to. Financial institutions

generally, and all suppliers of financial supplies, will have major issues even where they are simply business to business transactions. Of course, at the end of the day, if GST was charged it would simply net out and credit would be taken for what is charged. That is what I mean by the non-mainstream areas.

Senator CONROY—I see. You talk about cascading taxes. We have seen on the front page of today's *Financial Review* that the motor industry seems to believe that there is a cascading effect. Are you referring to something similar to them, if you had a chance to see that, or is it a separate cascading issue?

Mr Walsh—I have seen the article and I must say, without the benefit of having heard the presentation to your committee, I am surprised at what is reported.

Senator CONROY—We have not had a presentation yet. Perhaps we will be getting one. You talked about a cascading effect and I wondered if that were the same as what they were referring to.

Mr Walsh—No. In that situation there is not a cascading effect, in the sense that the tax that is charged at each level of the distribution of the motor vehicles will be taken as a credit at the next level of the distribution of the motor vehicles. There is not a cascading effect there at all. We do have a value added tax and it is very clear that the GST is a value added tax. When I talk about the cascading effects, I am much more concerned with the denial of input tax credits to financial suppliers, where that cost to the supplier of the financial service will—

Senator CONROY—The government is arguing that you are going to be better off. They have told the banks that they are going to be \$1 billion better off and it is only going to cost them \$600 million.

Mr Walsh—Yes.

Senator CONROY—Would you agree with the government on that?

Mr Walsh—No, I would not. I think that the financial institutions are very concerned, particularly when they start looking at their outsourcing and the continued trend towards outsourcing, at the impact of GST on that economic decision. Do you outsource or not on that business decision? The GST that is paid by financial institutions around the world where they operate in value-added tax systems and they are input taxed is very substantial—very significant.

Senator SHERRY—The GST replaces the wholesale sales tax and a number of other taxes, but the WST is the big one in terms of replacement. For inflation to be minimised, the savings as a result of a wholesale sales tax by price reductions have to be passed on to consumers, otherwise inflation will be greater than it should be, taking into account the GST. The ANTS package assumes full flow-on immediately of wholesale sales tax savings. On looking at your submission on page 2, you say:

There is no question that it will take years for the effects of the abolition of the WST and other tax changes to fully impact costs and prices.

Why? Treasury assure us that, on 1 July, WST prices come down instantly.

Mr Walsh—There are two levels of wholesale sales tax there. There is the tax that is on the goods themselves. At 1 July 2000, there will be no sales tax when I buy a television set. That cost reduction will be passed on instantaneously in the interest of competition.

Senator SHERRY—In all cases?

Mr Walsh—I would expect in all cases it will be. I cannot speak for the industry; I cannot speak for the retailers, clearly. We would expect that those sorts of cost reductions that are so obvious will flow straight through to retail price reductions. That will be driven by consumer expectations, the ACCC powers through the amendments to the Trade Practices Act and, regardless of either of those factors, just pure competition. The sales tax at a different level though, as I mentioned before, as paid on these tables and this audiovisual equipment, is the embedded taxes that the government has talked about in its ANTS paper that will ultimately find their way out of the system when all of these goods are replaced over some number of years. Computers obviously these days have a fairly limited life. It is a couple of years for a laptop and it is pretty well history. The turnover of those types of goods is faster than some others. The embedded taxes—in other words, the taxes that are right down the line and will ultimately come out of the system and flow up through the line—will take many years.

Could I add a clarification? This commentary is in the context of overemphasising the price expectations that some of our clients are going to be asked to meet. We are concerned to make sure that clearly the ACCC, in particular, with quite broad powers now, does take into account the real cost reductions and not just the anticipated cost reductions.

Senator SHERRY—What is the difference between real and anticipated? Surely it is clear: the TV prices are going to come down with wholesale sales taxes removed. What are these other anticipated costs?

Mr Walsh—It is the flow-through effect of having the stamp duty removed on the conveyance of the television manufacturer's factory from one site to another in five years time. It is that sort of tax cost that will ultimately filter through, but not immediately.

Senator SHERRY—It is pretty hard to work out, isn't it?

Mr Walsh—It is very difficult to work out, quite clearly.

Senator SHERRY—The ACCC assure us it will be done?

Mr Walsh—We have not yet heard anything official from the ACCC. When the amendments to the Trade Practices Act take effect, we do anticipate that Professor Fels will let us know what his expectations are.

CHAIR—Senator Margetts, do you have any questions?

Senator MARGETTS—Yes, thank you. I will try to be quick. Your submission notes that the legislation is highly complex. How would you compare the complexity and compliance cost with the current system?

Mr Walsh—It is a bit like comparing apples and oranges. If we are talking here about the wholesale sales tax system, it is a very complex system. It does not affect too many taxpayers. It has quite a narrow base and so the compliance cost for those businesses that are in the wholesale sales tax system are substantial. GST has a much broader base, so compliance cost will be spread right across a much broader range of industries.

Senator MARGETTS—So are you saying it depends who we are talking about as to what it would be?

Mr Walsh—It very much depends on who we are talking about.

Senator MARGETTS—In relation to compensation, page 4 of your submission notes that the \$500 million in compensation is grossly inadequate. What would you estimate to be a more reasonable figure?

Mr Walsh—I have not gone to the next step and tried to work out what would be required to cover the cost of the transition. It really depends on at what level of business do you stop. I know that this package was directed at small business. We have not yet understood how it is to be distributed—whether it is going to be cash or whether it is simply going to fund training or whatever. The transition costs are very substantial. We have clients that have budgets of in excess of \$5 million to cope with the transition. That includes systems advice and so on. It can be very substantial and it depends on the size of the business.

Senator MARGETTS—I guess there might be specific problems for those people producing goods and services partly for export.

Mr Walsh—I am sorry, Senator; could you repeat the question?

Senator MARGETTS—Do you see specific problems for those people who are producing goods and services that are partly for the export market?

Mr Walsh—Not really. I think that there is some added complexity where you have to make a decision: is a particular transaction taxed or is it GST free? Where you are selling widgets, some export and some local, I think that that decision tree would not be very difficult or complex to deal with.

Senator MARGETTS—What is your perspective on compensation for charities and community groups? Would it be better to give direct assistance, in your opinion, or give a GST-free label to charities and community groups?

Mr Walsh—Senator, I am not offering any comment on that issue, if that is okay.

Senator MARGETTS—Okay. I think that is all.

Senator GIBSON—Mr Walsh, this morning we had a couple of groups which included some New Zealand witnesses. They were asked specifically about, first of all, acceptance of GST in the New Zealand community, particularly the business community, and, secondly, about compliance cost. The thing that came through loud and clear in the advice from the practitioners from New Zealand was that the compliance cost was going to be quite low for those who are computerised, for instance, and more and more businesses are computerised. The software is available in New Zealand now for less than \$200—about \$150 was mentioned. Would you not expect that for a lot of Australian small businesses the current accounting packages, which lots of small businesses use to prepare their material before they go on to the likes of your firm, would in fact be modified to fit in with the legislation and will not cost very much?

Mr Walsh—I think that is quite possibly true. Over a period of time, I think the initial set-up costs for some will be substantial. For others they will be very little, particularly where they are already in the sales tax regime, for example—it will be to change the rate from 22 per cent to 10 per cent and count your blessings. For others it will be much more complex where they are actually coming into the regime for the first time. There are accounting systems that deal adequately with GST. There are internationally designed systems that cater for VAT. I think in the New Zealand scenario it does depend on who you talk to, as it does in Australia. It is a case-by-case analysis. We would trust that all of our clients, in some number of years time, once they are in the system and it is working for them, will not have a major concern about dealing with GST.

CHAIR—That concludes this session. Thank you, Mr Walsh, for helping the committee in its inquiry.

[2.35 p.m.]

FAHRER, Dr Jerome Gregory, Principal, Allen Consulting Group

HERSKOPE, Mr Michael Arthur, Senior Manager, Corporate Affairs, Philip Morris

LUCCHESI, Mr Adrian, Legal and Corporate Affairs Director, Rothmans of Pall Mall (Australia) Ltd

SILVER, Mr Stuart, Manager, Public Affairs, W.D. & H.O. Wills (Australia) Pty Ltd

CHAIR—Thank you for coming. I apologise for keeping you waiting. As we are running late, I am trying to catch up some time. I do not want you, in any way, to stilt your evidence but I would be grateful if you could bear that in mind. I will try to ensure that my colleagues do not waste any time as well.

The list I have starts with you, Mr Herskope. I am not sure whether you are the right man to throw to or whether there is someone else there. For the sake of convenience, I go to you first and invite you to point out who is the designated hitter on behalf of your team and ask that person to introduce themselves and the rest of you. We will then welcome a short presentation and overview of your written submission and trust that you will be available for questions.

Mr Herskope—Thank you for the opportunity to present to you today. We intend to supplement some of the material that we presented or submitted to you with some new material in a presentation which should take around 15 minutes. We are quite comfortable with questions during the presentation or after, whatever suits the committee.

Overhead transparencies were then shown—

Mr Herskope—The first slide up there is our agenda. What I thought I would cover today is firstly a brief dissertation on tobacco tax in Australia—a brief history, the current position and what is intended in the near future. Then I would like to put forward some issues for consideration by the government in its thinking in terms of how it intends to treat tobacco as part of the GST regime. We intend to show that, concerning the government's treatment of tobacco, its financial position post-implementation of the GST will actually be worse off. I will spend some time addressing the issue of unfairness of tobacco tax and then run through our conclusions and the industry's recommendation to the committee.

At the outset, I would like to put forward our contention that, while we do not oppose the introduction of a GST, unless the government reduces the tobacco excise to ensure the tobacco tax burden does not change when the GST is introduced, those who can least afford to pay tax will incur an increased tax burden and, furthermore, the government's financial position will be negatively impacted.

Turning to the next slide: we have experienced massive tax-driven price increases in respect of tobacco throughout the 1990s averaging around 11 per cent per annum in real

terms to the extent where now at least 67 per cent of the recommended retail price of an average packet of 25 is represented by tax.

Tobacco is taxed highly in Australia, even by international standards. This result makes intuitive sense. While Australia's proportion of tax receipts accounted for by indirect taxes is at the OECD average, Australia is very reliant on taxing a narrow range of goods such as tobacco. Nearly all other OECD countries tax consumption more evenly via a GST, thereby facilitating less reliance, relatively speaking, on tobacco tax. Conversely, in Australia, whilst the base for taxation will be broadened via a GST, the government has announced that it will not only increase its tobacco excise collection in November this year, but it will then apply a GST over the top.

This treatment does not seem to sit squarely with the government's stated criticism of the current tax system. Page 8 of the government's tax reform policy document says, 'The indirect tax base would continue to decline, rates would need to be increased again, and this debilitating cycle would continue.' This is, I guess, a reference to whether the existing system is allowed to continue without amendment. It appears that this debilitating cycle is intended for tobacco.

Tobacco incurs the highest level of tax of any goods and services in Australia. I would like to move to the next slide and come back to portray that comment. That slide actually has the wholesale sales tax equivalent rates on tobacco, alcohol and gambling. These three industries attract the highest levels of tax of any goods and services. But even amongst these three industries, tobacco stands out as the most highly taxed. Based on 1996 figures, the wholesale sales tax equivalent rates for wine are 41 per cent; gambling, 42 per cent; beer, 91 per cent; spirits, 253 per cent; and tobacco, a massive 339 per cent.

This tax burden is set to increase significantly, even prior to the commencement of the GST regime. The government's policy document on the Australian tax system published in August last year foreshadowed the change to the tobacco tax collection method from the current method to a per stick rate. The government announced it would increase its collection of tobacco tax by \$250 million concurrently with this change. The Treasurer recently announced in a press release dated 3 February that this change would take place from 1 November of this year and an additional \$440 million would be collected. This \$440 million figure represents a tax increase of around 10 per cent. But when looked at in aggregate with the GST effect, over the next 16 months, tobacco will incur a further 25 per cent plus in increased tax.

I would like to put forward some issues for consideration by the government in their intended treatment of tobacco and ask them to change that. The treatment of tobacco tax is inconsistent with the treatment by the government of other indirect taxes under the GST regime. The government intends to scrap many of the indirect taxes currently operating when it introduces the GST. However, the government has singled out the tobacco industry by applying a tax on a tax—the GST to the tobacco excise. This is further highlighted by the government's more equitable treatment in its tax reform package of the other excisable goods—petrol and alcohol—when compared to tobacco.

In New Zealand, when the GST was introduced in the 1980s, excise on tobacco was effectively adjusted to minimise price increases. The existing sales tax applying to tobacco of 105 per cent, along with all other sales taxes, were replaced by a GST of 10 per cent and, in the case of tobacco, an excise of 90 per cent was introduced. In other words, an allowance was made in the New Zealand system for tobacco when the GST was introduced by reducing the existing tax rate on tobacco. We believe this equitable treatment of tobacco is a good precedent for the government to take notice of, especially as it seems to have taken notice of the New Zealand model for tobacco excise collection which is due to commence here on 1 November.

The next issue we would like to put forward for consideration is that illegal trade in tobacco is on the increase. Following the High Court decision in August 1997 that invalidated state licence fees on tobacco and certain other commodities, the illegal trading of tobacco stocks across state borders ended, as the incentive to do so was removed. However, a new form of illegal trade has emerged since then, that is, the sale of illegal cut tobacco, known in the industry as chop-chop. Illegal operators have seized on the chance to defraud the federal government by purchasing, processing and selling chop-chop without paying any excise. This has disadvantaged not only the government but also all legitimate participants in the tobacco industry, manufacturers and retailers alike, who simply cannot compete. To put this in perspective, federal Customs has agreed with estimates that this problem is at one million kilograms per year, well over half the loose tobacco market, representing \$230 million in lost excise to the government.

The incentives for these illegal operators are clear. The tax on tobacco is so high that, if it is not paid and the product is moved through illegal channels, ultimately the tobacco is being offered to consumers at prices which simply make a mockery of the legitimate product. Furthermore, we are experiencing the rise of contraband and smuggled tobacco products from overseas into Australia. The recent Canadian experience is instructive in this regard. In listening to this experience, I ask you to bear in mind what I previously mentioned, which is that the government intends to increase tobacco taxes by more than 25 per cent in the next 16 months.

