COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE

of

PUBLIC ACCOUNTS AND AUDIT

Reference: Tax Law Improvement Bill (No. 2) 1997

MELBOURNE

Wednesday, 18 February 1998

OFFICIAL HANSARD REPORT

CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

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Mr Griffin (Deputy Chair)

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Senator Crowley	Mr Peter Baldwin
Senator Gibson	Mr Beddall
Senator Hogg	Mr Broadbent
Senator Watson	Mr Fitzgibbon
	Mr Georgiou
	Mr Sharp
	Mrs Stone

Matter for inquiry into and report on:

Tax Law Improvement Bill (No. 2) 1997.

WITNESSES

BACK, Mr Gavin Alexander, Assistant Commissioner, Tax Law Improvement Project, 2 Constitution Avenue, Reid, Australian Capital Territory 2601 . 177

BAXTER, Mr Duncan Robert Charles, Partner, Deloitte Touche Tohmatsu, 505 Bourke Street, Melbourne, Victoria 3000 177

BURGE, Mr John Gregory, Senior Officer, Tax Law Improvement Project, 2 Constitution Avenue, Reid, Australian Capital Territory 2601 177

FRESHWATER, Ms Lyn Margaret, Technical Officer, Tax Law Improvement Project, Australian Taxation Office, 140 Creek Street, Brisbane, Queensland 177

GARDAM, Ms Kim Louise, Tax Analyst, Deloitte Touche Tohmatsu, 505 Bourke Street, Melbourne, Victoria 3000 177

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HARDERS, Mr Geoffrey, Consultant, Australian Taxation Office, 2 Constitution Avenue, Reid, Australian Capital Territory 2601 177

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LANGFORD-BROWN, Mr Ian, Director, Taxation, Institute of Chartered Accountants, 37 York Street, Sydney, New South Wales 178

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REID, Mr Thomas Johnston, Second Parliamentary Counsel, Tax Law Improvement Project, 2 Constitution Avenue, Reid, Australian Capital Territory 2601 178

SPENCE, Mr Kenneth John, Senior Vice-President, Taxation Institute of Australia, 64 Castlereagh Street, Sydney, New South Wales 178

THRING, Mr Gordon James, Member, National Tax Practice Committee, Australian Society of CPAs, 170 Queen Street, Melbourne, Victoria 178

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Tax Law Improvement Bill (No. 2) 1997

MELBOURNE

Wednesday, 18 February 1998

Present

Mr Charles (Chair)

Senator Gibson	Mr Beddall
	Mr Griffin

The committee met at 9.34 a.m.

Mr Charles took the chair.

CHAIR—The Joint Committee of Public Accounts and Audit will now resume taking evidence as provided for by the Public Accounts Committee Act 1951 for its review of the Tax Law Improvement Bill (No. 2) 1997. I welcome everyone here this morning.

At the first hearing in Sydney last month, it was apparent that witnesses had been unable to properly scrutinise the additional material released on 8 January 1998. This material includes the important transitional and consequential provisions. The committee will first consider this additional material and then, if time allows, return to the clauses of the bill. This will allow witnesses to raise any additional concerns—and I would emphasise those words—which have arisen since the last hearing. I emphasise that the committee wishes to consider additional issues only. It does not wish to reopen the debate on matters covered at the last hearing.

As we will be using a round table format for taking evidence, I remind witnesses that only the committee may put questions to witnesses. If other participants wish to raise issues for discussion, they will need to direct their comments to the chair, who will decide whether or not to pursue the matter. It will not be possible for witnesses to respond directly to each other. As you make comments, it would assist Hansard if you identify yourselves.

Witnesses who attended the earlier hearing need not be sworn as they remain under oath. The committee will swear new witnesses. Before this occurs, I refer members of the media who may be present to a committee statement about the broadcasting of proceedings. In particular, I draw the media's attention to the need to fairly and accurately report the proceedings of the committee. Copies of the statement are available from the secretariat staff here at this meeting.

[9.35 a.m.]

BACK, Mr Gavin Alexander, Assistant Commissioner, Tax Law Improvement Project, 2 Constitution Avenue, Reid, Australian Capital Territory 2601

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THRING, Mr Gordon James, Member, National Tax Practice Committee, Australian Society of CPAs, 170 Queen Street, Melbourne, Victoria

CHAIR—I now welcome to today's hearing the representatives of the Tax Law Improvement Project and other organisations who attended the committee's hearings in Sydney last month. Those of you who were witnesses at those hearings in Sydney remain under oath. Other witnesses who were not present will need to be sworn or make an affirmation.

Mr Nolan, we have received TLIP's latest submission to this inquiry, dated 13 February 1998. Do you wish to present any additional submissions?

Mr Nolan—We presented, since the last meeting, two pieces of material. One was in response to some issues that had been raised at earlier hearings. The committee, through the secretariat, invited us to provide some additional material. One of the documents that we provided on 13 February does that. It deals with perceptions that the project team adopts pro-revenue positions and a number of other issues, including some further canvassing of the process for dealing with small 'p', as we call it, policy issues, and a range of other matters that I do not need to go through now.

The other document that we provided, however, was some further drafting material. It takes up four sets of amendments to the capital gains tax rules that have recently been enacted—or, in one case, is still going through the parliament—and that material has now been provided. It is proposed that that would be dealt with and added to the bill in the course of its passage. That material is on the table. It deals with the subjects of rollover relief for small businesses when they dispose of assets, an exemption for small business for retirement purposes when they dispose of assets, some provisions dealing with subsidiary company liquidations, the treatment of the cost base, and deductible expenditure of assets, which are provisions designed to ensure that there are not, effectively, double deductions. Those provisions are now provided.

CHAIR—Thank you, Mr Nolan. Do the representatives of the other organisations here today wish to present further submissions?

Mr Petersson—Yes. I am representing the Taxation Institute of Australia, the Institute of Chartered Accountants and the Australian Society of Certified Practising

Accountants with Gordon Thring, Jon Kirkwood and Ken Spence assisting. Perhaps there is one point of clarification.

When we received notification of this further hearing, we were rather given the impression that we would have an opportunity to go through things which were in our original submission which we did not have an opportunity to go through at the original hearing. I gather from comments you made earlier this morning that that may not be the case, although I note in the program that has been circulated here today, which we did not see previously, that in fact it appears that it covers items in the main bill which were not covered at the original hearing, which we assume means the matters in our submission which we were not able to speak to directly.

CHAIR—I assume you are referring to technical issues. I certainly left Sydney under the impression that everyone had had a fair go and that nobody felt they had been denied the opportunity to make appropriate comments on various sections of the bill as it existed at that point, excluding of course the transitional and consequential amendments which everybody agreed that you had not had time to examine, which is why we are having this hearing.

Mr Petersson—Certainly we had not had an opportunity to look at the transitional and consequential provisions, and we have some comments to make this morning. We were effectively allocated one hour on the second day of the hearing last month, and a good proportion of that was taken up with other issues. We did not get an opportunity to speak in respect of specific technical issues which are covered in the submission.

CHAIR—Okay. Let us see how we go. I am not averse to discussing issues that either have arisen since or that in fact we neglected to get to, but let us see how we go with the program.

Mr Spence—Until I arrived this morning, I also was not aware that we were specifically focusing on the transitional provisions that were released on 8 January. It may have been a communication problem within our organisation, but I am not aware of that. Certainly it had not been communicated to us that that was the focus of today's meeting. We are happy to make some comments, but we are not primed up and fully prepared to produce any documentation of our concerns, thoughts or issues that we see in those provisions.

Mr Kirkwood—We understand from this morning's discussion that there is an additional submission from the tax law improvement team which we have not had an opportunity to examine. Mr Nolan has just referred to further changes that have been made to the bill which we have not had an opportunity to examine.

CHAIR—All right; I hear you. Does anyone else have any general comments? Shall we go on with the agenda, which I believe you all have in front of you. The

committee will seek comment on the material released on 8 January which contained amendments to the bill and transitional and consequential amendments. Do any of the witnesses wish to make an opening statement?

Mr Petersson—Mr Chairman, may I? Looking at the transitional and consequential provisions and also the further amendments which were circulated on 8 January, basically it reinforces the body's resolve that there needs to be a no disadvantage clause in the bill, particularly in respect of the capital gains tax provisions, basically to protect the interests of taxpayers, given the highly technical nature of this and the impossibility that every conceivable transaction can be tested against the new provisions before their introduction on 1 July. What we heard at the last hearing was that the TLIP was saying, 'Trust us. If there is a problem, we'll fix it.' Unfortunately, I suppose it has tried to point out that the TLIP, as a group of officials, is not in a position to make that kind of undertaking.

Governments both past and present do not, in any event, have a strong record when it comes to correcting technical problems. The ATO's capital gains tax technical corrections register—which was set up specifically to log technical issues, with a future intention of legislating for them at some stage—has actually grown in recent years rather than contracted. In the meantime, taxpayers affected by such technical deficiencies in the law are still subject to tax and to penalties if their returns are not made in accordance with the law as it stands at that time. It is rare for technical corrections to be given retrospective operation.

If the TLIP is so confident of its product—and we have certainly praised it on previous occasions—why is it so opposed to a no disadvantage rule; unless, of course, there are undocumented changes that do in fact disadvantage taxpayers? Such a rule, we would suggest, could be implemented quite easily, and I offer this as an example of the way in which it could be implemented: it could provide that, unless a change of law increasing tax liability is noted in the explanatory memorandum of the bill, taxpayers would not be subjected to any higher liability than would be the case under the 1936 act. A similar provision is provided in relation to private and public rulings in section 170BA and section 170BB of the 1936 act, and so we do not see it as breaking any new ground. That is in terms of a general statement. I do have some particular comments, as do my colleagues, in relation to the transitional provisions themselves.

CHAIR—Mr Nolan, do you have any comments?

Mr Nolan—The subject of whether there should be a no disadvantage rule was discussed last time. It is also the subject of some of the material that we have provided to the committee. Basically we believe that the best way to correct any errors is by directly dealing with them by legislative amendment, which is the route that was taken with Tax Law Improvement Bill (No. 5) introduced last year. It is not a question of just saying 'Trust us.' There is in fact a process and a track record for dealing with corrections. To have a no disadvantage clause of the kind that was discussed would drive practitioners to

the need to continue referring on to both the new act and the 1936 act rather more than they would otherwise do, which would prolong the transition to the full adoption of the new legislation. We do not think that that is an appropriate or desirable thing.

The technical corrections register that Mr Petersson referred to is a separate issue. That is dealing not just with things that would be regarded as corrections. They are not things that come out of this legislation. They are points of difference and some of them are policy matters. They are a whole range of things that have been raised over the years as issues for consideration by other processes. I think that process is not really relevant to whether TLIP deals effectively with issues that call for correction from its work.

We do have a track record of getting on with doing those. It is true that the project team cannot guarantee anything will go through the parliamentary processes. That is not within our control naturally, but I think that is the more effective and, ultimately, more open process. A no disadvantage clause is also something of a one-way street. The way in which it has been put says, ‘If there is something that goes against a particular taxpayer, then he is entitled to rely on a view that would apply under the old law.’ It does not work in the other direction, apparently.We are quite opposed to the idea that there should be a no disadvantage clause.

