COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE

of

PUBLIC ACCOUNTS AND AUDIT

Reference: Tax Law Improvement Bill 1996

SYDNEY

Tuesday, 18 February 1997

OFFICIAL HANSARD REPORT

CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

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Matter for inquiry into and report on:

Tax Law Improvement Bill 1996.

WITNESSES

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CHAIR—I open today's public hearing on the Tax Law Improvement Bill 1996 and welcome everyone here today. As you are aware, this bill represents a second stage of bills being introduced into the federal parliament to progressively replace the Income Tax Assessment Act 1936. The bill supplements the Income Tax Assessment Bill 1996 which is still before the parliament.

The first series of TLIP's bills were referred to the JCPA for review last year. The committee's recommendations to parliament are in report 345. As a general principle in this inquiry, the JCPA will not revisit issues already covered in report 345. A continuing debate concerns the most appropriate way of dealing with the small `p' policy issues and anomalies that the rewrite process is highlighting. In report 345, the JCPA recommended that this task be undertaken by a suitably resourced parliamentary committee, preferably the JCPA, with supplemented funding. The committee awaits the government response to this recommendation.

We, of course, note the suggestions you make on the appropriate mechanisms to resolve small `p' and medium `p' policy issues. Please bear in mind, however, that the purpose of this inquiry is to review the clauses of the bill before us, not to make recommendations on policy. But the committee has determined that, if such issues do arise, we will report them to parliament but not make recommendations on them.

Parliament has asked the JCPA to report back on the bill before us today by 6 March. As a consequence, the committee will have time for only two days of public hearings and we will have a lot of ground to cover on each day. For this reason, I ask you to keep your comments as brief as possible. A number of you, in varying capacities, have given evidence to the JCPA before, often on several occasions. This is the first time that the consultative committee has given evidence as a group. On behalf of the members, I thank you all for giving your time and continuing assistance to the committee.

We will run this as a round table format which you will be familiar with. The committee will not be swearing or affirming witnesses, but I remind you that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The evidence given today will be recorded by *Hansard* and will be fully protected by parliamentary privilege.

As we go through each division of the bill, I will begin by inviting consultative committee members to comment. Once again, I ask you to keep your statements as brief as possible. We will not dwell on non-contentious parts of the bill. Following the consultative committee comments, I will ask committee members whether they have any questions before inviting officials from the TLIP to respond. Finally, each session will conclude with a general

discussion period in which everyone is welcome to comment. To start the proceedings, I will ask Mr Brian Nolan to outline the content of the Tax Law Improvement Bill 1996 before we discuss the individual clauses.

Mr Nolan—This bill is the second instalment in the progressive rewriting and delivery of the income tax law. After carrying out the most intensive inquiry into the administration of taxation law in this country, your committee recommended that a project to redraft the income tax law along these lines be put in place. In doing that, the committee was heeding what it had heard consistently from witnesses to that earlier inquiry, that the law was complex—impossibly so—and needed rewriting. That was the message that came from a number of professional bodies, other witnesses and professional firms acting in the tax field.

That need for clearer law has certainly not abated because there have been more and more tins of legislative spaghetti poured into that tax cauldron. So we have set about, methodically, to give back the law to the community in a way that is more lucid and manageable. We think we have made good progress. It was very reassuring to us to have broad endorsement of the approach in your report No. 345 of August 1996 on the first stage, the Income Tax Assessment Bill 1996 and two other bills, which set up the framework for the new act. In particular, we were pleased to have endorsement of the continuing use of plain language, the comments about the general quality of the drafting and the robustness of the structural design and numbering system.

You also then reaffirmed support for the phased introduction of the new act as the best transition, particularly for small practitioners and businesses. That kind of bipartisan support was echoed when the bill went through the House of Representatives. Last month we also received a good deal of encouragement at a conference in New Zealand of tax teachers and tax academics who are teaching students the new law. They are the new wave of practitioners for the future. They were very supportive.

With your indulgence, Mr Chair, I will quote what Michelle Asprey, a lawyer and plain language expert, had to say about the project:

The Tax Law Improvement Project team has taken one of the most complex and largest pieces of legislation and rewritten it in such a way that an ordinary taxpayer could, if he or she wanted, read from cover to cover and understand it . . .

She went on, and I think this is important:

This really is an access to justice issue, about the people's right to know the law and to understand it.

We have embarked on this journey. We expected difficulties, but we have resolved to produce a first-class outcome for the community. A great Australian, Morris West, the author, warned us that inevitably along the way there would be some fatigue, but he urged us to persevere because he saw the worthwhileness of the project. There have been some weary moments but, as long as we continue to attract community support, we intend to remain indefatigable. There might be some fatigue in some of the other players in the tax game, or at least a turning to the pursuit of other agendas.

It would be stating the obvious, I think, to say that there has been a concerted campaign in areas of the community for tax reform or some form of tax restructuring. The

crackling from that atmosphere does not really disturb at all the importance of what we are doing. We have no quarrel at all with those who advocate tax reform; they have got every entitlement to press their case. But the odds against income tax not taking a major role in any future tax system seem pretty long to us, and once you agree with that then the case for having lucid, usable income tax law is incontestable. That is what we are trying to deliver to the best of our abilities. We believe we are also helping to build a modern legislative style that can be a model for any future system and, indeed, going beyond tax law itself.

We have been very appreciative of the contributions of ideas, comments, critiques and criticisms by organisations and individuals throughout our public consultation processes, and there are numerous instances where those comments have helped us to further improve on what have been put out as public drafts. Naturally, there can be issues on which minds will not eventually agree, and decisions have to be made when that happens. But I remind us all that the present law is far from perfect, and its complex commercial and social setting does not allow it to be simple.

So our quest is for high standards of comprehensibility, access and for excellence, but not for the unattainable. The British are rewriting their law too. They are just embarking on that, and they have a saying that the best can be the enemy of the good, and I think that is what they have in mind there. Sometimes, with the best of goodwill and intentions, we will depart from other opinions as to the best way of expressing a particular provision or about how much detail to put in.

We do have to strike a balance—a balance that allows the principles of the law to stand out clearly for the majority of people, and that will not happen if we try to anticipate and chase down every fact situation for special mention within the law. After all, that is how the present fog that we have rolled in.

Thank you for that indulgence, Mr Chairman. The bill in front of you, the Tax Law Improvement Bill, rewrites provision of general application dealing with aspects of assessable income, exempt income, some specific allowable deduction provisions, the trading stock rules, the depreciation rules and gift deductions. It also rewrites more specialised areas including those about entertainment expenses, primary production deductions, the recoupment of deductible expenses and sales of leased cars.

We think that generally the overriding effect of the minor changes is to the benefit of taxpayers. Most of those changes either put into law administrative practices or provide clarity where current legal positions are somewhat uncertain.

There is one particular matter relating to trading stock converted to personal use that I am sure we will come to later. The bill for the first time provides a treatment for items of trading stock that the trader takes out of personal or capital use and for assets not originally acquired as trading stock that are put into stock. The changes of use are going to be treated under the bill as a disposal and an immediate repurchase of that item with its new status.During the consultation processes, private sector representatives, including the consultative committee, argued very strongly for that to occur at cost rather than market value, and that was put to the government on the recommendation of the consultative committee. It was accepted by the government and is now in the bill.

To go on briefly, the bill will have a broadly revenue-neutral impact. All but three of its

proposals really have no measurable revenue impact. I will not pick up now the ones that do in any detail. They are about deductions for rates and land tax on premises used to produce assessable income of societies and clubs where the principle of mutuality applies.

As to the valuation of livestock, we have brought the valuation methods for livestock more closely into line with those for other kinds of trading stock. The third one is that measure that I talked about, the conversion of trading stock to personal use or the taking of items and putting them into stock. That is the only measure that has a revenue-positive outcome. We think that the bill should generally reduce compliance costs due to the impact of a great number of small improvements and because of the clearer language reduction in text and so on.

Our charter of course excludes policy review, but there are some 30 minor enhancements included in the bill that help to make the law simpler and clearer and generally less burdensome for taxpayers. We can deal with some of those as we go through the particular clauses of the bill, if that is your preference, Mr Chairman.

The bill is scheduled to commence from the beginning of the 1997-98 income year, provided it receives passage by 30 June. We regard it as very important that the bill be passed by that time, and we are hoping that the committee will be influential in achieving that. If that were not to occur, that would result in the provisions in the bill being delayed by an additional year, and that puts strains on the project and it increases the amount of double handling of legislation. All of the measures in the bill have been issued as public exposure drafts and have been reviewed, including by the consultative committee. In some cases those exposure drafts have been out for a long time, back as far as July 1995.

As you know, Mr Chairman, this project was set up initially with a three-year charter. We have sought a continuation of the project for a further two years until June 1999. We believe that it will take that long to complete the task. The government will decide on that formally in the course of the 1997-98 budget deliberations. We cannot presume the decision there, but I have no reason to believe that that will not be accommodated.

So on that premise we envisage an additional three annual bills after this one for introduction into the parliament in 1997, later this year for 1998, and in 1999. The bill that is planned for the end of this year can be expected to contain re-writes of capital gains tax, deductions for expenditure on the environment, Australian films, intellectual property and research and development, averaging of income for primary producers, the rules about companies and corporate distributions, partnerships, deductions for bad debts and the treatment of corporate limited partnerships, corporate unit trusts and public trading trusts. So there is quite a volume of material coming in that further bill at the end of this year which we would expect to be proposed for a 1998-99 commencement. You can see why, if this present bill stacks up with the same commencement date as that, you begin to have a very substantial amount of material to be absorbed at the one time, which is something we are trying to avoid.

Finally, Mr Chairman, your committee has twice now considered how the new law should be delivered. I have regarded that matter as settled because of that and mention it now only because other parties continue to argue the big bang case or some variant of that. We remain resolutely of the opinion that progressive delivery is the most efficient and user-friendly plan for the transitional period. I will not go over what is now well worn ground, but we do not believe that there is any substantial new evidence to change the position on that.

There have, though, been claims that the bill in front of you contains an excessive amount of transitional and consequential provisions which, it is said, would not have been required had the entire law been enacted in a single package. The inference behind that is that drafting resources are being wasted. We say quite emphatically that is not so. All of the work being done within the project on transitional and consequential provisions would have been necessary under the big bang approach.

A minor amount of consequential changes would have taken a different form, and some of the work would have gone on behind the scenes in the sense that it could have been incorporated in the new assessment act rather than enacted separately. However, big bang would have required a lot more work to be done that is not needed under progressive delivery. Drafting of all business as usual legislation in two quite different forms—one that is compatible with the existing law and one compatible with the new law—would be a major drain on drafting and other resources. The resulting inability of the project to sign off progressively on rewritten material, we believe, would cripple progress. That is all I want to say at this point.

CHAIR—Thank you, Mr Mullen. I now invite Mr Droder to make an opening statement on behalf of your consultative committee.

Mr Droder—I do not know what to say, Mr Chairman.

CHAIR—I have not heard you say that before.

Mr Droder—I think the consultative committee is, on reflection, concerned about a number of points. I think Brian raised the first one of the transitional provisions and the volume and the complexity that that adds to the progressive implementation, particularly in relation to having that act out, and having the old, act and having to cross-reference. That is seen to be excessively complicated.

The implementation date is one that certainly is worrying the consultative committee. The same arguments that were put, I think, in the first bill, apply in this bill, that there is a degree of retrospectivity. I am not quite sure how you overcome it, but there will always be a degree of retrospectivity. Mr Bryant, for example, refers back to his taxpayers who balance at 31 December being caught up in that.

We also have major concerns around trading stock, and there are two issues to that. Firstly, there is the expression that has been added, apparently, into the definition of trading stock with the words, `or held for'. The other one which does seem to have a major problem is the value of change of intention at some stage through the career of a particular asset of a taxpayer. Finally, the consultative committee is still very concerned as to how unintended changes of the rewrite are going to be processed and fixed when they come to light in the experience of taxpayers implementing the new law.

CHAIR—Thank you. Would anyone else like to make a comment before we start looking at the clauses?

Senator WATSON—Should the tax law improvement project be looking at what I term machinery provisions just to reduce the absolute size of the act? I think the size is quite

formidable in itself. And even though the terminology might be fairly simple, a lot of people get overwhelmed by the sheer size of it. It has been said to me that it is a policy issue, in a sense, to do more than just rewrite the existing words. But it does seem sensible to adopt that particular approach. Would you like to comment on that?

Mr Nolan—Are you saying, Senator, that the volume of transitional provisions could be reduced?

Senator WATSON—Shared provisions. Please explain how you get to a stage of having to tax something or the environment or the setting. I do not want to come back in five years and say, `This was a big opportunity that we really missed.'

Mr Nolan—Some of my colleagues might like to join in. A lot of what we are doing in setting up structurally the various areas of the new law is to try and put them into a contextual setting, for example with the use of introductory areas which are not necessarily operative. In fact, they are not non-operative provisions, but we set up for people—sometimes in diagrammatic form, sometimes in narrative—a broad indication of what the area of the law is about so that people can decide whether that is an area of the act that they need to trouble themselves with. A lot of effort and attention has gone into helping that navigational side of the act. I think we are managing to do that without adding a great deal of volume. In fact, overall, the volume of the act is coming down considerably—certainly by an average of 50 per cent; sometimes more, sometimes less. I am not sure if I am addressing your main point.

Senator WATSON—It is just that we had this commitment to reduce red tape for small business by 50 per cent. Obviously, tax is a big area in that. I think David Russell raised this particular point. There is some food for thought in it.

Mr Nolan—I believe what we are doing does help small business. Having law that is reduced in volume and clearer in itself helps them in terms of getting their tax position right or having their tax advisers get it right. We also, in many small ways throughout the re-write, address their needs by reducing some of the red tape; the particular bookkeeping requirements that some of the election details and so on that are dotted throughout the present act. Each time, we look at those and say, `Is this really necessary? Does it add value?' Where we are able to conclude that it does not add value, then we recommend that it be removed and try to find a simpler way. I think there are countless instances of where that has been done.

Senator WATSON—What about uniforms and that sort of thing?

CHAIR—We get to that in the provisions a bit later on, John.

Mr BEDDALL—I have a procedural question for Mr Nolan, not so much about these bills but flagging the concern of this committee when it received these bills. We got this bill on 11 December and we set a deadline of 6 March by which this committee was to consider these bills. That is right at the end of a parliamentary year so this is the only hearing we could schedule. If that happens with the next tranche of the bills—there was a strong argument in the committee about whether we accepted the reference this time—there will be a stronger one, I would think, particularly if you are dealing with capital gains tax. When do you do think the bill will be available for the committee? If it comes in on 11 December you will not get it through by 30 June next year.

Mr Nolan—Thank you, Mr Beddall. We too hoped to have had that legislation available considerably earlier than that. It is partly the fact that the consultation processes are so extensive that it is very difficult to actually close off on the bill. There is always somebody with additional points they want to raise and quite often they will have some value. The point you have made is absolutely valid. I do not think it would be reasonable to expect you to deal in that sort of period of time with the next bill, which is going to be a very substantial one, including the capital gains tax. There is the rub. Because capital gains tax is going to attract a lot of public interest and professional interest, there will be again a pressure to keep on extending the feedback period, the consultation period.

We are always going to be in that sort of squeeze as a project trying to give people the most possible time, both from the public point of view to feed in their comments to improve the bill for the parliament and then, on the other hand, to respond to your need for a decent amount of time so that you can consider the bill without blowing out the overall time frame and commencement date. It is a difficult problem but we will certainly take a great deal of heed of what you have been saying. If it means closing off on the bill earlier and perhaps even if that means some areas cannot be included in it, that might be what will have to be done. It is too early for us to—

Mr BEDDALL—The committee has the responsibility to make sure that it peruses the bill properly, and we just would not have the time frame to do that by the same mechanism you have put in place this year. I just foreshadow that.

Mr Nolan—I am taking that comment very seriously.

Mr Russell—Mr Chairman, two points: one in response to Senator Watson's question and the other in response to Mr Beddall's comment. In terms of the capacity of the professional bodies represented either formally or informally on the consultative committee—and I think even more so for those of us who are here as individuals—it would be quite impossible for us to discharge any function the committee may wish us to discharge in terms of placing properly reasoned submissions before you if the time frame that was involved was of the sort Mr Beddall was talking about. In fact, the joint professional bodies have prepared a submission, which we will no doubt be referring to during today but which is to be presented tomorrow, which makes it clear that the capacity to respond in time within these sorts of deadlines is quite difficult.