In Canada, between 1980 and 1993, federal excise levies increased by over 550 per cent, while provincial levies increased by more than 500 per cent. By 1994, contraband apparently accounted for 40 per cent of the market. This surge in contraband brought a number of undesirable effects. The federal and provincial governments lost an estimated \$1.5 billion Canadian in potential cigarette tax revenue per year. Canadian wholesales and retailers who sold tobacco experienced a decline in sales due to consumer shifts in cigarette purchasing from legitimate retail outlets to contraband offerings. According to media reports, high cigarette prices brought on by high taxes increased cigarette theft. Thieves breaking and entering shops bypassed the cash tills and went straight for cigarette stocks. The increase in break-ins led to soaring security and insurance costs, which further deteriorated the wellbeing of retailers and wholesalers.

On 8 February 1994, the Canadian Prime Minister announced the roll-back of federal tobacco taxes as part of a national action plan to combat smuggling. As a result of the roll-back, smuggling reduced as Canadian smokers returned to purchasing cigarettes from

legitimate outlets. The Canadian experience is surely a situation that Australian would wish to avoid.

I turn now to our contention that the government's position post-GST would be worse off in terms of the treatment of tobacco tax. Many studies of price elasticity of demand for tobacco indicate a measure of negative 0.4. We understand federal Treasury regards this as the current measure. However, the Allen Consulting Group believes the most recent estimate of this elasticity, using data for the period 1987 to 1997, is more like negative 0.86. That is more than double the usual estimate. That means that tobacco consumers are far more sensitive to price rises than federal Treasury believes is the case.

This change to elasticity must mean that future government revenues from tobacco taxation will grow at the very least much more slowly than in the past and, quite possibly, not at all, or even fall, as we will show in a moment. The era when governments have been able to use smokers as an easy source of tax revenue, on this evidence, has come to an end.

The effect on the government's financial position as a consequence of its proposed treatment of tobacco in the context of the GST, adjusted by reference to the elasticity information we have just covered, and the consequent effect on CPI related government expenditures, in all likelihood presents a very different picture than that which federal Treasury believes is the case. If a GST is simply added to existing tobacco taxes, the government will be financially worse off as it will end up spending more in CPI related expenditure than it receives in additional tobacco taxes. This conclusion was reached by modelling created by Professor Neil Warren, and the modelling was conducted for us by the Allen Consulting Group.

Tobacco tax is unfair and this position will be exacerbated in the next 16 months with tobacco taxes set to rise by over 25 per cent. Low income earners tend to smoke more than people with relatively high incomes and spend a much larger proportion of their incomes on cigarettes and tobacco. This point is exemplified by the conclusion reached by London Economics, in a report prepared for Philip Morris in February 1997, that 29 per cent of smoking households in 1993-94—that is, around 656,000 households—actually paid more in tobacco taxes than income taxes.

The government has stated in its tax reform policy document that a new system needs to be fair and non-discriminatory between different sectors of the economy. The tax reform package provides a reduction in the lowest marginal income tax rate. The government's tax reform policy document identifies that this will help all taxpayers, but is of particular benefit to low income taxpayers. The government states:

Low and middle income taxpayers, in particular, will keep a higher proportion of the earnings they receive after tax, providing them with greater rewards for their work efforts.

Hence, if a GST is simply added on to the current tobacco tax, on the one hand the government is giving by reducing the lowest marginal tax rate, but on the other hand it is also taking by increasing the tobacco tax burden. Therefore, the government's justification for tax reform will be undermined by the treatment of tobacco. This tax package will cause

the regressivity situation to be compounded as the increased tobacco tax will fall disproportionately on low income earning smokers.

Raising tobacco taxes cannot be justified on the basis of recovery of cost to government because smokers more than pay their own way. This fact is evident in the cost-benefit analysis for government of tobacco consumption in Australia which was carried out by Christopher Doren and Rob Sanson-Fisher of the New South Wales Cancer Council, and Moira Gordon of the Economics Department of the University of Newcastle. Their study was published in the *Australian and New Zealand Journal of Public Health* in 1996, and I have copies for members of the committee which I could tender.

CHAIR—Mr Herskope, could I indicate that you are right on your 15 minutes now. I do not want to artificially restrict your submission, but can I just draw that to your attention and hope that you can wind up fairly soon.

Mr Herskope—Senator, you will be pleased to know I am reaching the conclusion shortly.

Senator CONROY—Just before you finish, Mr Herskope, I thought you said ‘fair and non-discriminatory.’ It is just that your slide says ‘discriminatory.’

Mr Herskope—That is an error, I apologise.

Senator CONROY—It should say ‘non-discriminatory.’

Mr Herskope—Yes, thank you. As I mentioned, a paper on this topic was published in the *Australian and New Zealand Journal of Public Health* in 1996, and the authors concluded that the benefits to government exceed by more than three times the cost to government, which brings us to our conclusions.

We trust we have demonstrated that tobacco taxes are highly regressive and inequitable, and much higher than can be justified by reference to the alleged social costs of smoking; that tobacco consumers have now become highly sensitised to price increases to the point where tax increases may not add anything to government revenue; and that adding a GST to existing tobacco excise would actually cause the government’s financial position to be worse off due to the effect on the CPI and consequent indexed government expenditures.

The industry’s recommendation to the committee is that the GST should be imposed with a commensurate reduction in tobacco excise, thereby effectively having a neutral impact on the price of tobacco products and a neutral impact on the government’s financial position. Thank you.

CHAIR—Can I assume you are speaking on behalf of the full table?

Mr Herskope—Yes.

CHAIR—Thank you, but everyone is available for questions?

Mr Herskope—That is correct.

CHAIR—Have you put this proposition to the Treasurer, and if so, what has he said?

Mr Herskope—We have put this proposition to the Gibson task force and we have followed up with a submission to the committee. In terms of directly to the Treasurer—

Mr Silver—Each of the companies has independently made representations to the Treasurer. Certainly, there were questions which related to how the calculation of the extra tax revenue from tobacco was calculated and, as Mr Herskope said, those questions go unanswered at this point in time. But there have been representations made, yes.

CHAIR—Has the government dismissed your representations? Is that why you are approaching us? Is the government still considering them? What is the status of those representations?

Mr Silver—We followed the channel of presenting to these committees in order to get heard. But in terms of direct representations to government, we are not aware whether they have been dismissed or not.

CHAIR—My concern is simply this. We have to report to the Senate and we would rather report on issues that are in dispute rather than issues that are in suspense. If you have not got an answer, we might have to ask the government what is the answer for your industry so we know where we stand in terms of making any recommendations or considerations as to what the Senate should do to the government's legislation. That is why I asked the question. So, if you are aware of the time in which the Treasurer may respond to you, would you notify us of that response when you receive it?

Mr Herskope—Yes, certainly.

Senator GIBSON—I was interested in your new estimates of price elasticity. Do you have any evidence with regard to demand elasticity? The government's tax package will give substantial income tax cuts across the board for all people of about \$40 to \$50 per week on average for the average employee. Will a significant proportion of that end up being spent on your products?

Mr Silver—One point that should be borne in mind is that the data shows that for a great number of smoking households in Australia, some 29 per cent of those actually pay more in tobacco tax than they do in income tax.

Senator GIBSON—I understand that.

Mr Silver—That might be redressed through the changed income tax rates. However, what we are seeing is that through the change of elasticity, as that is increasing, so we are seeing a large number of people who are changing their consumption habits. That has been a desired outcome, certainly from the view of the health department and the health minister; less, though, from the view of the Treasurer who likes to see the income generated.

It is a matter of a dog chasing its tail, though, where perhaps it reaches a point where the rates will have to be jacked up so high to achieve the same revenue result. That is what we are saying right now, given the modelling that has been conducted for us by the Allen Consulting Group, that those assumptions cannot be continued.

Mr Herskope—The gap between tobacco tax payment and income tax payment, after the introduction of the GST, will widen. In other words, if income tax goes down and tobacco tax goes up, these households are actually going to suffer a more regressive effect from tobacco tax.

Senator GIBSON—You still have not answered my original question. If people have more disposable income in their pockets, will they spend some proportion of that, on average, on your products?

Mr Herskope—I guess that goes back to the elasticity issue. On these current estimates that is less likely to occur than federal Treasury believes.

Senator GIBSON—Okay. Is there any other comment?

Dr Fahrer—Apart from the elasticity effect, I would expect that if people get an extra \$50 in their pocket they will spend the \$50 in the same proportion on various things as they spend it now.

Senator GIBSON—Thank you. I did not quite understand the chop-chop story. Could you explain what is going on?

Mr Silver—Certainly. Chop-chop is the generic term given to illegal trade in cut tobacco. Tobacco taken from the farm gate is processed by literally chopping it up—very minimal processing takes place—and it is put into plastic bags and distributed through a wide network to retailers. There are estimates that about 75 per cent of retail outlets throughout the country in capital cities and regional centres are now selling chop-chop.

It is a very attractive thing to retailers because, having no excise paid, the price of it is very attractive to customers. We have seen an absolute ballooning in the growth of this illegal trade which really began, as Mr Herskope outlined, following the High Court case in August 1997. Because of the very nature of the trade, it is hard to put a figure on the extent of the trade. The retail price per kilo of chop-chop is in the vicinity of \$45 to \$80, whereas legitimate tobacco is \$300 per kilo and the excise component of that is about \$232 per kilo. You can see the very great incentive that there is to achieve massive windfall profits through this illegal dealing.

Senator GIBSON—Mr Herskope mentioned a figure of about one million kilograms per year of that.

Mr Silver—Yes.

Senator GIBSON—You would need to give us what proportion of the total tobacco used in Australia would be 'cut cut'.

Mr Silver—Originally, it was attractive to the roll-your-own market—the people who get cigarette papers and roll a cigarette. That market is about 1.4 million kilograms. With one million kilograms, it is about 60 to 70 per cent of the roll-your-own market. In more recent times, we have seen smokers of tailor-made cigarettes purchasing little tubes the same size and dimensions as a cigarette. Into that they pack their tobacco. It does not have to be hand rolled because that is not attractive to some people. Those tubes now mean that people can smoke this cut tobacco in a more convenient way than previously. It is starting to eat into the cigarette market as well as the roll-your-own market.

Senator GIBSON—How many million kilograms of tobacco are sold a year in Australia?

Mr Silver—To put it in perspective, roll-your-own is about seven per cent of the total tobacco market. So extrapolating from the approximate 60 to 70 per cent, we are down around two to 2½ per cent of the total tobacco market.

Senator MURRAY—I am familiar with the price substitution literature on alcohol. In both Norway and the United States there were extensive studies done as to the consequences of price movements and excise on the generation of illegal stills—the higher the price, the greater the number of stills. They have tried to establish an excise regime which keeps that down to a minimum. Is there any equivalent empirical study available which indicates at what level price will result in substantial illegal activity with smoking?

Mr Herskope—We are not aware of any empirical data although, like other interested observers, we are noticing more and more media reporting of such conduct. We are aware that Customs in the last couple of weeks has seized a container on a wharf in Sydney and it appears to be increasing in regularity in terms of reporting. There is no particular cut-off point. We just see that at this level it is on the increase. We submit that the higher the rate, the more likely it will be to increase.

Mr Lucchese—The High Court decision on 5 August 1997 was really the beginning of the blossoming of the illegal trade in tobacco. At this stage the estimates are that excise is not being collected to the tune of about \$220 million, and that seems to be increasing. The higher the level of tax that you put onto tobacco products, the more incentive there is for this trade to continue. It is quite a pervasive thing at the moment in the marketplace.

Mr Silver—I could also add that, because it has only been about 18 months since this new chop-chop industry began, it is probably a little early for people to start conducting reports of the nature that you are speaking of. I am certainly not aware of any. If we find that there are some we would be happy to forward them to you.

Senator MURRAY—The other question concerns the health side of things. Is there any difference in the health consequences of smoking plain cigarette roll-your-own for which you manufacture the tobacco or using this chop-chop illegal tobacco?

Mr Silver—None that we would allege, although we have to point out a couple of things about chop-chop. The first point is that it comes packaged in a plastic bag, so it does not carry the requisite health warnings and other information that even roll-your-own packets do

carry. The second point is that the processing, as I mentioned before, is quite simplistic. It is taken from the farm gate to the retailer just through a simple process. But we would make no claims about the health content of that.

Senator MURRAY—With illegally distilled alcohol, quite often you can get very bad side effects, such as numbers of people dying. I was interested if there was any comparison. The other point you made quite strongly is that government revenue could decline. Governments quite often make tax changes and expect a decline. For instance, the tariff reductions were a deliberate move by government which resulted in very significant revenue decline. Have you any guarantee from government that they want to maintain their tobacco revenue or that, alternatively, they would be happy to concede that the consumption of tobacco will fall and their revenue will fall? On what basis do you regard them as desiring tobacco revenue to be maintained at the existing level?

Mr Lucchese—I think one reason that can be shown is that initially the government said they would wish to collect an additional \$250 million from tobacco and the new figures are closer to \$440 million or higher. I think that shows that they are interested in gaining revenue from tobacco. But there has been, as far as I am aware, no direct approach or discussion with government in relation to that.

Senator MURRAY—But that implied a higher take off a lower actual usage, didn't it, according to your relationships? You say price goes up, consumption goes down.

Mr Lucchese—Eventually that would happen.

Senator MURRAY—And there is a turning point, in your view, as to when declining consumption starts to reflect itself in declining revenue as well.

Mr Lucchese—That is correct.

Senator MURRAY—You have modelled that, and that is—

Mr Lucchese—They are the modellings that we have conducted, yes.

Senator SHERRY—Turning to the issue of this chop-chop—the illegal trade of what is a legal product, tobacco—wouldn't you expect on the same argument that at least there would be some substitution of tobacco by illegal drugs such as marijuana?

Mr Silver—My intuitive response to that is probably. But not all smokers of tobacco are partakers of illegal drugs, so it is not a measure, obviously, that we would conduct.

Senator SHERRY—No, I would not suggest it. That is why I said 'some'. Certainly, in some of the comments I had back from people who smoke marijuana, there is some substitution impact because marijuana is very readily available and very price competitive to the legal tobacco trade.