Mr Burge—I would like to respond to some of the issues that have been raised and to support the comments that Brian Nolan has just made. First of all, in relation to the submission from the Tax Law Improvement Project dated 13 February, Jon Kirkwood mentioned that that material has only recently been made available. That material concerns the catch-up amendments in the second volume of submissions. On the very last page we listed those provisions which were still before the parliament, or which had only very recently been enacted, which the tax law improvement project needed to include. The important thing is that they are either enacted or the details have been provided in a bill before the parliament.

At the last hearings, I undertook that we would have that material ready by the middle of February. That was the case and we made it available to the committee as soon as it was completed on 13 February. Our plan is to send it out in the next day or so to our capital gains tax consultation groups. There is an issue that, if a matter is a submission to this committee, we are not in a position to release it until the committee has authorised its release. That was a factor there.

In relation to the points that Geoff Petersson made about the technical corrections register, it is important to emphasise that a technical corrections bill before the parliament at present deals with a number of issues from the technical corrections register. Our bill itself deals with a number of issues from the technical corrections register. One example would be the replacement for section 160ZM, which is CGT event E4, and its relationship with the withholding tax provisions. The technical corrections register is being dealt with. There is a technical corrections bill before the parliament and our bill will deal with a

number of those issues.

Mr Kirkwood—The concern I have with the ongoing situation with the legislation is that it is not my understanding that the Tax Law Improvement Project, TLIP, team will be here in three or four years time. It will have disbanded. Somebody could correct me in relation to that impression, but my understanding is that the TLIP team will be disbanded within a year or so. Therefore, the corrections that we are talking about will fall back into the general body of corrections that the Australian Taxation Office and Treasury and the government have to consider from time to time.

The track record in that regard is not good. Indeed, there is a technical corrections bill before parliament at the moment. As John was saying, there have indeed been a number of technical corrections made in the TLIP process. But there are still many issues on the register, which I personally do not believe qualify as policy issues, that have not yet been attended to. So it is a question of what certainty there can be that when an error is found it will be fixed.

Dealing with another issue that Brian Nolan raised concerning whether there could be a no disadvantage clause and the reference to having to read two acts of parliament, that will have to be the case for any adviser whether or not there is a no disadvantage rule. That adviser will simply have to read both acts of parliament to determine whether the TLIP rewrite has expressed the same idea in different words, because if it has not there are provisions in that act that bring other factors into play.

Therefore, it is quite necessary to have a good understanding of what the old law was compared with the new law. The problem is that without a no disadvantage rule you do not get the benefit of the old law applying where the new law does not provide that same advantage under the old law. So there is an ongoing difficulty. Every adviser for some time will have to read the old act; you cannot avoid it.

CHAIR—This is an issue that was debated almost exhaustively last time. Could you please tell the committee what are those other provisions that come into play?

Mr Kirkwood—Reference was made to section 1(3) which does not provide a no disadvantage environment. It only applies where there is clearly a difference, unarguably a difference, between the new law and the old law. Where an argument might arise the taxpayer is going to find himself in court presenting the position of the old act against the new act. He is going to have to do that and his adviser, to give proper advice to his client, is going to have to do that in respect of these provisions, no matter what.

CHAIR—Are you arguing only for those provisions that theoretically might make a taxpayer worse off, or also for those that might theoretically make a taxpayer better off?

Mr Kirkwood—Any change, both.

CHAIR—Thank you for that. We are going back over old ground at the moment. My secretariat has informed me that the document of 13 February with amended clauses was faxed last Friday to Mr Baxter and to Anna Carey, who is the body's coordinator. So that was done.

Concerning amendments to schedule 1, page 5, are there any comments? We are going down through the list now. This is relating to the documents that were released on 8 January, amendments to the bill. We are now into the detail. If there are no comments, what about schedule 2, part 1?

Mr Petersson—This schedule provides, if you like, the main transitional provision in proposed clause 102-5, working out capital gains and capital losses. Basically, it provides that in working out whether you have made a capital gain or capital loss from a CGT event, if it happens in relation to a CGT asset in the 1998-1999 income year or later year, you use only the provisions of part 3-1 and part 3-3.

We do make a comment in our submission that it becomes very cumbersome to have to refer to parts 3-1 and 3-3 every time you want to refer to the capital gains tax provisions. That is by the way. Basically, what this provision is saying is that you use the new law unless a provision in this part, being the transitional provisions, or part 3-3 of this act, being the other part of the transitional provisions, requires you to use some other provision as well.

I have a problem. It may be that I just do not understand it but in relation to CGT event E4, which is basically the event which deals with distributions by unit trusts and other trusts, but primarily it focuses on unit trusts, E4 actually requires the cost base of the unit trust to be recalculated once every year where there has been one or more distributions to the unit holder. E4, in fact, makes an improvement to the current provision, which is section 160ZM, which actually requires a cost base adjustment to be made every time a distribution is made, which theoretically could be up to four or five times in a year depending on how many distributions are made by the unit trust.

It seems okay that in applying this transitional provision, if there is a distribution by the trust, that CGT event E4 will apply. It would seem that what that means is that, where you have held units for a number of years and there has been a number of distributions in the prior year, you actually have to go back and recalculate your cost base right back from the start. You might have, for instance, held the units in particular public unit trusts for 10 years since 1988, and you have had distributions every year since then, and there might have been three or four distributions every year until the present.

So, this provision appears to be saying that you have to actually recalculate the cost base to take into account all those distributions for the last 10 years. If that is right, if people know about that, institutions will be able to assist their unit holders in doing the calculations, but obviously it is going to be a very expensive exercise.

The point of my comment is not so much that approach. We would certainly accept that generally, if you are moving to a new law, the more you can move into that new law completely the better. So the general idea is good. Where I have a difficulty is that, if we are talking about units in a unit trust, there seems to be a different result.

For example, if during a particular year you sell the unit so you have a disposal so that the CGT event that applies in that situation is A1, being a disposal of a CGT asset, in that situation if you sell your asset on 2 July 1998, being the second day of the operation of these provisions, CGT event A1 applies, it being a disposal. As I read this, what 102-5 will require you to do will be to take the cost base you had as calculated under the old law.

Again, that is probably good, but you would have to have two cost based calculations running side by side depending on what CGT event applies. If you did not sell it on 2 July but in fact at the end of the relevant quarter you received a distribution or a distribution for that year, you would have to actually recalculate the cost base. However, if you sell it, you do not; you apply the existing base cost calculations under the old law.

So, basically, it seems to create the anomaly that you have a different calculation requirement depending on what CGT event happens. Unfortunately, there is nothing in the specific provisions relating to CGT event E4 which assists you in that regard. It raises a question to which there may well be a simple answer, but it is certainly one which concerns me.

Mr Burge—I would like to confirm that the approach that we have taken is to try to ensure the smoothest and simplest transition to the new law, and to ensure that taxpayers get the full benefit of that new law.

We have made a change to CGT event E4, to require only annual adjustments for non-assessable payments rather than every time a non-assessable distribution is made. The approach that we are contemplating will give taxpayers the full benefit of that change and would result in a slightly lower tax liability. I think it is important to emphasise that this change does benefit taxpayers in terms of the tax payable and in terms of compliance costs and record keeping requirements.

Another important point is that you can never know with certainty what your cost base is until you dispose of the relevant asset. That applies to units in a unit trust, just like any other asset. You do not know until you dispose of the asset whether it is cost base, indexed cost base or reduced cost base that applies, and, in particular, whether it is indexed cost base or reduced cost base because the rules are different. So there is no sense in which a taxpayer can keep a running tally of the cost base and be certain that that is the position. It really does depend on the eventual circumstances.

In relation to the interaction with CGT event A1, our firm intention is that

taxpayers would still get the full benefit of only annual adjustments for it. We will check the wording of that provision to ensure that it does achieve that result.

Mr Spence—In relation to that issue, I think that a number of taxpayers do and have had every reason to apply the previous provisions quite accurately to keep track of where their cost base is moving, particularly in the case of distributions from a unit trust. From personal experience, I have found it the only way to keep track of the tax status of assets that you may have owned or clients may have owned. The legislation was quite clear as to the way it operated.

To tell the people that have spent considerable time over the last 10 years or so in keeping track of how their cost base is moving that now they have got to go back and recalculate their cost base is a very serious issue. What we were proposing is that if, in fact, they do not want to do that, they do not have to do that. They could rely on the cost base mechanisms that they had calculated over that enormous period of time.

I think that as a taxpayer you have some reason to be able to look at the legislation when you acquire an asset and understand what its cost base will be, so that you can project out when you sell it what tax you are likely to see. That is certainty in the system. There are a couple of other aspects that lead to this certainty in the system. Some people may have obtained rulings in relation to the way the previous legislation applied, to ascertain the cost base of an asset that they acquired. I am not sure how it is anticipated that those rulings would now apply, or whether those rulings would continue to apply after 1 July of this year—what the status of a ruling about the cost base of a particular asset you may have got, a private binding ruling, would be and how that would apply on a prospective basis under these new laws.

There are some other issues in relation to the transitional aspects that I would also like to discuss, but I would be interested in the—

CHAIR—Can we leave those to be considered as we go down the list? Do they relate to other sections of the act?

Mr Spence—No. They relate to the transitional provisions, which are the broader ones that we are just discussing now.

CHAIR—We are doing this item by item. We are doing schedule 2, schedule 3, schedule 4 and so on.

Mr Spence—No, it is still in the same schedule, schedule 2.

Mr Burge—Mr Chairman, if you are happy, I would be happy to answer on that point.

CHAIR—Thank you, John.

Mr Burge—I would re-emphasise that taxpayers cannot be certain of what their cost base is until there is an eventual disposal. If taxpayers were to maintain existing records based on quarterly distributions, it would be to their disadvantage.

On the issue of rulings, the general position is that the Taxation Administration Act 1953, in sections 14ZAAM and 14ZAXA, ensures that public and private rulings carry over to the new law to the extent to which the ideas are the same. So, provided that there is not a change contemplated by the new law, those rulings will carry over to the new law.

CHAIR—I would like to ask a question. Maybe it is too simple; I know this stuff gets very complicated. If I buy a parcel of BHP shares for $1,000, that is what it costs. If I index that every year or however often for inflation, is that not my cost base? Why would I have need to go back and recalculate it?

Mr Burge—It depends on whether you sell the BHP shares for a profit or for a loss. If you sell them for a loss, there are certain expenses that cannot be taken into account. For example, if you have borrowed money to acquire those shares and the interest is not deductible, for the purpose of calculating a gain you can take that interest into account; for the purpose of calculating a loss you cannot. It really does depend on the circumstances.

Mr GRIFFIN—Correct me if I am wrong on this—I might be; I often am. The inference I made from what you were saying earlier on the question of rulings is that a ruling, in effect, carries over. Legislation changes but, if a ruling is made to interpret the legislation, in the change of legislation the intent of that ruling carries over. Is that correct?

Mr Burge—To the extent that the idea is the same.

Mr GRIFFIN—Is it the intention with the rewrite that the ideas are the same?

Mr Burge—That is the intention except where we have set out to make a change. We document them in the explanatory memorandum.

Mr GRIFFIN—I see Mr Spence getting a bit animated.

Mr Spence—The area we are discussing is one area where there has been a change notified in the explanatory memorandum, as there have been a number of notified changes in the explanatory memorandum. If somebody had been going along, perhaps based on a private binding ruling or a public ruling, then to the extent that there is a change notified in here their cost base, calculated as they had understood how it was applying, would be modified—mainly to their advantage, but it would still require calculation.