The second point is Senator Watson's proposition as to whether or not simplification opportunities may be being lost because of the way in which the process is developed—as I understood his question. It is perhaps useful for the committee to have an example of how this works in practice. The first set of simplification legislation was the substantiation provisions. The proposition was argued in the consultative committee that an alternative approach to the substantiation provisions would be simply to require taxpayers to produce corroborative evidence in order to support their obligation to satisfy the onus that an assessment is excessive, rather than have long and detailed prescriptive rules. That was debated at some length in the consultative committee but, ultimately, we were advised that it was the view of the then government that the actual substantiation rules themselves were considered by the then government to be there as a matter of policy and therefore that the consideration of their removal was not a proper part of the responsibility of the tax law improvement project.

While no doubt that was an entirely genuine view by those who advised us of what the

terms of reference of the project were, there is also no doubt that, in that sort of area, there is an enormous range for simplification without in any way changing the revenue effect or changing policy in the sense of permitting people to get inappropriate deductions for work related expenses. Yet, within the terms of the project, that has been regarded as a no-go area. To pick another example, the law at the moment in relation to travel expenses requires that people keep a written diary in the English language if they want to claim deductions for overseas travel expenses. Exactly what Australian businessmen of non-English speaking background who arm themselves with personal computers think of those sorts of requirements is difficult to say and, arguably, it may not even comply with our obligations in relation to non-discrimination legislation.

The real point is that if that sort of thing is seen as being a policy issue then there are areas of simplification that are available to the parliament without in any way changing policy which are ruled out of this project. The parliament needs to understand very clearly that, as the terms of reference of the project are currently written, changes like that are being seen not really as debated within the project so much as being ruled out by the terms of reference.

I want to emphasise that in saying that I intend no criticism whatever of the project team which, after all, is bound by the terms of reference. If the parliament is anxious to see simplification in that area then the parliament would certainly need to consider whether or not the present terms of reference are adequate in that regard.

Mr Bryant—One issue that we raised earlier today—and Brian touched on it—is the question of implementation or the delivery option. Brian has put his case for progressive implementation. He has done that before and it has been debated here. We have put alternative views today. I just want to put it to the committee to make sure that this does remain on the table. I think that is something that could well be tested during the course of the two days we have before us, and perhaps you might reserve judgment.

Brian did put the case that that has been dealt with before and, I think, was concerned that we do not go over old ground. The position of many commentators, including myself, is that there is a compelling need in the light of evidence to date that that debate has to be held now. It is against the evidence of what we are seeing that it needs to be revisited. I just urge that we look at it over the course of the inquiry and just keep it to the forefront.

Mr Langford-Brown—Just following on from Mr Beddall's question—and I note the constraints that the project team is under—given the importance of issues such as capital gains tax, I do hope that it is not going to in any way concertina backwards the amount of discussion which is appropriate and warranted from the community's point of view. I know they are two conflicting issues, but I do hope the committee is aware of that view that I hold as well.

Mr Gaylard—It must be understood that the length of time that people are given to comment is contradictory to getting the best result. Capital gains tax is going to be the key issue where that particular tension is raised. There are a significant number of issues there that the tax community realises should be fixed. If we are going to truncate the time that we have to consider them then we are not going to get as good a result as is possible. I do not know whether there is any answer to that other than extending the project even further. I do not think that is probably the option either.

Mr BEDDALL—The government may have to introduce legislation without the support of this committee. This committee may continue to look at the thing while it is legislated. That is a choice the government has to make.

CHAIR—If it is a choice between good law and bad law, maybe we need more time.

Senator SHORT—Just where are you at at the moment on the capital gains tax consideration?

Mr Nolan—The drafters and instructors are currently working towards an exposure draft, probably in two volumes. A lot of progress has been made. I cannot give you a particular date on which we will release those drafts, but I expect it would be around April. Until you get well into the drafting and deal with some of the problems, the amount of time it is going to take is hard to predict closely.

Our current prediction would be that it will be around April. That allows a good deal of time then for public consultation. I do not know whether there is any way in which this committee could involve itself at an earlier stage even than when the bill is introduced into the parliament. I am just floating that as something that might be possible—not to actually wait for the bill but to start looking at issues when they are in draft legislation form.

CHAIR—The committee recognised that, Brian, when we suggested the revenue committee of parliament be established and we would look at tax matters on an ad hoc basis. But, as this is an ongoing process and you are extending the life of the project by two years, there is a good case for an ongoing committee to look at this along with the project team and the consultative committee.

Senator WATSON—In relation to the original report, No. 326, we are often quoting some of the recommendations of that report out of context, because at 5.28 you say:

The committee is of the view that any attempt to redraft the act must necessarily look at broader, structural issues within the total taxation system. Simplification, in this context, should concentrate on achieving a tax system which is fair, equitable and economical.

Then at 5.38 you say:

The government commits sufficient resources to the task force as will allow it to complete a priority simplification.

We are talking about a simplification redraft, not just a rewriting of the tax act with a renumbering and in plain English. So somehow, we have restricted the original thrust of report No. 326 to very narrow confines. That is where we are running into some trouble. What happened so that we went off the track from the thrust of what was put to us a few years ago in terms of simplification to confine it to just a rewrite, a renumbering and a use of plain English? I think that is where a lot of our problems are inherent today.

CHAIR—That was a conscious decision of government at the time, by Dawkins.

Mr BEDDALL—It has not been changed by government since.

Senator WATSON—I know, but we have now got a new government so we should

probably remind them of that.

CHAIR—We need to get on to the bill.

Mr Nolan—I would like to make one observation on that. I think we are doing a lot more than just rewriting. But, even beyond that, the project team certainly recognises that rewriting the law is not the end of the process. It fits in well with that original recommendation that, beyond the rewrite, there are other things that need to be done. But they are things that essentially are decisions for government and not for us to make.

Mr BEDDALL—Capital gains tax is going to be the toughest issue that you tackle, we tackle, we collectively tackle. There are currently laws before the parliament to be debated on capital gains tax rollover for small and medium enterprises. Are they being considered in your rewrite? You are rewriting capital gains tax and, at the same time, another section of the tax department is changing the act that you are rewriting. The concern I have is that you will have a set of recommendations about an act that does not reflect the act.

Mr Reid—We have a general position on how we relate our work to the work that is happening in the `business as usual' stream. It is largely determined by practicalities. When we have an exposure draft in process, there may or may not be available to us drafts of the legislation that are happening in the `business as usual' stream. If that is not the case, we take the position that it is not appropriate to include a rewrite in our drafts, because we may not be in sync with what is happening out there. I am not sure where—

Mr BEDDALL—It is in the parliament now.

Mr Reid—With ones that are in the parliament, we would definitely include them in the rewrite. There are other things that have been announced but not drafted and we would tend not to include those.

CHAIR—We will go to the amendments to the bill itself, and handle them in the same order as in the bill. We have until half past 12 to cover from division 15 to 387. We will do 42 and 70 after lunch as specific problems.

Mr Nolan—Could I have some of my officers join us? You know Michael Bradshaw from previous occasions. We are going to start with division 15, dealing with various elements of assessable income. These particular provisions relate to amounts that are included as assessable income. There are no major structural improvements. It is largely a rewrite, but one where we have managed to achieve an 85 per cent reduction in the text, essentially due to leaving behind redundant material, or material that has a very minimal ongoing operation because its use-by date has passed. The provisions were exposed in an exposure draft document in July 1995 and, so far, that particular division has had very little, if any, comment.

CHAIR—Are there any comments on division 15?

Mr Russell—This is a comment from one of the working groups that the consultative committee had established. There was a concern, particularly in relation to the provision on page 4, proposed section 15-15. You will see that:

(1)Your assessable income includes profit arising from the carrying on or carrying out of a profit-making undertaking

or plan.

(2)this section does not apply to a profit that:

(a)is assessable as ordinary income

This provision replaces what was the original second limb of section 26A(1), more recently, subsection 25A(1).

The concern that one has, apart from the fact that the word 'scheme' has been replaced by the word 'plan', is that the law has developed since the original section 26A was introduced. There was a long debate in the cases about whether the second limb of section 26A actually caught anything that was not income according to ordinary concepts. The balance of authority appears to have moved to the view that it was really only a profit arising from something that had the character of a business deal that was brought within the scope of the provision.

At the same time, the law has moved on in the sense that in the Myer Emporium case, the High Court held, effectively, that any transaction that had the character of a business deal generated income according to ordinary concepts. This section actually provides a very neat case of how re-expressing the old law, perhaps in different words and in slightly different circumstances, has the capacity to change the law in an unintended way.

I have got no doubt whatsoever that, in formulating the section in this way, there was no intention to bring to tax anything which was not brought to tax by the second limb of section 26A. But there is, I think, a very real risk, because of the provisions of subsection (2), that that may be done in this case. It is perfectly plain, for example, that it is intended to be an additional charge to tax and not simply a tax on something of a business deal. That appears, more than anything else, from the presence of subsection (2) which says:

It does not apply to a profit that is assessable as ordinary income.

I do not think that it is really productive to debate whether the High Court, or a court, is likely to hold that the law has been changed by this new formulation. It is really sufficient to point out that it may have been and, absent some explicit indication in the legislation, that the law is to be treated as not having been changed unless parliament intends to change the law.

There is the risk that a court will say that the previous debate about whether or not the second limb of section 26A caught things that were not ordinary income is now resolved in favour of the view that it does. What the courts must then do is work out exactly what the additional type of transaction caught is. One has the word 'plan' rather than 'scheme', and one has the decision in the Myer Emporium case—which says that anything that has the character of a business deal is caught as ordinary income. Has one moved to the situation where any purposeful activity by any taxpayer is brought to tax if it produces a profit? If so, that is not the present law. The present law is that the enterprising realisation of a capital asset does not produce a liability to tax. It is not productive to have a long debate about all those issues, but this section raises in a very neat way the problems that come from rewriting the law in changed circumstances without an interpretation provision which makes it clear that there is no intention to change the law, if such is the case.

CHAIR—On this subsection, what are you suggesting? Should we include this in the EM or change the wording?

Mr Russell—The difficulty is that the EM is only referred to if the section is capable of ambiguous interpretation when one looks at it. When one looks at this section, it is absolutely plain that it brings to tax something other than things brought to tax as ordinary income. Subsection (2) makes that perfectly plain, in a way that was not plain under the former section 26A. So putting a statement in the EM that parliament does not intend to change the law is probably not going to be very helpful in this case.

It comes back to the character of the provision in the No. 1 bill, section 1-3, which deals with the effect of changes in the law. It is in terms of simply negativing the presumption that if parliament uses different words to deal with an issue that parliament intends something different. My view is that one needs something stronger than that. There needs to be a very clear indication that, unless parliament intends a change in the law, parliament is presumed not to have changed it. After all, this legislation is being put to parliament on the basis that it is a rewrite or re-expression in contemporary language of existing provisions, unless it is advised otherwise. In that situation, if parliament is not consciously trying to change the law, it would not seem appropriate, in principle, for changes to happen by accident, as it were.

CHAIR—Was this raised in the consultative process with the TLIP team?

Mr Russell—We have been working with the Australian Taxation Office over the last few days. I have not put that proposition to the TLIP team in the context of formal consultation, so I am not putting it forward on the basis that the TLIP team has acted in any extraordinary or inappropriate way.

Mr Gaylard—Are you saying that something has changed the proposition that the second limb of section 26A did something more than section 25, as expressed in Gibbs's clear words in that case?

Mr Russell—Those are the words of one judge. Do not forget that Mr Justice Gibbs held that the income was income according to ordinary concepts in that case.

Mr Gaylard—At one stage in the judgment he said, and I quote:

It is implicit in what I have said that I consider that the second limb of s.26(a) includes profits which would not otherwise have fallen within s.25, because they could not be described as income in the ordinary sense.

It seemed very clear to me, I must say.

Mr Russell—One of the things that has happened since Mr Justice Gibbs said that is the decision of the High Court in the Myer Emporium case. Whatever argument there may have been that Whitford's Beach was not caught as ordinary income before the Myer Emporium case, it would plainly have been held to have been income according to ordinary concepts after that case.

Prof. Krever—Mr Chairman, I suggest that what is happening around the table here does suggest one thing, which is that, on apparently settled matters of law, the more people we have talking about it the more interpretations we will have. So, if we were to amend the

interpretive provision of the new law to say something to the effect that we are not changing the law at all from the old law, we are still going to have a round table debate on what that old law meant.

Mr Nolan—David Russell had foreshadowed to us the sort of view that he has now put. We have thought about whether section 1-3 from the first bill does the job adequately. As we go through and rewrite the law and use different words, there is always going to be the possibility that those words could be interpreted differently. In the past, the courts have tended to look at legislation and, where a different set of words have been used for something expressing a similar notion, they have said, `If the parliament has used different words, it must have had a different meaning in its mind.' That became something of a presumption: if there was a different expression, you had to see whether there was a different intention. To deal with that, section 1-3 effectively says to the courts, the tax office and anybody else involved in interpreting the law, `Where the same ideas are being expressed for greater clarity, don't have that presumption; don't assume that there is any change intended at all.'

That is what section 1-3 tries to do: give a broad signal to those interpreters. It is based on section 15AC of the Acts Interpretation Act. I corresponded with the drafter of that provision, Ian Turnbull QC—now retired but formerly, and at that time, First Parliamentary Counsel. I will pass on that correspondence to you, Mr Chairman. Basically, he has looked at section 1-3 and has concluded that it does do the sort of task that he saw as necessary when he was trying to introduce, perhaps at one of the earliest stages, simpler legislative drafting. He tried to introduce some differences of approach and simpler drafting, but he recognised the problem that judges might start to look for differences of intention. So, section 1-3 specifically addresses that question. We think that it does the job well. We have asked him to review the position, and he has put down in correspondence with me how he came to put that provision in the Acts Interpretation Act. I will submit that to you for the record.

Mr Russell—There is certainly no dispute that section 1-3 attempts to deal with the issue. The question really is whether it does so adequately. The point in relation to 15-15 is that there is a new provision that was not in the former section. If one looks at the proposed subsection (2), there was never anything which is equivalent to the proposed paragraph (a). So, it would be very easy for a court to say, `Parliament has given an indication that there is a different idea involved as well—namely, that this must be something that goes beyond ordinary income.'

The point that Professor Krever has made is certainly valid. As you have heard from the discussion across the table, there was dispute about what section 26A meant. It was one of the more litigated sections of the act. The view of its operation changed with just about every judge who had made a decision about it. But the fact that the law is presently uncertain is not a reason for parliament to move off and say something else. It would seem a proper principle that, if parliament is intending to change the law, parliament should know what it is that it is seeking to change and to achieve. It surely should not be the result of this process that changes occur by accident when parliament intends none. If that is the proper principle, then section 1.3 does not sufficiently say that.

Mr BEDDALL—Rather than just talking about these things, it would help if we could get some examples. You talk in 15(1) about a `profit-making undertaking or plan' that is any other source of income, and 15-15(2)(b) says that this section does not apply to a profit that `arises in respect of the sale of property acquired on or after 20 September 1985'—that is,

after the introduction of capital gains tax. Does that mean that, under this provision, any property which was bought prior to that and was capital gains tax free is, if sold now, capital gains taxed?

Mr Russell—The short answer is that one does not know.

Mr BEDDALL—It was not taxed before, was it?

Mr Russell—Not unless you engaged in an enterprise of sufficient activity. But this was 12 years ago. It would seem on the face of it that a `profit-making plan' is certainly something that neatly describes the enterprising realisation of a capital asset. The dispute in section 26A cases was always whether you merely had the enterprising realisation of a capital asset or you had something in the character of a business deal. Obviously, there is a grey line between the two, and there would undoubtedly be many people who would argue that it is an illogical distinction to draw.

The point though is that, if one accepts that there was a category of realisation that took the form of the enterprising realisation of a capital asset that was not within section 26A, then it is entirely arguable now that such a realisation is caught. In other words, that means that one is extending the capital gains tax back across all property but on a different basis, the difference basis being that the second limb of section 26A applied to take the market value of the property at the time the plan was commenced and to assess the profit on the deal from that time; whereas capital gains tax takes the value of the property at the time it was acquired and applies to that an index crossbase.

Mr Bradshaw—I would like the chance to respond to a couple of the points David has made, perhaps suggesting that there might be some possible change here. In relation to the word `plan' being substituted for `scheme', `scheme' is now a defined term and it has been standardised. In accordance with our general practice, where a term is defined, it is not also used in its ordinary sense. The word `plan' is a good plain English term which is synonymous with `scheme', and the section actually refers to the `carrying on or carrying out of a profit-making undertaking or plan.' The courts, as David expounded, have consistently held that much more is involved than the mere realisation of a capital asset.