Mr Silver—I certainly would agree with that. Unfortunately, it is fair to say that the regulations that apply to tobacco—how old you have to be, how much it costs, where you

can purchase it et cetera—do not apply to some illicit drugs. From our point of view, it is a shame that the same attention is not given to those as it is to a legal trade.

Senator SHERRY—I am not suggesting a policy prescription. I am just attempting to analyse the problem and the side effects which are perhaps not well recognised or accepted in the current problem with tobacco. So I think it is a real issue.

Mr Silver—Yes.

Senator O'CHEE—I have a matter for clarification. Your submission was that smokers are becoming price sensitive. Yet, in answer to Senator Murray's question, we were told that government revenues would go up in spite of the volume going down, which would suggest that tobacco was still price inelastic. That would seem to contradict the earlier assertion that tobacco smokers are now price sensitive.

Mr Herskope—I will take the opportunity to clarify that point. The government announced its intention to increase its take by \$440 million in November of this year when the system for collection of excise is to change. That is the government's intention. We are aware that the federal Treasury operated on an elasticity measure of negative 0.4. Our contention today is that, on more recent estimates via modelling, that elasticity measure is more like negative 0.86. So whether or not they achieve their target is another question.

Senator O'CHEE—But you still accept the fact that, if you have got a negative 0.86 price elasticity, you are still accepting the fact that it is price inelastic, but not as inelastic as the Treasury believes?

Mr Herskope—Anything under negative one is not perfectly elastic. But it is closer to one than it is to negative 0.4.

Senator O'CHEE—Okay. I just wanted to clarify where you drew your assumption.

Senator CHAPMAN—On the issue of price elasticity, you do not spell out the details of the model in your paper. But is it possible to completely filter out other factors affecting the elasticity of demand over the time period that you are talking about, such as anti-smoking campaigns and those sorts of effects on consumption?

Dr Fahrer—The model did attempt to estimate all the usual factors that affect demand, such as income and price. The effect of hard to measure variables like anti-smoking campaigns is more difficult to ascertain but an attempt was made in the model. So we are confident that the elasticity does capture all of the important demand effects on tobacco consumption.

CHAIR—There are no further questions from the committee. Thank you, all four of you, for your submission and for the assistance you have provided to our inquiry.

[3.17 p.m.]

ANDERSON, Mr Jason Leigh, Senior Economist, Australian Stock Exchange

ROCHE, Mr Michael Anthony, National Manager, Strategic Planning and Review, Australian Stock Exchange

CHAIR—Welcome. The normal process is for us to invite you to address us briefly on your submission and then we will go to questions.

Mr Roche—We appreciate the opportunity provided by the select committee to appear here today to discuss our submission. The Australian Stock Exchange or, as I will refer to it, ASX, provides a market for the share investments of millions of ordinary Australian citizens. At the last count, some 5.5 million, or four in 10, adult Australians had consciously decided to own shares, including some 4.4 million specifically involved in direct share ownership. In addition to these 5.5 million Australian share investors, many more Australians have superannuation savings which are invested, amongst other assets, into Australian shares.

The value of those share investments on the Australian Stock Exchange, which totalled some \$553 billion at the end of February, can be greatly influenced by government regulatory, savings and taxation policies. It is for that reason that ASX has made submissions to several government reviews and parliamentary inquiries in recent years. ASX's primary purpose in making a written submission to the Senate Select Committee on a New Tax System was to draw to the Senate's attention the impact of the new tax system proposals on share investment and on the efficient channelling of funds to investment.

While ASX does not regard the GST as a panacea for all the ills of the tax system, the GST does allow Australia to remove the current heavy taxation on financial transactions through stamp duty on marketable securities, financial institutions duty and bank account debits tax. These state indirect taxes, earmarked for abolition in the package, currently place a harsh burden on ordinary citizens in their conduct of day-to-day financial transactions, they unduly add to the cost of capital and severely impede Australia's position as a regional financial centre.

Stamp duty on marketable securities, by adding significantly to the cost of trading, has been shown to have a substantial impact on the spread between buying and selling prices for shares and therefore on the liquidity in the equities market. It is, in turn, the liquidity of the market—that is, the ease with which a seller can find a buyer at a suitable price—which impacts on share prices and therefore on the cost of capital for new investments by Australian companies.

To illustrate the significance of stamp duty on the cost of buying and selling shares, I will give the committee the example of the purchase of a \$10,000 parcel of shares. The direct transaction charges are as follows: ASX charges for trading and settlement total \$3.76, marketable securities duty claims \$30 and broker charges vary but typically could total \$60. In other words, government taxes represent one-third of direct transaction charges.

Professor Peter Swan, Professor of Finance at the University of Sydney, has produced estimates of the impact of the abolition of marketable securities duty based on the experience of the halving of the duty initiated by the Queensland government in 1995. Professor Swan estimates that abolition will reduce overall transaction costs, including the cost of the spread between buyers' and sellers' prices, by 27 per cent. It will increase liquidity, or average turnover of shares, by over 60 per cent and, in the long run, boost the market capitalisation of listed Australian companies by \$65 billion. I should add that what flows from that previous figure is that it creates a potential capital gains tax windfall of \$16 billion for the Commonwealth government through the increase in the value of those shares. I should also add that this tax is only collected upon realisation of the shares.

These benefits from the abolition of marketable securities duty will not be concentrated amongst a privileged few. The same study which found that 5.5 million Australians own shares also found that half of households with incomes between \$30,000 and \$50,000 per annum have some form of share ownership and around one in four households with an annual income of less than \$30,000 are direct or indirect share owners.

Finally, I should briefly address the impact of a GST on share investment. In consultation with Treasury and the ATO, ASX is currently reviewing the GST treatment of ASX services. While financial services are generally input taxed in countries with a GST, the treatment of stock exchange services tends to vary from country to country. No final determinations have been made about the GST treatment of ASX services. However, for purely illustrative purposes, if we were to take the example I quoted earlier of the \$10,000 share trade and we were to assume that a GST added 10 per cent to the cost of ASX services, then we are looking at an additional 38c for GST on that \$10,000 share trade but the removal of \$30 in marketable securities duty. Clearly, from these figures, the position of share investors and the efficiency of the equities market would be greatly enhanced by the new tax system proposals. That concludes my remarks.

CHAIR—Thank you, Mr Roche, and let me thank you for your succinctness and your brevity as well. Is it your intention to ask Mr Anderson to supplement, or are you happy to just take questions at this point?

Mr Roche—We are available to take questions.

CHAIR—I think you are facing the same difficulty as some of us in the sense that for you the government's attitude to business taxation is not clear. It certainly is not clear until it has responded to the final report of John Ralph. In your remarks here you have indicated how the GST affects you, and I accept your submission on that. How do the other changes, the other matters, affect you, though? Do you have a view on the other matters that are under consideration in the Ralph report? How do they affect the ability for Australia to emerge as a regional financial hub or your ability to operate efficiently as an exchange? Are there any preferences that you would express in that area?

Mr Roche—There are substantial qualitative differences between what we address today, which is a package of legislation before the Senate, and the package that is currently being reviewed by the Ralph committee which has yet to come near parliament. What we are dealing with in the context of the review of business taxation is a set of ideas that were in

the new tax system package issued last August and which are now being addressed through the Ralph committee. It is a process with which we are cooperating, and we do intend to provide a comprehensive submission by the mid-April deadline.

As to the nature of the proposals, there would be no secret, from the submissions we have made to this committee and the first Ralph committee discussion paper, that we have flagged that there are some concerns that we have, depending on outcomes from the review and the government's acceptance or non-acceptance of review recommendations. But it is probably much too early to say which way Australia's outlook for a regional financial centre and some of the issues you have mentioned will fall as we are yet to have a set of recommendations. We do have some proposals before us which give us concern but there are also, within the Ralph second discussion paper, the platform for consultation paper, options which we believe, if adopted, will go a long way towards addressing any concerns we have.

CHAIR—The problem I have is that we are inquiring, at one level, into a document which is entitled *Tax reform: not a new tax, a new tax system*. Yet we find that there is quite extensive review of business taxes going on offstage from this inquiry but which affects the issues that you have addressed us on in this inquiry—questions about transactional taxes, the efficiency of the exchange, elements of regional financial centres and things of that nature. If we take these things compartmentally we can get a view; if we take them in an overview we may well get a different view. My question to you is motivated by an interest in knowing what views you took about the ideal outcome for the Stock Exchange from the Ralph review so that I can evaluate in this inquiry how your concerns presented to us should be weighed.

Mr Roche—To fully respond to your question, I would be needing to preview to this committee a submission from the ASX to the Ralph committee, which is yet to be discussed with my board, nor is it fully drafted. We have some ideas about what we want to say to the committee. We have made no secret about the issues we have flagged as ones that are of interest to us in public documents already.

Senator GIBSON—The Ralph committee put out three discussion papers and they are not before us today. I think it is a bit unfair asking witnesses to comment on what they think should happen out of that when it is not going to even report recommendations to the government until the end of June.

CHAIR—I understand that. I accept the answer, and this is the best answer that Mr Roche can provide because he has not cleared his submission with his board and it is reasonable he cannot therefore address us. But the argument, as I apprehend it, that you put to us, Mr Roche—and this is to answer your question, Senator Gibson—was that for business reasons a reduction in transactional taxes is a benefit to the ASX and a benefit to what many of us might regard as an ideal outcome: Australia emerging regionally as a financial hub. That is only one part of it and, in order to get the overview, all other issues of business taxation do arise.

To take the principles of what you will put to us, it may well be, depending on how the government jumps on the Ralph review, that we could do what you ask in this compartment but be knocked over or undercut by what is done in the other compartment. Your argument carries less force if that is the case. I was curious, but you have given the answer. That is

the reason I introduced the matter. I have no further questions at this point. Senator Gibson, over to you.

Senator GIBSON—Mr Roche, I would like you to expand a bit on Professor Peter Swan's estimates of increased liquidity of the equities market in Australia as a result of the proposed reduction in duty on marketable securities in July next year if the ANTS package goes through the parliament. First of all, I am surprised at the 60 per cent increase in liquidity of average turnover and also the market capitalisation number of an additional \$65 billion. What is the current capitalisation of Australian companies on the ASX?

Mr Roche—As of the end of February, it was \$553 billion.

Senator GIBSON—So we are talking about a 12 per cent increase in capitalisation purely as a result of making trading easier for people to do.

Mr Roche—That is right. Mr Anderson might be able to supplement my remarks, but I will paint you a picture of the background to this. Professor Swan, together with Professor Aitken at the Securities Industry Research Centre for Asia-Pacific—SIRCA—conducted a seminal study of the impact of the halving of stamp duty in 1995 and produced results in this sort of direction. They have then taken the real life results they observed from the 1995 halving of stamp duty that was initiated by the Queensland government in that year and then followed by all other states and applied that experience to the 'what if' of the complete abolition of stamp duty.

They observe that there is a direct reduction in transaction costs from the removal of stamp duty and then a further benefit to the costs of transacting in shares through reductions in the volatility of the market, through a narrowing of the bid and ask prices on the market, through reductions in market impact, so that the overall reduction in transaction costs is more like 27 per cent. It is that 27 per cent number that drives a lot of the other numbers you find hard to fathom. Mr Anderson might like to add to this.

Mr Anderson—If you focus on the increase in market capitalisation, clearly the reduction or, in this case, the abolition of stamp duty, leads to a price rise for shares. That arises due to the fact that buyers incur less stamp duty and sellers incur less stamp duty. Buyers are happy to offer a little bit more to pay for the shares; sellers are willing to take a little bit less in order to off-load the shares. The net effect of those two in this circumstance is to lead to a price rise, but it is not necessarily the case; it is due to the elasticity responses of the buyers and the sellers. The empirics suggest that there is a price rise totally attributable to the reduction in stamp duty, in this case the halving.

Senator GIBSON—Is there other international experience and evidence that would complement the estimates done by Professor Swan?

Mr Roche—Professor Swan's own modelling is probably leading the world. He has had the unique opportunity of being able to look at the real experience in 1995 and model based on that experience. There was, with different sorts of numbers, an event that occurred in Sweden in the 1980s where we saw the opposite occurrence, where the Swedish government

introduced a securities transaction tax at one per cent and then raised it to two per cent. Sweden virtually saw its market transfer to London overnight.

When the tax was decreased in progressive stages and then removed, liquidity in the market increased dramatically. But the actual imposition of the tax diminished liquidity from 37 per cent to 14 per cent. We are talking about an occurrence where the tax comes down and about liquidity going up, but I think the principles are similar.

Senator GIBSON—A further point you make in your opening statement is that as a consequence of the increased liquidity we could expect that the cost of capital for Australian companies would come down. Do we have any numbers on the likely impact there?

Mr Roche—We have not translated that into a cost of capital for a typical company. It is certainly a matter worthy of further study to translate that. These sorts of studies look at a subset of companies. Professor Swan looked at 90 leading companies in the All Ordinaries Index as his sample. To answer your question, I think you would have to take it down to individual companies and look at the impact on each of those companies.

Senator O'CHEE—Following on from that, one of the consequences is that because you take that additional cost away, the spreads get closer. It makes it easier for a buyer and seller to actually agree a price, doesn't it?

Mr Roche—That is right.

Senator O'CHEE—That is part of what leads to the increase in turnover, isn't it, because you do not get spreads that are so far apart that people are not going to get matching prices when they trade through SEATS?

Mr Anderson—That is correct. A corollary to that is that the study found that the smaller shares in the sample that were analysed tended to have higher bid-ask spreads and the liquidity for those shares was increased more proportionally than for the larger shares in the sample.

Senator O'CHEE—That was my next question. When we look at stocks that are not blue chips, the smaller capitalised companies, you tend to have high spreads there and they tend to be illiquid because people have to absorb these transaction costs. Is that the case?

Mr Anderson—Indeed.

Senator O'CHEE—So it would mean that it would make investing easier because people could get out of shares more simply if we took these costs off. Is that the case?

Mr Anderson—That is correct. We believe that is what underlies the positive elasticity response with respect to prices, because people who are looking to buy shares have to consider the transaction cost of getting in and getting out again if they wish to subsequently liquidate that asset, whereas if you already hold the asset it is a one-way transaction cost to leave. That is part of the reason why you have a positive price response, particularly for a smaller asset.

Senator O'CHEE—Yes. That makes a lot of difference to a private investor, doesn't it? They have a limited pool of funds that they have to invest and their ability to invest is dependent upon selling one share in order to be able to buy another one.