Mr Baxter—I would like to add one point to this. I believe John Burge suggested that a taxpayer was entitled to wait until they sold the asset before calculating their cost base, et cetera. This provision is a perfect example of why you cannot do that. As currently drafted, when you run out of cost base with respect to these non-assessable distributions, the provision itself throws a capital gain. You cannot simply wait until there is a CGT event A1, a disposal. You must keep track from quarter to quarter of what your cost base is in order to know whether you have run out of cost base and you now have a capital gain to include in your return. There is no question that a taxpayer who is currently operating properly in accordance with the law should be keeping track from quarter to quarter of what their cost base is.

Mr Gaylard—Mr Chairman, I have two comments on that. One is that we are generally dealing with property unit trusts, where you have to account in a specific way for non-assessable distributions. In terms of the chances of that ever reducing the cost base to nil, I have never seen it come anywhere near to reducing it to nil. So, while that is a theoretical point that is made, it is practically completely wrong.

On Ken's situation, I wish our clients would keep records as they go along. Section 160ZM is the most terrible provision, in a policy sense, that you could have in the law. The whole thing should be thrown out and rethought. It is mindlessly stupid. I have hardly ever seen taxpayers keep records as they go along. It is an absolute mess when they come in at the end, they have sold the asset and you have to go back and calculate it. So, in a practical sense, I do not think either of those points really holds a great deal of water.

CHAIR—Do you get lots of shoe boxes?

Mr Gaylard—Worse than that!

Mr Petersson—I would certainly endorse Simon Gaylard's comments with respect to the current provision, section 160ZM. Admittedly there are some improvements in the rewrite, but certainly our original recommendation, which is in fact part of our submission being appended to the current submission, was that the need for cost base adjustments be totally removed. That would save literally hundreds of thousands of taxpayer investors very large sums of money in terms of compliance costs.

The other comment I would make is that, irrespective of the number of times that a unit property trust may have actually reduced its cost base to zero through tax-free distribution, there is always that possibility, so you must still keep tracking those things through on a quarterly basis, or whenever you are getting a distribution. In fact, there are computer programs out there which are designed specifically to do that. I was speaking to a software developer yesterday who was rather alarmed at the prospect of having to rejig his software and at the cost that institutions, mainly property trusts and the like, would have to incur in adopting a new system or basically doing those recalculations.

It is certainly a real issue. We would just come back to the point that, if there were a no disadvantage rule which would operate to permit people to continue on existing cost base, despite the potential saving if they were to adopt the new cost base under the new provisions, that could be quite attractive to many individuals.

CHAIR—Does anyone else want to comment on this issue?

Mr Spence—On the transitional issues, and this is the broad import of them, I would like to move on to a somewhat different aspect of those transitional provisions. In this document we got today from the tax office, it says, for example, in the area of transitional arrangements, 'Nothing TLIP have done in applying the CGT rewrite to CGT events which occur after the commencement date of the bill can be classified as retrospective.' Both from the government's perspective and the taxpayer perspective, I suppose it depends on what you regard as retrospective. I can give a couple of examples where it could be regarded as retrospective, both from the government's perspective and a taxpayer's perspective.

I will use one area of intragroup transactions as an example. From December 1989 to December 1990—around that time frame—when an asset was transferred between two 100 per cent group companies, the requirement was that when the asset was transferred you had to receive shares back as consideration. Those shares had a specific tax status. They had to have a market value equal to the asset transferred, and the cost base of those new shares was equal to the cost base of the transferred asset. So that meant that you might have got shares back on day one, as part of one of those transactions, that were worth $1 million, but for capital gains tax purposes they were regarded as having a cost base of perhaps $100,000.

John may correct me here, but that transition has not been picked up in the rewrite. So, if the particular company sold those shares for $1 million, under the previous bill it would have been looking at paying tax on $900,000, but, if it sells them after 1 July, my reading of the TLIP bill is that they will not have any tax liability at all if they sell them for $1 million.

So that is an area where the transitional provisions could be at a cost to the government and not identified and they ought to be aware of that. I could work through that example again, if you would like. But there are issues where some of those government revenue protection measures have been dropped off in this and not identified, so that is a cost that the government should be aware of.

From a taxpayer perspective, in the same area, that regime was modified substantially and in 1992 a new regime was introduced where, if you transfer an asset between two group companies, if the company that now owns the assets ceases to be a part of the group—between two BHP subsidiaries, to use your example before, and BHP sell off that subsidiary—there would be immediate disposal of that underlying asset that

had been transferred over. That could cost that particular company a considerable amount of money. In other words, after you have rolled over an asset, that asset retains a specific tax status that it is deemed to be disposed of and reacquired whenever the company that owns it ceases to be a member of the group.

Those provisions quite specifically applied to transactions after December 1992—I think that was the time of the change. They did not apply to transit rollovers that had occurred before that date. That was the way in 1992 when the government changed the law. It said, 'If you have done one of those rollovers before that date, the old provisions will apply. If you have done one after December 1992, you have now got to be aware of this little hook on the asset that could subject you to some tax at some future time.'

My reading of the transitional provisions—and, again, John may wish to comment on this—is that that transition has not been picked up either. That timing aspect has not been picked up. So, from a taxpayer's perspective, they may in good faith have done an intragroup rollover in 1990, for example, under the longstanding old provisions, or even earlier. Now, the particular subsidiary that owns that asset might be sold out from the group and all of a sudden these new provisions apply and, out of the blue, they get a very substantial tax liability. This is one example where the transitional provisions have a very significant impact.

In a number of due diligence tests, which most companies do when they are acquiring a particular subsidiary or group of companies, one of the 'top of the list' due diligence checks is to determine whether the underlying assets of that company were acquired after 1992, under these more rigorous provisions, or were acquired before that time. The protection that people thought they were getting through that due diligence review, as to the particular status of assets under those provisions, appears to me—and, again, I am interested in John's comments on this—to be totally blown. Now, irrespective of whether you did a rollover in 1985 or 1993, you are subject to this more rigorous regime, which has applied since 1992 but now applies to all assets irrespective of the rollover event.

That is just one example of the subtleties and very important implications that come from the way these transitional provisions play out. It is one of the situations why we suggested that there be this no detriment rule; that if you thought, in relation to the tax status of your assets, that they were enshrined in the previous laws, then those particular tax attributes do carry over to the new law.

CHAIR—Does TLIP have a response to that?

Mr Burge—Yes, Mr Chairman. Perhaps it would be helpful if I explained the general approach to the transitional arrangements. Since capital gains tax was enacted in 1986, there has been a very large number of amendments of those provisions by the parliament. Various transitional arrangements have applied. For example, in 1989 the cost

base rules for certain assets—mainly shares—changed. Those new rules applied for assets acquired after the announcement of the measure, so the old provisions could still have an effect.

Our approach is to include a brief signpost below the relevant operative provision in the new act, referring the reader to the transitional provisions act. All the details are set out there.

That is, in fact, much clearer than it is under the existing law for many of these when taxpayers in practice have to rely on the commercial publishers' history note. For the first time it would be set out clearly by the parliament itself what are the relative transitional arrangements. By looking at the Income Tax Assessment Act 1997, together with the Income Tax (Transitional Provisions) Act, with relevant signposts from the first act to the second act, the taxpayer will be able to find their position.

In the cases that Ken Spence referred to, we have received some comments on the exposure draft that we circulated on 8 January. It has been brought to our attention that there are a limited number of transitional provisions that we need to include which have not yet been included. We had already identified a number of these ourselves and we are in the process of including them now. The basic position is that, in relation to past transitional arrangements, we are not undoing those.

The important point I would like to make is that it would have been all too easy for us to come up with a very complicated transition to the new law ourselves. One of the factors we have taken into account is the present complexity of the law as a result of past transitional arrangements. We thought that, in moving to a new act, it was important to draw a line in the sand and come up with a very sensible transition to the new law. What we are trying to avoid—and the transition that we propose would succeed in avoiding it—would be having to refer back to the old law all the time to achieve that result.

If I could also comment on private rulings, it is important to note that private rulings relate to a particular income year or income years—they cannot be open ended. The number of circumstances in which an issue will arise in relation to a private ruling would be quite limited.

Mr Kirkwood—Mr Burge's response leaves me now with an impression that it is necessary not to look at two acts of parliament but three. I, in fact, had a question in this regard that schedule 2, which is now under discussion, appears to go only to the bottom of page 18, unless we are led to believe that parts 3-1 and all the pages following that are, indeed, part of schedule 2 and will only be incorporated in the transitional provisions. If that is the case, then these operative provisions, may I say, which go on for many pages after page 18, will now be in a transitional act and taxpayers, in order to understand how the law applies to them, must at least read the transitional act and the new law.

There are many transactions—and Ken has referred to one of them; the cost base carryover provisions in respect of unit holders in a unit trust—and I could now, and certainly will later, discuss employee share plans. It is quite typical for involvement in employee share plans to be developing a cost base over more than 10 years. I find extraordinary the idea that in eight, nine or 10 years time an employee—who may by that time have left the work force and may be not adequately advised—has to understand that he needs to not only read the rewritten law that is current at that time but also find the transitional provisions and should perhaps work out, as I am suggesting, as to whether he has an advantage or a disadvantage under the new law,

Perhaps the answer to that question is that these provisions that start from page 19 are going to be embodied in act No. 2 and therefore are directly within the rewrite, but it is not the way I see this applying. It appears that all of these provisions that are here will be in a transitional provisions act, yet they are operative provisions.

Mr Burge—The choice that the project had to make was, on the one hand, to include all of the past transitional arrangements in the new Income Tax Assessment Act 1997 itself, and thereby greatly add to its length for arrangements which will, over time, have less and less effect or, on the other hand, to include an appropriate note signpost in the Income Tax Assessment Act 1997 to the transitional provisions act, and that is what we have done. The alternative would be to clutter up the main act with provisions which, over time, have less and less importance. The location of an appropriate signpost does alert the reader to the fact that there are relevant provisions in the transitional provisions act.

But let us contrast what occurs with the existing law: the Income Tax Assessment Act 1936 does not present the whole picture. There are a range of transitional operative provisions spread over a very large number of taxation laws amendments acts. It is the commercial publisher’s history note which draws readers’ attention to that. The approach that we are proposing ensures that all of the material is made available by the parliament itself for the reader.

Mr Kirkwood—I think that response suggests that the 1936 act was unsatisfactory, and that to some extent to follow that pattern is satisfactory.The 1936 act is indeed very difficult to read. In discussions with the ATO over many, many years—certainly, for as long as I have been involved in those discussions—this is the point I have been making: you cannot pick up the 1936 act and fully understand the law as it applies to you in every respect. That is true and that has been becoming worse and worse.

The TLIP process has made a choice, and to some extent it has preserved that problem by referring taxpayers to another act of parliament. There are now two acts of parliament that will at least go forward into the future in order to determine a taxpayer’s position under the income tax laws.

CHAIR—It is my understanding that all of schedule 2, schedule 3, schedule 4 and schedule 8A are in the transitional and consequential amendments. Is that correct? They are not part of the bill as such?

Mr Reid—With regard to the structure of the bill before the committee, there are a number of schedules, as you have pointed out. The first schedule includes new material in the new assessment act. Each of the later schedules, except for the last couple, amends a range of acts to deal with transitional and consequential matters.