In relation to 2(a), that was the view reached in the Whitford's Beach case by the then Chief Justice Gibbs and by Justice Mason, who succeeded him as Chief Justice. As the EM explains, it merely expresses the existing interpretation of the law. In relation to 2(b), that merely restates what is in the present subsection 25(1)(a). Basically, when CGT came in, there was a cut-off. The reason it is still there—which might be behind Mr Beddall's question—is that there are some profit-making undertakings or schemes that may not involve property. Also, there might be some that do not involve the sale of property: perhaps property is disposed of in some other way. So, there is still some room for its operation in relation to perhaps some less common types of schemes or plans.

Mr Gaylard—On Mr Beddall's point, what he may have also been alluding to is the way the second limb of old section 26A, that has now been encapsulated in 15-5, could work. You could have a capital asset that well predated capital gains tax but which, at some point in very recent times, has become part of a profit making plan at that point. So it may have been held for many years and then become subject to a plan that was to develop property.

Mr BEDDALL—If I had a large piece of provincial Queensland and I had held that property and then, all of a sudden, the city of Brisbane expanded out and I had a plan to sell it up and subdivide it, would it get caught up in that provision?

Mr Gaylard—Yes, it would.

Mr BEDDALL—Would it have been caught up under the old act?

Mr Gaylard—Yes.

Mr BEDDALL—If you had held it for a long period of time and then subdivided?

Mr Gaylard—Yes.

Mr Russell—I think the authorities were that it depended to a large extent on the scale of subdivision. Certainly Whitford's Beach was such a case—I think it was 100 acres being subdivided into very small lots, and that was caught. But then, to take another Western Australian case—McClelland's case, where land was subdivided into four lots, again, on the outskirts of Perth, so in the same physical situation, although it was Rockingham, which is not on the outskirts of Perth anymore—that was held not to be assessable.

I think the point is that this may move the goalposts. Another indication of moving the goalposts is that 26A always talked about the resale of profit acquired for the purpose of profit making by sale or the carrying on or carrying out of a profit making undertaking or scheme. The first limb, one imagines, has been left out because it is considered that the Myer Emporium decision catches such circumstances. I think that, plainly, it does.

That really means that the court can look at this and say, `Well, there are at least two changes in this. There is an explicit exclusion of sale of property acquired for the purpose of profit-making by sale.' There is an explicit statutory statement which previously only appeared in judicial decisions of some judges, that it comprehends income other than ordinary income.

On top of that there is the change of the words, in effect, the old formulation, `enterprising realisation of a capital asset'—and in the ordinary meaning of the term, `the enterprising realisation of a capital asset' is the carrying on of a profit making plan.

Mr Langford-Brown—Mr Chairman, I do not wish to prolong the thing other than to say that the tax law improvement project team have not yet seen the latest joint submission. It was still being finalised. But it has a lot of points relating to this particular discussion, and we just ask that when they get a chance they consider it. It may influence the wording in the explanatory memorandum.

CHAIR—Maybe we can consider that tonight, Mr Nolan?

Mr Nolan—Yes, we will have a look at that if that is available to us.

Mr Reid—It has taken a long time to go through this point, but I think the original point that David Russell has raised is one of general application and it is, therefore, important to be clear about it. Implicit in what David is saying is an assumption that in deciding these

sorts of issues, the court will only have regard to these textual changes. You can point to textual changes of this kind and you can certainly attribute significance to them, but you need to see that in a much larger context. The larger context includes section 1-3, and it includes lots of statements in the explanatory memorandum and elsewhere that the intention is not to change the law without explicitly saying so.

So I suspect it would be underrating the judges to attribute to them a mind-set which would look for changes to the law where everybody is saying that none is intended. So a commonsense view of it involves saying, 'Well, look, okay there are lots of issues about the effect of—

CHAIR—But if everybody said that, it would not be in the court.

Mr Reid—No. The point I am making is that there are still differences of view about what the law means and that has been clearly brought out in the discussion. But the point is that there is nothing in the discussion to indicate an intention to actually change the parameters of that discussion. There is nothing in the legislation. You can point to these textual features, but if they are seen in the larger context, then the debate simply continues as before uninfluenced by anything that is in the legislation.

Senator WATSON—What happens if the judges in the High Court are not tax lawyers? For example, they may not be aware of 1-3. They just read the words there and interpret them according to the words as they see them.

Mr Russell—I am sure that counsel would draw it to their attention. That is what they are there for.

CHAIR—We will move on to division 20. Have we got any problems with division 20?

Mr Russell—Not in a formal sense. It does involve a change in the law, but the change in the law is appropriately noted in the explanatory memorandum. The question then arises whether or not the change in the law is appropriate. To pick a typical situation, a taxpayer is entitled to a deduction because he incurs a particular expense in year one. In year two that expense is reimbursed to the taxpayer. The law presently is that in most cases, although not necessarily all, the taxpayer—if the taxpayer is not a business taxpayer—would lose the deduction in year one. In effect, the tax office would take the view that the expenditure was not incurred.

The proposed change will produce the result that the reimbursement is treated as assessable income in the second year. That can be a more simple way of achieving the same result, but not necessarily. It certainly will not be a fair way of doing it in circumstances where for example the taxpayer in the earlier year had losses which effectively means that the amount recouped would not have been taxed in the earlier year. But if the losses are not capable of being carried forward to the later year, then the amount will be a tax in the later year. There may be questions of rate differential. It will not always be a fair way of dealing with the matter. Certainly that raises a policy issue for the parliament. One could not cavil with the way in the explanatory memorandum deals with the issue, because the nature of the change is fairly brought to the attention of the parliament. But it will not always be a just result.

CHAIR—Would this become apparent to tax practitioners in advising their clients on tax planning?

Mr Russell—In terms of the explanatory memorandum or the change of the law?

CHAIR—The change of the law. It becomes law on 1 July this year. Will it affect expenses incurred this year?

Mr Russell—No. The question will happen with the recoupment. If the expense has been incurred this year and the recoupment occurs next year, the result of the change will be that the amount is added to assessable income next year rather than an amended assessment being issued this year.

CHAIR—I am saying that, if this law is up and running, in subsequent years people can plan that. But they cannot plan it in the current context, because it becomes applicable from 1 July. It has a sort of retrospective effect, does it not?

Mr Russell—Yes, although it could not really be argued to be an unjust one, because the question is: what treatment do you give to the recoupment of money of a taxpayer? It really has to be treated—except in those cases where it is not appropriate to bring it into income at all—either as a reduction of the deduction in the year in which it was incurred or by way of bringing it into assessable income.

CHAIR—You are flagging your policy change, but it is not a problem.

Mr Russell—It is a policy change that could bring about unfairness. A more appropriate way to deal with it may be to give a taxpayer the option. Indeed, it is proposed in the joint body's submission that the taxpayer be given the option either to take the amount as income in the year in which it is received or by way of reduction in the earlier year.

Mr Nolan—What has happened here is that some two dozen provisions scattered through the law which deal with recoupment of various amounts have been brought together and standardised. David Russell has kindly acknowledged that what has been done has been done very clearly and enunciated. What is being put is that, in taking a straight down the line approach here in order to simplify the rules and standardise them, sometimes people will have had a deduction at one tax rate and then be taxed perhaps at a later time. So there is a bit of an offset there, but they could be taxed at what could be a higher or a lower rate. This is one of those swings and roundabouts trade-offs that you have to sometimes take on if you want to achieve simpler law overall. Any unfairness—and it could go either way—is, we think, quite marginal. It is one of those judgments that you have to make.

CHAIR—Any more comments on that section?

Mr Bryant—Yes. In subdivision 20-B there is a change in the definition of `car' and this has been brought to your attention. My question is simply that we are talking in subdivision 20-B of leased motor vehicles that the lessee at the end of the lease might take full possession or ownership and then subsequently dispose of that vehicle at a profit. The law as it presently stands is to make sure that that is brought into the income tax net and there is no problem with that. But the existing definition of `car' is pretty much confined to motor vehicles

and station wagons, whereas the definition has now been changed to include other things like vans, utilities and perhaps other vehicles and that has not been flagged in the process.

Mr Bradshaw—We acknowledge that it is arguable that the definition is now wider than before and we intend to introduce an amendment to ensure that it is not.

Mr Bryant—Was that change of the definition of a car an oversight? Is that what you are saying?

Mr Nolan—It was, yes. That is exactly what we are saying and this is one of those occasions where we are grateful for the comments and review by others. It is something that was not intended and, having been pointed out to us, we are correcting it.

Mr Bryant—So it will be fixed.

Mr Russell—Moving on to division 25, the consultative committee has no comment on that, except a technical issue which we will raise in section 25-75. But I think that is something that we can deal with with the project team, rather than concern this committee with it.

CHAIR—Division 26.

Mr Russell—I was responsible for that. We have no comment.

CHAIR—Division 30.

Mr Bryant—Yes. I had a responsibility for that, unless Mr Risstrom wants to comment. Anyhow, this is not controversial stuff and there is nothing of any great concern. There is one that we are delighted with.

CHAIR—Division 32.

Mr Bryant—For the purposes of this discussion I think I can safely say that we have not encountered any major concerns in the translation of the existing law. The mess that revolves around entertainment issues is inherent in the present law. I think it has been generally acknowledged as outside the scope of the project to do anything about it. There has not really been anything terribly controversial around that, but it has perpetuated the problem we already have.

CHAIR—Any comments on that?

Mr Nolan—We have made a number of improvements in terms of the structure, with the operative rules being more clearly located at the beginning of the provisions. There has been the considerable use of tables to show exceptions to the general proposition that entertainment is not deductible. We have managed a substantial reduction in text. Generally the reactions that we have had through the exposure draft process have been very favourable, even though people do not like the fact that they cannot get deductions for their entertainment, which is a policy question.

Mr Russell—Leaving aside the issue of whether or not people like getting their deductions or not, the joint professional body's submission on this says:

By international standards Australia's entertainment deduction rules are a joke. The present Government, when it was in opposition, promised to fix them up.

The rewrite of these farcical rules, which consists mainly of 5 and a bit pages of complex tables, does nothing to ease the task of compliance, nor will it help with the rewrite. The rewrite of these rules could be seen as undermining election promises.

At the end of the day I do not really think it is open to the committee, even if it accepts that entertainment is a big `p' policy issue, that we have a satisfactory set of laws in relation to entertainment. There were over 43 examples in the commissioner's ruling on entertainment on the present law. It is an area that, even if you accept that people are not entitled to get a tax deduction for lunch generally, it really cries out for attention. One could not cavil with the proposition that the project team have largely reproduced the existing law with some marginal improvements. This really does get back to a point which I think the committee is going to have to consider, which is whether or not the existing terms of reference are adequate to enable appropriate reduction of levels of complexity.

Mr Nolan—The only simple way of rewriting the entertainment expense rules would have been to have a one-line provision that said `entertainment expenses are not deductible'. Everything that follows after that allows people to claim some kind of entertainment expenses on the basis of particular occupational categories or situations. The complexity of the rules is not about the disallowance of entertainment expenses; it is about trying to accommodate the particular cases of people who have essentially pressed their case for an exception. It is very difficult to take away exceptions once they have been given.

Mr Gaylard—There have been quite a few generous comments made about some aspects of the rewrite. I think we are probably selling the entertainment rewrite provisions and they are problems that David leaves to one side. I challenge anyone on the committee to look at old 51AE and compare it to division 32. I am prepared to wager that they will find a significant improvement on what was there before. The provisions are a lot clearer than the old provisions. For example, you had to turn three or four pages simply to find the rule that Brian was just talking about, that generally entertainment expenses are not deductible. I think they are a considerable improvement on the old 51AE.

Mr Bryant—Since we are getting into the area of grandstanding, I should mention that we have identified two specific, very minor flaws where in one case we believe that the new law arguably denies a deduction where they are not allowed under the existing law. We have another similar case. We have raised this for discussion. They are not major, but I just think for the sake of the record I should mention them in this context.

Ms Morton—I have a similar comment. In the joint profession's submission there are a couple of issues which indicate that provisions have been left out. For example, 51AE(5)(g) which basically contained an otherwise deductible rule, has been excluded from the rewrite on the basis in the EM that it has limited application.

My understanding is that it does not have limited application; it has possibly limited

application in that it results in limited amounts being included in assessable income because it specifically allows it not to be an assessable income. But, it is an important provision and there is some concern that it is not in there. There are a couple of other minor points. I think the most important point here is that the small business to regulation task force has indicated that this is an area that has to be fixed and fixed very quickly. I find it disappointing that we have something which is about to go into law which contains these complex rules where maybe in six months or so we might have a far simpler rule which is being put forward from that task force, that could simplify this whole area and really narrow it down to, say, maybe one page. I think that most committee members would highly recommend to the JCPA that a proposal like that which is on a percentage basis be implemented so that pages and pages of specific legislation are just not needed.

Mr Nolan—I will not restate what Simon has already eloquently said in that the re-write is well done. As to what government response there will be to the recommendations of that other committee, we cannot anticipate. But there is a general issue here that in the tax field there will always be a court case, another inquiry, or something going on that could conceivably change the situation in relation to areas of the law that we are currently working on. It is an occupational hazard for us to try to anticipate those and allocate our time and resources to ensure that we do not waste our time on re-writing things that are about to change.

We do try to do that. A lot of our scheduling is around that sort of thing. But in the end it is almost impossible to get that 100 per cent right. Yes, somebody might come along and make some changes; the government might decide to make some changes in the entertainment area and that might require some adjustment to what we have been doing. But we really cannot anticipate all of those possibilities and sit on our hands waiting for that to happen.

Mr BEDDALL—There is a good chance the Senate might disagree.

Senator SHORT—Mr Chairman, I think I am right in saying that the government has committed itself to a detailed response to that small business inquiry by the end of this month. Assuming that it does stick to that and assuming that there is a reasonably detailed response, which would presumably cover this area, it may be something that would need to be taken into account in the consideration of the bill in the parliament.

CHAIR—I suppose the ultimate test will be—we have covered this many times—the cost of compliance and the cost of complying with the simplified act where we make major savings to individuals, taxpayers. That is the rule of thumb that we use. We talk about the effects of these provisions but bear in mind that we are also interested in the cost of compliance differences. Is that enough on 32? We go on to 34: non-compulsory uniforms.

Mr Bryant—If I can just briefly comment on that. We have identified three. They are relatively minor but it is in the same genre of what David was talking about before when you do change words. This has been and acknowledged as a possible unintended outcome in relation to the definition of protective clothing. There is a position here. It is only slight but the new definition does seem to widen the scope of what is in contemplation with the result that certain conventional clothing, which does provide protection, may now be treated differently to what it was under the previous law. There are two other minor things. I do not need to go into them at this stage. My understanding is that the TLIP team has not had the opportunity to

respond to those, so we will take it up there. But just to raise the point that there are these little subtle nuances and we are working through it as we go.

CHAIR—How will it affect the bill?

Mr Bryant—I do not think anyone is going to lose any sleep if it goes in its current form, but we will still try to articulate it; it is relatively narrow. Again with uniforms, what we have in the present law is quite a nonsense and excessive but that is not the fault of the TLIP project; they have done a reasonable translation.

CHAIR—Thank you. Anymore on that? Mr Nolan, do you want to respond to the same point?

Mr Nolan—No.

CHAIR—Clause 42 we are leaving until after lunch.

Senator WATSON—Mr Chairman, this is a classic area where I think you could have simplified it quite a lot.

CHAIR—Which one?

Senator WATSON—This whole section 34. If you really wanted to simplify rather than just rewrite, you could not get a better example.

Mr Russell—But, again, Senator, one comes back to the problem of the constraints of the mandate. Certainly, if the provision is a nonsense, perhaps the great advantage of expressing them in more contemporary language is the fact that they are nonsense will be more apparent to parliament and to the public than was previously the case. So it gets that transparency and, within the present terms of reference at least, the project team feels unable to move.

Mr BEDDALL—Who keeps the register?

Ms Morton—There is actually an organisation that does this and it has established a bureaucracy all of its own. So much so that I have put in submissions for some of the uniforms that our employees wear and have been knocked back. They are valid uniforms.

Mr BEDDALL—Do you have to send a sample?

Ms Morton—It has not got the right colour, the right number of colours or the right size. It is absolutely absurd; it has gone out of control.

Mr BEDDALL—Does it have a board?

Ms Morton—Yes.

Mr Bryant—Textile clothing trade association or something like that. It is a government body that regulates in relation to the TCF—textile clothing and footwear. It is an authority. It is not set up for this purpose, mind you, but it has been handed to them.

Mr BEDDALL—It has found a new purpose in life, I think.