Mr Anderson—That is correct.

Senator O'CHEE—What impact does that have on capital gains revenue for the Commonwealth?

Mr Anderson—Overall?

Senator O'CHEE—Yes.

Mr Anderson—The estimate in the study of net present value over time is \$16 billion.

Senator O'CHEE—Do you have any idea of what that would be within 12 months or two years?

Mr Anderson—It is difficult to say because it would depend on the realisation behaviour of the shareholders. Given that most shares turn over within 12 months, it would be a fair proportion. It would be very difficult to say exactly because you are trying to predict how people respond. It would be a large proportion, I assume.

Mr Roche—That is right. We saw the report in today's press previewing the release of the taxation statistics, albeit for 1996-97, speculating that a boost to capital gains tax revenue was associated with growth in share ownership and share trading.

Senator O'CHEE—So you are saying that a large proportion of the \$16 billion would be received by the Commonwealth in the next couple of years after implementation. Is that correct?

Mr Roche—It would be highly speculative to say that. We cannot predict the actual trading behaviour and realisation behaviour of individual share owners.

Senator O'CHEE—But it would be more than a couple of billion dollars per year, on what you said.

Mr Roche—I would not feel qualified to put a figure on it.

Mr Anderson—Perhaps we could take that question on notice and respond after some more analysis.

Senator O'CHEE—Could you, please?

Mr Anderson—Certainly.

Senator O'CHEE—One of the questions I get asked is, 'Why should we be so concerned about the Stock Exchange? What are the real benefits to Australia?' People say

there is no real benefit to Australia in having a Stock Exchange that has a high turnover and a high market capitalisation. What is your answer to those people? What is the economic benefit to Australia, other than just employing lots of brokers and analysts? What is the economic benefit to Australia of having a more efficient Stock Exchange?

Mr Roche—As explained in our opening remarks, we believe that it is the activity on the exchange, the greater liquidity, the greater ease with which buyers and sellers can meet and agree price, albeit in an electronic environment that we provide, that is underpinning the buoyancy in share prices. Of course, share prices in turn dictate a large part of the cost of capital of companies. So if a company can issue onto the market and receive attractive prices, that is reducing their cost of capital, making investment more attractive for those companies, hopefully job creating investment.

Senator O'CHEE—In other words, it flows through into real benefits with more companies being able to list and, therefore, more jobs being created as a result of that capital base increase.

Mr Roche—There is a range of motivations for listing on an exchange, but the typical motivation is to raise capital, capital they feel they cannot otherwise raise through alternative sources of finances, or cannot raise as cheaply. So by issuing onto a market to raise that capital they are doing so in turn to invest those funds in new projects.

Senator O'CHEE—One of my colleagues on this committee has a habit of asking anybody who might have any reservation about any portion of the package as to whether this package should be voted for now or not. Do you believe that this package should be voted for? Do you believe it is good for Australia?

Mr Roche—Certainly. Given our remarks we are supportive of the intentions of the package. We are not here to argue every fine detail of the package. We are not here to rule out the fact that someone will come up with proposals to improve the underlying principles of the package. But certainly the underlying principle of the package, the thrust of the package, is one that we support.

Senator O'CHEE—So looking at the broad thrust of the package and the broad thrust of the principles of the package, you would strongly urge any senator who had doubts as to whether they should vote for it or retain the existing taxation system to vote for this rather than retain the existing taxation system?

Mr Roche—That is a very leading question. I am very satisfied with my previous answer.

Senator O'CHEE—Thank you.

Senator MURRAY—Mr Roche, in the section on deferred company tax, page 8, there is this unqualified statement:

Australia should avoid increasing the taxation burden on cross-border profit flows.

You would be aware that there is a great deal of community anger at companies that are avoiding paying their way and are having a free ride on the backs of Australian taxpayers. This government, at least partially, shares that anger because this government has asked the tax office to increase its vigilance on transfer pricing, to attack aggressive tax planning, to attack the minimisation and avoidance of tax, and to examine ways in which persons presently avoiding paying their full amount of tax should contribute more.

Now all those would, in fact, increase the taxation burden on cross-border profit flows. Surely you did not intend to put an unqualified statement such as that and mean us to believe that you did not support any increase whatsoever in the taxation of cross-border profit flows.

Mr Roche—I will ask Mr Anderson to address the specifics of the package that contains those proposals about which we may have concern. On the general principle of cross-boarder income flows and taxation, we support the rule of law and the rule of taxation law and companies paying what the law requires them to pay. I think you were describing attempts by government to ensure that result. We have no problem with that. This is a reference, however, in our submission to some proposals which may or may not see the light of day at the end of the review of business taxation, and which will legislate to increase the tax burden on Australian corporates, with perhaps some unintended side effects.

Mr Anderson—I do not have anything to add to that.

Senator MURRAY—Would you not concede that that is a difficult statement to make as a generalisation? For instance, a company with an average taxation level of nine or 11 per cent needs to be viewed entirely differently to one which is up in the high twenties. It should very much be a question of particular companies. I put this proposition to you because I notice in your paper that you are again repeating the threat from companies which are able to move their operations that they will move out of Australia if they get an additional tax burden. Frankly put, they have to pay whatever companies have to pay on average and should not be able to avoid the taxation burden that the government of the day is inclined to impose upon the corporate community as a whole. I would just like your reaction to that because I am very concerned about this general sort of statement.

Mr Anderson—To clarify what we are discussing there, we are really focusing on the difference between a company that earns purely domestic source profits in Australia and one that has a fair proportion of offshore profits. Due to the imputation system, we have a removal of one level of tax from domestic source profits, but we still have at least two—and in some cases more than that—levels of taxation for foreign source profits.

The issue that we have then is to say that, if we have a set of policies which exacerbate the problem for Australian global companies earning a large proportion of their profits from offshore, we are exacerbating the problem of a bias that already exists. That is the direction of our comments in terms of cross-border income flows.

Senator MURRAY—Perhaps I can move now to the comments made on Professor Swan's work. Professor Swan, according to this document and your own evidence earlier, has produced estimates of the impact of the abolition on marketable securities which will

boost the market capitalisation of listed Australian companies by \$65 billion and, consequently, create a potential capital gains tax windfall of \$16 billion. Is it the case that the Australian Stock Exchange has put a submission to the Ralph business tax review for the abolition of capital gains tax?

Mr Roche—We have made no such submission. As I indicated in answer to an earlier question, we will be making a submission to the review of business taxation by its deadline of mid-April.

Senator MURRAY—Do you have any views as to what you will be saying about capital gains tax and whether it should be abolished?

Mr Roche—As I indicated in an answer to an earlier question, I was not intending to preview a submission which we have yet to put to our board.

Senator MURRAY—But you can see that, from our point of view, if you are indicating through the work of Professor Swan that one of the unintended benefits of this package is that there would be \$16 billion of potential capital gains tax windfall, if you were then to advocate the abolition of capital gains this benefit falls away, if the government were to accept that recommendation. You can see that consequential argument, can't you?

Mr Roche—Your argument is based on false presumptions about the likely position of ASX to be put to the review of business taxation. I am not sure where you have got that impression.

Senator MURRAY—Have a further look at this potential capital gains tax windfall. You appreciate that the total GST income in year one is about \$27½ billion and then it rises through the thirties over a number of years. You could see that a potential capital gains tax windfall, just by addressing the abolition of marketable securities duty of \$16 billion, is an astonishingly high figure. You would then have to ask, 'Why not just get rid of this and forget about GST? You can supplement all the other income shortfalls that are there.'

Mr Roche—Sure. I think we need to clarify, if we have not already, what we are talking about in terms of capital gains tax windfalls. First of all, it is an estimate based on a model which, in turn, is based on some experience from the 1995 halving of share duty. Secondly, this is a potential capital gains tax clawback over time, if and when shares are realised. The third point is that it is a one-off. It is not an ongoing revenue stream to government.

Senator MURRAY—But, from our point of view as a committee concerned with government revenue needs, which they maintain are confined, you can see the absolute joy many people would have if they could spend \$16 billion—even if it was a once-off benefit—on railways, roads, hospitals, schools and defence needs. I mean \$16 billion goes a long, long way. Therefore, the claim that this is available could transform the view as to the positives of this package. We have to be very sure that this is a well-established and credible figure if we are going to accept it into the committee's consideration. It is a huge number, even if it is a one-off number, relative to the numbers we are looking at.

Mr Anderson—It is a net present value over time, so it takes into account all the realisations over what it could be a 10- or 20-year period. It is not a \$16 billion per annum value, as Michael has already indicated. If it was distributed over 10 years, you could roughly say that there was a tenth there potentially from its reduction.

Senator MURRAY—I must have misunderstood an answer to an earlier question, because the earlier question was over what time period these shares would be realised. I think the answer from Mr Roche was that, on average, shares turn once in a 12-month cycle. So you need to explain to the committee why it would take 10 years for the capital gains to be realised if that was so.

Mr Roche—Just to explain market turnover, it could be a mixture of institutional trading happening and turning over those shares many times within the one year and, say, individual investors putting the shares in a drawer and leaving them there for the grandchildren.

Senator MURRAY—I do not recall the ANTS package, in any of the estimations, having a capital gains windfall stream, so this committee would need to take it into consideration. Let us just say in the time span we are primarily looking at—which is the next three years: year one, year two and year three—on the basis of this estimate, what would be the capital gains windfall that would accrue to government in each of those years?

Senator O'CHEE—That is a question we have already taken on notice.

Mr Anderson—Yes. I think we would like to respond to that at some later stage.

Senator MURRAY—Have we given that a time deadline?

CHAIR—I have not given any questions on those a time deadline, but it is certainly my intention that we follow up on that.

Senator HARRADINE—Mr Roche, given the market value of the corporation now, do you think that the government sold the first third at a bargain basement price and, if so, what should be done to prevent the same thing occurring in the next 16 per cent?

Mr Roche—I do not have a view. I think it is probably inappropriate for the Australian Stock Exchange to be positing views on whether our customers' flotations are at prices that are too cheap or too dear. The market determines the prices and sometimes the market surprises us.

Senator HARRADINE—But all of this material that you have given us seems to lead me to the conclusion that now is not the right time. I mean, leave it off until the tax measures have been determined by the parliament and then sell. As I read this material that you have provided to us, it seems to me that what you are saying is that listed Australian companies will experience a boost in market capitalisation as a result of the taxation reform proposals. Wouldn't that seem to indicate that it is better then for major Australian listed companies to engage in—in this particular case—future privatisation after the reform packages have gone through, or has the Treasurer got another idea about that?

Mr Roche—I do not offer advice to people in relation to their activities for listing on the ASX. There are people who are paid good money to provide that advice. The point about the improvement in market capitalisation that flows from the abolition of stamp duty is something that flows over time and not in one year. The market will do what the market will do for a range of other drivers in the economy and in the international economy over that same period. So you cannot just look at this in isolation and say that, because this study says that market capitalisation will grow in the long term by a certain amount because of the abolition of stamp duty, there will not be other factors coming into play in the nearer term—positive or negative.

Senator HARRADINE—But you would be able to give us an idea as to whether this is a good time to be in the market?

Mr Roche—I am afraid that I would not be the right person to give you that good idea, Senator.

Senator SHERRY—On the first page of your submission, you say:

ASX does not regard the introduction of a GST as a panacea for all the ills of the tax system . . .

What ills of the tax system doesn't a GST resolve?

Mr Roche—The review of business taxation in itself is looking at a substantial part of the tax system which is under separate review.

Senator SHERRY—Nothing else comes to mind?

Mr Roche—The ASX has a range of issues that are, from this committee's point of view, the minutiae of taxation which impact on individual products and submarkets but are not matters that we feel are worthy of bothering this committee with.

Senator SHERRY—In your submission No. 747—and you are both economists—you draw attention to the fact that tax reform enhances the 'national competitiveness and fairness in taxation' and creates 'a climate favourable for investment, job creation and saving'. You would not suggest to this committee that the ANTS package that we are considering would increase national saving? It does not do anything for saving, does it?

Mr Roche—I am not sure that I would agree with you in terms of looking at it in conjunction with changes in tax rates. I have not seen modelling one way or the other, but I would think that the general thrust of the package would be a pro-saving package. Its overall magnitude, I would not hazard to—

Senator SHERRY—Let us look at it very briefly. GST largely replaces indirect taxes—wholesale sales tax and some state taxes. The income tax cuts are funded largely out of a budget surplus. How is that going to improve national saving? The only way it could do that is if everyone takes their income tax cuts and saves them—the whole lot. So how does it improve national saving?

Mr Roche—You may be right, Senator. I have not seen estimates that look at the overall impact on national saving. I am not aware of those estimates. As a statement of principle, I am not sure that you could place the contrary argument that it is anti-saving.

Senator SHERRY—I get a little bit tired and weary of organisations coming before the committee and making the assertion in their submissions or giving evidence that national saving is going to increase as a result of this package, when clearly it cannot. You are both economists.

Mr Roche—What you actually read out was the Business Coalition for Tax Reform's objectives for tax reform. While we were stating at the outset of our submission that that is an objective with which we agree, we did not go on in our submission to assert one way or the other the impact of the tax package on savings. We did make some claims about the impact of the package under review by the committee on investment in Australia. The source of that investment may be Australian savings or they may be foreign savings.

Senator MARGETTS—Have the ASX looked at issues re tax on e-commerce and what they think might be the impact on the revenue base of the growing trend to e-commerce?

Mr Roche—We have not done such a study, Senator, I am afraid. It is a subject of interest as the ASX moves increasingly towards a capability to offer its services on the Internet. At the moment I guess we would claim that we have been running electronic commerce through an automated Stock Exchange since 1987 and I do not believe there have been particular problems with collection of taxation over that period. If you are referring to moving forward in a period where transactions occur purely on the Internet, it is also blue sky for us.

Senator MARGETTS—Thank you very much.

CHAIR—As I understand your submission, you are very keen about the abolition of taxes on transactions in the Stock Exchange. It would be possible for the government not to impose a GST and buy out all those transactional taxes in one fell swoop, wouldn't it?