The provisions that we are currently looking at are in a part of schedule 2 that amends the Income Tax (Transitional Provisions) Act which was enacted at the same time as the new assessment act. So these provisions will go into that act when it is next consolidated and reprinted. I do not know whether I have actually addressed your question.

CHAIR—I think you have. Thank you for that.

Mr Morgan—I am interested in John Burge's response to the specific examples which Ken raised because I think they are quite dramatic on both the taxpayers and on the revenue side. In other words, with regard to the 8 January document that we are looking at, does it address the problems in a way that Ken had not anticipated, or has Ken pointed out something that we are perhaps looking at fixing now?

Mr Burge—I understand the 8 January document to be operating in accordance with what I have explained at various consultation meetings and seminars, many of which have been attended by Ken and at which he has made a very useful contribution.

It is the case that there are a limited number of transitional provisions that need to be included in the bill which were not included in that document and they will be. We have identified them. Some have been brought to our attention. The important thing to emphasise is that they are limited in number and, with the bill going into parliament, for the first time the taxpayer will be able to refer to the 1997 act and either get the full picture there or have a signpost off to another act.

It would have been the case that to build everything into the 1997 act would have been to clutter it up with provisions that progressively over time have less and less impact and would have made it difficult for people to navigate their way around.

CHAIR—Just so that I am clear, the question Mr Morgan asked related to the examples that were shown by Mr Spence. Are those problems that he has identified real and are they going to be dealt with by further amendments?

Mr Burge—The particular cases in relation to the rollover relief provision, section 160ZZO in the 1936 act, will be included as additional provisions in the package of

government amendments to be introduced to the parliament when it resumes.

Mr GRIFFIN—So it is a problem but you are fixing it?

Mr Burge—In a number of areas, Mr Chairman, there are some transitionals which we have omitted and we will be fixing them, yes.

Mr Spence—I normally talk to John from time to time but one of the reasons I did not particularly raise this in advance is that, to be honest, I did not know we were going to focus on transitional provisions today.

CHAIR—That is not our fault.

Mr Spence—No. I would hope that they were picked up and fixed but I think it really does reinforce the fact that this is moving very quickly. There are a number of things which I have picked up. There may be others that John is aware of and I am not. There may be others that other people are aware of that John is not. It is really this haste aspect that we have discussed previously.

The issues that I have raised are very big issues and very important to a number of companies. That is one of the reasons that we are supportive of John's approach not to unduly clutter up the act. I think you have got to move on. It is just that some transitional, no-detriment period, while a number of these issues can come out and be appropriately addressed, would be important. If we had not raised that today, on 1 July there would be enormous impact on a company that then hopes that they will get it fixed retrospectively, but who knows?

CHAIR—If you had another five years, would you still be finding problems?

Mr Spence—I do not think so, no. We have really only had a bit over a month. There is a balance between—

CHAIR—Are we done with part 1 on schedule 2?

Mr Petersson—Mr Chairman, I have another specific issue in this particular part. Just before jumping to that—

CHAIR—The way we are going we are not going to get done, I can tell you.

Mr Petersson—It is quite a brief provision. Before jumping to that, through you to the TLIP team, is there a list of transitional provisions which have not been translated into the current amendments to the Income Tax (Transitional Provisions) Act and could that list be made available so that we know which ones have been covered, which ones are still to be included and which ones have been eliminated?

Mr GRIFFIN—Why are we not considering a list?

CHAIR—Mr Burge?

Mr Burge—Mr Chairman, we would be pleased to make available a list of these provisions. We are working on them now and we will be happy to make that available to the committee.

Mr GRIFFIN—It is not ready at the moment?

Mr Burge—No, that is not ready.

Mr GRIFFIN—That is why we are not looking at it?

Mr Burge—That is correct.

Mr GRIFFIN—There are changes proposed which you are still working on which we cannot consider as part of our process of considering the bill?

Mr Nolan—Mr Chairman, the processes that we are having here, including the January hearings, are part of a constant refinement of the work that has been going on. A number of very useful suggestions came from witnesses and from members of the committee last time and we are building those in. In our own ongoing review, some transitional provisions were noted to be missing and, to a large extent, they overlap with the kinds of points that Ken has been raising. It has not been a question of preparing or not preparing a list; it has been of getting on with making those amendments. Now that we have been requested to prepare a list, we are more than happy to do so.

Mr GRIFFIN—We accept that, Brian, but do you not see the point from our point of view. We are being asked to sign off on something and we do not even know what it is yet. It is a final form.

Mr Nolan—Of course, but there are degrees of finality. I am sure that you would not want us to stop looking for further improvement.

Mr GRIFFIN—True. I still do not want to sign off anything that I do not know what it is yet.

CHAIR—Do any of these additional issues that you know about now have any retrospectivity possibility?

Mr Burge—Mr Chairman, it would be consistent with our general approach. We believe that there is no retrospectivity element to it. That would apply to these on the lists.

CHAIR—Thank you.

Mr Langford-Brown—Mr Chairman, I want to pick up on what Mr Griffin was just saying and I am grateful that we now have some rewritten law in respect of small business rollovers and other things. We only saw it this morning, so yet again we have another rather significant area of the law for business people at which we have not had a chance to look.

Mr Kirkwood—Mr Chairman, may I add something there? The response to our earlier submissions was only received—

CHAIR—I do want to say in defence of the committee that that information was faxed. Please do not blame the committee for the fact that it was not faxed on to you.

Mr Langford-Brown—Mr Chairman, I am a member of the consultative committee, not a member of the bodies to whom Anna Carey might have circulated documentation.

CHAIR—It was faxed to the chair of the consultative committee, I am advised.

Mr Langford-Brown—I hear what you say.

CHAIR—It is not our object to keep you in the dark, I can tell you. We do not want to waste time sitting here today arguing about what you have seen and what you have not seen.

Mr Kirkwood—My comment is on another matter, but it is in this area. The responses to the previous submissions were only received on the morning of our attendance at the previous hearing on 28 and 29 January. I am still working my way through those responses at this time. There is a matter that we could raise here but just getting into one issue regarding cost base and rollover has taken an enormous amount of the committee's time this morning. I think it is a very clear example of our submission that there are faults in this legislation. We have said that and that is a matter that we wanted to get into discussions on last year and we did not get the opportunity. We would be very happy to get it into discussion in these hearings but they are matters of considerable detail and I have great sympathy in this committee's time being taken up in such matters of detail.

I could, if you wish, refer to a matter in which I have had responses from the ATO from time to time but in fact those responses, I believe, are incorrect. The rewrite as it stands will not work the way in which the previous law worked. I can get into detail but I think it is a concern. It is wrong. I have no doubt—

CHAIR—Mr Kirkwood, I do not think the committee is in any sense, in these

hearings, going to examine or try and deliberate on whether or not the ATO made a correct decision or not.

Mr Kirkwood—No, I am saying that the law in this particular area, which I can detail if you wish, reads differently. It does not convey the same idea as the previous law. Ken Spence has referred to similar issues this morning. When that matter is conveyed fully to and understood by the Taxation Office, I have no doubt that they will wish to amend it. That leads to the matter that came under discussion only a few minutes ago: are we dealing with the law as it will be presented to parliament workable for taxpayers? I do not think we are.

Mr GRIFFIN—I hear what you are saying, Mr Kirkwood. On that particular issue, if you would like to provide a further submission detailing that particular instance, we would be happy to take that submission. The feeling I get from the chair is that we have got a clear understanding of the concerns that have been raised on the general issues and specifics about where it is all heading, but in view of the time we probably had better go back to the agenda.

CHAIR—We are on schedule 2. I assume we have finished part 1.

Mr Petersson—I have one very quick one, Mr Chairman. It is proposed clause 110-35, incidental costs. I wonder whether I should be raising this because it seems to be rather beneficial to taxpayers, but I am not sure whether it is intended to be. What that provisions provides is that:

The requirements in subsection 110-35(2) of the Income Tax Assessment Act 1997 that the professional advice about the Act or the Income Tax Assessment Act 1936 be provided by a recognised tax adviser does not apply to expenditure incurred before 1 July 1989.

That seems to suggest that, if you incurred expenditure by a tax adviser who was not a recognised tax adviser, or in fact a tax adviser who was a recognised tax adviser before 1 July 1989, you can include them in your cost base as part of the incidental costs in relation to the acquisition of an asset such as a block of land, a block of flats or something like that.

My understanding of the law in respect of acquisitions before 1 July 1989 is that you were not allowed to include in your cost base costs incurred in obtaining advice, whether from a recognised tax adviser or not. This provision seems to in fact do the opposite.

CHAIR—Do you have a response to that?

Mr Harders—This is a typical example of a transitional provision in that it is picking up on a change that was made to the law at a particular time, and where that

change had prospective effect only. So people who already had incurred expenditure before the change was made could still count that expenditure as part of their cost base. What this provision is doing is preserving the position of those particular taxpayers.

It should be recognised that many of these transitional provisions apply to very few taxpayers indeed. What they are doing is preserving the position of those taxpayers who had preserved positions under the existing law.

CHAIR—Thank you for that.

Mr Petersson—It seems to be doing the opposite because the previous law—that is, prior to 1 July 1989—was that one could not get those expenses, whereas now you can if the services are provided by a recognised tax provider. But the second and perhaps more important point, as Geoff Harders states, is that it applies to very few people and it is probably one of the ones which could be happily dropped out of the transitional provisions.

CHAIR—Mr Petersson, with respect, if there is a problem, why don't the two of you get together and discuss it and see if it is right or wrong. Quite frankly, I think it is the kind of detail that we are not really here to expose. Are there any comments on schedule 2, part 2? Schedule 2, part 3? Schedule 2, part 4?

Mr Burge—Perhaps I should make some very general comments about the schedules. They are mechanical in nature. It is because we are changing terminology and references. It means that other provisions which refer to the existing CGT provisions need to have their language updated.

CHAIR—Thank you. Schedule 3? We are fairly ripping along. Schedule 4, part 1; part 2; part 3? Schedule 8A, part 1; part 2; part 3? Schedule 9? We will break for morning tea.

Proceedings suspended from 10.49 a.m. to 11.14 a.m.

CHAIR—Ladies and gentlemen, I think we will recommence. We have now dealt with the transitional and consequential amendments portion of this. We will now, as the schedule says, revisit the bill itself. That is what we did in Sydney—concentrate on new technical issues.

I understand that there are some issues that some of the participants feel were either not dealt with or not dealt with adequately last time. We are prepared to hear that. Who would like to go first?

Mr Spence—Perhaps I could go first. One of the things that did not really come out in the previous discussions is that there are a number of things which are not in the

bill but which we had hoped would be in the bill. While there was a very extensive and very worthwhile consultation period, through that process we had been hopeful of a number of issues being addressed which are not really policy issues but which are really tidying up clarification issues. The EM itself to this bill does state that the project did see it as part of its role, for example, to state the rules clearly, to bring the law into close alignment with administrative and commercial practice and to address anomalies and inconsistencies.

I will highlight some of the points and, if you like, we could make a fuller submission on some of the points that have been raised in this context. One that I think is at the top of our list is in relation to compensation payments. How the present capital gains tax regime handles compensation payments is very difficult, to say the least, and this was not really contemplated when the original provisions were drafted. The tax office were accepting of that fact and issued ruling TR95/35, which, after a considerable consultation period back in 1995, addressed the issues and made the existing provisions work. Most people think that was a fair ruling; it was a very extensive ruling and addressed most of the issues.