CHAIR—I think that people are anxious that we cut off this item.

Ms Morton—Actually, it is referred to in 34-25. You write to the Secretary of the Department of Industry, Science and Tourism.

CHAIR—Division 50, page 204. Are there any comments on that?

Mr Nolan—There is a group of provisions there: division 50 deals with exempt entities; division 51 with exempt amounts; division 52 with particular pensions, benefits and allowances that are exempt; division 53 also relates to particular exempt payments and division 55 to payments which are not exempt—they are the headings. You might consider whether you would like to take those five divisions together.

Those particular divisions rewrite areas of the Income Tax Assessment Act that identify amounts of income that are exempt from income tax or identify particular entities that are exempt from income tax. We have made a number of improvements to structure and layout. There is better set-out and tabulation, improved readability and so on. But we are not aware of any comments of substance—no issues of substance have been raised with us before today. It may be that there are some in the submissions that have just come in.

Mr Russell—Was there any particular reason for taking away the exemption of the Thalidomide Foundation?

Prof. Krever—I think the reason was that the exemption actually applied to beneficiaries who were under the age of 25 until there are no longer any in Australia.

Mr Reid—Yes, that is my understanding also. I do not think the EM addresses that.

Mr Nolan—We will take that last comment on board and we may add something to the EM to cover the point.

CHAIR—Are there any other comments on those five divisions? We will discuss division 70 after lunch and 385 and 387 together. Brian?

Mr Nolan—If you would like to do that, Mr Chairman.

Mr Droder—Mr Chairman, our farmer expert, Tony Parker, is not here. He looks after the primary producers.

CHAIR—He has probably got a flood, has he?

Mr Droder—I asked him why he was not coming and I got a long story. He had to get up at 11 p.m. last night to catch the 12 o'clock train to Sydney and then he would get home at about three o'clock tomorrow morning, so he respectfully declined the invitation.

He did tell me this morning—and Rick earlier—that he has ground through the primary production parts and that he had his staff go through it and they really do not have any

problem with it. The joint submission has a couple of what seem to me to be relatively minor problems with the double woolclip—whatever that means—and some cows dying of tuberculous. A copy of this will go to Brian tonight and so he may be able to think about it then.

CHAIR—Does anybody else have a comment on those provisions?

Mr Nolan—Only that, again, there has been a good deal of re-assembly to make the provisions easier to deal with structurally and there has been a substantial reduction in text. The people who worked on those areas have, again, produced a very good outcome.

Ms Morton—I do apologise for having to leave the room earlier. I have a couple of points that I did want to raise back on division 15 but I am happy to do that after lunch if I could just be granted a couple of moments.

CHAIR—We have got a couple of minutes. I would prefer to get them finished before lunch.

Ms Morton—Thank you, Mr Chairman. Most of these points are highlighted in the joint profession submission but I would like to raise them because a few of them have concerned me considerably. I do not need a detailed comment on this at the moment, but on the provision that David was talking about before—section 15-15—which deals with the old section 25A, the first limb of that section has, in fact, been left in the 1936 act. If we are rewriting provisions, I would think that we should rewrite the provisions and bring them all into the new act, but an entire limb of that section has been left out. I am sure that has been done because it is very complex, it is quite difficult and it probably does not operate as much these days, but nevertheless neither does the second limb operate as much.

If we are rewriting one part of a section, I think it is very misleading to a taxpayer to read this. If they had the old provision beside it to see that there were a whole lot of provisions that are now not here, a number of taxpayers would jump to the wrong conclusion that in fact those provisions do not operate any more because they are not in the new act. I do not want to debate whether or not they are valid but I think it is very wrong to rewrite part of a section and leave a whole section in the old 1936 act when it is within one section of the act.

Two other points that concern me considerably are in relation to section 15-30. In a number of those other provisions in that division you will notice that they have a part A and a part B. The part B normally says something similar to, `The amount you receive is not assessable as ordinary income under section 6-5.' Section 6-5 brings amounts to account on an accruals basis effectively because it taxes income when you derive it. `When you derive it' is very vague in many regards, but there is lots of precedent on what derived means. Historically, these provisions which came out of the old section 26 are amounts that have been taxed. They have overruled the general provision of the old section 25 which taxed amounts on an accruals or a derived basis. These provisions were always taxable on a receipts basis. There are particular concerns in relation to the bounty and subsidies clause there.

The project team may say that I am reading it incorrectly. If I am, there is a major problem, because if I read it incorrectly, there is a good chance that a significant number of other people are going to read it incorrectly. It appears to a number of us that the part B now overrules the specific provision. The specific provision says, `When you get an insurance

payment it is taxable when you actually physically receive the money.' And for good reason, because there are so many vagaries about, 'Will you get the payout? Will the insurance company dispute it? When do you actually derive the money? Is it when you have the cause of action? Do you derive it when you get the insurance claim? Do you derive it when they write a letter and say it may be payable?'

CHAIR—Are you saying it is different in the rewrite compared with the old act?

Ms Morton—Yes. I am saying that the treatment—the second part—the B section and a number of the provisions in division 13 on pages 4 and 5 et cetera were not in the old act. It appears that those items overrule the specific part of it which says that it is taxable when received, whereas this is now saying it is taxable when derived.

CHAIR—I would like to ask Mr Reid to respond, firstly, on the earlier provision.

Mr Reid—The reason we have not rewritten 25A is that it is of even more limited operation in terms of time than 15-15. It is, however, potentially relevant to assessments after the new law comes into operation. There are a number of provisions in this category of things that are not worth rewriting because they are too long and complex for the amount of application that they will continue to have. We have a proposal which has been flagged with the consultative committee previously that towards the end of the project we will re-enact as part of the Transitional Provisions Act without rewriting the provisions that were in the 1936 act and which fall into this category, so that you do not have to continue to maintain a set of the old legislation. The old legislation will be closed off. It will only apply to previous years of income. Any provisions that have not been rewritten up until that point will be transferred into the miscellaneous provisions act.

The point that Jocelyn mentioned about people making the association between 15-15 and 25A is partly addressed by the fact that section 25A is identified in the checklists of assessable income. We could perhaps reinforce that by adding another note in 15-15 which identifies the existence of 25A and the fact that those provisions deal with similar or related subject matter.

Mr Bradshaw—On the other issue Jocelyn raised, she is correct in so far that she says that 15-30 and some other provisions expressly exclude an amount which is otherwise ordinary income. The result of that is that they are assessed under the ordinary income provision according to those ordinary principles. In many cases that will actually be on a cash basis; in some cases, it will be on an accruals basis.

The main effect is that carrying on a business of receiving that type of income, in accordance with ordinary tax accounting practice, would be accounted for on an accruals basis. We believe that that is the correct interpretation of the current law. We particularly relied on the work of Professor Ross Parsons in his most authoritative book on ordinary principles in Australia. In paragraph 4(17) he says that it is arguable, in accordance with what Jocelyn said, that the effect of some of the paragraphs in the present section 26 of the law put all taxpayers on a cash basis of accounting in relation to the relevant items. He says that it is more likely that the proper interpretation is that the general principles of tax accounting remain unaffected.

That interpretation was also taken by the AAT, constituted by senior member, Peter

Roach, sitting in case V1(22). It has also been taken by the Commissioner of Taxation in a succession of rulings. For example, it is taken in relation to royalties, IT2669, and in pharmaceutical benefits in taxation ruling TR96-19. So, in our view we have clarified the relationship between ordinary principles of income in these specific provisions in accordance with the existing law.

CHAIR—Jocelyn feels that there was a change of law in the rewrite. Simply put, are you saying that there is not?

Mr Bradshaw—We believe that we have really expressed the existing law more clearly.

Mr Risstrom—I wonder whether in 15-30(b) the word `already' does not do quite a remedial job when it says that the amount you receive is not assessable. But when you inject the words ` not already assessable' it means that, in fact, it has been received. So, what is the problem?

Mr Bradshaw—I think that we did consider the possible inclusion of `already' in this provision. I think that Brian suggested it, Eric. In some of our drafts we had the word `already' and, in the end, we decided that there might be some extra confusion about it having a timing function, rather than being `already' in a conceptual sense.

Mr Risstrom—You have got the word `already' in 15-30 and, I think, that puts a different cloak of meaning over the whole subdivision.

Mr Reid—I would like to make a comment there. I think, Eric, you are working from the last version that went to the consultative committee. It has been changed since then.

Mr Risstrom—So you have deleted that word?

Mr Reid—As Michael was saying, we have taken it out.

Mr Langford-Brown—I would just like to support Jocelyn because I believe that there has been a rather significant change to a number of taxpayers by changing the words and giving them their A and B allocations within a number of the subsections. That is expressed in the joint body's second submission.

Mr BEDDALL—What you are saying, Jocelyn, is that if somebody is awarded a compensation, but has not got it because of process, that that person now has a tax liability. If so, that should be wrong.

Ms Morton—Yes, that is so. The current law would only assess those amounts when they are actually physically received. Let us say that there is a determination in favour of a taxpayer on 25 June, but the person does not actually get it for another three months because of process. That person would be taxed in the previous financial year when he or she did not even have any cash to pay it.

What Michael said about it being consistent with the current law is not correct. It is actually inconsistent with the tax office's own determination. It says specifically that in relation

to bounties and the diesel fuel rebate that the old section 26 overrules the general provision. For many of the people who get the diesel fuel rebate, that is part and parcel of their business. That ruling says that the specific provision that says it is not taxable until received is the ruling provision. That has been a long-established fact. If you have a specific provision, that overrules the general provision of the act.

We had this out fairly early on when, in a very early edition—if you would like to look at it—the proposal to tax insurance and indemnity receipts on a derived basis was put to us. The consultative committee strongly opposed it because it changes the fundamental basis and creates an uncertainty in the whole taxing system because when do you actually derive a lot of these things, especially when you are dependent on other people passing those amounts of money to you?

Mr BEDDALL—For members of the committee, what about the *Melbourne* and *Voyager* incident where the Commonwealth appealed and they were successful. But with this provision, the particular gentleman could have been actually up for the tax.

Mr Bradshaw—What Jocelyn says is misleading on this point. It does not apply to individuals who are on a cash receipts basis. It would only have effect on taxpayers who are carrying on the business of receiving that type of receipt and returning it on an accrual basis, which they do in relation to all their other business income. If it is the income of your business, it is accounted for on an accrual basis. Businesses are well used to that; they do it for all their business income.

Mrs Gibson—Could I offer an alternative example? Let us assume that a business has a loss through fire and a substantial amount of trading stock is lost. An insurance claim is submitted. At what point in time is that to be derived and so returned as assessable income? If that claim is, say, submitted in 1997-98, it is not settled by the end of the financial year for that corporation. When it is settled, the decision of the insurance company is appealed by the insured corporation. At what point in time should they be paying tax on the claim for insurance proceeds?

Mr Bradshaw—It is where the entitlement arises. I am glad you raised the trading stock case, Margaret, because an extra effect, of course, is that the item will have gone out of the trading stock account. If the right to the receipt is not recognised at that time, there is a misleading timing outcome because the taxpayer—if they are fully entitled to be indemnified—have suffered no loss. But there would, in fact, be a timing misfit if it goes out of the trading stock account and the right to the insurance were not recognised.

Mrs Gibson—They may not know, at that point in time, that they are entitled to a full indemnity. Often the amount that is claimed by a business under loss of profits, or whatever damage type of insurance policy it is, is not necessarily reflected by the amount that they will ultimately receive on settlement. There may be large variations between the two.

Mr Bradshaw—Businesses estimate all the time how much they are going to receive. They do it perfectly well in claiming deductions. It happens all the time.

Mr Gaylard—It would seem the business might be better off in that case. They would have lost the trading stock and perhaps not brought back the full amount of the compensation until they knew what the full amount was.

Mrs Gibson—I thought what Michael was saying was that, at that point in time, you would claim a deduction for the trading stock which you have lost and you would have a matching return of the insurance claim for that. So they would, in effect, negate each other. But if you did not actually get the full amount back and a couple of years later you maybe got half the proceeds back, it seems to me that you have actually paid tax on an amount that you would never have received.

Mr Gaylard—That gets you to the insurance-type cases as to how you actually work out how much you are going to get. I think you and I would be advising our clients to take up a conservative amount if there was any doubt about getting the full amount back, would we not?

Mrs Gibson—Under what provision of the Tax Act can I make some sort of estimate of what I might get? I would put in a claim for the full amount, so what provision allows me to come up with another amount to return this assessment?

CHAIR—It is obvious that there are points of difference between the TLIP team and the consultative committee on this.

Mr Droder—Could I just have a quick word on this?

CHAIR—Yes.

Mr Droder—I raised this matter at the first hearing of this Joint Committee on Public Accounts and I had the very distinct expectation that the argument between derived and `derivable'—if that is the right word—had been sorted out. I certainly expected that the law was going to be written on a received basis, as opposed to a receivable basis. I personally find it very disappointing to hear this argument because I had been led to the other expectation.

Mr Gaylard—Mr Chairman, from that original discussion the law was changed. The fact that people are making comments that it is not clear obviously makes it silly for us to stand here and say it is, but I believe that the way it is expressed does express the law as it currently applies. If we do need to see whether there is any confusion in what has been stated, certainly from my point of view we will do that. But I do not see the law as saying anything different from what it currently says. We did change our position quite considerably from those first discussions with the consultative committee, when it was a lot more apparent that we were potentially bringing in amounts on a receivable basis, rather than a received basis, where that was the appropriate basis.

Mr BEDDALL—If there is no disagreement on a desired outcome, then surely there can be agreement on desired words?

Mr Gaylard—Or a desired process.

Mr Bryant—It brings us right back to process, where we were earlier this morning. We could probably go on for hours around this, and that will be okay—we will sort it out. But it does highlight how there is the propensity to vary words and the style of stuff—and this is not controversial stuff. This is stuff that we did not expect to be getting into when we were

going through the earlier processes, and to be here now, with a bill before parliament, is concerning. It comes back to process.

Luncheon adjournment

CHAIR—If we can go back to item 32, entertainment expenses, there is one more thing there that we discussed at lunch which may need to be clarified.

Ms Morton—Thank you, Mr Chairman. I think maybe from our discussion I did not quite expand enough on the item. It is in relation to section 51AE(5)(g) and it is in the joint profession submission. What has happened there is that the `otherwise deductible' rule has been removed out of the legislation; it just does not appear any more. The EM says that it has been removed because it has limited application.

The thing is that this provision is meals while travelling overnight on business that are not excluded from deduction under one of the other provisions. This is how you normally got the deduction for that expenditure. So, unless another provision has been put in to compensate, it is our view that that no longer is going to be provided as a deductible meal. There is some comment that it could be excluded under the normal definition of entertainment, but it is very difficult to see how it gets excluded out of the normal definition of entertainment because it is such a broad definition, and that otherwise deductible rule was specifically there to grant that concession to people travelling overnight.

CHAIR—And it represents a change in law?

Ms Morton—Yes, it does.

CHAIR—Can I have a comment from TLIP?

Mr Pinder—Perhaps I could comment, Mr Chairman. I am a project officer with the tax law improvement project. You will have to forgive me for not being familiar in detail with these particular provisions, but I rang the chap who worked on them during lunch time—he is still in Canberra—and he gave me the background. If you want a more detailed response we would presumably have to submit something in writing later. As I understand it, the answer is that section 51AE(4) denies you a deduction for entertainment expenses. Subsection (5) creates a list of exceptions and paragraph (g) is one of those. The view is now held that paragraph (g) deals with things that are not—

CHAIR—Held by whom?

Mr Pinder—As I understand it, it is held by the commissioner, based on what was in the original explanatory memorandum that introduced 51AE, and is a view stated in his most recent ruling on the matter. He holds the view that these things are not entertainment and therefore, not being entertainment, they do not fall within the general exclusion and so you do not need an exception to bring them back within deductible expenditure.

Mr Gaylard—I am glad Greg answered that question the way he did. When this issue came up, 51AE(5)(g), which I think also leads into 51AE(10), are two almost totally impenetrable provisions in the entertainment provisions. When we came to rewrite the

provisions, we decided whether or not it was possible—for the reason that Greg has just stated—to leave the provision out, the reason being that the shared view of entertainment expenditure, or expenditure incurred for travel away from home for extended periods, was deductible as a general loss or outgoing; whether, as I say, we could leave that provision out.