Mr Roche—If you are including financial institutions duty, bank account debits tax and stamp duty on marketable securities, you are talking about a very significant sum of money to be funded from somewhere. The halving of stamp duty that occurred in 1995 was led by the Queensland government, for whom the potential revenue loss was not great. They were a very far-sighted government that saw the benefits to Australia as a regional financial centre, but it did cause pain to other state governments who actually had to increase taxes—New South Wales and Victoria, in particular—to fund the loss of that revenue. The taxes that they increased were in fact those taxes which have been removed from them by the High Court decision of a couple of years ago. I suppose the problem is: where does the replacement revenue come from?

CHAIR—If I understand Senator O'Chee's questions to you, the replacement revenue comes from the dynamic growth dividend that is achieved by virtue of the removal of transaction taxes, meaning a more liquid market and a greater attraction for people to invest not only onshore in Australia but also to attract other listings from offshore?

Mr Roche—You would have to be very confident about the matching of the revenue you were forgoing and the revenue you were gaining. I suspect, particularly in the short term, there would not be that match.

CHAIR—But the bottom line for the exchange is to remove all of these taxes, not just to rest on a 10 per cent GST. The bottom line is to remove the lot, isn't it?

Mr Roche—To remove the taxes on financial transactions?

CHAIR—Yes.

Mr Roche—Certainly. Those taxes are, unfortunately, reasonably unique to Australia and we believe are a major factor in impeding Australia's competitiveness as a regional financial centre.

CHAIR—Thank you, Mr Roche and Mr Anderson, for assisting our inquiry.

Proceedings suspended from 4.06 p.m. to 4.16 p.m.

HOLT, Mr Philip Matthew, Managing Director, Australian Business Ltd

ORTON, Mr Paul, Manager, Policy, Australian Business Ltd

SCHUBERT, Mr Jeffrey Brian, Economic Adviser, Australian Business Ltd

CHAIR—Welcome, Mr Philip Holt, and your colleagues from Australian Business Ltd, Mr Paul Orton and Mr Jeff Schubert. I am sure you have been drilled in the procedure here, Philip. The idea is that we extend you the courtesy of addressing us for a few minutes on your submission, and then, if you are kind enough, we have a few questions for you. My apologies for keeping you waiting; we are running behind.

Mr Holt—Thank you, Chairman. I might just underline those opening remarks with an explanation that Mr Orton, on my left, is the head of the policy department of Australian Business and Jeff Schubert is our economic adviser who has been spending a great deal of his time on this whole debate on tax. We have been very much a part of the Business Coalition for Tax Reform and have conducted a deal of research of our own members.

I will make some opening remarks about our organisation for those of you who may not be aware. It had its birth in the 1880s. It was known for most of its life as the New South Wales Chamber of Manufactures. It changed its name and its spread and direction in line with the changing economy just three years ago. It is a broad based business organisation and represents in excess of 5,000 members who employ over 300,000 people and who produce a turnover in excess of \$60 million.

We are a broad based business service organisation. We also fund industry research and management education through two separate foundations. We have developed a major interest in Internet in Australia through our business online and in electronic commerce as well as on the net recruitment for jobs.

Australian Business has been a long-time advocate of the proposed GST at a rate of around 10 per cent with minimal exemptions and minimal GST-free items. It is also argued that revenue that the GST might raise will be used to replace existing taxes. We have been long critical of the existing indirect tax system with its multiple wholesale sales tax rates and the variety and inconsistency of state based taxes. We have argued against them because of the way they add to business costs both in terms of compliance with legislation and the relative costs to businesses that are trying to engage in our export markets—the cascading effect.

We think wholesale sales tax also is too dependent upon and too discriminatory in its application on the goods sector. We recognise of course that the service sector will not always welcome the idea of there being an expansion of the indirect tax base to their output, but we believe that a broader and more even indirect tax base is in Australia's interests. We think that the introduction of the GST with few exemptions and few GST-free items will minimise compliance costs. They are indirectly a community burden in themselves and, because exports are GST free, that will certainly be a boost to that most important sector of our economy.

We are quite aware of the views and concerns that the inclusion of food in the GST tax base may have an adverse effect on low income households. However, we also accept the arguments of such experts as Dr Neil Warren that the exclusion of food is not the best way to address this issue. The reason is that while low income households spend a larger proportion of their income on food than higher income households, it is the higher income households that spend the most in absolute dollar terms and this is significant when one comes to consider the revenue implications.

You have probably already had quoted to you the research that is based on the observation that the top 20 per cent of households ranked by income spend twice as much on food as the bottom 20 per cent. Most of the tax revenue that would be forgone, if food was excluded from the GST net, would therefore remain in the pockets of higher income earners. As Dr Warren has pointed out, removing food from the base would reduce revenue by some 17 per cent or \$5 billion, whereas if there was to be even a direct refund of all the GST on food for the lowest income quartile, the cost would be in the vicinity of \$650 million.

In the interests therefore of achieving a better taxation system and fairness, we understand that the crucial question is the question of compensation—that is not something that we have particular skills at calculating—but we also recognise that there is an issue of concern, both political and in the community, about undertakings that the compensation system will always be adjusted to care for those who need compensation. If one could put it as high as the mistrust of the political system being the hurdle in winning the people's confidence, then we say that ought to be confronted full on. We recognise it as a problem but we also think it is important to keep the tax system as simple as possible.

In order to win the confidence of the people, it may be necessary to establish a formula in the legislation to ensure that low income earners are adequately compensated, so that if any change was to be made to the formula, it would require legislation itself and, therefore, be open to the scrutiny of the parliament. How this would be done is we would submit something that is worthy of consideration by this committee.

Australian Business welcomes the government's proposal to provide some financial assistance for the small and medium sized sector to upgrade their record keeping capacity. I do not think anybody is arguing that that equals the total cost, but it is a fair contribution at a point of change. Australian Business has had a longstanding opposition to the imposition of payroll tax and is disappointed that it is not being removed as a consequence of this package. It nevertheless supports the introduction of the package proposed by the government as a significant improvement and a step forward. We will continue to push on the payroll tax front at the state government level.

We believe that governments that spend taxation revenue should ideally also be responsible for raising it. However, the increasingly complex constitutional picture that is now emerging really does curb the states' ability to raise the revenue that they require. This only reinforces us in our view that giving states the revenue from a GST is a better approach than forcing them to rely on more and more inefficient, non-uniform, broken gauge state taxation, which has become the bane of business because of its inefficiency and difficulty in administration.

We would like to make a comment about electronic commerce because it appears in the reference of the committee. It is sometimes argued that electronic commerce—particularly, say, for the supply of services that might be delivered directly over the Internet—will open up vast areas of untraceable transactions and, therefore, slip through a GST style tax net. We do not believe this comfortably fits with reality.

Our own experience in developing an Australian electronic commerce trading platform tells us that the records of transactions will not be any less efficient than the present paper based ones. We think that in time they will in fact be more efficient and more reliable. Reputable companies will always want to keep accurate records of business transactions, both costs and revenue, so that there is one source of information and a base for tax auditing—and that is to say nothing of the built-in incentive that would be there through the need to claim rebates or credits on GST paid.

Full-blooded electronic commerce in Australia and, indeed, anywhere is dependent upon a secure and reliable payment system. Concern about it is very much at the centre of the current debate about Australia's uptake of electronic commerce. So a secure, reliable and reputable payment system will also provide a further point for the audit of transactions, we think at least as reliable as, if not more reliable than, the present banking system, which we rely on for the purposes of the cash transactions examinations.

Finally, may I say we do not propose here to embrace in any detail the current review of business taxation. We are in the process of making our own detailed submission to that review, but we are happy, if it assists, to respond to any questions that the committee may want to raise.

Suffice it to say that the debate about the reduction in company tax versus concessions for R&D or accelerated depreciation of assets is really an issue on which business has a variety of views, and quite sensibly so, because it depends on their size, their nature, their enterprise, their reliance on expensive capital assets and particularly those that are subject to frequent and technological advancement.

To sum up, there are three points that Australian Business would wish to press, and that is that we have for a long time supported the introduction of a broader based indirect tax system. We have done so for some 10 years. We believe that a lower rate on the broadest base is least distortionary and a more secure revenue base for the government of the nation.

Food should be included to minimise the problems that make wholesale sales tax a problem—determining what is in and what is out. Taking food out is not the best way to focus on the compensation issue and we believe it would be at a very significant cost to revenue.

It is very problematic to think of the alternatives. If GST does not go ahead with some broad base, the states will have to continue to impose their existing array of inefficient taxes like the bed tax, electricity levies and so on. The system is creaking. We would hate to think, as we approach the centenary of our Federation, that we are being fixed with a tax system that is as broken gauge as some of our economy was at the time our Federation was created.

CHAIR—Thank you, Mr Holt. Is it your intention to invite Mr Orton or Mr Schubert to supplement now or shall we just go straight to questions?

Mr Orton—We will go straight to questions.

CHAIR—I will just ask a couple of quick questions, first of all. You have eloquently reminded us that you have been long in the field arguing for a GST, but that it has not gone far enough in the sense that payroll tax has not been eliminated. As I understood it, your view is to pass this legislation now and Australian Business will then lobby hard, at an appropriate level of government, for the removal of payroll tax. In summary, there is an ongoing agenda for you of tax reform, as you would term it. Is that correct?

Mr Holt—It should be of absolutely no surprise that we would much prefer to have seen payroll tax swept up amongst those that would be displaced by a broad based tax. We have done an immense amount of research on the question. We think that it would be positive for jobs growth, et cetera. However, we have to deal with the reality. The reality is that we are dealing with what might be done at the federal level in a federal system where the present tax that is our bane is a state tax. It is all tied up with the extent to which this new tax will provide a growth base for state governments. We think that it, together with the outcomes of the grants issue and a little bit of healthy rivalry, might give us the base to begin to work on that issue again. To sum up, we would prefer a step forward rather than not have any.

CHAIR—So that I understand this correctly, despite your views on the need to eliminate payroll tax, you are not putting it to this committee that we should recommend to the Senate that the legislation on which we will vote some time soon should be amended to include the elimination of payroll tax.

Mr Holt—No. We do not think that is a real proposition. We have convinced ourselves that it is too hard for governments to say to ordinary taxpayers that the prospect of some easing in their income tax will be displaced by the prospect of giving business a holiday on payroll tax. We think it is just too hard a sell politically.

Mr Schubert—Senator, I might just add that there is no prospect of the states agreeing to give up payroll tax.

CHAIR—That is a judgment. We have to answer for ourselves on what we do when we vote in the Senate. I am just trying to tie down exactly what your position is.

Mr Schubert—Our judgment would be that there is not much point in us pursuing the matter.

CHAIR—Okay. People live and die by judgments we make of this sort. One of your ongoing agendas for tax reform is payroll tax. The other point you made is that you favour as broad a base as possible in order to get as low a rate as possible. This base is not as broad as it possibly could be: it exempts health and education. Would part of your continuing agenda for tax reform be to extend the base under this legislation further at some future time?

Mr Holt—I think we have to take the package as it is. That is our focal point. We are focusing on the food aspect because of this argument that it will severely affect those in our community who most need some assistance.

CHAIR—Yes. I think we are talking past each other, Philip, if I may say so. I am really asking: what is your true view of tax reform? You are saying that for political reasons for these judgments that you make—judgments which, over a beer with you, I might privately agree with—you are folding your camp behind this legislation but you are going to preserve the right to campaign further on payroll tax. Because of the principle you espouse to this committee, which is a lower rate on a broader base, I am simply asking the question: does that mean that at some future time you might be arguing for a broadening of the base to keep the rate down? That is all.

Mr Holt—I think that reserving the right to lobby or press for further changes down the track is, firstly, focused at a different level; secondly, it is dependent upon the experience with this broader indirect tax; and, thirdly, it is dependent upon the experience of the states, as they have said, in their revenue from grants. When we see all of that more clearly and we understand more about the actual growth in this form of taxation and therefore revenue for the states, we will be in a better position to start to focus on the issues at the state level—the options for servicing hospitals, police and so forth versus other forms of revenue.

CHAIR—So you are not ruling it out?

Mr Holt—We have never ruled it out. We said on the day this package was released that we saw the prospect of a growth tax for the states being a most important step forward and that held in prospect the hope in the future that we can start to focus on some of the remaining indirect taxes, payroll tax being the most prominent.

CHAIR—Sure. So that I am not leading you unfairly: you are of course ruling in the continued lobbying on behalf of the elimination of payroll tax, but you are not ruling out the further argument that at some future time you might want to argue for a broadening of the base of the existing package?

Mr Holt—We are not ruling it out, and we will do it in the light of experience with the revenue raised in this measure.

CHAIR—At one level, we are looking at 16 bills which constitute the legislative expression of the principles announced in the ANTS package. Have you had a chance to look at those bills?

Mr Holt—We have looked at the package in broad. In detail, we would rely on more expert analysis—as we do on these things—from the professions. We know that the accounting profession is in this process. They are represented on our own tax committee. We will be going through that process as well. Of course we cannot sit here and speak for every bit of detail, and we have not undertaken that study which we understand is very much before you. We are trying to speak in principle. We are trying to speak from the experience of listening to and trying to collate the messages we get from the business community.

CHAIR—The Australian Institute of Taxation, which is a body representing tax professionals, appeared before us and said in summary—my summary—that, even if you support the government’s legislation, you would defer it between six and 12 months for two reasons: one, that the introduction coincides with Y2K and that makes it too complicated for business; and, two, that they are the experts who detect the devils in the detail—there are a lot of little devils in this detail—and in order to ferret them all out, deal with them and settle the package down so that it is a package that would work, you would need to defer the legislation by between six and 12 months. Given that you have not studied it, that you defer to the experts and that this is an expert body, do you agree with them?

Mr Schubert—I understand the Institute of Chartered Accountants are doing a more detailed study on this, and it might be available in a few weeks. So rather than prejudge it, we would prefer to wait.

CHAIR—I am not prejudging it. The bird we have in the hand is the Institute of Taxation, tax professionals who have no axe to grind. They are saying, ‘We are the people who can talk to you about the technical translation of intent into legislation with a minimum of stuff-up. This is our view.’ We are bound to take them at their word. Someone else may be doing the work as well, but in view of what they, as experts, say, isn’t this cause for pause?

Mr Schubert—It is cause for further work by us, but work which we are undertaking in any case. We are continuing to try to get on top of various issues of specific concern to us. We are leaving the more general issues up to such bodies as the Institute of Chartered Accountants.