It was hoped that, as part of this rewrite, issues like that would have been brought within the law. A ruling is really not an appropriate way for some of these very mainstream issues to be dealt with on a long-term basis. Taxpayers cannot rely on a ruling as specifically as they can in relation to issues that are dealt with in legislation itself. It is better to get these issues out now into the mainstream legislation, but that has not been done. It is a real pity that that has not been done.

There are other examples which we could discuss as well where, for whatever reason, they were not taken on. I do not believe they are issues of policy; if they were, then the ruling itself would have been addressing issues of policy rather than interpreting existing law. It is just some of those issues which we are disappointed that the process did not take on and did not deal with. We wonder whether, in the lead-up to this legislation being presented to parliament, some of those issues could not be appropriately addressed.

CHAIR—Could the committee have a response from TLIP?

Mr Burge—The issue of the capital gains tax treatment of compensation receipts has caused some difficulty over the years. We see taxation ruling TR95/35 as providing a substantial measure of certainty in this matter. It is a legally binding ruling on the Commissioner of Taxation. We did look to see whether it would be feasible for us to include specific rules about compensation receipts in the rewrite. It would have immediately raised a policy issue.

Taxation ruling TR95/35 essentially provides that, if you receive compensation for permanent damage to an asset or a permanent loss in value of the asset, you reduce the cost base of the asset by the amount of compensation received. But, once the cost base has

been reduced to nil, the excess compensation—if I could call it that—over and above the nil amount is not brought to tax in terms of the ruling.

If we had codified this area of the law, there would immediately have arisen the issue of whether the statutory regime should tax that excess. Because that ruling is a legally binding ruling, it would have meant that, in practical terms, there was some prospect that many taxpayers would be worse off than they are under the existing law. As Mr Back mentioned at the last hearings of the committee, any change which has a substantial impact on taxpayers is likely to find itself outside the scope of the project, and that was our conclusion.

Mr Morgan—As part of the process of making a limited number of small ‘p’ policy changes at the invitation of the Assistant Treasurer, I have prepared a little paper on how we might try and fix this thing. It features near the top, I think, of a list of things that might be fixed.

Also I went as far as having a shot at drafting the changes, which are not that extensive, because I thought it would be excellent that, if it were possible to fit it in by 1 July, it should be fixed along with everything else. I was alerted to the fact that drafting resources might be scarce, so I had a bit of a crack at it myself. That paper is available if anybody wants it, and no doubt will be circulated in due course.

The other thing I should say is that, if we were to fix this thing up, there would be a kindness required to the taxpayer and a kindness required to the revenue, really, for parity. Resolving that is probably the policy issue that is difficult.

Mr Nolan—Mr Chairman, that last comment actually reflects what John Burge just said. We all like to be drafters, and I am indebted to John for having a crack at the drafting, but that really is not the issue here. It is the policy question of whether, in codifying this area and replacing the ruling, you would be driven to a position where a substantial number of taxpayers would be worse off. We are always very reluctant to get into that territory.

As John Morgan mentioned, the small ‘p’ policy mechanism that the Assistant Treasurer has arranged, with the assistance of the consultative committee, is now under way. There was a meeting just a week or two ago where members of the consultative committee began to identify its range of priorities, out of a substantial list that it is starting from, to put issues to the Assistant Treasurer where matters that cannot be dealt with by TLIP could be advanced. This particular issue is on that starting list.

Mr Spence—Just on that comment, I do not believe that the way in which people can access this small ‘p’ policy type framework has been publicly advertised. The members of that consultative committee are not representatives of professional bodies; they are people there in their own right. This is the first I have heard of any submissions

going forward to be reviewed by that committee. I am just wondering how taxpayers, individuals or groups access that process and whether your committee has any idea as to how people access that process.

CHAIR—We are in the dark too, Mr Spence.

Mr Nolan—The process is essentially one between the consultative committee chairman and members, and the Assistant Treasurer. But the chairman of the committee and the members are actually, in other guises, members of the various organisations that have been appearing as witnesses here, and I am aware that they are intending to canvass with those organisations additional items that could be considered. But I have to say that they will be faced with some difficulty in getting down to a manageable number of items from the ones that they have already got on their plate.

Mr BEDDALL—Mr Nolan, is this not just a response to the fact that these small 'p' policy issues kept arising and there was nowhere for them to go, rather than a formal asking for submission process?

Mr Nolan—There has been no decision as far as I am aware that the government will advertise for submissions.

Mr BEDDALL—We had, over this one and in the previous bills, a number of issues that arose, and we had no way in which to funnel them. I imagine what is happening now is that the consultative committee is referring those on to the Assistant Treasurer.

Mr Nolan—Yes, but in a funnelled way, where they do some analysis of the possibilities themselves to get it down to a manageable list. It will not be a kitchen sink approach where everything that gets raised goes through this process.

Mr BEDDALL—That is my point: it is not an open slather thing; it is just those issues that do arise.

CHAIR—It might assist the committee if you could tell us about something that arose last time; I am not sure that I went away totally understanding it. I believe that TLIP said during the Sydney hearings that in this bill you have addressed some small 'p' policy issues; is that correct?

Mr Nolan—Yes.

CHAIR—How do you decide when you will address one and when you will say, 'It is too hard. It must go to the executive'?

Mr Nolan—That is a very difficult question to answer because the labels that we

put on things keep changing. We talk about small ‘p’ or micro ‘p’. Fundamentally, we start from this position: does this particular proposal have any substantial revenue implications? Will there be winners or losers as a result of it? It is not just a question of whether the net effect will be neutralised. It may mean that when you look at an issue some people would gain and some would lose. That is a starting point.

Then there is the question of how difficult, how time consuming, in the context of a project that is basically about rewriting the existing law, it will be to actually address and resolve the question. That must be balanced against the compliance costs benefits that might arise from dealing with it. For example, when we are told that a ruling that runs to a substantial number of pages, maybe 80 pages, should be built into the law, that is obviously not going to be a simple task.

It is by no means a clear-cut issue. It is an on-balance thing. It looks to the timetable—how much time we have got left to rewrite this particular area of the law—and judgments are made, admittedly pretty much on the run, as to whether or not we can take something up. The list of possibilities is almost inexhaustible and we, quite truthfully, do have to pick and choose.

CHAIR—I think I recall that TLIP was going to give us a list of these small ‘p’ issues that are unresolved; when are we likely to receive that?

Mr Nolan—That material is one of the attachments to the document provided on the 13th.

Mr Langford-Brown—If I can speak as a member of the consultative committee, there has been a tremendous compendium of issues developed by the TLIP team over the years, most of which flow from submissions by various parties, so it is in that light that there has been input from various parties. I am very conscious of what Mr Spence says—that he is unaware of what specific issues are going on—but that is the base from which the consultative committee is trying to start and produce a far more modified, realistic list. But I am sure that there will be consultation between the members of the consultative committee and the professional bodies.

Mr Petersson—On this issue of treatment of compensation, just to put it in a little more perspective, very briefly, what we are talking about here is effectively double taxation. It goes to the very heart of the capital gains tax provisions because the problem arises where you have an asset such as a block of land, out of which there are perhaps legal proceedings arising. The way in which the current capital gains tax law operates is that you effectively have two assets, even though your action in relation to the block of land, be it a valuation issue or some defect in the block of flats, arises in relation to that one asset, whereas the current provisions say that the block of flats or whatever it is is one asset, and the right to recover compensation is a separate asset. That is how the problem arises. Basically, that problem has continued in the new legislation.

One of the suggestions made to the TLIP team originally, when it was indicated that these kinds of issues would be addressed by the rewrite, was that you could simply have a preambular statement at the front of the legislation indicating that the approach to CGT is to look at the main asset. Where you have a block of land, you do not try to create a whole lot of other CGT assets giving rise to separate liabilities. That has problems, but it does focus on what is really the major problem—that is, the potential for double taxation arising under the CGT provisions.

The rule in TR 95/35 sought to deal with that in an administrative way. One would have thought that, although there were lots of issues arising out of it, that could have been addressed in a more direct and comforting fashion than it has been in the bill. There have been some changes in the bill which seek to give some effect to TR 95/35, but they do not really go far enough and are rather in the nature of backdoor changes. We specifically refer to this issue in our formal submission at paragraph 2.1.6.

Miss Haly—This is a very complicated issue. The position that we have taken is that, if this was going to be dealt with in the legislation, we would have to deal with all of the issues and not just part; otherwise the basis of our terms of reference would be that things more or less revenue neutral would be affected. As has already been indicated, in this case we did not have the time nor the charter to deal with all of the issues that needed to be dealt with. Given that we had a ruling there, which industry said was working quite well, we left that issue alone. I do not think we can say any more about it.

Mr Gaylard—I would like to say a fraction more. I do not totally agree with what Margaret has just said, although I normally do. That was very high on the list of priorities for the tax on improvement to deal with. We did have quite a good mechanism to follow. Time was an issue, but we were all very committed to doing something about the compensation issue because of it being a problem.

When we put this to Treasury, along with a lot of other submissions, they raised that if you want to legislatively clarify this any excess amount is going to form part of an assessable capital gain. Whatever anyone says, if that had been put to the professionals, it would have been unacceptable. We were so clearly of that view that we dropped the matter straight after that meeting and it has never been re-raised as an issue.

You have to accept that it was taken on board extremely seriously and we would have dealt with it. Almost certainly, we would have dealt with it if we had been able to. But with people being assessed on the excess of a gain, it just would not have stood up. It is all very well for people to say now that they wished they had it, but the ruling gives the better result because it does not lead to that effect. It is unsatisfactory that we have to rely on a ruling, but it is better than what we would have been allowed to produce.

Mr Morgan—I endorse Simon's comments about the priority, although I was not there when the discussions were happening. I just want to make one thing clear though.

The ruling is not entirely kind. If the thing were to be resolved it needs to be resolved properly, as Margaret Haly has said and as Treasury has insisted.

That would involve taxpayers losing the tax holiday that they enjoy on things that we all call excess recoupments, which I think is an unmeritorious holiday. I would be surprised if we could not deliver the taxpayer public as being in favour of rationalisation of the regime because there would be another considerable benefit which I think is the far more common case; that is, the ruling at the moment requires taxpayers to lose their indexation if the asset is merely damaged and not totally destroyed. That is by far the more common case.

The two problems that do come up are in the case where assets are damaged and not destroyed and, therefore, you have got to deal with the compensation under the ruling by way of recoupment of cost base. Those provisions do not work well. I think Treasury is right to say that, if we are going to fix that, we should fix them both. Probably, they would be roughly revenue neutral, but as Gavin Back and other people would say, that is only the net position; in the individual position there are technically some losers, but we really perhaps have not had enough spine on this one.

On the question of the 80-page ruling, that is not really a reason for not making the change; it is a reason for making the change because every taxpayer receives compensation receipts. They have got to wend their way through 80 pages worth of logic. It has taken me, I think, about eight lines to fix it. I do not really see the size of the ruling as a reason for not grasping the nettle.

CHAIR—Mr Burge, we are real non-experts. It sounds to me like a very substantive policy issue in play here. Is that correct?

Mr Burge—We believe that making a change to the practice of the law so that the excess recoupment is taxed is indeed a big policy change.