In the exposure draft that we sent out, we did highlight what we were doing in this regard and we asked for people's views on whether or not they had any difficulty with the treatment the way we had proposed it. I do not think we got any comment whatsoever, although in fairness I think Ian Langford-Brown at one of the consultative committee meetings did previously mention this as an issue two or three meetings ago and we gave a similar answer at that time. So basically it is an extremely difficult provision and very few people really quite understand how it works to start with. It is allowing a deduction in an area where very few people are having any doubts as to whether a deduction should not be allowable; in other words, the deduction should be allowed. And it is one of those areas where the law has been significantly simplified by taking out, as I say, a fairly impenetrable provision and the law is to apply in the way that people would expect it to apply.

In other words, if I go away on a business trip and I incur expenditure on buying myself a meal and that sort of thing, then I should be able to get a tax deduction for it. The previous provision did actually state that in those circumstances you would get a tax deduction, but now it is the shared view that a deduction is allowable in any event.

CHAIR—What happens if you have to travel to Melbourne and you take a client out to dinner while you are travelling?

Mr Gaylard—That is a very interesting area which 51AE(5)(g) I do not think helps people with in any event. The commissioner in his ruling does address issues like that. It is a fairly detailed ruling and has been heavily criticised no less than by the present Treasurer in a talk, I think, to the Institute of Chartered Accountants just after the August 1996 budget. I think the current ruling says that if you do take a client out in those circumstances and if you consume alcohol, which seems to make a reasonable degree of difference in these circumstances, then it is not deductible, whereas if you went away and you perhaps had dinner with your staff from another office then maybe the position is different. It is not an area that is particularly clear, but I do not think that 51AE(5)(g) helps clarify it. I think we have removed a provision that was extremely difficult and I think we have saved people the problem of trying to work out what it meant.

Ms Morton—If that is the case, then it would have been nice if we could have had a provision in there saying that meals when you travel interstate are deductible to you. Because, at the moment, the way the provision reads is:

> You are taken to provide entertainment even if business discussions or transactions occur.

And there is nothing in the definition of `entertainment' that indicates to you that if you are having a meal while you are travelling it is going to be deductible to you. I quite agree that the ruling that the commissioner has issued says that it will be deductible, but the problem is that we have moved something out of the law and we are now relying on a ruling that the commissioner can change at any time if he wishes to do so.

That entertainment ruling has come into so much dispute. The second one that came

out was significantly better than the first one, but I know of a number of companies that redesigned all of their expense claim forms on the basis of the first ruling that came out, went to the cost of all of this printing of stationery, then had to redesign them because the second ruling that came out was different. Who is to say that in a year or so time there will be a decision that the tax office view is now that travelling overnight—and I am not saying that the project team have done this intentionally; please do not construe that—but the commissioner is at liberty then to change his mind on the transaction. I think that it behoves us to make sure that, if the tax deduction was there originally, it should still be there. And if it is that clear then we should have a simple line that it is deductible.

Mr Nolan—I was wondering whether we could look at whether there is something we could do in the explanatory memorandum to address that but, on the question of whether the commissioner can just—I am sure Jocelyn Morton was not suggesting that the commissioner can just change his mind willy-nilly. There are objection and appeal and other review processes in the law. I do not think that anybody is suggesting that the commissioner would act in a cavalier way. The fact that a first ruling was changed substantially, I suspect, is a function of the fact that the rulings process is now a very open one and where there is a lot of discussion and deliberation with professional people before the final rulings are issued.

Mrs Gibson—Mr Chairman, can I just say on that one that there are a number of rulings which do change where the commissioner changes his mind and the child care discussion last year, I think, emphasised that. Where we have had, in the existing act, a provision which is specifically giving an exclusion, I think it ought to be moved across into the amending legislation. To rely on a statement in an explanatory memorandum, or the fact that a ruling will stay in place, or a new ruling might be issued which will maintain the status quo, I do not think is to repeat the law, which is the objective of this exercise.

CHAIR—Thank you. I thought it was important to read that anomaly into the record because it was not mentioned in discussions before, but it can be looked at further down the track by the TLIP team. Now we are onto the non-controversial 42, page 138.

Mr Langford-Brown—I would like to lead off the discussion on depreciation. Firstly, it is one of the few times that there has been unanimous decision amongst the consultative commission that depreciation, as a segment of the income tax law, should be contained in one area. This is something I know that Helen and her colleagues have considered. We know that people from areas such as mining and others have indicated strong views that they would like to see their depreciation segment retained within their own operative part of the law. But the consultative committee was unanimous, and still is, that every segment of depreciation would equally fit better under the one head.

I would like to make another general point. I am sorry—Helen, do you like to comment bit by bit?

Ms Duffy—You may finish.

Mr Langford-Brown—The other major anomaly that we have a bit of disappointment with, in relation to depreciation, is that we have had a practice over the last 60 years in relation to allowing a deduction for depreciation of plant that is fixed to leased premises where the lessee has paid for the plant. It has been administrative practice that the person who has paid—the lessee—is entitled to the depreciation. We would have greatly appreciated seeing

the rewritten law embrace that practice because it certainly would have put in place something which everyone has come to expect.

On the third basic point, we believe that a major recommendation—and I accept it is from a policy viewpoint—would have been to ensure that ownership requirement ceases to be a fundamental prerequisite to the granting of depreciation. We submit, as the consultative committee, that aligning the tax depreciation rules with commercial reality would allow this aspect of the legislation to be greatly simplified.

In terms of more minor matters, the next one relates to the commissioner's discretion. The practice in the past has been that a taxpayer was only entitled to claim depreciation on the original cost of the particular item of plant, unless the commissioner saw fit to exercise his discretion to allow depreciation on, say, the cost to the second purchaser of the plant. What has happened now is that the onus has been reversed, and we do not have any quarrel with the reversing of that onus at all. The point I would like to make is that the discretion is now with the commissioner as to whether he wants to dispute that cost. It is just one of the issues within the five criteria that the commissioner must exercise, which a number of us have concern about, and that is the concept of how the acquisition was financed. I, for one, am a little bit puzzled as to what the significance of that particular criterion within the commissioner's discretion might be.

With those opening comments, I will be interested to hear Helen's comment at this stage.

CHAIR—Thank you.

Mr Nolan—To start the response—and I will ask Helen and Liz perhaps to supplement what I say—depreciation is a vital area of the law and it affects virtually every business and many other taxpayers as well. We have put a lot of store into rewriting this area. We have actually reduced the text from something like 24,000 words down to 9,000 and just the way in which the new provisions have been structured is a very substantial advance on the present law and we have had a fair deal of positive comment about that.

We have tried to align the law, in a number of respects, closer with administrative practice. For example, in the area of hire purchase where hirers of plant have always been treated as owners, we have attempted to legislate that situation. There are differences of view about some of the issues that Ian, on behalf of the consultative committee, has put. As you know, we have not yet had the opportunity to see the detail of that submission, so we may want to make some further remarks tomorrow, if that is possible, having had a look at the detail of it overnight.

On the question of ownership: what has been put really is that instead of having depreciation deductions based on who owns plant and having the depreciation deductions taken by the owner of the plant, unless there are particular exceptions specified, that there should instead be a deduction based on who made the expenditure. That is something that we did not feel able to accommodate. We did it in the case of hire purchase where there is not strictly an ownership. The hirer is not strictly the owner, although in a great number of cases that is the end result. But there had always been that practical application.

Whilst we have addressed that there, to jump from that to say that we should have

fixed up all of the other problems that emerge under the existing law in relation to who owns plant, really got us—very quickly, as we went into the issues there, we could se that it was so bristling with problems that we could not hope to achieve that kind of outcome without getting into fairly substantial policy considerations. I just wanted to make those opening remarks.

The exposure draft has, of course, been out for a considerable period of time. The issues that have been raised with us we have tried to look at and address dispassionately. There will be an opportunity tomorrow, perhaps, when the representative of Matrix Finance is here, to talk about some more specialised aspects of this. You may or may not want to talk about those today. Perhaps you might want to wait until people from Matrix are here. Essentially, we have tried to do a good job with the depreciation rewrite. I think, structurally and in terms of the way in which it is presented, it is a considerable advance.

Some of the issues that are now being raised are ones where we just did not feel that we could, either within our charter or—in an area where there is so much case law, rulings and so on, to try to codify it in a way that is different to the way in which it is expressed now would have got us into so much detailed discussion and debate that you would have taken a very long time to resolve those and we felt unable to do that. Could Helen address a couple of the specific matters that have been raised, Mr Chairman?

CHAIR—I think there was a comment on something you said.

Mr BEDDALL—I would like to raise an issue which Helen may comment on. Going back to my dim dark days in the small to medium sector—because a lot of plant and equipment is basically timeless, I have been to factories where lathes that were used in the Second World War have been computerised and are still be used now in very high technology industries. There was a tendency some years ago—and I have been out of the business sector for some time—to take the plant and equipment of a business that was being purchased and get the most favourable valuation you could, because then you could actually lease the equipment and wash away much of the goodwill and get the finance company to finance it through lease. When we were talking about this earlier, there was some provision where, I think, the Taxation Commissioner had the right to determine the price that it was sold at.

Was that because of that possibility that you could actually completely depreciate an item then leverage it all the way back up again? I can remember instances where, say, a Caterpillar D9—which in those days, was an almost irreplaceable piece of equipment which never lost value—was depreciated and then sold for hundreds of thousands of dollars.

Mr Nolan—It can happen with aircraft as well.

Mr Langford-Brown—Mr Beddall, before Helen replies, my own experience as a tax consultant was that very rarely did the commissioner seek to evoke section 60 because he recognised the commercial reality of the buying and selling of plant and equipment. Would that be your understanding?

Ms Duffy—That is a great lead-in, thank you very much, Ian.

Mr Bryant—I just have one quick question to ask Brian before Helen answers. Brian, are you saying to us then that with an issue like that of, say, fixtures, or when something

comes up and it is put to you that this might be something that taxpayers or the like are seeking some redress, the decision as to whether TLIP goes ahead with something like that is yours?

Mr Nolan—I am not sure that it is quite as straightforward as that, Bob. I think we have already got 230 recommendations in a joint submission for changes to CGT. We already know that it is impossible to deal with all of those. There is a great spectrum in terms of their relative importance and the weight you should attach to them, and the submissions themselves acknowledge some of that.

Somebody has to make the call, but if it is a matter that is being pressed very hard by respectable bodies—professional bodies like yours and others represented here—I do not make those decisions in a cavalier way. They are weighed up within the project team. Sometimes we will feel that we need to bring those to the attention of the Assistant Treasurer to see whether he agrees with our decision on the point.

Essentially, somebody has to make the call and, as project director, it really has been vested in me to make those day-to-day decisions. It is a tough job but someone has to do it. If I make the wrong call, other people will challenge that.

Mr Bryant—The point I am trying to make is that there are initiatives and there have been some good changes pursued. It is just around that question of which ones should be pursued and which ones not. We have seen some—I have not measured them all up—that are not things that, say, the externalists have wanted to pursue. We have not had a lot of success in getting those sorts of changes adopted. It is back to this process question of who makes the decision. I hear Brian's answer and I am happy with that.

Mr Nolan—It is very difficult. You have heard today that we have moved from a three-year project to a five-year project. Some at least of that is attributable to the fact that we have tried to accommodate views that have been put to us. The tracing rules relating to losses in the public company area is one which took us an inordinate amount of time to resolve. We took that on because we believed that it was something that was going to be worthwhile to major companies. I suppose, in hindsight, had I known the amount of time and effort that would be put into that, I am not sure that I would have agreed to pursue it. They are judgment calls that do have to be made.

If you took a very precise reading of our charter and said that you cannot ever do anything that is remotely a change of law, I suppose our job would be easier but the result would be less satisfactory. I do not make any apologies for the fact that I make those decisions almost on a day-to-day basis about how much we can take on. As I said, we have moved from three years to five years. I am going to try the best that I can to make sure that it does not become anything longer than that and that will mean some people will be disappointed.

Ms Morton—I would like it noted that the consultative committee—I think, virtually as one—views this as a very serious issue. I believe that even the members of the project team wish that they could have done something about the matter. It would be excellent if the JCPA could see their way clear to putting it as one of their recommendations, that this is an area that impacts on a significant proportion of the businesses in Australia today. It should be given a high priority so that it can be resolved in a manner which is equitable and represents the way that taxpayers have been treated in the past. The matter has to be resolved. There is probably

no use debating any further around this table but I have to say that it is a great disappointment to us.

Mr Russell—If I could follow up on that by tendering to the committee the coalition policy statement issued before the last election in relation to these matters, including questions of the ambit of the tax law improvement project, because it does address this issue. At pages 95 and 96, it says:

The Federal Coalition has three concerns with how this process has developed. First, with only minor exceptions, participants in the tax law simplification project have not been allowed to advise on policy. They have been limited to undertaking a rewriting exercise. Second, they have not been consulted on new tax bills before they enter the parliament and whether they conform with the principles of tax simplification. Third, they are under-resourced . . .

The second point as been addressed in testimony before you today. With respect to the third point, I think you have also heard evidence that has been addressed administratively. Of course, the remaining concerns are still there. You did earlier invite submissions from the consultative committee about these issues and, for myself, I would simply submit to this committee that it should adopt what might seem, at least to some members of the committee, the fairly attractive observations that were made in the coalition policy documents before the election.

CHAIR—Thank you for your comments, and I think we have found a name for the report.

Ms Duffy—Ian said three or four things. The first thing was simply a statement that he would have preferred to have seen the capital allowance provisions drafted together. It is a statement of opinion and I do not think I should comment on that.

Mr Langford-Brown—It is a joint opinion.

Ms Duffy—Yes. As you know, we did make some attempt to highlight the similarities by the use of the common rules, and to draft the depreciation provisions basically in tandem with the capital works provision so that there is a great degree of similarity—not in content but in drafting style.

I think I will leave the lessee issue alone because I do not know that I can say any more about that. The only thing I will say is that we have done a lot of work on this area and the one thing that became apparent to me—it stems from something that Mr Ian Phillips, who works with Bob, said to us—is that, even in the introduction of the 1936 act, lessees were allowed to claim depreciation in respect of some fixtures.

Every piece of research that we have undertaken indicates that it was a concession made to pastoral leases. It was never extended across the board. There was an amendment or ruling made in 1927 but we could not locate it. From my research, and that of everyone else who has been on this project, we could not find anything else.

Mr Risstrom—How do you feel about tenant rights?

Ms Duffy—As I said, we did not find the actual ruling. There is just a statement that says that we recognise that the lessees on pastoral leases will be able to continue to claim

depreciation for dams that they have fixed during the term of their lease. It is as simple as that and that is all it says.

Mr Bryant—In relation to IT175, is the commissioner's ruling consistent with that?

Ms Duffy—That ruling goes even further than that. It tries to break up who—and when various lessees—will be allowed to claim. But I see it as very different. I see it as an extension possibly of the 1927 ruling which just mentioned dams and attachments on pastoral leases.

Mr Bryant—That was the ruling written in 1970 and not shown to the public until 1983. I can certainly testify that my experience, and that of many other people, was that that had a fairly relaxed application. It might have been concessionary, I agree, but it was done by a more relaxed interpretation of the word `owned' than what is being given it today.

Ms Duffy—As I have said previously, I do not think that in the rewrite we have changed the meaning of the word `owner'.

Mr Bryant—No, I agree with that.

Ms Duffy—I have left every argument open. Anyone who wants to claim that they are an owner in any way, shape or form, the argument is absolutely still left open for them to do that. We have taken on board comments from Ian and you on the use of the term `quasi-ownership'. We have put in the EM that the use of that term is not in any way to affect the meaning of the word `owner'. What we have not done is legislate for lessees and the tenant fixtures issue. I know that members of the joint committee have a copy of the famous draft ruling D26. If you read that, it will give you some indication of why we did not go about legislating for tenants' fixtures. It has taken 20 or 30 pages to get across that very basic issue. It just is not possible for us to get into that sort of detail in the legislation. I think a termination is largely a matter of policy.

Mr Bryant—I agree with what you are saying. I think that you have faithfully interpreted the law. The interpretation, historically, has wavered, and that is another issue. That is an administrative matter. Throughout, we have said that the fact that this issue has not been picked up is an opportunity lost. I think what is there does rewrite the existing law but it perpetuates major problems in the current law.

Ms Duffy—Thanks for that, Bob. I do think we have faithfully reproduced the law. I will move onto the `commissioner's discretion.' We have done some pretty in-depth research when we have been rewriting these provisions. It is my opinion on the papers that I have seen that the old section 60 discretion was a tax avoidance discretion. It was intended to limit the cost to a purchaser of previously depreciated plant from which he was able to depreciate that plant. There is not a lot on it. There was some discussion about the ability of associates, in particular, to inflate the price of plant and bring it in.

Mr BEDDALL—The capital gains tax has basically knocked it out.