CHAIR—They have not produced the work they are doing for us, so we cannot judge it either.

Mr Schubert—But I understand that you might have it before long.

CHAIR—I will be delighted if I do. But I know that this august body has told us and we are bound to take note of them. That is a debate we might have some other time, Mr Schubert. I should defer to Senator Gibson, who is eager to ask you a question.

Senator GIBSON—Mr Holt, first of all, congratulations to your organisation on being a long-time critic of the current tax system. Congratulations for your organisation’s contribution to this current debate. We are seeing the culmination of that in looking at the 19 bills before us right now. Following on from the chairman’s question to you a minute ago, in contrast to the Taxation Institute of Australia, which wanted everything perfect before proceeding, the Institute of Chartered Accountants, the ACCI here this morning and the Business Coalition for Tax Reform were all in favour of pushing ahead with the bills that we have in front of us.

There are two general matters I want to raise with you: the first is simplicity and the second one is the compliance cost. On the first, you are probably aware that Senator Meg Lees of the Democrats has made a statement that the importance of simplicity has been overstated. From your organisation’s viewpoint, could you comment on that?

Mr Schubert—Everything is a trade-off. It would be nice to have very simple legislation, but it might fall down in a lot of other areas, including uncertainty. I am not too sure what that statement means. Whether or not it is overstated is very much a judgment. It is very important, but it has to be balanced against what you can achieve in other areas.

Senator GIBSON—I know your organisation for a long time has been very critical of the complexities, the difficulties, and the unfairness of the existing tax system.

Mr Schubert—Right.

Senator CONROY—The tragedy is that it is only going to get worse.

Mr Schubert—Obviously we would prefer much simpler tax legislation. We do not want three pages of tax legislation covering the whole economy because you then leave it up to government regulation or court decisions. You have to balance it.

Mr Orton—Certainly, the wholesale sales tax regime is a concern to many of our members. We spend a fair bit of our time attempting to help them or refer them to others better qualified than we are to sort through the existing regime. We would be looking to a GST to minimise the number of exemptions to the maximum extent possible in an attempt to avoid definitional problems.

Senator GIBSON—On to compliance costs for business: yesterday we had some wild accusations from Mr Ray Regan from the NTAA about the high cost of compliance for business. I know he has had numbers out in the public arena of \$7,000 per firm and 228 hours work per year for quite some months. He reinforced those numbers yesterday with us. As against that, this morning the ACCI had a person from New Zealand—Mr Holdsworth, President of the New Zealand Employers Federation.

Later in the morning we had the Food and Grocery Council and they also had two people from New Zealand. The New Zealanders were stressing that the compliance costs, particularly for small businesses, were very low indeed and that in New Zealand, if you are computerised, the cost of a computer program to cater for GST is only about \$150. Their expectation was that the common accounting programs which small businesses use today—like MIOB, et cetera—which are currently available for \$A400-odd, will be modified to fit in with the legislation when it is passed—assuming it is passed—and will be available at relatively small cost to business.

Mr Schubert—The Institute of Chartered Accountants has also indicated its belief that that is pretty clearly the case.

Senator O'CHEE—One could form various views as to the issue of taxation and whether the bill should or should not be supported. One could also form views as to what other people may do after the bills are passed. I think a cruel and unfair person might suggest that maybe Senator Cook was seeking to create an argument that the tax package and the exemptions would never last because you are on an endless crusade and that you will eventually see them come down. I do not think Senator Cook would be that sort of

person, but if somebody wanted to create that argument, do you think that would be a fair portrayal of your position?

Mr Orton—No. I do not think our position is that we are on a crusade to extend the base of the currently proposed GST. We are on a crusade to do the most we can to get rid of payroll tax. We acknowledge that the exemptions that are contemplated in the current bill are those that are needed and were agreed to by the electorate at the last election.

We certainly do not think that that is an issue that we need to devote our attention and time to for the foreseeable future. Avoiding the creation of new and inefficient state taxes is an issue we have had to face already in New South Wales with the bed tax and an electricity levy. Really, getting the states up to speed and coming on board with the whole idea of minimising the burden of indirect taxes is, I suspect, going to take a lot more of our time.

Senator O'CHEE—You spoke about growth taxes. That encompasses a whole range of taxes but could potentially include the GST if the level of economic activity were to rise in real terms. Is your belief that tax reform will lead to greater levels of economic activity?

Mr Schubert—All reforms should be seen in the light of an ongoing process. One of the reasons this economy or any other economy has grown over the decades or the centuries is that people are continuously engaging in reform, including economic reform. I would not expect a sudden spurt of GDP to massive levels because of this package. I think it needs to be seen as something which is part of an ongoing process to improve the tax system and improve the economy. As far as the amount of revenue you get is concerned, I would expect that the amount of GST revenue would grow roughly in proportion to a nominal growth in GDP.

Senator O'CHEE—I accept that. That is perfectly logical. My next question that follows on from that is: do you believe that, by these tax reforms, we can have an ongoing benefit in terms of better performance and therefore some reflection in GDP growth which we would not have if we did not embark on a reform process?

Mr Schubert—Yes.

Senator O'CHEE—Thank you.

Senator MURRAY—Mr Holt, an integral part of the tax package is the question of tax levels for income tax payers. Those at the upper end are certainly very far in advance of the top company rate—47 per cent versus 36 per cent. That throws up its own problems, as we are all aware. The evidence before us on income tax rates has been that by and large most taxpayers are right at their level and often have an effective marginal tax rate certainly in the lower quintiles of income, which can be exceptionally high. In contrast, my understanding is that there are not that many businesses which reach the top rate of corporate tax. Have you done any surveys to establish the actual rates of tax paid by your members? I am concerned that this desire to drive down the top rate actually does not mean much, because there are not many people paying it.

Mr Holt—I will ask Paul Orton to comment on that question, but may I open with this remark. Was your question whether we had surveyed our members in terms of what sorts of levels of taxation they prefer?

Senator MURRAY—No, that they pay.

Mr Holt—There are two questions there: they, as people and individuals and they as businesses. We would never ask the first. As for the second, we have conducted some recent surveying trying to keep the question which involves the issue of the review of business taxes to a comprehensible series of questions. I might ask Paul to comment on that.

Mr Orton—I might ask Jeff to do that.

Senator MURRAY—Thank God there are not six of you!

Mr Orton—That is right; we would be along the table.

Mr Schubert—The answer to the first question is no. The survey that Phil refers to really relates to the reform agenda as set out in the review of business taxation.

Senator MURRAY—I think the tax office can give us these figures generally. I do not have them before me, but my expectation is that not many companies pay the top rate. One of the things which concerns the Senate and the people at large is how little so many companies pay. I think the chairman was on a committee with me when the tax office expressed excitement that a very large company in this country had moved up from an effective tax rate of nine per cent to 11 per cent. There were very substantial sums involved in such a movement. Is not the corollary of arguing for a lower top rate of corporate tax to argue for a minimum rate of corporate tax?

Mr Orton—We are not arguing for a reduction in the lower rate—not yet at any rate—of the corporate tax rate. That may well be considered in the context of changes to accelerated depreciation. Really, that is something we still need to follow up in more detail with our membership.

Mr Schubert—In the review of business taxation, one of the objectives would be to get the effective tax rate of companies closer to the regulatory rate.

Senator MURRAY—What lies behind my proposition is that it may be in the interests of your members for those who are paying too little tax to pay more, so that the top tax rate could effectively come down. For that to be acceptable to the community as a whole, you may need to look at that issue.

Mr Schubert—That is an underlying principle, I think, of the review of business taxation.

Senator MURRAY—The difficulty we have as a committee is that we have the sense of this Ralph thing hanging over us. In fact, it affects many of the decisions we may make. For instance, the people who submitted before you were talking about the possible windfall

consequences of a capital gains tax from the package—that has not been put to us before. If capital gains was to be interfered with in any way by the Ralph committee, that would affect that. It is with that in mind that I put that to you. I will not pursue it further. I will leave it at that.

The second issue a number of persons have drawn our attention to, but I would really like you to expand it more fully to us. On page 2 of your submission you make the remark:

Aspects of the proposed deferred company tax arrangements are of concern to many businesses.

You expand on it in section C in a minor way. I wonder if you could talk to us in more detail about why the deferred company tax proposal is an issue with you and what it means.

Mr Schubert—I think the main difficulty relates to foreigners holding shares in Australian corporates whose effective tax would rise from 15 per cent to the corporate tax rate, assuming they were in a double taxation treating country. Now the dividends which are distributed, if they were in a double taxation agreement country, are subject to 15 per cent withholding tax. The DCT proposal—

Senator CHAPMAN—Unfranked, is it?

Mr Schubert—Yes, sorry. The DCT proposal, if implemented, would actually raise that to the corporate tax rate whatever it was.

Senator MURRAY—But if that is an intended consequence of the package you need to tell us why in principle it is wrong. May I give you an example? The committee would typically look unkindly upon a double taxation measure or a retrospective tax measure or those sorts of things. What is there within this proposal which is unfair or unjustified?

Mr Schubert—I think from the point of view of domestic shareholders there is not a lot. It is already a cash flow issue. The real concern is with foreign shareholders in Australian companies. Their effective tax rate would rise.

I understand there have been some earlier suggestions that that could be countered with a renegotiation of double taxation treaty arrangements, but it is not clear that could be done. This is why the domestic withholding tax alternative has been floated by Ralph and others, including us.

Senator MURRAY—Are we to look at this in the balancing sense? If, for instance, you look at the ordinary Australian consumer, he or she is being told, ‘Look, don’t worry about GST going up 10 per cent because we are going to give you back income tax cuts, reduce wholesale sales tax and make the states operate more efficiently.’ In other words, they get one negative for a series of positives. Is it not so for business that there will be negatives but they are countered by the positives in the package?

Mr Schubert—Yes, I guess it comes down to the issue then of international tax competitiveness. Obviously, we would like to be competitive and attract international capital and there are lots of countries around the world who have various types of taxes which are

lower than some of ours. We cannot compete everywhere, but in some areas where it makes sense to do so it probably is wise to try to accommodate them.

Senator MURRAY—But if we deal with companies which have got international interests, either Australians operating internationally or international companies operating here, aren't there compensating benefits from the package within the international ambit?

Mr Schubert—Are we talking about GST or—?

Senator MURRAY—I am talking about the package as a whole. Aren't there benefits to those companies, such that they would lay off, if you like, the negative against the positives elsewhere?

Mr Schubert—I think it would depend very much on the individual sector and the companies. One of the things that is very difficult in looking at business tax reform, even within a group of companies in the same sector, is how each company is very different from each other company.

Senator MURRAY—I guess the proposition I am putting to you is that the committee not only has to pay attention to what the Treasurer has described as rent seekers—and I am not suggesting that is so here—but also there are people who will be losers within the approach. It is impossible to make everyone a winner, I would put to you. I want to know how big a problem this really is and how much we should attend to it.

Mr Schubert—The deferred company tax and the foreign shareholder issue?

Senator MURRAY—Yes.

Mr Schubert—It appears to be a problem. We are still talking to some people doing research on this issue. Ralph is doing research. We will be putting a submission to Ralph by the 16 April deadline. But at this stage it does seem to be a significant problem for various sections of business, particularly those engaged in attracting international capital.

Senator MURRAY—Frankly, I do not know what weight to put to it. The ACCI will appear in front of us and say the food thing will be a problem for 412,000 businesses. I can understand that. Or the insurers with long-term contracts will say that there are \$2½ billion worth of contracts which will be affected by this, and I can understand that. With this deferred company tax area I am not sure I have seen anyone put a finger on what weight or what numbers we should pay attention to.

Mr Schubert—I suspect because nobody has a good idea what the numbers are at this stage.

Senator MURRAY—Can I suggest, on notice, if you do not tell us or somebody does not tell us, you are unlikely to get us paying much attention to it.

Mr Holt—Can I take that line of inquiry on notice and undertake to provide you and the committee with the outcome of our further inquiries and research that we will be conducting anyway in the context of the review of business taxes?

Senator MURRAY—Thank you.

Senator CONROY—Your submission—and you made reference to it in your opening statement—talks about the food question. Mr Schubert, you have obviously been following the committee's deliberations fairly closely. I know you have been here most of the day. I am not sure if you were there yesterday. I am sure you have also read Professor Quiggin's articles in the *Australian Financial Review* where he puts the sword through the rubbish around food. I am not actually advocating the position; I am just disappointed to see the perpetuating of a very poor analysis. When you disaggregate households, individuals—after you take restaurant food out—pay exactly the same for food each week. It is only by aggregating them into households that it is possible to claim what you do—because the rich have more people, on average, in their households. Certainly political commentators have been slipping between the household and the individual in terms of the debate.

There is no argument after you have gone through the Quiggin material, and nobody has yet rebutted the Quiggin material, that individuals pay the same amount. The fact that there are more people in a rich house than in a poor house—whatever description you want to put on it—is not an argument to say that the high income household is going to be better off. So I am just disappointed to see you continuing to put that in your argument. Most of your other arguments that you are putting forward are very reasonable; they are arguable. This one I am disappointed to see, given the strength of the rest of your submission.

Mr Schubert—I want to make the point that I do not normally read Professor Quiggin's stuff but I think actually I did see some reference to this particular issue. We have relied on Neil Warren because we think he is a pretty reasonable, sensible sort of person who brings an objective approach to things.

Senator CONROY—I am not arguing with Professor Warren's argument. The point that Quiggin makes is that he is not comparing apples with apples. When you take into account the number of persons in a household and you take out restaurant food, the dollar amount per person on food is the same. It is a regressive tax and to turn around and try to then argue that high income households are better off when you look at the individual situation is not comparing apples with apples. There is no arguing about Quiggin's use of the statistics—it is when you disaggregate the statistics and look at the assumptions that went into the statistics—but I accept your point that you are following the Warren argument.

Senator MURRAY—He referred to the poll tax.

Senator CONROY—Yes, the poll tax, I think he described it as. The same as a poll tax, which is generally considered to be the unfairer style of tax. You have also invited questions, Mr Holt, about the creaking system that you described. This is an argument which has been dealt with at length by the committee. I am just wondering if you have seen any analysis provided to you by Treasury or anybody else about the revenue projections for either ANTS or the existing system.