Mr Petersson—The wild card in all this exercise appears to be Treasury, which are not actually represented here today so they cannot speak for themselves—not that I am doubting what Mr Gaylard is saying. Basically, what we are looking at is giving effect to a ruling which is admittedly quite a difficult one. The ruling is simply an interpretation of the current laws. Of itself, there is no policy issue. That could have been translated into the new law without raising a policy issue if it were seen purely as a matter of interpretation.

The other point which I would like to make, and it just follows on in relation to the ruling, is that we have a ruling which is a substantial document in itself purporting to interpret the previous law, and now it will have to be relied on in relation to the new law. Whilst we do have section 14ZAAM, which purports to keep in effect rulings issued in relation to the old law, the problem is one of more fundamental importance because—and

I do not think anyone has raised this—the new law is such a radical departure in form from the current law that I have real doubts whether you can simply rely on the provisions which say that existing rulings can be applied in relation to the new law.

The TLIP itself is proud—and I think we all applaud them—that they have come up with a totally radical change to the current law in terms of format. That raises the real issue as to whether you can rely on rulings that have been drafted specifically in relation to the old law. Basically, that is the dilemma that we are facing: we have got this ruling which is of uncertain validity in relation to the new law.

Miss Haly—The CGT cell and the ATO have undertaken a review of the existing rulings relating to capital gains tax. They have advised us that there are only nine rulings which have to be substantially rewritten and those nine rulings only have to be rewritten in part. They have assured us that those rulings will be out in draft form early in July of this year, so the rewritten rulings will be available, at least in draft form, at that time. Mechanisms are in place to update the other rulings which are affected only in an insignificant way. The actual impact of this rewrite on existing rulings is quite small.

Mr Nolan—I am not sure about the number of rulings that are out in the public domain on the existing law. Tom Magney, who is one of the professional advisers to the members of the tax ruling panel, may be able to say more specifically. We are talking here about one ruling. There are literally hundreds of tax rulings. Not all of them are as long as TR 95/35, but quite a number of them are. It really is a mission impossible to try to codify all of those rulings into the law. I think it has been illustrated here that there are some significant issues around this one as to who would gain or who would lose from the attempt to codify it. TLIP have certainly looked at the question very carefully, as Simon Gaylard said. I do not think we were being spineless about it. I think we were just being practical.

Mr Burge—In relation to the main asset issue that Geoff Petersson raised, TLIP has provided comments on this issue and I would refer the committee to page s 317 of volume 1 of the submissions. In relation to the losers issue, by taxing any excess recoupment, the situation could arise in any case in which the compensation is calculated by reference to the market value of the asset and that market value is greater than the indexed cost base of the asset. It can arise in quite a number of cases. Importantly, it can arise in relation to goodwill which has been generated by the business person. That can alert us to the sensitivities of the area. Our experience has been that those who are losers do not see themselves as technical losers.

Mr Morgan—I am pleased to concentrate on the issue of losers. In fact, the recipient of the damage will not be the loser, because an astute plaintiff will say, 'Listen, you are actually better off by getting damages than if the thing had never been damaged at all, because you are getting a tax holiday on the damages that you would not get if the thing were undamaged and you disposed of it of your own free will.'

Really, the loser here is the defendant who caused the damage. He is getting a discount on the damage he is going to have to pay. I think that is an unmeritorious position, and a person we do not really need to be overly concerned about in this policy debate. My touchstone as to whether these things are aberrant or not is whether it would cause a judge to award a different sum as damages. In the case of loss of indexation, the judge would be inclined to gross up the damages for the lost tax benefit. In the case of what is—in my view—an unmeritorious tax holiday, there would be a discount.

Just to finish on Brian's comment about it not being possible to codify all the rulings, I would be quite horrified if we were codifying rulings. What I am talking about is more fundamentally addressing the problems that confront the entire Australian taxpaying community—that a thing that is inherently compensatory could be treated as a gain. We just need to address that in a more fundamental way than an 80-page ruling for which the courts have showed scant regard.

CHAIR—Say I have a machine tool worth $1,000 and a bulldozer gets out of control and runs into my factory and destroys the machine tool. I have it on the books at a written down value of $100, but I have it insured for replacement cost for $1,000. Are we saying that if I get the $1,000, then, Mr Burge, if we change the rules, I am going to have to pay capital gains tax on $900?

Mr Burge—Mr Chairman, this issue does not arise in relation to the disposal, including destruction, of the asset. The compensation that you receive is just part of the disposal consideration. The issue arises where you have an asset and there is a permanent loss in value of that asset, or that asset is permanently damaged. If you receive compensation, you reduce the cost base of that asset to zero and no excess is taxed. If there were a change to tax the excess, then that excess would by its nature be taxed.

CHAIR—Any further comments on that? I think we have about explored this one to death. Mr Petersson?

Mr Petersson—If I could just comment on what John Burge has said: if we did not have the ruling, there was the potential for double taxation both on the compensation and on the asset when it was disposed of. What the ruling was trying to do was to interpret the law in the most sensible way possible, but that does not escape the fact that the legislation as it stands has this potential for double taxation. What has happened with the rewrite is that that potential has been carried through into the new law, and the only way out of it is to go back to the 80-page ruling which applies to the old law to try and come up with a result which does not result in double taxation. That is unsatisfactory, in my view.

CHAIR—I cannot speak for the whole committee, but I see a bit of a balancing act here. Practitioners would like to have lots of these issues resolved that are a bit unclear one way or another, either because they are only tied up by rulings or because you think

there is some lack of clarity in the law. TLIP does not disagree that those issues ought to be addressed, but too many of them are too hard because they relate to policy and therefore are up to the executive to decide whether to proceed or not, not TLIP to produce it. Does that explain the tensions? Is that reasonable?

Mr Langford-Brown—Yes.

Mr Kirkwood—If it is felt that this matter is adequately dealt with, there is another matter where I think there is much less doubt about the changes that have occurred in the law, if I may raise it. I want to talk briefly about employee share plans. A very common feature of employee share plans is the use of a trust. The trust is put into place to ensure that a share which is being paid off by an employee cannot be transferred by that employee because, whilst they owe money paying off those shares, then it would be improper, quite wrong, for those shares to be transferred.

When assets or when property—in this case shares—are transferred to a trust, and the trustee holds those shares as a benefit for someone else, the trustee steps into the shoes of a taxpayer and any dealing by that trustee in those shares is potentially a taxable transaction.

The old law dealt with that possibility by referring to transfers from a trust to a taxpayer under the provisions of a trust deed that entitled the trustee or empowered the trustee to transfer the shares to the employee. Unfortunately, the rewrite has not faithfully reproduced those provisions and now talks about a transfer to an employee where there is also a requirement that the trust deed empower the trustee to make the transfer to the employee. But the primary requirement under the rewrite is that the transfer is to an employee—not, as it was under the old law, a transfer to a taxpayer under a trust deed that empowered the trustee to make those changes.

This is a matter that I have been raising, and I think Brian Nolan can confirm this, since June last year when I raised the question of transfers to employees not being what the old law did, and I have raised it in submissions. I have to say there has been a great deal of cooperation with the TLIP team in trying to get this matter heard. Obviously they cannot deal with these provisions themselves; it is necessary for the TLIP team to go back into the ATO, to the people who specialise in this area and ask the question, 'What is intended here?' It was reported at the previous capital gains tax subcommittee meeting that that question had been asked and the response was, 'That's the way the old law reads and that is what is intended'.

That is not the way the old law reads and that is not intended. It is certainly not a policy imperative that a transfer from a trust to a person who has just retired, who is in fact not an employee at that time—and that is a very common circumstance because a person retires, and often the trust triggers their capacity to get the shares—should be taxed. That is what will happen if the current rewrite stays the way it is. I do not pretend

for one moment that is intended, but that is the way the law reads now.

Mr Morgan—Have you got the sections off the top of your head?

Mr Kirkwood—I can give you the sections. The old provisions were sections 160ZYJA and 160ZYJD—ZYJA dealing with transfers under section 26AAC, employee trust, and ZYJD dealing with transfers under division 13A trusts. The new provisions are sections 130-90, dealing with the 13A trusts and—unfortunately, only in the transitional provisions but not in the new law—130-110 dealing with transfers under section 26OOC. Both of them convey the same idea, that the transfer must be to a PAYE employee and the transfer must be under a trust deed that empowers a trustee to make that transfer. The old provisions in both cases said the transfer is to a taxpayer where the trustee is empowered to make that transfer under a particular trust deed. There is a big difference.

Mr Burge—Mr Chairman, Jon Kirkwood has referred to meetings of the Tax Liaison Group (Capital Gains Tax Subcommittee), which is an advisory body to the Commissioner of Taxation in relation to capital gains tax matters and has members of the tax professional associations on it. When we released exposure draft No. 10, capital gains tax part 1, on 16 June this year, there was a meeting soon after that. At that meeting Mr Kirkwood indicated that we had made a mistake in the rewrite - that we had referred to 'PAYE earner', which means in effect current employees, whereas it should have covered past employees. We undertook to examine the matter. One of the members of the team, after checking the provisions closely, telephoned Mr Kirkwood. It was reported back to me that Mr Kirkwood accepted that we had accurately translated the effect of the current law, but he disagreed with it from a policy perspective.

At the most recent meeting of the tax liaison group the issue was raised again. The minutes record Mr Kirkwood as accepting that we had accurately translated the existing provisions. Mr Chairman, if I could refer you to page s 99 of volume 1 of the submissions, where we have the joint submission from the professional associations on this bill, at the top paragraph, the last sentence, I will read out the relevant point for the *Hansard* record:

> . . . the exception in proposed s 130-90 for transfers from a trustee—

and this is the professional body speaking—

> apply only where the transferee is currently a person in receipt of salary or wages, whereas it is commonly the case that the transferee is a person who has recently retired from the workforce and is entitled to call for their shares or rights. Whilst this fault in the law is evident in the 1936 Act,

They are important words: whilst this fault in the law is evident in the 1936 act—

> the outcome is clearly not intended and certainly should not be perpetuated by the rewrite.

We contacted the relevant area of the Taxation Office to seek advice on the area. They indicated to us that it was the policy position that only current employees should benefit from these provisions, not former employees. I found out today that Mr Kirkwood still has concerns that we have not accurately translated the 1936 act, and we will be very pleased to re-examine that issue from that perspective. If, indeed, we have not accurately translated the law, we will do so, but all the signs are—including their own submission—that there is no problem.

Mr Kirkwood—I will respond to that. The previous provisions referred to an employee and the new provisions refer to a PAYE earner. In that regard, there is a clear translation of the term 'employee' into 'PAYE earner'. I may not have made that clear when I was talking to John and to others in the past. The problem arises because the old provisions required the transfer to be only to a taxpayer, whereas the new provisions require the transfer to be to a PAYE earner, ergo an employee. I have no argument with the fact that 'employee' translates quite clearly into 'PAYE earner'. The difference in the provisions is that the requirement of the transfer, rather than referring to a taxpayer, who can be anyone, now refers only to a PAYE earner.

Mr Burge—Perhaps I could re-emphasise that we would be very pleased to re-examine this issue.

Mr Kirkwood—I did discuss this earlier with Mr Burge, and I would like to pick it up with him again. Mr Chairman, I raised that for the reason that there are problems in this legislation that need resolution, and I think we have been talking about many of them today. It just goes to reinforce the need for there to be a no disadvantage rule. There will be a period of time during which further changes will be made—I have no doubt about it—but this has to be an area where, if no change is made in time, the taxpayer should be able to take advantage of the old law instead of the new law.