Ms Duffy—Yes and no. I think that its use has been limited by the impact of capital gains tax. To some extent, that is one of the factors that gave us some comfort in what we

have done—and I will move on to thank Ian. What we have done is something that was impressed upon us right from the very first consultation that we had with the externals in this area. That was: when I am dealing with someone at arms-length and everything is above board, why should I have to inquire of that person what his written down value is plus balancing charge and has he returned one? It is just irrelevant.

We took that on board. Why should the average taxpayer have to come to the commissioner in every instance where he wants to go above that cost? Taxpayers do not do it, we recognise that. What we have done here is reverse the whole situation. You are dealing with someone; you purchase a unit of plant, you depreciated its cost to you, it is very simple. But we are fully aware that the old section 60 is a tax avoidance provision. I will go back to what Ian said. The commissioner rarely exercised section 60, but there are cases where he wants to restrict the value of the cost to the purchaser to the written down value plus balancing adjustment.

For an up-to-date version of what is happening around the place people should read this. It is an AAT decision—case 38-95, `95 Australian tax cases at 341. The case is difficult. The facts had to be suppressed because if they had given them everyone would have known who the taxpayer was. Nevertheless, it was going through the AAT at much the same time as we were doing the re-draft of section 60. We were au fait with what had happened in that case.

We are not talking about average, everyday purchases of plant by taxpayers. We are talking about, in this case, tax avoidance situations where it is fair to say there is a fair degree of manipulation of the depreciation rules to achieve an end result. A member of the tribunal listed nine factors that had to be taken into account in deciding whether the commissioner was justified in maintaining a limit on the acquisition. All we did was select from those nine, to give a fairly reasonable indication in what circumstances taxpayers might expect that their purchase price might be reduced.

Bear in mind that at the moment there is no guidance. In every situation the commissioner can limit the cost price. What we have done is reverse it, given you the free-for-all, but down the back is this tax avoidance provision, which I would say would be exercised in the limited situations. We attempted to give some guidance after discussions with the Senate standing committee in this area to come to some understanding of what sort of guidance taxpayers might like to be given.

One thing we looked at was the way the transaction was financed. People have said to me, `How on earth can that be relevant?' One of the nine factors, in fact, was the general economic substance of the transaction by which the plant was acquired. That is our interpretation of that. That was one of the factors that was taken into account by the AAT: the general economic substance of the transaction. We believed that the method of finance goes to the economic substance of the transaction, in particular, whether the purchaser suffered any factual financial loss in acquiring the plant. I think that would be relevant. We had to find out whether there had just been a simple—dare we say it—round robin with no expenditure incurred by the purchaser. I can recommend that case to people who really want to get some idea of the nature of the transactions that do happen and have to be accounted for.

CHAIR—I think we can safely leave that section.

Mr Langford-Brown—I do not know whether some of my colleagues would like to talk on other issues like pooling and the de minimus rules et cetera.

Ms Morton—There are a couple of issues. One is the $300 limit which is clearly a policy limit. Just for the record, I would like it noted that it is disappointing that the $300 limit is still there and that it has not been increased to reflect the reality that many taxpayers have private rulings which allow a $1000 write-off, or even higher in some instances. There is actually a general public ruling that says certain companies can have a $500 write-off. I just put that for the record. I know that the project team feel that their hands were tied in that area.

The other issue that I would like to raise—and it has been raised with the project team before—is in relation to section 42-105 and working out the effective life of the plant. A couple of taxpayers have mentioned this to me as a matter of concern. The new words in that section require you to work out the effective life of plant by estimating how long it can be used by any entity for income-producing purposes. The concern there, of course, is that if you have a business which operates on a 24-hour basis you are clearly going to have a rather speedier diminishing value in those assets. Whereas the new law does not refer to the taxpayer's rate, it says `can be used by any entity'. What that means is that if another taxpayer can depreciate it over a longer life, that is how it is being read at the moment. You cannot claim an accelerated rate. This is not mentioned in the EM—Helen, would you like to make some comment on that?

Ms Duffy—I will, Jocelyn. The first point would be that we increase the write-off from $300 to $500. I have some costings on that and it is quite horrendous; there is a large cost to revenue. I will just make that statement because I know we have always said it was a policy issue, which it is, and there is a large cost to revenue.

Mr Nolan—It really is a budget issue for the government.

Ms Morton—The point that I make, though, is that in reality, companies are already writing off to the higher limit. If you assume that every company is not, then your budgeting would be right. If companies already have rulings—I know of companies out there that have write-off rulings for $1,000, $2,000 or $3,000.

Ms Duffy—It is not just that, Jocelyn. One thing I think everyone should remember when we are talking depreciation is that we are talking Mum and Dad who buy the unit at Maroochydore for rental purposes, and we are talking BHP and Telstra. We are talking across the board. Whilst some companies have got that—hey, Mum and Dad at Maroochydore have not got that and they are depreciating every little bit of item of plant that they have got. They have no concessions at all. So when you are talking about cost to revenue, you have to look at the greater number of taxpayers out there. I know, and I agree with you, because I know for a fact, too, that some taxpayers have got some concessions and I think there are general concessions which are given to certain industries that might have a little bit more than $300. But, we have to write legislation and think of things across the board, not from a single perspective like that.

With the other one, I am pleased to say that I think we have got it right, that is 42-105. At the moment, we must look at 42-105(1) and that is the provision which attempts to give, in the great many cases, the standard effective life. That is the whole point of the effective life determinations. The commissioner has 26(8)(v) out there which gives the effective life for

taxpayers to use. That is based on the great norm. The plant is new, it would be used in this way by any taxpayer, and that is what happens.

If you do not want to use those you come into 42-105. Basically, 42-105(1) at the moment says something like, 'will be used by you or any other taxpayer,' so it does say that. Instead of putting 'you or any other taxpayer' we have put 'entity'. But then, if you have got particular circumstances and/or case, 42-105(2), in making that estimate you assume that the plant is new and will be subject to wear and tear at a rate that was reasonable for you to expect when you were working it out having regard to the expected circumstances of your use. There is your subjectivity. If you have got plant being used 24 hours a day, that is the one that allows you to take into account your circumstances and get yourself a quicker write-off.

I think we have faithfully reproduced it. We did not have it quite right in the exposure draft. I think Ian Phillips picked us up on that and Peter Roach did as well. We had already seen it, we knew we changed it, and we have changed it back. I think that the subjectivity has been written back in there and will give you the answer that you are looking for.

Ms Morton—The point that has been raised is that previously, as I did say, it said, `the taxpayer or another person'—

Ms Duffy—Or any other taxpayer—I cannot see what the difference is.

Ms Morton—That is right, so when people read that they said, `If it is mine then it was not "and other taxpayers," it was just—

Ms Duffy—That certainly was not the interpretation that they wanted you to put on it. They wanted you to start from the norm case and then look at your own particular circumstances of use. If you have got special circumstances you can look at your own wear and tear.

Mr Droder—So if I buy a new bulldozer which spends all its time ripping hard rock off, and then I sell it to Joe Blow who is just doing a bit of grading on a road, they can change the depreciation rates, or vice versa.

Ms Duffy—Will they change the depreciation rates? Just let me think about that. The use is different, I guess you may have a quicker write-off than he will.

Mr Bryant—He has not got a chance, though, if he has bought it second-hand.

Ms Duffy—All he has to do is to think of it as being new, but then the subjectivity does come in about being subject to wear and tear at a rate—

Mr Risstrom—You assume that it is new.

Ms Duffy—Yes, you just assume that it was new.

Mr Risstrom—It says so here.

Ms Morton—Helen, the way that this is being interpreted is that in subsection (1) you

have to look at how long it can be used by any entity.

Ms Duffy—That is right.

Ms Morton—So if you think you can use it for three years, but there is a possibility that somebody else out there, when you sell it, can use it for, say, another five years, you cannot depreciate it over three years—in fact, you have got to depreciate it over eight years.

Ms Duffy—It is the use that gives you the variation in rates.

Mr Risstrom—Nothing says you must take the longest period.

Ms Duffy—It is the use that gives you the variation in rates, Joycelyn. That is the factor that is different.

Ms Morton—Are you saying that the years would be three years in my example, or eight years?

Ms Duffy—I have already answered this question for Peter Roach, in fact, and I wrote him a good answer. I just have to remember what I said.

Ms Morton—It is very important, Helen, because a number of people are now reading that first subsection to say that you can only use that thing for three years regularly, but there is a second-hand industry out there where you can dispose of it—maybe the shop fittings or something like that—and there are people who take them and put them in warehouses and stuff like that.

Ms Duffy—I will tell you what I think and, if it is necessary, I will have to do some more work on this later, because I have thought this question out. The whole idea is to make two assumptions. The plant is new, and can be used for a certain period of time by any entity; it is not subjective by you or any other taxpayer. It was always objective, we say it is objective. So you make those two factors because that will give you the rate. What we are trying to do here is give a rate to everybody.

But the thing that changes the whole ball game is your use. If your use is greater, or has something peculiar about it, then that is the determining factor which allows you then to claim a faster rate. I cannot see how that can be detrimental or can be misconstrued. If you have got a use that is going to wear it out quicker, that is it, that is the factor. You say, `Look, my effective life then is factored by this use and it is not as long as it otherwise would have been.'

CHAIR—I do not think we can go any further on that.

Mr Risstrom—My concern about that is that this judgment has to be made in the first year.

Ms Duffy—Absolutely.

Mr Risstrom—If the first year was light, if you just started up business and you got

20 customers a day, and then suddenly you move on to three shifts the next year, you have established your use in the first year, or the first day, and you cannot increase it.

Ms Duffy—I guess, Eric, my only answer to that is there has to be some point in time.

Mr Risstrom—For decades we had the system that the rate was based on normal use, except the clock, which was 24 hours a day anyway, but if you used a longer period you added half the surplus over normal and did a pro rata adjustment. And that could be done each year.

Mr Bryant—That was changed a few years ago, though.

Mr Risstrom—Yes, sure, but it was very useful and it was fair.

Mr Langford-Brown—Mr Chairman, can I just acknowledge on behalf of the consultative committee the professionalism and the dedication of Helen and Liz and her team on this. It has been a very well done exercise, and thank you.

Ms Duffy—Thank you very much, Ian.

Senator SHORT—I have one question for clarification. It is of you, Brian. On the issue of ownership versus expenditure on the depreciation—and you did not go down the expenditure route—did I get you right in that you said that was a tough call but it was a decision that you could have made, or was it, rather, that you took the view that it was a policy issue?

Mr Nolan—I believe it was fundamentally a policy issue. Depreciation has been based on ownership virtually since the law—

Senator SHORT—I thought you said that that was a tough call, implying that you felt your team had the ability, had you so chosen, to go the other route. I am just seeking clarification.

Mr Nolan—I believe it was, essentially, a policy question. Had it been a question, however, that was capable, if the government had wished, of being resolved fairly simply and without major revenue consequences and so on, we could have gone to the government and asked for permission to do something different. I believe it was a substantial policy issue but, having got to that point, I also say that it is so bristling with difficulties that have been there for a long time that, to try to resolve them, even if we had the permission, would have bogged us down in a very lengthy exercise. I would have said that we could not do it on both grounds.

Senator SHORT—You killed it on both counts, yes. One other question: did you do any arithmetic on the financial implications?

Ms Duffy—No, we did not. In answer to that other question, I guess that the question of fixtures—I think I have written a paper on it—is just one of the reasonably minor ownership issues that have arisen. It is just not the only ownership issue. As they arose we spoke to Brian about them so, no, we did not cost anything.

Senator SHORT—I would be interested to see your paper.

Ms Duffy—I think it has been given to James. Is that available?

Senator SHORT—I do not want it at the moment, but in due course I would not mind it.

Mr Bryant—On the point that Jim has raised there, and in terms of the decision process that Brian is undertaking, what I am really talking about is that it was always acknowledged there was a policy aspect—and there are a number of policy aspects. But on the point at which my concern arises, Brian has the call as to whether or not a policy issue should be referred to government. We did not have anywhere to go, really, other than to government, but not through the TLI process, once Brian said, `I'm not going to pursue that as a policy issue within TLIP.' We have got a number of small items here that have been told back to us in depreciation, but I am not going to raise them now. We were told that they are outside the ambit, but Brian tends to have the call on that. That is the point that I want to make. A lot of them are policy, but that is not the determinative thing. It is whether you should pursue them or not, and that is where Brian has the call.

Short adjournment

CHAIR—We will resume now, and go to division 70, on trading stock.

Prof. Krever—The trading stock provisions, as I mentioned briefly earlier this morning, are an area where the act attempts to deal in a comprehensive fashion with a tax issue that, up until this point, has been dealt with in more of a piecemeal manner. The new act has rules to deal with all of the situations on which the original act was silent. In particular, the new act deals with conversions to trading stock of property which was not originally trading stock, and with conversions of property that is trading stock out of trading stock. It is a question on which the consultative committee has had a lot of discussions with the TLIP committee responsible for preparing this. Together, representatives of the TLIP committee and the consultative committee have made representations to the government.

There are a couple of issues that the area raises. I have submitted a paper that outlines six of those. Today, I will discuss in detail only two of them: what actually happens when items that are trading stock cease to be trading stock and when items that are not trading stock become trading stock. In both of these cases, the law provides, in effect, a rollover mechanism so that it treats the ultimate use of property as if that were the original use. If I have a piece of property that is trading stock and which ceases to be trading stock, the effect of the rule is to treat it as if it had never been trading stock, so that there are no tax consequences from the fact that it went into trading stock and then out again. If I have property that was not trading stock but becomes trading stock, the effect of the law is to treat it as if it had always been trading stock, so my gains are measured from day one, when it was originally acquired for possibly another purpose.

I will start with the simpler of the two, which is property that was trading stock and which ceases to be trading stock. An example that has been mentioned is a brick manufacturer creating bricks for trading stock and then taking the bricks out of trading stock and moving them to the building of an extra factory. The effect of the rule is simply to ignore completely the period in which it was trading stock, and to treat it as if it had been bought for putting into building in the first place, which we think is the right result. It simply treats the original cost as

the cost for the purpose for which it is being used.

There is one change in the law which has become a matter of concern. While I said the original law was silent on a lot of issues and did not deal at all with what happens when you have an item of trading stock that ceases to be trading stock, there was one exception to that rule. If you sold trading stock out of the ordinary course of business, the 1936 act deemed you to have sold it for its market value.

This provision was put in place largely for the sale of businesses where people sell an entire business—goodwill, buildings, leases, trading stock and so forth. They wanted to make sure that we caught the gains on the trading stock part of the sale as income from the sale of trading stock, so we had a provision that said that disposals out of the ordinary course of business are treated as disposals for market value.

But there was no law with conversions, and we now have a rule in the 1997 act which says that we just ignore it and there will be a rollover. The two potentially conflict, we believe, in the sense that if you take an item out of trading stock for your own personal consumption, as the provisions are now worded, it is possible—it has been suggested to us—that you can read it so the two provisions apply.

That is, if a small trader takes an item out of trading stock from a fruit shop, takes it home and eats it, the result that should happen—and the TLIP team and the consultative committees agreed on this, and after a visit to Treasury by the combined efforts of the two, Treasury has now agreed, too—is that the law should simply treat this transaction as if the fruit shop owner had bought some fruit for the shop and some fruit personally. The fact that it went into the shop and came out again should not matter. It should be treated as if that person had bought it directly for consumption.

The problem is, when you take something for your own consumption, if you actually literally consume it and eat the fruit, you have a disposal of the property in addition to a conversion. It is converted to personal use, but it is also disposed of. So the two provisions apply. One says there is a disposal on market value and the other says there is simply a rollover of the cost. The rollover of the cost we think is the right one, but we have suggested that we might change the provision that deals with the disposal outside the ordinary course of business to make it clear that if you are disposing of it to yourself, by consuming it yourself, you are not caught under that provision.

The second issue is items becoming trading stock. I mentioned before the effect of the rule on property which you have held for a long time for other purposes. The examples that are usually cited are for personal purposes, part of a personal collection or for personal investment reasons, or for a completely different business reason. The most common example is a primary producer—a farmer who has fields in which crops are growing or animals are grazing, and later that property is subdivided. If the property becomes trading stock, the effect of the rule is to measure the gains from day one. If this property were acquired prior to 1985 we would measure the gains from day one all the way up. If the property were acquired after 1985, we would still measure the gains from when it was acquired without any indexation because we would be treating it as if it was always the trading stock.