Mr Schubert—Obviously, ANTS has some—

Senator CONROY—It does not have revenue projections long term. None. Treasury admitted they have done no modelling—

Mr Schubert—When you say long term—

Senator CONROY—Two, three or four years. They model up to 2001. But on revenue projections—and I think you actually made the point to Senator O’Chee—you expect the revenue to grow the same as GDP.

Mr Schubert—For a broad based consumption tax, yes.

Senator CONROY—Yes. Which is actually what work commissioned by this committee shows also. But Treasury have not done that work, despite the hyperbole of the 1930s tax system being replaced by a 1945 tax system. The modelling that this committee has had done shows that the existing tax system in actual fact also has a growth at GDP. So when—

Mr Schubert—Can I make a comment? One of the things that has disturbed me to some degree about this whole tax debate is this emphasis on models and projections. These things are very useful, but a fair bit of commonsense goes a long way in economics, in my experience. I think commonsense should tell you that if you are increasing or changing the tax system to pick up the growing services sector of the economy, however defined—

Senator SHERRY—But you do.

Mr Schubert—Under a GST, you are going to get good revenue growth, and you are faced with the alternative of a whole group of taxes with various compliance costs and difficulties which may or may not give you the same result. It is much simpler and I think it makes much more sense to take the commonsense route.

Senator CONROY—No-one has actually come before the committee and said compliance costs are going to fall. In fact, the government concede compliance costs are going up. I accept that your members, most of them, are probably copping WST at the moment, but even Mr Walpole, who appeared yesterday and who is one of the country’s leading experts on compliance costs, argued that there is going to be no net benefit to members like yourselves because you have an existing set-up, and even a simple assumption of setting up the new \$150—which is one figure that has been tossed around—or \$450 new computer package will still have the same compliance costs. There is actually no net gain, except for the fact that you have 1.4 million new tax collectors for you who were not collecting a tax before and have to set up a compliance cost. So commonsense would actually suggest that the compliance argument is not as strong as you are perhaps suggesting.

Mr Schubert—It is not only issues of compliance; it is issues of efficiency, et cetera, distorting economic activities.

Senator CONROY—Economic efficiency. You would be familiar with optimal tax theory?

Mr Schubert—Vaguely.

Senator CONROY—Does economic efficiency suggest that a single broad rate tax is the most economically efficient to avoid distortions?

Mr Schubert—I would say it would almost certainly be better than a whole group of different taxes on different things at different rates.

Senator CONROY—What it says is optimal taxes should be based on inverse relationships to elasticities of demand, which actually suggests a whole range of different rates. That is the Ramsey optimal tax theory.

I have one more question on tax avoidance. We were given an example by Customs agents who put to us that they saw a developing scenario—and this is in relation to e-commerce—where you could walk into David Jones, Myers or Grace Bros, depending on which state you were in, and look to buy a Pelaco shirt, for instance. It would be possible for the sales assistant to say to you, ‘Here is your shirt, \$80’—or \$90, whatever it is right now. ‘If you want to take it away today, you can buy it right now and pay the GST, but, if you are prepared to wait two days for a delivery through the mail, we can sell this to you without GST.’

They were very concerned that e-commerce and trading on the net this way in actual fact are going to blossom when there is an incentive for a 10 per cent reduction in price on goods that can be delivered within 48 hours to your door—the same shirt that sits in the actual store but is delivered from their offshore holding store. In the view of the Customs agents, this is a very real possibility and it is growing now. You have www. Amazon—and I am not computer literate. That is actually a growing problem, not a diminishing problem as you were suggesting, Mr Holt, in your opening submission.

Mr Holt—Undoubtedly, we have all got to learn a lot more about the challenges that electronic commerce is going to present. Anybody who can sit and say, ‘There will be no problems; there is nothing else to learn; it is all exactly the same,’ is plainly a fool and has not really spent a lot of time trying to develop the platforms. What I was trying to say—and I will return to the barrier entry issue in a moment—is that the fundamentals of commerce do not change. They actually do not change.

We might get efficiency in time, efficiency in delivery, we might even get improvements in competitiveness and pricing and so forth, but the fundamentals do not change. The thing that we are discovering—if I may just digress for two seconds—is that it is not the magic of switching on to the Internet and gaining all the benefits of efficiency; the challenge we are finding now is that people who want to make that step are like the companies that were making the step in the 1960s and 1970s to computers, but they could not make the step because they did not have their systems. Their paper based systems were not efficient. So a lot of the improved efficiency is going to come that way. Now let us get to the cyberspace transaction and options about, ‘If you can wait, it will come from somewhere else,’ et cetera. The fact is that can happen today.

Senator CONROY—I know that; they made that point.

Mr Holt—What you are, I think, identifying—quite fairly, and probably there will be more that we have not thought of—are challenges that are going to come from the globalisation of trade. Right down at the consumer level, now facilitated by individuality of ordering and so forth, it is with us. It is going to give us the challenges anyway. The mere fact that we are talking here about a tax system that focuses on the transaction really I do not think changes that challenge all that much. It focuses on it—because undoubtedly Mr Carmody will have to begin to think about these issues—and is already, as are other regimes across the world that focus on indirect taxes.

This is not a phenomenon peculiar to us. It happens to intersect with our debate about whether we embrace another model of taxation, certainly, but I do not think there is anything unique here. I think it is just in the bag of challenges, including barrier entry, including international transaction, including pricing. I cannot sit here and give you all the answers. I think we just merely have to recognise that it is part of progress. Now whether we have this model indirect tax or some other I do not think is going to change the challenge.

I come back to my opening point. I think the records are going to be better than we presently have. And I say that on the basis of the mess we see now in supply chain management in corporations whose central role, their main reason to exist, is supply chain management. And we think that getting up to scratch is going to give us better and more reliable records.

CHAIR—Senator Margetts, are you there?

Senator MARGETTS—I am.

CHAIR—Do you have any questions?

Senator MARGETTS—I have, yes, thanks. If, as you say, payroll tax should be abolished, does your organisation have an opinion on what should be substituted for payroll tax if it is removed?

CHAIR—Could you repeat the question, Senator Margetts? It was indistinct at this end.

Senator MARGETTS—Right. If, as you say, your organisation says that you would prefer that payroll tax was abolished, does your organisation have an opinion on what could be substituted if payroll tax was removed?

Mr Orton—Basically, our original position was that we probably would have preferred to have forgone some of the personal tax cuts in order to fund the removal of payroll tax.

Senator MARGETTS—And you put that view to the government?

Mr Orton—We did.

Mr Schubert—Yes, we did. We put in the part for the BCTR, which was pushing a similar view, as you might remember.

Senator MARGETTS—Right. Earlier you mentioned e-commerce, but you seem to have an assumption that governments will need to accelerate their efforts to develop harmonious policies that foster the growth of electronic commerce. Is it not a problem if we are jumping into this new tax system and we have not worked out how we are going to deal with the tax treatment of e-commerce and how we are going to deal with it in terms of accountability?

Mr Orton—This is a problem that other countries with similar tax regimes are already facing. E-commerce is coming whether we like it or not, and, given that most of the issues require harmonisation of international tax arrangements, we cannot see any reason for delaying one because of the other.

Senator MARGETTS—Right. But it is likely some things will fall between the cracks in the interim until a policy is brought together.

Mr Orton—That no doubt is a problem that our international competitors may also face if it does exist.

Senator MARGETTS—Okay. Thank you very much. Can I just advise the committee that I have now got a meeting, so fare thee well.

CHAIR—Thank you, Senator Margetts. I thank you as well, Australian Business, for your evidence this afternoon.

[5.16 p.m.]

BEAVON, Mr Norman Charles, Chief Executive Officer, Australian Duty Free Association

ROGERS, Mr Anthony John, Vice President, Finance, DFS Australia Pty Ltd

RYAN, Mr Warwick Michael, Ernst & Young, Indirect Tax Adviser to the Australian Duty Free Association

STRANG, Mr Christian, deputising for President, Australian Duty Free Association

CHAIR—While the interchange is going on, let me say I apologise to the Australian Duty Free Association. We fell behind very early in the day and we have been struggling to make up time ever since. You can see that we have been manifestly unsuccessful in making up very much time at all, and for that I apologise, although I recognise that you have been very patient.

Let me also go on and say, while you are taking your seats, the normal format is for your lead speaker to introduce the other speakers, to then address the committee for a very short time on your submission which we have before us, and then make yourself available for questions. With those remarks, if we are in a position to commence, would whoever is the lead speaker identify themselves and proceed.

Mr Strang—Senators, I am deputising on behalf of Mr Julian Levy who is President of the Australian Duty Free Association. Mr Levy is unable to attend today's hearing, unfortunately.

We understand that you have received over 1,000 submissions, and we would like to thank you for the opportunity that you have given us to appear before you today. I would like to make a short opening address and then ask Warwick Ryan to make a short presentation on the screen.

Senators, ADFA supports the government's tax reform plan as set out in its document titled 'A new tax system'. The topic which we wish to address today relates very specifically to the tourism shopping aspects of the ANTS document and the relevant sections of the GST bill which is currently before the Senate.

ADFA represents Australia's duty free stores. Our membership comprises 78 companies operating 179 duty free stores around Australia. All of these stores are selling duty free and sales tax free to incoming and departing travellers. ADFA owns a non-profit private company called Duty Free Security Limited. Duty Free Security Limited operates the well-known sealed bag system for duty free sales of otherwise dutiable goods such as alcohol and tobacco. Sales of duty free goods to either departing Australians or to departing foreign visitors are required to be made under the sealed bag system.

Duty Free Security Limited employs staff who inspect all sealed bags and retrieve the sales dockets from those bags at Australia's international departure points. What is probably

not well-known is that, in addition to the 179 duty free stores, the sealed bag system is used by over 1,300 tax free retailers. These are retailers of, for example, jewellery or photo or electrical equipment who sell sales tax free to outbound Australian travellers. Furthermore, the sealed bag system is available to any retailers wishing to join, subject only to the regulations governing export of purchases.

The total annual revenues of these duty free and tax free stores derived from sales to both inbound foreign tourists and outbound travellers exceeds \$1.2 billion. The current sales tax rules require that sales tax free sales to departing Australians can only be made in the sealed bag system. These rules apply even if the goods, such as a camera, are not subject to customs or excise duty.

The sealed bag system is a robust and very efficient system which has been in operation in Australia for over 21 years. The costs of the system are fully borne by the industry. The system provides full protection for government revenue. This is because if a sealed bag is not presented for inspection at the point of final departure from Australia, then the retailer is required to pay the duty and the sales tax payable on the goods concerned.

In the August 1998 ANTS document the government announced its proposal to introduce a tourist refund system. Under this scheme departing tourists and Australian residents would be entitled to refunds of GST on purchases of at least \$300 from any one business prior to departure. ANTS was silent regarding the future of the sealed bag system. However, after extensive discussions with the government, we understand that the government has decided to retain the sealed bag system.

The GST bill contains a section which will provide GST-free treatment for certain sales to departing travellers. These sales will have to be made in accordance with the rules to be specified in future regulations. ADFA is consulting with the government regarding the development of these regulations. Over 70 per cent of the tax free retailers who use the sealed bag system currently, as well as 100 per cent of the duty free stores, want to retain the existing system.

We request the committee to support this category of GST-free sale as a parallel system to the proposed tourist refund system. The rules for the tourist refund system are also to be contained in future regulations. We do not believe that these rules should have a \$300 threshold. Our industry survey suggests that between 75 per cent and 80 per cent of sales in selected duty free shops are less than \$300.

I would like, if I may, to hand over to Warwick Ryan to make a short presentation on the screen, after which we will be very happy to take questions about our submission.

Mr W. Ryan—It is a pleasure to be here, Senator. Thank you for your time once again.

Overhead transparencies were then shown—

Mr W. Ryan—The two key points that we would like to make in our presentation to you today are that we think there is a significant risk that the GST refund system may not be viable or accessible. There are a number of reasons for that, and we will go through those in

a little bit more detail in our presentation. We think that the administrative costs of running it could be a little bit too high. We think the refund commission that the refund operator will want to take will be a large part of the GST refund for many purchasers, and we think that that might make the savings to the purchaser marginal.

We have put the view that Australia should retain a parallel sealed bag system at the same time as the refund system proposed by the government. We believe the parallel sealed bag system should be kept because the cost of running it is less than half the cost of our estimate of running a GST refund system and in the absence of a parallel sealed bag system you have really put all your eggs in one basket with the tourist refund system.

I will just give a brief overview of the structure of the current tourism shopping system in Australia at the moment. We are all familiar with the ubiquitous sealed bag. I gather many of us have purchased goods from a duty-free shop in the sealed bag.

CHAIR—Many of us are familiar with the Bundy rum bottle, I am sure!

Mr W. Ryan—If the goods that either an Australian resident or a foreign visitor wishes to purchase have customs or excise duty on them and they wish to buy them duty free, the goods have to go in the sealed bag regardless of the identity of the purchaser. That is the sealed bag system that Christian Strang described before.

Similarly, there are some products which have no significant amounts of customs or excise duty on them, and a camera is an example of that. The sales tax rules provide that if an Australian resident wishes to purchase goods such as a camera sales tax free, those goods will have to be sold in a sealed bag as well. So there is a category of products that has to go into a sealed bag that you can buy from camera stores such as Ted's Camera Stores if they have set up to make sales to you in the sealed bag. They are not a duty-free shop; they are what we call a tax-free retailer. There are a large number of tax-free retailers, over 1,300, who use the sealed bag system to make sales to Australian residents leaving Australia.

The other system we have in Australia at the moment is the open bag system. If the purchaser of sales tax-free products like a camera or a watch, for example, is a foreign visitor, that person can buy those goods in an open bag. They can come into any store, whether it is a duty-free store or a tax-free retailer, and purchase those goods in an open bag such as this one. They are required to fill out a declaration affirming their intention to export the goods, and they are required to leave a copy of their travel documents and their passport showing a visitor visa. So we have two systems in Australia at the moment: the sealed bag system and the open bag system.

In terms of the future system, we believe that the government has decided to retain the sealed bag system. We expect under the rules that will apply in the future that whether you are an Australian resident or a foreign visitor, if you want to buy your goods duty-free or GST-free, you will be required to purchase them in the sealed bag and that the administrative system that goes along with the sealed bag will be very similar to the one we currently have. We have not seen the regulations yet, and we are waiting to see those. We do not expect to see them before 30 June, but we expect that the current sealed bag system will be retained as a parallel system.