CHAIR—What is the next issue?

Mr Petersson—In paragraph 2.1.9 of the joint submission we raise an issue concerning a full Federal Court decision in the Commissioner of Taxation v. Guy, where basically the court decided that a holding deposit was exempt from capital gains tax when it was in the hands of a vendor of a residential property. The court also decided that damages received in relation to an action brought by the vendor were also exempt. Basically, the court looked at the principal residence exemption provision, which is section 160ZZQ in the current law. It gave that provision quite a generous interpretation, one might have thought, but nevertheless it was the interpretation of the court.

The rewrite purports to deal with that case by actually providing for a specific CGT event, H1, to deal with pre-contract or holding deposits. There is an issue here as to actually why the rewrite would go down that route. The explanatory memorandum suggests that it has done that to give effect to Guy's case and, on face value, that seems

quite reasonable.

The comment we make in the submission is that it is rather peculiar because in the sale of real estate holding deposits or pre-contract deposits are really only a very minor aspect of the real estate transaction. One would have thought that, if you were going to have a specific forfeited deposit CGT event, which H1 is expressed to be, it would have dealt with all forfeited deposits rather than with just pre-contract holding deposits.

I suppose the point is that CGT event H2, which is the more general provision, will catch other forfeited deposits. So you have this strange dichotomy between pre-contract holding deposits which have been forfeited and ordinary deposits, that is, deposits paid under a contract, which have been forfeited. That is really a drafting comment. I think there is some reason why that is so.

The real concern which I wanted to draw to attention today, which, as I say, is covered in the submission, is the fact that the explanatory memorandum says that it gives effect to the decision in Guy, whereas when one looks at the provisions dealing with principal residence exemption, which are now translated into the main residence exemption, it seems to me to be quite clear that, if you receive damages in relation to your principal residence, they are not exempted under the rewrite. Under the present law, as interpreted by the Guy decision, that in fact is the case. So what we have here is a misleading statement in the explanatory memorandum and, I would submit, yet another reason why there needs to be a no detriment provision in this bill.

Mr Burge—The issue raised by Mr Petersson has been answered by us on page s 396 of volume 2 of the submissions. We have ensured in the rewriting of CGT event H1 that the relevant wording which gave rise to the decision in Guy's case has been retained. The example that we included in the provision is on all fours with the Guy decision. So we believe that we have faithfully represented the existing law.

We have also indicated in our response that it is arguable that the rewritten main residence exemption for forfeited deposits is too narrow, having regard to the decision in Guy's case. We also said that we are reviewing how this can be best addressed, and that is the position.

Mr Petersson—That does not really address the issue of damages, does it? It is really my main beef—that the law at present, as interpreted by Guy, means that if you receive damages in relation to a contract for the sale of a principal residence they will be received exempt because they will be seen as part of the disposal of your principal residence and therefore exempt under the principal residence exemption provision. The specific CGT events which are covered by the main residence provision in the rewrite do not include the H2, which would be generally the damages provision.

CHAIR—Mr Burge, have you any further comment?

Mr Burge—No, other than to repeat our undertaking to examine our rewrite of the main residence exemption in relation to Guy's case and to see if we need to do any finetuning there. So we have given that commitment and we are in the process of doing that.

CHAIR—Senator Gibson makes the valid comment: we do seem to serve a useful purpose, after all.

Mr Baxter—I add one comment on this matter. A major theme of our submission last time was this very problem of the scope of various exemptions and the fact that we have now confined ourselves to specific CGT events. The parameter in which we are talking about this—and it applies to compensation receipts as well as these damages questions and so on—is that we have an existing, comparatively unclear law and that has allowed the tax office to issue rulings which produce a comparatively sensible result for taxpayers by adopting this underlying asset approach. With the new law, that is no longer possible because the law has been clarified and has removed the scope for adopting that sort of approach. It has removed it both for the tax office ruling as well as for judges in decisions like Guy's case.

We do need to look very seriously at this question: by dividing up into CGT events, by specifically dividing up the special rules and the exemptions, what impact have we had on all of these sorts of areas? I have not heard anything further from the TLIP team since the discussion that we had a few weeks ago on that particular point and I would obviously welcome the opportunity to enter into a dialogue. I am just concerned that we may have either put it aside as too difficult to consider or perhaps reached a decision that there is not much that can be done. I would certainly be very interested in the views of the TLIP committee on that.

CHAIR—Does TLIP have a response?

Mr Burge—Yes. Part of the fundamental approach to the rewrite of capital gains tax was to use direct language to describe transactions which had previously relied on extensive deeming provisions. The use of that direct language requires, in the rewrite, that a number of issues be clarified where the existing law may not be clear. However, it is the case that there is no general principle that, because the underlying asset is, say, a pre-CGT asset, other CGT events cannot apply in relation to it. Such a principle would be clearly inconsistent with the full Federal Court decision in Gray's case.

There would be significant anomalies if the principal residence exemption, for example, extended to all CGT events. It would mean, for example, that a taxpayer who received a significant lease premium and then low rent would go tax free on that lease premium. That is clearly not appropriate. It is clear that the existing law does not allow that to be the case.

We will be having further discussions with Mr Baxter. Until now we have been concentrating on getting those catch-up amendments done. They are now completed and we propose to speak to Mr Baxter to see if there are any cases where we need to change our approach. But we do see our approach as being fundamentally sound and consistent with the general approach of undoing the deeming in the CGT law.

CHAIR—One of the things that members of parliament are always interested in in new legislation, or even amending legislation, is whether or not retrospectivity might be an issue. Do any of the participants today have any views, in relation to either the transitional and consequential amendments or the bill itself, excluding the issue that we already dealt with this morning in terms of schedule 2 part 1, that there are any issues of retrospectivity about which you might have concern?

Mr Spence—I think we raised those comments this morning—

CHAIR—I said excluding schedule 2 part 1, because you dealt with that.

Mr Spence—Yes.

CHAIR—There are no retrospectivity problems? Thank you. Does anyone have anything else to raise?

Mr Baxter—One of my concerns in going through the legislation was to identify specific areas where there is currently a transitional provision which has not made it through into the new one. When I was going through, one of the things I identified in relation to 160M, which currently tells you what a disposal is, is that very few of the historical amendments and transitional provisions to that appear to have made their way through into the legislation. I have a concern that, if we do not include some transitional provisions which import some of those rules into the new legislation, we may end up in a position where we deem disposals to have happened which had not previously taken place.

I am aware that the new legislation starts off by saying that it applies to disposals post the commencement date. But I am concerned that the absence of those transitional provisions may mean that they are talking about disposals in a different sense from what would be the result if you amended that law. It is probably not the forum to go through this in detail because it relies very heavily on specific dates and times and transactions.

CHAIR—Thank you for that, Mr Baxter!

Mr Baxter—I just raise that as a concern.

CHAIR—I am forever in your debt.

Mr Burge—If Mr Baxter could provide us with the details, we would be very

pleased to look at that.

Mr Spence—In your summation of that previous point, you said there were no problems with retrospective aspects. If I could just clarify that, we do not believe there are any retrospective aspects that were not already raised this morning. I would also like to raise a point that I know John Burge would be very disappointed if I did not raise, and the same with Simon Gaylard.

CHAIR—I'll bet!

Senator GIBSON—In the interests of consistency.

Mr Spence—Also, picking up that Senator Gibson is very keen that this committee can make some ground in some areas here, this is one area where universally, I think, you will have no difficulty in feeling that you can make some ground. This particular issue is one that has been around for some time—since 1985. That is that where you own a share or a unit you acquired before 1985 and you sell it after that date, where you prima facie think you are out of those provisions, there is a section which says that in some circumstances you can be taxed.

It is an enormously important provision, because it addresses a wide range of transactions, but it is notoriously unclear as to what it does. In fact, out of some meetings with the tax office a few years ago, at a national tax liaison group meeting the tax office produced its own paper which identified no fewer than 37 ambiguities and uncertainties within this small provision of the act. As representatives of the tax professionals bodies, we met with the TLIP team and some tax office people on 16 July 1996, and a number of these issues were discussed in a very worthwhile and productive meeting. The TLIP team felt encouraged that they might be able to take on a number of the issues. They did not commit themselves to, but they indicated that they might be able to, just to sort out ambiguities—nothing more or less.

The rewritten legislation has totally ducked the issue. It is a clear restatement of the existing ambiguities and uncertainties in the existing legislation. That was raised in our submission, at paragraph 2.1.8. We only received the tax office's response to that submission at the last meeting, and I understand why that was. Their response is that an ATO legislative proposal is currently being progressed through other processes. I am heartened by that fact. I was just wondering whether, through your committee, we could get some more clarification as to how those important issues are being currently addressed and whether that will form part of the TLIP process or be outside it.

CHAIR—Thank you for your confidence, but I really think it is outside the scope of the committee to advise you or answer questions on any issue. The committee is here to take submissions and to hear issues surrounding Tax Law Improvement Bill (No. 2) 1997 and to bring down a report to the parliament. With respect, we do not report to

individuals.

Mr Spence—Okay.

CHAIR—I would suggest to you that you need other mechanisms. It is not because of any reluctance on my part. It is simply that we have no power to do that kind of task for you.

Mr Spence—I understand that. It appears to be a major deficiency in the rewriting that these issues were not addressed.

Mr Kirkwood—I think that is the point. The rewrite in this area, which was section 160ZZT, is arguably—perhaps unarguably—less clear than the previous law which was—

CHAIR—Would you like to ask me to ask TLIP if they might be able to find that information for you?

Mr Kirkwood—Could I, through you, Mr Chairman, ask Mr Burge to tell us what these other processes are by which we might seek a response?

CHAIR—Does TLIP have a response?

Mr Burge—Yes, Mr Chairman. I am able to provide a limited amount of information, not the full information that Mr Spence and Mr Kirkwood are seeking. There is a team based in the Parramatta office of the Australian Taxation Office which is dealing with issues arising from existing section 160ZZT (CGT event K6). Those provisions work reasonably well when you have a simple business structure of a company and shareholders. It is the case that there are difficulties once you have tiered entities, where you have a number of companies or trusts in the structure.

The project team based in the Parramatta office is looking at these issues to see which could be dealt with by way of ruling and which would require legislation. In terms of our own project, it was one of those cases where we had to make a hard decision about what would at first seem desirable, as distinct from what is feasible, in the general scope of the project. While we would have liked to go further than we did, it was not feasible.

I have noted that, on the list that the consultative committee have raised as small 'p' policy suggestions, the section 160ZZT issue appears. I understand that the consultative committee are refining that list down. They may well include that on the list and it could well be picked up through that process, but that is all I am able to say at this stage.

CHAIR—Thank you. Has anyone else got any other issue they wish to raise? Mr

Morgan?

Mr Morgan—Over the weekend I was having a look at a provision and I think that the old section 160M(1A) has not made its way through in all its glory to the new law. It is half there, I think, in 104-10(2) but I think it does only half its work. The deficiency is that it does not provide for a rollover, essentially, when you are changing trustees. In other words, a mere change of trustees could still provoke a capital gains tax disposal, because I do not think that provision has entirely been translated correctly. As I said, I have only just discovered it through work myself over the weekend; I have tick-tacked with John Burge at morning tea and I would like to get his comments on it—through you, Mr Chairman.