Originally, when the committee looked at this, it felt there probably was not that much of a risk because in all the cases that were cited to the committee of farmers realising their land

in an enterprising way and so forth, in none of these cases did the property become trading stock. Gains were assessable on subdivision of a farmer's land under other provisions of the act—as a profit-making scheme or under other provisions—but they never actually became trading stock.

While people were concerned about this, there was not universal concern because it was the view of many persons that there has never been a case in Australia in the courts. Nobody can actually cite a case where anybody has taken farmland and turned it into trading stock.

Senator WATSON—What is this division?

Prof.Krever—Division 70.

Senator WATSON—What part of 70?

Prof.Krever—There are two versions: 70-90 deals with the disposal out of the ordinary course of business—70-90 says you realise market value when you dispose of your property outside your requested business; 71-10 says when you convert the property to another use you have to roll over that cost.

Senator WATSON—Where does it say that land becomes trading stock?

Prof.Krever—It does not. None of these provisions does, which is why, when people said there was a risk that this could now happen, we suggested that historically this has never been the case. There have never been any cases in Australia.

Senator WATSON—Why will it happen now? I am looking for the words.

Prof. Krever—You are jumping ahead of me, but the reason is that the definition of trading stock has been changed, in 70-10, and there have been suggestions put forward to the committee—and this was discussed earlier today before this hearing started—that, if property is held for the purpose of sale, it may well be that the minute the farmer decides to subdivide and sell the land then it is being held for a different purpose—namely, for sale—and suddenly becomes trading stock, even though under existing law it clearly is not trading stock and the person would not be caught under the trading stock provisions.

Mr BEDDALL—Does the fact that that is not his type of business have any impact?

Prof. Krever—That is exactly the issue. There are two ways of reading the new definition of trading stock. One is that it still requires it to be part of your business, in which case that person is still out and it has no impact on that person at all. The second is that, if read in its broader sense, it does not matter what your business is—if you hold it for the purpose of sale, it suddenly becomes trading stock.

Mr Risstrom—Maybe he has got two businesses.

Prof. Krever—There are not cases where farmers have been held to be also in the subdivision business. But, on the broadest interpretation of these words, it has been argued to

the committee that that is a result. So the committee has suggested that the problem might be dealt with in two ways. One is that we might perhaps look at the definition of trading stock and try to narrow it back to closer to what the original definition was by adding the words ‘held for sale in the course of a business’, as opposed to a realisation, or a farm—whatever.

On the second question, as to what happens with property that was not trading stock but which becomes trading stock, if the definition is changed so that we leave out the farmers and everybody else, it is not as pressing a concern. Nevertheless, it must be conceded—and, indeed, over the next couple of days you are going to have a lot of submissions on this because many of those I have seen from various bodies make this point—that conversions to trading stock might result in people paying tax from day one up until the time it is sold. There have been different suggestions made on how you might address that, some of which are fairly simple and some of which are very complicated.

The simpler suggestions tend to involve an election: when property becomes trading stock, the taxpayer can decide either to roll it over and recognise costs from day one, or treat it as if it had been acquired at that day, recognise the gain up to that day as a capital gain and recognise it from that point on as trading stock gain. Another variation which has been suggested is a lot more complicated version which requires an election, but non-recognition of any gain until ultimate disposal. Then there are variations on that.

The committee does not hold strong views one way or the other on which approach should be taken, other than to suggest that, if this matter of the conversion to trading stock is to be addressed in the legislation, then the simpler the solution the more preferable it will be in terms of tax administration; and from the taxpayer's perspective, the simpler solution, involving a simple election at best, would be the way to go, not one of the more complicated routes.

CHAIR—What happens to a canefarmer who has an offer for his land, subject to a rezoning, and the settlement specifies that he takes two blocks as a part payment?

Prof. Krever—It is not entirely clear, because until the case goes to the High Court we are not entirely sure. Under the current law, the consensus view would probably be that it would never enter trading stock. If, however, the person takes enterprising steps to maximise the value of the land—that is, goes out and has it subdivided, draws the lines between plots—it is a grey area as to where you cross the threshold and have actually entered into some profit-making scheme, as opposed to simply selling off your land if you sold out completely for the first offer.

At some point, if you start doing something, you will be in a scheme and you will be taxable under current law for the gain from the time at which the scheme started. In the case you have just described there may not be very much gain, because from the point at which you say, `Okay, I will subdivide the land,' to the time you subdivide it, it might not rise in value very much.

CHAIR—It happens all the time in my electorate that a canefarmer gets an offer from a developer, sells it subject to rezoning and takes a couple of blocks in payment. The farm might be worth $250,000, but each of the canal blocks will be worth $180,000.

Prof. Krever—With the initial sale, the person is probably not taxable, as ordinary

income or profit-making scheme income; it is a capital gain which may or may not be taxable, depending on when they acquired their land. As for the two blocks that they have acquired, it will depend on what use they put the land to afterwards. If they took it intending to resell it by putting houses on it, the gain on that part probably will be taxable.

Mr BEDDALL—Even if it is vacant land, if they have another property they would be taxable on capital gains?

Prof. Krever—It is a subjective question—our law works on this peculiar notion of subject intention. Their intention may be to rent it for a few years and, in that case, it would not be a profit-making scheme under current precedents.

Mr Gaylard—But it would be subject to capital gains tax.

Prof. Krever—It would be subject to capital gains tax.

Senator WATSON—When you say their action has triggered, that defeats your earlier concern about the provision of trading stock, because it is this action which triggers. It does not necessarily mean it triggers bringing it into trading stock; it can trigger an action of bringing it into capital gains or one of the other provisions.

Prof. Krever—The concern that has been raised in submissions to the consultative committee—and it is not my concern, so it should not be attributed to me personally—is that, in its broadest reading, the terms of the definition of trading stock catch people whatever they do, the minute the intention changes so that it is now held. It does not matter what the original purpose was, as long as it is held for sale, even in a personal capacity—

Senator WATSON—But that then triggers, at that point of time, a new set of provisions of income tax law.

Prof. Krever—If it becomes trading stock, the trading stock provisions say your cost is the original cost when you acquired the property for another purpose.

Senator WATSON—The point I am making is in relation to Bob Bryant's case of the factory land. It is true that it might trigger something else, but I would find it very difficult to see, from this reading, how it would trigger trading stock provisions.

Prof. Krever—As it turns out, Senator, I agree entirely with you. However, there are a large number of tax advisers who take a contrary view, and it is fair to say that, if there are a large number of tax advisers, there are a large number of taxpayers who are concerned about it. We are just raising an issue that, clearly, is evoking some concern in the community and maybe there is a way of resolving it to alleviate things.

Mr Bryant—Senator, are saying that it does not trigger anything as trading stock or giving it a tax consequence that it otherwise would not have had. How do you come to that view?

Senator WATSON—Using your case, which I thought was fairly clear-cut, at the point at which you decide to subdivide the land you have had for manufacturing or storage or

something for 60 years, I would not have thought it would suddenly become a trading stock if you decide to sell it.

Mr Bryant—Looking at the literal words of section 70-10, I think it would be categorised as anything that I have acquired that is held for sale.

Senator SHORT—That is now held for sale.

Mr Bryant—Now held for sale.

Senator WATSON—It comes back to your original intention.

Mr Bryant—No, it does not. It did before, because the old definition said `anything that you acquired for the purpose'. But they have changed the nexus of the word `purpose' to a holding purpose, not an acquisition purpose.

Mr Bradshaw—I could help the committee about why we made the change. It is a consequential change that followed on the general scheme that Rick has outlined under which assets will be treated according to the commercial reality of the purpose for which they are held. So if they were originally held for trading and now they have ceased to be so held and are held just for private or capital purpose, you get them out of trading stock, and the converse going the other way.

In relation to the definition of trading stock, the courts have put two important qualifications onto the words that Bob is trying to read literally. They are: firstly, that they must be an asset of a business; and, secondly, they must be a revenue asset. If Bob read the words of the current definition in the literal way he is trying to read the words of the new definition, his factory would be acquired for the purposes of manufacture and that would also be trading stock. So there are two important qualifications that apply to the old law and, in our opinion, apply equally to the new law.

Mr Bryant—There is a very strong competing legal view that the view that Michael holds—and it is quite arguable—is wrong.

Mr Bradshaw—I think the draft submission that Rick Krever has done on behalf of the consultative committee put forward a suggestion that perhaps words to the effect `in a business' could be added to the end of the section. So it would read `be held for the purpose of manufacture, sale or exchange in a business'. Although we feel they are not necessary, we found those words were acceptable.

Mr Russell—It is doubtful, really, that that changes the position. Let us get away from land and look at, say, a jeweller who, as part of a bequest, receives a certain volume of jewellery from her late mother's estate and decides she does not like it and so she is going to sell it. It is put into the business and is sitting physically as part of the trays of stock to be sold. Ultimately, when it is sold it is just sold in the ordinary way.

On both the definition as in the draft and, for that matter, the draft as it would be if you added the words `in a business', it seems to us that there is at least a distinct risk—and I would go further and say it is the better view—that those items became trading stock and the tax

consequence would be that, unless amendments are made to the draft, the whole of the proceeds of sale, without any deduction for any cost—because there was none—would be assessable income.

Mr Bradshaw—On that, we have circulated to the consultative committee an amendment that would treat the cost as the market value as at the date of the gift. We believe that is within the scope of the government's decision.

Mr Russell—What you circulated to me was market value at the date of the gift.

Mr Bradshaw—Yes, that is correct.

Mr Russell—Even that, you see, raises a problem. Take the situation that I have discussed before. The jewellery is held for 15 years for private purposes and then a decision is made to sell it. The effect of taking market value at the date of the gift is to treat as a trading profit the increment in value that accrued for a period when the assets were not being held for business purposes.

The purpose of the trading stock provisions, one would have thought as a matter of principle, is surely to measure the profit that comes from business activity. The appropriate value to be brought into account is market value at the time that the asset becomes an asset of the business. That, of course, means that if you have a—

Mr Risstrom—It becomes a revenue asset.

Mr Russell—Yes. It gives you an exactly identical measure of profit to that which arises under a profit making undertaking or scheme.

Mr BEDDALL—But if Michael is right and it comes in at the market value at the time it becomes a gift, this is a person who actually deals in jewellery, so it is part of that trading stock. What happens if they take jewellery from the shop and wear it for 15 years? Does it move out of the trading stock if it goes into personal—

Mr Russell—It does not under the present law, but one of the proposals is that that change. The short answer is that if it becomes trading stock initially, then certainly market value at the time of the gift is appropriate. But what makes the transaction appropriately taxable is the dealing with the asset as part of the assets of a business. The starting point for that in point of principle ought to be the time at which the asset is committed to the business, not some earlier time.

Senator WATSON—What are the words that you want in?

Mr Bradshaw—David is arguing for `market value' which was expressly rejected by the government in its consideration of this issue.

Mr BEDDALL—Who is the government? When you say the government, who do you mean?

Mr Bradshaw—Under the present government.

Mr BEDDALL—You are missing my point. Was it someone in the tax office, someone in the Treasury, or someone in Finance who gave a minute to Senator Short to sign on behalf of the government?

Mr Nolan—Perhaps I should recount that the existing act does not deal specifically with the question of what happens when assets that have previously been held as a personal or a capital asset are taken into trading stock, nor the more frequent case when stock is taken out of stock for personal consumption or private use. Under considerable urging, I would have to say, from the consultative committee and others, we have tried to put something in to clear up that situation and have a clear rule.

At the time, the unanimous view of the consultative committee—and this was put to the then minister—was that those events should be taken to have occurred at cost price. The main benefit there was for those who were taking goods out of stock—say, a butcher or some other person—as they did not want to be overtaxed. There was a view that there should be a single, even-handed rule that all of these arrangements, both going in and coming out, should be on the one basis and that would be at cost. That was the view which was put to the project team by the consultative committee and which, after a lot of discussion, was conveyed to the minister at the time on behalf of the committee. It was agreed to, and so it found its way into the bill.

As a project, we have tried to reflect what was being asked of us and what the minister agreed to. Since then, some other issues have emerged. I would have to say that, numerically, there is a very small proportion of cases where somebody has held land for a very long time, for example, and ventures that into trading stock. Rick Krever said that is a pretty rare animal; nevertheless, it may happen. It has been said that is a bit tough because, if you bring it in at cost and the land was bought back in 1930, it has accumulated in value and today's prices mean they will be assessed on an unreasonable amount. So one of the issues that we are wrestling with today is whether that is a sufficiently significant practical case to need something done for it. We do question that, but we recognise that it is being pressed on us. That is the first issue.

Senator WATSON—Are you actually recognising that does get brought into trading stock?

Mr Nolan—No; we are saying that we believe it would be a very rare case that a cane farmer or someone had land and then, deciding to go out of business, or not to use that land in that way any longer, developed that land in such an organised way as to make that land trading stock. Rick was suggesting that there has never been a case that has actually reached that view. It would be very rare for that to be the outcome.

Even if that were going to be the case—in, say, a very large development—there are ways in which the arrangements could be organised to avoid that: by having another entity do the land development, say; and for the original owner to transfer that across to that development entity at the current market value. If it is a 1930 block, it is outside CGT, there are no tax consequences and it gets into the new venture at the right starting point.

There is the issue of whether they might have to pay some stamp duty there. That is a separate but related issue, and not of such high consequence. These are not day-by-day cases.

What we are dealing with in trading stock is covering a much larger field of daily transactions, and trying to do that in a clear way. That is the first issue, and we say that there probably is not enough in that point to warrant a departure from what is in the bill; but you are hearing contrary views.

The second issue is the point of whether, by reading the words in 70-10(a) very literally, there is a problem that says, in effect: 'Well, as soon as you start to hold it for sale'—even for the farmer who did not ever acquire it for sale in the first place but is now going to sell it—`it becomes trading stock.' We say that is an unlikely interpretation, but we hear that there are different views. We are suggesting that there is a way, by adding some words to that provision, that could make the point clearer. We are certainly interested in pursuing that.

Senator GIBSON—Are you really saying, using your butcher example, that taking trading stock out for personal use should be at cost? But the jeweller example of David's, in putting private use back into trading stock, should be at market value?

Mr Nolan—We are certainly saying the first. That is what everybody wanted. But what David was talking about was something where you did not have a cost in the first place.

Senator GIBSON—A very low or negligible cost, yes.

Mr Nolan—A gift, say, of jewellery. When that was actually ventured into trading stock, having previously been a gift, for the new trader in that—the person who had acquired it by gift—the tax consequences should be measured by reference to the market value of when it was gifted to them. We are saying that is probably a reasonable proposition, too.

Senator GIBSON—So we need a re-look at those words to make sure we are getting that intention?

Mr Nolan—When I say that there may be some changes possible to help with these points, I am sure you recognise that the bill is one that the government sponsored and any changes would only be ones that, after examination and recommendation, have got that sort of endorsement.

Mr Risstrom—There is another way of expressing the butcher argument or the one about the farmer who eats an animal. Why should he pay tax on profit, or why should he pay tax on his own wages when you have work he did for himself in looking after the lettuces?

Mr Bryant—May I ask a couple of questions, just to get some clarity into this thing? I acknowledge there has been a consultative process around trading stock that has gone on for something like 18 months. The matter that was referred to the Assistant Treasurer took place, as I believe, around July-August of last year. When was the decision taken to change the definition of trading stock?

Mr Bradshaw—It was fairly late in the piece, Bob.

Mr Bryant—Give me a month.

Mr Bradshaw—After the public consultations. The point was actually made to us in

the public consultations at a public meeting in Brisbane. One of the panellists at that meeting said, 'Well, if you are concentrating on the purpose from which it is now held, is it not therefore necessary to change the definition?' We went back and considered it and discussed it with Tom Reid, the head drafter, and concluded the commentator was right.

Mr Bryant—I am looking to put some time frame on this. I think this is critical in terms of process.

Mr Pinder—When was our Brisbane meeting, Simon?

Mr Gaylard—The Brisbane meeting?

Mr Pinder—Yes, in the hotel in Brisbane, where Ruth Jenner was on the panel.

Mr Gaylard—Was that when we were discussing the early part of capital gains tax?

Mr Pinder—No. The public meeting to discuss the bills, when we were doing the circuit around Australia.

Mr Gaylard—That was in September-October, I think.

Mr Bryant—Of last year? So, following that, a decision was made to change the definition of trading stock to what we have now got. I put it to you, Michael, that you just said that that decision was made after the consultative process was completed.

Mr Bradshaw—Yes, as a result of the public consultation. You would know that we have made many changes as a result of the comments that both the committee and the public have made.