The government has announced in the ANTS document that it will have a GST refund system. We have not seen the regulations to give effect to this. We expect under that proposal that whether you are an Australian resident or a foreign visitor, if you want to buy goods GST inclusive—your watch, your camera, your radio—you will be able to buy them GST inclusive in an open bag, and as long as you have proof of export at your point of departure you will be entitled to a refund of the GST you have already paid, less the administrative cost of the refund operator which would be deducted from your GST refund entitlement.

It is unclear whether the open bag system which currently applies and which allows people to pay no sales tax at the point of purchase will continue to exist under the new system. In terms of some of the background information about the amounts that visitors spend in Australia, our information suggests that there is about \$1.2 billion worth of expenditure by Australians departing Australia and incoming foreign visitors in the duty-free and tax-free shops that I have described. About half of that is spent in duty-free shops and about half of it is spent in the tax-free shops—the tax-free jewellers and the tax-free camera stores.

When we look at that \$1.2 billion, we try to allocate it between Australians and foreign visitors. This slide shows that about \$800 million of that \$1.2 billion is spent in the duty-free and tax-free shops by foreign visitors. Some \$500 million of that is spent in the tax-free shops and about \$280 million is spent in the duty-free shops. That is the expenditure by foreign visitors on goods that they want to take out of Australia when they leave. We are not talking about goods that they buy for consumption in Australia.

How much do visitors spend in Australia overall? The estimate from the international visitor survey is about \$1.5 billion. In addition to shopping in duty-free shops and tax-free shops, they go into general retailers and purchase the goods inclusive of sales tax and do not get any sales tax free benefit from making that purchase. If they go into a general retailer and purchase goods they are taking home, they will probably not have received a sales tax free purchase price, but they are taking the goods home anyway. Our best guess is that about a half of what foreign visitors spend in Australia at the moment to take goods home with them is spent in retailers in that way.

When we have a little look at the \$1.2 billion that is spent in the duty-free shops and the tax-free shops by Australians and foreign visitors, we see that about \$300 million is spent at the duty-free shops at the airports: the departure shops and the arrival shops. About \$900 million is spent in the downtown or the metropolitan stores. We have done a small analysis here to show the difference between the sealed bags sales that are made in those shops in metropolitan locations and the differences between purchases by Australians and visitors. You can see that the sealed bag system accounts for about \$250 million worth of sales of products that go out of Australia in sealed bags such as this one. You can see that visitors are making about 80 per cent of all of those purchases.

I will not take you through all the rows in this chart. Basically, we have identified that visitors buy more duty-free and tax-free goods off airport than Australians do. Our estimate is that the average sealed bag sale is about \$164.

If we look at the relative merits of two parallel systems—the sealed bag system and the GST refund system—our estimate is that the cost of operating a sealed bag transaction is about 2.3 per cent of the price. The industry bears that cost completely, and the government plays no role in the administration of the duty-free sealed bag system.

The duty-free security company that Christian Strang mentioned before is a privately owned company. It employs the staff at the airports who collect the dockets off these sealed bags. They are not customs officers; they are employees of the private non-profit company, Duty Free Security.

Our estimate is that if, under a GST refund system, you made a \$200 sale, about six per cent of your GST refund entitlement would go in administration costs for the refund operator. In Canada, a refund operator was charging a minimum of \$12 administration cost for each transaction. That refund operator has ceased trading recently and Revenue Canada has had to take over that administrative activity. A certain volume of transactions are required for the private operator to be making a commercial venture of the activity.

When you look at the sorts of refund commissions that are required to be paid in some places, they can be as high as 61 per cent of the refund. If you are paying a \$12 fee, and you only have an \$18 refund entitlement on a \$200 camera, then about 60 per cent of the refund will go in commission.

Overall, running the sealed bag system is about half the cost of the refund system. We believe there should be two systems. We believe they should run in parallel. There are different advantages. People who want to use the goods and want to get them in an open bag should have the opportunity under a GST refund system.

We have conducted surveys of the average value of transactions that visitors and Australians spend in duty-free and tax-free shops. It is quite interesting. Looking at the pie graph on the right, you will see that 43 per cent of all the transactions are less than \$100. Only 25 per cent of the transactions were more than \$300 in the survey period that we took. This covered departing Australians and foreign visitors. Some 43 per cent of the transactions had an average transaction value of about \$42. People are buying a bottle of alcohol, some cigarettes and maybe a bottle of perfume, and that is all they are taking out in their sealed bag. It is quite a small transaction price.

Those averages apply for the visitors as well. When we look at 75 per cent of all transactions, the average transaction value is about \$98. We suspect that the \$300 threshold the government has published in its ANTS document is based on the economics that oversees refund operators expect they need to meet to be able to make a profit in conducting a refund system. Obviously, the threshold will need to take account of this large number of quite low value transactions. There is a risk that the refund system will not be commercially viable. I think we have explained that well enough.

We have analysed the frequency with which Australians travel. We have found that in duty-free shops, as an industry average, we sell more product to outbound Australians than we do to inbound tourists. A lot of Australians are buying at our airports and downtown before they leave Australia. If they do not make those purchases here, they will probably

make them overseas. This slide shows that in a period of two years when we interviewed Australians returning from overseas and another group, we found about three-quarters or so of the Australians had not travelled in the last two years. The remaining one-quarter had travelled the number of times indicated there. A small number are travelling a number of times a year.

When we look at where those people had made their duty-free purchases—and some of them had purchased in a couple of places, either in Australia before they left and then overseas while travelling—we get a total sample of about 178 per cent to reflect the fact of multiple purchases. What we have highlighted in the red bars on the left is that 43 per cent of those 178 per cent of purchases are actually made in overseas duty-free shops or at overseas airports. They are the competitors that we see ourselves competing against. Our objective is to be as price-competitive internationally as we can, so that we can reduce those red bars on the graph and can increase the expenditure by Australians before they leave, so that they are making their purchases in Australia rather than overseas.

I have one final comment before we invite questions. One advantage of a sealed bag system for a foreign visitor is that, if they make the purchase at a GST-free price, then they have the GST component of the purchase to spend on other things in Australia. If they make their purchase in an open bag GST inclusive, and get a refund at the airport, they may not get the opportunity to spend that refund before they leave the country.

In summary, we believe that there should be two parallel systems. We look forward to working with the government to see those regulations come into place.

CHAIR—Thank you. This is a logical story. Have you put it to the government? If so, what have they said? If they have knocked you back, are you asking us to recommend to the Senate that we amend the bill when it comes forward to reflect what you have put?

Mr W. Ryan—To take the first question, we have had many discussions with the government about the benefits of retaining the sealed bag system. It has been indicated to us informally that they have made a decision to keep it. So we are confident they have made that decision, but we have not yet seen the content of any regulations to give effect to that.

In terms of our submission to your committee, the bill contains a section which sets up the mechanism for a GST-free sale of this kind. Our submission is that you support the retention of that provision in the bill. There will come another day when the regulations come to the Senate when we may want to have another discussion.

CHAIR—If the regulations do not reflect the proposals for the sealed bag option that you have put, is that when you would like us to exercise a view, rather than at the legislative stage?

Mr W. Ryan—Absolutely.

CHAIR—The trouble with regulations is that it is either knock them all off or accept them all, so we have less scope to negotiate. You will have to succeed with the government and the regs if that is the case.

Senator GIBSON—Where are you with the government? But basically Warwick has already answered that, Mr Chairman. Thank you for the clear exposition of what is proposed.

Mr W. Ryan—We have copies of those slides to hand out to you.

CHAIR—I think some of the committee might have been wondering whether you have got copies of sealed bags for them.

Senator CHAPMAN—How does your proposal differ from the system that operates in the European Community, in terms of their VAT system? Sealed bag or dual bag?

Mr W. Ryan—The sealed bag is particular to Australia. It does not operate anywhere else. New Zealand has the legislation in place to be able to use it if they want to, but they do not at this stage. It is all airport pick-up. We are unique in that regard.

Senator CHAPMAN—You have given us a detailed presentation, but what is the advantage of obtaining that system as against the European Community system?

Mr Strang—Australia has been remarkably far-sighted in having the system. It is actually one that goes to customer service. The sealed bag system actually allows the customer to make a choice over a wide range of retailers and take time to make that choice, rather than just leaving the choice to buy duty free at an airport. That is one aspect.

Senator CHAPMAN—In the EC you do not have to buy at an airport; you can buy anywhere.

Mr Strang—But you do not have the choice; you have to go and get a refund, basically. That is the customer service angle of it, if you like.

Senator CHAPMAN—Sure. So that is the difference? With this system you do not have to pay up front and get a refund? With the VAT system in Europe, you have got to put in your form to get the money back.

Mr Strang—That is correct. That is the main difference.

Mr Rogers—We do believe there is an opportunity for the people to purchase more if they have not had to bear the cost up front and wait until they get to the airport when they are in a rush to try to get a refund. It will probably go into their pocket and out of the country.

Senator CHAPMAN—Thank you.

Senator MURRAY—Is not the real reason that the European Community retain the open bag system because they make more money out of it? The reason I put that proposition to you is that the queues are so long and the process is so difficult that you end up not claiming your refund and the government pockets the consequences of an inefficient and unfair system? Is not that the real reason they do it?

Mr W. Ryan—I agree, Senator. We would expect that the higher you set the threshold, the less people will avail themselves of the refund as well. You have got the problems of the paperwork and the possible delays at the airport when you may be concentrating on getting on your flight. There are issues about the value to you if you receive a cheque at home later. We certainly agree that it is likely that the government is going to collect a lot more revenue if it had only a GST inclusive refund system, than if it had an alternative system that allowed you to purchase GST free in advance.

Senator MURRAY—Who would be opposed to your proposition in Australia and why?

Mr W. Ryan—I think that there is a possibility that a small number of tax-free retailers who use the open bag system only, because they sell to foreign visitors and who are not required to use the sealed bag system, would prefer to keep using the open bag system that they currently have. I think it is possible that they might argue that this is a cumbersome system, that it would cost them to participate in this system and that they would prefer to continue to have an open bag system.

Senator MURRAY—But you are recommending a dual system, a continuation of both the open bag and the sealed bag system, aren't you?

Mr W. Ryan—Yes, we are, but the difference is that the question is whether the open bag system is GST inclusive with a refund at the airport or whether it is GST free at the point of purchase. We think it is likely that some will argue that if you want to keep a sealed bag system, keep a sealed bag system. If you are going to have a GST refund system, that is fine. We actually want to have a third system which is an open bag system which is GST free at the point of purchase, with a declaration that you intend to export the goods but no requirement to actually prove export of goods.

Senator MURRAY—Does that open up any major opportunities for people to rot or adopt corrupt practices or avoid paying tax any more than the existing system?

Mr Beavon—Not any more than the existing system, no. The existing system allows people to, if you like, rot the system should they wish to do so whereas the refund system would not.

Senator MURRAY—It has been said to me that the sealed bag system is, in essence, a restrictive practice because of the barrier to entry that exists because you are required to have fairly substantial administrative resources to set up a company that can do it because it is a cumbersome process.

Mr Beavon—Not really.

Senator MURRAY—Would that be a wrong statement?

Mr Beavon—I think so. The mere fact that we have in excess of 1,300 medium and small sized businesses running that sealed bag system at present and they do not find it in any way cumbersome, plus the fact that in the survey that we conducted 74 per cent said that

they wished to continue with the sealed bag system, makes me believe that it is a suitable system. It also retains revenue from a Treasury point of view.

Senator MURRAY—Based on very careful research and the proposition you put to us, it would make sense, wouldn't it, for the government to accept this as a method of operating and to evaluate it over time. If they found it had detrimental side effects or unintended consequences—express it how you will—they are always at liberty to tighten up and change it at some further date to line it up with overseas practice or whatever else they wish to do. You would accept that proposition, wouldn't you?

Mr W. Ryan—Yes, we would. In fact, at the time when the current sales tax law was rewritten, a similar approach was taken when the government took a decision that Australians who wanted to buy sales tax-free cameras, et cetera, would need to use the sealed bag system. They said, 'We will put this into place and evaluate it and see if it works successfully for all of those small to medium tax-free retailers who are not duty-free shops.' The experience has been that that has worked satisfactorily. I would imagine the government would consider taking a similar approach.

Senator MURRAY—That is all I have, Mr Chairman.

CHAIR—Senator Conroy.

Senator CONROY—I have not got any questions. I think it is a compelling case and I am taking on face value Senator Gibson's and Senator Chapman's nodding of agreement when you indicated the government had seen the light. So we will wait with bated breath on the regulations, Senator Gibson.

CHAIR—I think this committee is comprised of people with first-hand experience of the issues that you are talking about. Senator Sherry.

Senator SHERRY—Just one point. I assume, if your position were not accepted, the substitution effect by customers would mean that domestic Australians would presumably buy a much greater proportion of their purchases overseas and the same with foreigners visiting Australia. They are more likely to buy overseas than buy in Australia.

Mr Rogers—That would be the case. It is a very keen market out there, in particular the Japanese aspect of duty free. They are very aware of what their local retails are on products that they are going to buy. They keenly shop out the duty free stores when they arrive. If they do not think they are getting a bargain they will not buy it. It is a real issue for us going forward. Likewise, if the local market decides that it is of no great benefit to buy locally, we are going to see dollars go overseas.

Senator SHERRY—You believe the substitution effect would not be Australians going out and buying in the retail sector generally in Australia because it is obviously going to be more expensive. When they go overseas, they put their money aside. They are going to spend X amount—whatever that may be. They just take the money overseas and spend it there.

Mr Rogers—That would be a likely outcome, yes.

Senator SHERRY—Thanks.

CHAIR—We are all done. Thank you very much, Mr Strang, Mr Ryan, Mr Beavon and Mr Rogers, for your submission. It is not my job to sum up the mood of this committee, but if I were to I would probably sum it up in your favour. Thanks very much.

This concludes the hearing for today. We resume here tomorrow at 9 o'clock. Let me conclude by thanking *Hansard* for indulging us today. It has been a very difficult day to get through and we do appreciate the service you have given.

Committee adjourned at 5.49 p.m.