CHAIR—Mr Burge.

Mr Burge—Our understanding and firm belief is that we have accurately translated existing subsection 160M(1A). It is important to note that as part of the general approach in the rewrite it is now made quite clear—this is in section 960-100(3) of the 1997 act, so it is already law—that a legal person can have a number of different capacities in which the person does things. In each of those capacities, the person is taken to be a different entity. It states that, for example, in addition to his or her personal capacity, an individual may be a sole trustee of one or more trusts and one of a number of trustees of a further trust. It goes on to say that, in his or her personal capacity, he or she is one entity; as trustee of each trust, he or she is a different entity. The trustees of the further trust are a different entity again, of which the individual is a member. Our thinking is that with that guidance on the meaning of entity, particularly in relation to trustees, and the provisions to which John Morgan referred, we have accurately translated the effect of the law.

Mr Chairman, you may wish to ask Ms Freshwater whether she has anything to add to that answer.

CHAIR—Do you?

Ms Freshwater—I am just having a look. I thought that the answer was here.

CHAIR—May I say that Senator Gibson and I have memorised all those words! It is certainly as clear as mud.

Ms Freshwater—I showed this to John very quickly and I think I pointed him to the wrong subsection. I think we should actually have been looking at subsection (2), which says that the trustee of a trust or a super fund is taken to be an entity consisting of the person who is the trustee or the persons who are the trustee at any given time. So if there is a change of trustees they are taken to be one entity. I am sorry, John.

CHAIR—Does anyone else have any further comments?

Mr Petersson—I have one final comment. Quite a number of major technical issues which we have covered in the joint submission highlight the need for a no disadvantage rule. I would like to refer very briefly to one final one, which deals again with the principal residence exemption. That is clause 118-190, which deals with using a dwelling for producing assessable income. What the explanatory memorandum suggests, at page 88, is that it reflects a change to the current law to confine the income producing limitation to situations where interest on a mortgage in relation to the dwelling could have been deducted.

To explain what that means in this context: if someone is using their principal residence to operate a business from, the bill seeks to limit the extent of their exemption from CGT in relation to their principal residence, to the extent that they are using a portion of that residence for income producing purposes. The test proposed is that, if the owner of the property is able to claim a portion of the mortgage interest, then the exemption will be reduced.

That actually goes back into a bit of history. What the explanatory memorandum suggests is that this change is merely reflecting administrative practice. Ruling IT2673 issued by the tax office purported to set out some guidelines as to the circumstances in which a person who, for example, worked from home might claim a deduction. I suppose at this point I should reveal my interest in this issue. Nevertheless, it is important, because there are lots of people who are in a similar position.

Basically, what the ruling said is that one of the characteristics—among others—would be that, if you were able to claim a deduction for a portion of the interest, that would indicate that you would lose a part of the exemption. But, obviously, it was only one of the factors. There could well be circumstances such that if you used, say, your living room on a non-exclusive basis to provide music lessons, you might not be able to claim a deduction for part of the mortgage but you would not lose the principal residence exemption. So that is at one end of the scale.

At the other end of the scale, you might be a doctor or a vet who has a separate entrance to their residence, which is clearly a business premises. That would clearly be caught. Obviously, in that situation you would be able to claim interest in relation to that portion of the residence which was used as a surgery.

In between, however, there are lots of situations. Perhaps I find myself somewhere in between, and that is why it concerns me in particular. For example, a study may be used for income producing purposes, but not on an exclusive basis. It is quite arguable—one would say reasonably arguable—in that situation that that usage does not affect the principal residence exemption and that the change proposed in the law to reduce the exemption in cases where you are claiming mortgage interest goes further than the current

law.

If I could perhaps explain that, it seems to be a situation where you can actually claim a deduction for interest under the current law and still in fact be entitled to the full principal residence exemption. The rewrite is denying that. Therefore, it is a change which is adverse to lots of taxpayers. Again, it is one which, in the absence of a no disadvantage rule, could be seen as illustrative of the problem that we have raised.

There is one further aspect, and that is that the rewrite seeks to create a test based on what they call notional interest or money borrowed. It assumes that everyone is in a position that, if they own a principal residence, there will be notional interest on the home; whereas, of course, that is not always the case. The problem is that these provisions were written specifically with a view to making it easier for ordinary taxpayers—being the kinds of taxpayers who have principal residence exemption claims; whereas, by creating this concept of notional interest where in fact there may or may not be interest paid on a mortgage or where there may not be a mortgage, the actual provisions seem to me to create a situation that is not particularly desirable if one is trying to make the law in respect of the principal residence exemption more accessible to ordinary taxpayers.

In that regard, it is understood that the tax office's figures were that about 70 per cent of inquiries to the tax office in relation to capital gains tax related to the principal residence exemption. It was recognised, right from the start, that the issues in relation to principal residence exemption tended to be far and away the greatest issue for most taxpayers. So the introduction of a concept of notional interest in cases where there may not be a mortgage, let alone interest, seems to be somewhat at odds with the desire of the rewrite team to create an exemption provision which is accessible and understandable by taxpayers.

CHAIR—Does TLIP have a comment?

Mr Burge—Yes, Mr Chairman. It was precisely because of the large number of inquiries and the large number of people affected that the rewrite team put such an effort into improving the principal residence provisions. A significant number of the changes to the effect of the law that we have made relate to the principal residence exemption for that reason. In relation to income producing use of the taxpayer's home, we have provided an answer on pages s 409 and s 410 of volume 2 of the submission. We stand by our statement in the explanatory memorandum that we have given effect to the ATO's current administrative practice, which is at least arguably more favourable than the existing law.

The existing law in subsection 160ZZQ(21) refers to using the dwelling for income producing purposes. One interpretation of the existing law is that merely taking work home and thus being eligible to claim variable expenses, such as the cost of electricity while working and the depreciation of such items as the desk in the home office, is enough to trigger a CGT liability. The ATO has never construed the existing law that way,

and it was made clear at one of the very earliest meetings of the Tax Liaison Group (CGT Subcommittee).

Taxation ruling IT2673 does posit this rule of thumb test of eligibility for deductions for such expenses as mortgage interest. That test is an appropriate one. We have to ask ourselves, 'What is the basis on which a taxpayer can claim a proportion of the mortgage interest in those cases?' The answer to that is, 'To the extent that that part of the dwelling does not have a domestic character but has a business character, it is appropriate.' And the courts and the ATO recognise that deductions are available.

When it comes to CGT, the same principles apply. If it is appropriate that a deduction be allowed on the basis that the relevant expenditure does not have a domestic character, it is appropriate that CGT apply in relation to that part of the dwelling.

Mr Petersson—Mr Chairman, I have one final comment: you did ask before about retrospective operation. It is quite clear—certainly, in my view—that the change as now contained in the rewrite is a change of the law; so, in the absence of a transitional provision, it will operate retrospectively.

Mr Burge—To the extent that there is a change, it is a change that favours taxpayers.

CHAIR—It advantages taxpayers?

Mr Burge—Yes. It advantages taxpayers.

Senator GIBSON—Thank you for submission No. 17 and the list of all the small 'p' issues in attachments A, B, C, D and F. Attachment F at the back, on the non-CGT issues outside TLIP's mandate, has 14 issues listed. Is that all the non-CGT issues that have been raised with TLIP over the past several years?

Mr Nolan—The list deals with the subject matter of this bill. It does not go back into previous rewrites. I will ask my colleagues to confirm that that is our understanding.

Miss Haly—That is right. The issues in attachment F are only those non-CGT issues relevant to this particular bill. Other issues that have been raised with us are in the compendiums that were referred to at the previous hearings and also briefly this morning. All of those compendiums for all of the areas of the law that we have dealt with are now with the consultative committee members, as part of that process for raising small 'p' issues with the Assistant Treasurer.

Senator GIBSON—Can the committee see them?

Mr Nolan—We have no problem with making those available. It is a very thick

document, however.

CHAIR—Mr Nolan, we do not need 20 copies. One would suffice.

Mr Nolan—We will provide that to you.

CHAIR—This has been raised. My understanding is that it was an issue when the committee met with representatives examining Taxation Law Improvement Bill (No. 1). It was made a lot of as an issue in Sydney. So that it can make recommendations to the parliament, the committee would like to know and come to some sort of view on how the heck you deal with this in a mechanical way outside of partisan politics: some way to try and let the process work, I think. Isn't that what we are looking for? It is to try and help all of you.

Mr Nolan—Thanks, Mr Chairman. We would be very pleased to make that list of documents available.

CHAIR—We cannot tell the Assistant Treasurer what to do but we certainly can make recommendations. We will not answer your questions but we will answer his!

Mr Morgan—Just to give you some perspective, the CGT compendium is about one inch thick, and John Burge has helpfully distilled towards the top of those 157 the main issues in his view. I think he has also spent a day briefing the tax office, which would naturally have every bit as much interest in these as taxpayers do.But, given that the Assistant Treasurer has asked if taxpayers could limit their submissions to perhaps two lots of six per year and perhaps keep them revenue neutral, is there anything John Burge can tell us about his dealings with the tax office proper and their interest in this list, Mr Chairman?

CHAIR—Mr Burge, can you comment?

Mr Burge—Thank you, Mr Chairman. The Taxation Office has been briefed fully on the issues that have arisen in the rewrite, and the capital gains tax compendium of issues has been referred to the tax office, with the intention that it be dealt with as part of the Tax Liaison Group (CGT Subcommittee) work. At the next meeting of that committee, they will be receiving an updated position and, as I understand it, will be selecting a number of issues to progress at each meeting.

CHAIR—Thank you. Are we all done?

Mr Spence—Mr Chairman, I could perhaps sum up on behalf of the Taxation Institute and from a Taxation Institute perspective. We have felt not only that these meetings have been worth while in this process, but also that the TLIP consultative process as a whole has been very worth while. It has been going on for an extended

period, and John Burge in particular has made a real effort to consult and has always returned calls and always, as demonstrated here, considered issues. There are a number of things we continue to disagree on and have different views on, but it has been a very open and very worthwhile process from that perspective.

Our major focus has been on some of the issues that we thought fell within the ambit of the process and that we are disappointed have not been picked up. To the extent of whatever your recommendations are, it may well be that they will have to be dealt with on another occasion. As I said, the only major disappointment in the whole process was the lack of input and the toing and froing in relation to our major submission, which we only at Sydney realised had caused the tax office such a hiccup in their whole process, and that did surprise us.

As for going forward here on consultation, I would very much encourage the TLIP project team, if they have not already thought of doing this, again to run with the professional bodies some outreach type meetings with other professionals, to expose them to the issues. There was a process run in the middle of last year, and it was very beneficial and was to everybody's advantage. As the Taxation Institute, we would be very happy to form part of that process again in educating people on this bill—particularly if it has got some sort of antidetriment aspect to it. That would help to flesh out some of those aspects. Thank you very much.

CHAIR—Are we all done now? Let me thank all the participants, both TLIP and members of the consultative committee, members of private practice and other organisations, the observers, Hansard, my colleagues, my secretariat and my advisers. It has been a valuable experience for us. I gather it has been so for you. We will in due course bring down our report and also receive the other things that you have offered to provide to us. Thank you all very much. I declare this public hearing closed.

Resolved (on motion by **Senator Gibson**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Committee adjourned at 12.38 p.m.