Mr Nolan—I do not think you can concentrate on this one solely. What is emerging here, Mr Chairman, is that we have a wide consultation process. The point of that process is to try to improve the product that goes into parliament, and it does do that. But there has to be a recognition that in order to get the bill into the parliament there has to be some end to the consultation. You cannot keep on regurgitating the next iteration and the one after that and the one after that into further rounds of discussion because that way, as Mr Beddall said, there is a concern about getting bills into the parliament too late.

Mr BEDDALL—I am concerned about the process, I am not concerned about the time frame. I think you should get it right.

Mr Nolan—Yes, but ultimately you cannot go back with every single point and open up the process again. What we say is that most of these changes that we have been making are in good faith and, we believe, generally accurately, things that better reflect the existing law. They are tidying-up things.

In this particular case there is a difference of view about whether what we thought was a tidying-up, put to us in the consultation process as something worth doing, is just a tidying-up or whether we have actually made a change that we did not intend. We are saying that we did not make any change; we did not intend to make any change. It would have been

quite strange in that event to go out with a blaze of trumpets and say, ‘Hey, everybody better have a look at this because we have made what we regard as some minor drafting changes.’ There are countless numbers of those.

Mr BEDDALL—Could I just follow that up, because it is about process. You have a consultative committee, then you go into a public process where you go around Australia. What you are saying to me is that at the end of that process you make changes and it does not go back to the consultative committee for a final look before it gets drafted.

Mr Nolan—Sometimes it does. I think the consultative committee is often unfairly saddled with the public perception that they can be across and up-to-date with every single word that we chisel out of the rewrite process. It never was a reasonable ask of them to do that. I think sometimes others in the community look at what they are doing and tend to be critical of them.

If things that people do not like emerge, they will go to the consultative committee member that they happen to know and say, `How on earth did you let that go through?' I think very largely that is an unreasonable proposition because they cannot really expect to be across every single word. I cannot be across every single word. There is just too much being produced for that.

CHAIR—Does the consultative committee receive a copy of the draft bill before it is presented?

Mr Nolan—In this case, yes.

Mr Reid—The final bill—I think Eric has a copy of it there—was—

Mr BEDDALL—That has got different words. Eric was quoting some before that was not—

Mr Reid—That is right. That is the version that went to the consultative committee at the end of last year and even that, as we saw this morning, is not absolutely final. I believe it contains this change, although we could check that. It may be—we could check our records on this—that an earlier draft of the trading stock provisions was also circulated separately.

CHAIR—In my mind, consultation has taken place if the draft bill was given to you as a committee.

Mr Bryant—I do not think I received a copy of that.

Mr Russell—It was given to us on the day of the meeting.

CHAIR—Anyway, it is necessary for the bill to be referred to the Public Accounts Committee so that these things can be aired and discussed. We are concerned that the bill is right before it goes to parliament.

Mr Nolan—We are too, and that is why, even up to a day or two before the bill goes to the parliament, the draftsmen will be looking to make polishing type refinements. In that

process, nine times out of 10 there are improvements, and occasionally something might go in the wrong direction. That is part of the risk, I suppose, but perfection really is very hard to attain.

Senator WATSON—Could we get this right now, though? This body of people around here, can we get this definition right?

Mr Gaylard—Could I just make a comment first. I would like to endorse what Brian said, that the consultative committee has got an extremely difficult job in tracking issues like this down. The case we talked about with the farmer: the courts have generally held that the proper and smart exploitation of a farm at the end of its use as a farm is proceeds of capital, but there are these slightly changed degrees that get you into other kinds of taxable situations. The High Court in a case in St Hubert Islands, which has been quoted in many cases, held that the land held by the company in that case was trading stock, and so the possibility that land can be trading stock, albeit quite remote, is capable of occurring. So, while it may be quite a rare case, I think there is the possibility, however small, that land can be trading stock.

So the concerns that have been expressed are, in my view, real concerns, and the fact that it might only happen in a small number of cases I think is no real reason to say that we should not be trying to address those concerns. And who knows whether the High Court might in the future move to interpret land as trading stock in a greater number of cases than they presently do. So I think it is a real concern and I think that we should find a solution. Michael and Greg have certainly been working hard to do that. Bob's point about the time in which it was done is a point, but it is a process that we were trying to wrap up and get the legislation out.

Mr Russell—There is a process issue here, and I want to emphasise in saying what I am about to say that there is absolutely no criticism intended of the project team, who I am sure have acted in good faith throughout. But it is important that this committee should understand, because, as Mr Nolan has quite properly pointed out, there is a perception, and I think to some extent a misperception, of the role we play. He has already said that we are all working against very tight deadlines, but I will tender to the committee, if I may, the document that, as I say, it is my recollection we were given, either at the meeting or very shortly before it, in which trading stock was discussed. I want to take you through that and compare it with some of the provisions in the bill that is now before the parliament.

You will see that that is a document generated by word processor on 22 November. If you look at the bill before the committee, section 70(10) is a definition of trading stock; the section 70(10) in the document that I have just tendered is not. There is in the bill a provision, section 70(15), which is not in the draft that we had; there is no section 70(15) in the draft which we had. There is also no section 70(30). So I emphasise that there is no suggestion whatever of deliberate inappropriate conduct. The reality is that the way in which the process operates means that, in so far as we might be regarded as having signed off on anything, we have signed off on something which is really quite radically different from what has gone to the parliament.

To the extent, therefore, that the presence of the consultative committee in this process is regarded as giving some sort of comfort to the parliament that, as it were, the private sector has signed off on the legislation that goes to the parliament, as again I point out Mr Nolan himself has quite properly said, it is just not an assumption that will always be valid.

I emphasise that the trading stock provisions were one of the later groups of provisions that were being put together, and the comment that I am making certainly does not apply to the bill as a whole. One of the things that one needs to be looking at is processes which mean that, quite apart from anything else, there is not this sort of embarrassing discussion in front of a parliamentary committee.

Mr Nolan—Mr Chairman, the inference that you are impliedly being invited to draw is that there is very substantial difference between the trading stock provisions in the bill and the trading stock provisions in that very late draft document that was given to the consultative committee. I think you will find, on closer examination, that there is relatively little difference between the two documents, except for changes made quite late, and necessarily late, in the arrangement of the numbering of provisions. There is a lot of late difference being made in the numbering, but I do not think there is very much difference in substance. But Tom Reid may be able to confirm whether that is the case.

Mr Reid—If I could be shown a copy of the document.

Prof. Krever—Mr Chairman, I wonder if I could comment on the process that has been raised, since I originally raised this matter before the committee. The consultative process involves the committee reviewing bills. Most of the concerns that have been raised here today have been raised as a result of the bill being in the wider community for a fair time and people expressing concerns that are reviewed by the consultative committee. In terms of the things that we have raised today as being matters of general concern to the community, some of them have been endorsed by this committee and some not; we have explained them to you because we have heard that there is concern that these may be interpreted in this way. We are aware of this because it has been through the community and people have prepared documents and written articles, letters, editorials and so forth, and we have reviewed these.

So the public access to the bills means that its consultative process is an ongoing process. It does not mean that we review a bill and say, `Okay, that has the stamp of approval, please send it off to parliament.' What happens is that right up to the last minute people read it and they will find other things in it. Or somebody will come up with an interpretation that 90 per cent of this committee may say, `That's just off the wall, we don't think anybody would come up with that interpretation.' Nevertheless, if there is somebody out there who believes that it is capable of being interpreted in that way, we take it on board and we use this particular hearing right now as an opportunity to alert you to the fact that some people have said this to us, and we see that there could be some concern in the community. That is why we have this committee.

I certainly do not see it as in any way casting any negative reflections on the work of the committee or on the consultative process, the fact that we are coming up at this point with things that had not been mentioned before, because it was not until there was widespread community discussion of it that people became aware of the fact that some people out in the community might read it differently from the way that other people read it.

Mr Russell—The point was made about the suggestion of inappropriate conduct. I thought I went out of my way to make it absolutely plain that there was no reflection whatever intended on the project team, at least on my part. I hope I made that clear. If I did not make it sufficiently clear for my colleague, I would like to reiterate it now.

Mr Reid—Mr Chairman, there is a very simple confusion that explains what is happening here. The provisions of the Transitional Provisions Act are numbered in a way that reflects the numbering of the main bill, and I think the provisions that David Russell was looking at when he made that comment were in fact the part of the bill that deals with the Transitional Provisions Act. I have now opened the document to the provisions of the main bill and they do contain those sections. They also contain a definition of trading stock which is in identical terms to the definition in the bill, in particular including the words `that is held for'. I think that really puts the matter to rest.

Mr Bryant—It does not entirely, Mr Chairman. The point at issue here is that we have had an extensive 18 months consultative process. The matter has been referred to the minister in a certain context and the context was changed after the event. It is like trying to find a needle in a haystack in this process. We are saying that when, for whatever good reason, we have circumstances that compel the making of last minute changes that really threaten to tip the framework on its head, we need a bit more time to test the sort of law that is being put before us,

There is dispute about what the effect of the definition is. There is a pretty solid legal view that it does make a substantial change. Rick's point is that this is on the periphery, and it is very rare that something held can come into a trading stock capacity. That is true, if you stick with the old definition. But it is potentially no longer true, if you introduce this new definition. That is the point at issue. More importantly, it was brought in at a very late stage and it requires a longer testing period, because there could be other changes like this that we do not know about and need to find.

Senator WATSON—Between all of us, can we not get a consensus on what the definition should be?

Mr Bryant—Not entirely. That is not the answer, in so far as there is a problem with the transitional provision. If this were passed, there is a potential that something before June of this year could come into the trading stock net, but it might not get an opening value. We are still debating the impact of that. We have got these new concepts of deemed disposal, and it is my understanding that the interaction with the capital gains tax provisions has not been fully thought through. Where exactly do we stand there? They are waiting for another day. We really need to know.

I take the case of someone with some investment shares. He wants to put those into a circumstance where he might want to sell them. If they do become trading stock and, from the very earliest day until this change of holding, he does not get the chance to expose them to capital gains tax—to which historically they would have been exposed—where does he stand? He might want that outcome, because he could have some capital gains tax losses over here. That could be far more effective for his purposes. We do not know the answers to those questions.

Mr BEDDALL—Is there not a definition in the act that, if you are buying or selling shares, you are a trader or a holder?

Mr Bryant—There is not a definition, no.

Mr Russell—There used to be a provision that, if you held the shares for less than 12 months, you were deemed not to be a trader. But that was repealed in about 1973.

Mr Risstrom—Mr Chairman, going back to the substance of what we were talking about before—land which becomes trading stock—do I take it that the Whitford's Beach case would have been a different decision under the proposed legislation? I have never believed that the Whitford's Beach case was all that marvellous. I think there was a new batch of directors and, at worst, a new approach was taken to the land from that moment, and they should not have been assessed over the whole span of the period but only from when the change of attitude in the minds of the new directors took place. Would the new definition protect Whitford's Beach?

Mr Bradshaw—The concept of the isolated profit-making venture has not been disturbed. In that case, the outcome was that they were only assessed on the profit from the time the companies changed and, effectively, the controlling mind of the company had a new purpose.

Mr Risstrom—But is it changed by this proposal?

Mr Bradshaw—No, we believe not.

Mr Bryant—But yes, arguably, it is. This is the tension. It could well have changed. I have got major companies who are pretty concerned about this, and there is a lot of money at risk.

Mrs Gibson—One way of rectifying the problem might be to go back to the existing definition of trading stock by reinserting the words `acquired or purchased for the purpose of manufacture, sale or exchange.' There is nothing wrong with that.

Mr Risstrom—But the change may happen a day later.

Mr Pinder—Mr Chairman, the reason we had to change the definition was that, if something is acquired for the purpose of manufacture or sale and that makes it trading stock, then there is no such thing as a change of use—it is trading stock into perpetuity.

CHAIR—I understand that.

Mr Pinder—The definition had to be changed to reflect the fact that its use can influence whether or not it is now trading stock.

Mr Bryant—The point that is being made is that we needed to consult around that change. We have had this put to us at the eleventh hour after an 18 month period of consultation. It would have been terrific if we could have done this in mid-1995.

It was never in play until the last minute of putting this bill together. That is the problem. I understand where you are coming from and there is a lot of merit in what you are saying. But there are also some potentially negative outcomes that need to be tested. With all the best will in the world, it is just not good enough to have something like this just tossed into a bill, and have it before parliament with a view to it being passed, if the consequences are not

fully ascertained.

Mr Nolan—Mr Chairman, there is a process going on. There are these hearings today; there is your examination of the bill; there is the fact that Bob and others are here making their point; that others have put in submissions to the committee and that the bill has still to be debated in the parliament. There is a very substantial process. There has been the consultation process dating back many months now. Really, all we are hearing is that, at the last minute, some changes were made which, on one view, might have made a substantial difference. As we say in all innocence and in our belief, that is not what has happened here. But, obviously, we are prepared, after hearing what is being said, to see whether some adjustment can be made that satisfies everybody. But it really is a non sequitur to suggest that, because we have got such an open process as this, that process should continue on and be elongated further and further.

CHAIR—We have heard the evidence on both sides of this argument. I think the committee can come to a conclusion and it will appear in our recommendations.

Mr Russell—I should say that the comments that were made before by the chief parliamentary counsel are correct. I was, in fact, reviewing the transitional provisions and not the main bill. It was my error and the other people involved I will not name.

Mr Risstrom—I made that same mistake. I looked at a division number, didn't I?

Mr Russell—Yes, we all did. The point really is that all of this discloses the difficulty of trying to deal with a very large volume of material in a very short time. It is certainly the case that the original part of the bill, as opposed to the transitional provision, did contain provisions in terms of this. Still, there is a very real possibility, as part of a process like this, that important issues will be omitted by people. All that is given the extent that the consultative committee is regarded by parliamentarians as an important step in the process of ensuring that this project is something which is jointly authored, as it were, by the tax profession and the representatives of the TLIP team. They are the sorts of difficulties which you have observed.

Mr Bryant—Are we clear on the capital gains tax interlinkages with these sorts of changes—something that is changing from trading stock into something else or vice versa? There are some pretty important CGT implications. Are they dove-tailed?

Mr Pinder—We think they are. There may be a need to make that slight change as a result of the acquisition by way of gift that Michael alluded to earlier. Otherwise they are. If we were to change the rollover into a rollover at market value or a rollover collection, there would obviously be a need for some quite considerable changes to those provisions.

Mr Bryant—We have raised this before, but there is a another change in trading stock, done quite deliberately and openly. We have been talking around it for some time. It is the change that, in any particular year, the opening value of the stock must be equal to the closing value of the preceding year's, which seems a nice symmetry and we do not have any argument with that. However, that is an area where, in any year, you have this problem occurring in a whole range of things where there is a change of basis on which the taxpayer is reporting. This particular provision introduces a symmetry that has not been there in the act before.

The possibility was that, in such a change, you could have an opening position that was not the same as the last year's closing one and get a timing advantage. That needed to be rectified. What we have raised is the same principle—it is commonly referred to as the country magazines issue—arising where there is a change of basis. We have got it with the workers compensation issue that is with the commissioner at the moment, and the provision for that.

In a change there is a circumstance that, for the same reasoning, you could miss out on a deduction altogether. We have put it to the committee that, having gone down the path of the trading stock issue and rectifying that, why couldn't we go the extra step of sorting that out. It really comes back into assessable income in the deductions area. At this point, I think you have decided not to proceed down that path. You have done it for the one, which is an outcome that favours the commissioner, but you have not done it for the rest. Have you any comment on why that was not undertaken?

Mr Nolan—Let me say for a start to all here that Bob Bryant is quite right. This change has been quite clearly enunciated and spelt out in the explanatory memorandum. It was one that we had authority and approval for. It does bring about symmetry, making sure that the closing value for trading stock in one year is the same as the opening value in the next year. That is symmetric; it is an appropriate outcome.

What we have done, however, does not necessarily favour the commissioner, the wider community or the particular taxpayer. It is going to depend on what the differences were between the opening and closing stock in a particular year. All we have done is try to produce a symmetrical and even-handed outcome.

Bob is saying, `That is fine, I do not really disagree with that, but I've got some other problems with the law and you should have fixed those up as well.' Again, that is just one of those judgments where we concluded that this could be done, should be done and was very straightforward to do. The other things were rather less straightforward. We believe that they are being looked at elsewhere, in any event, and can be handled under other processes that are currently under way outside the project.

Mr Bryant—To challenge something that Brian said, may I just say this: the experience that I have had, and almost everybody else has had, is that it is not true that the change—although you could argue this in a vacuum or a hypothetical sense—could go either way. The reality is, as we all know, that the circumstances tend to arise only where the commissioner wants to increase someone's value of trading stock. Therefore the change that has been put through will ordinarily work to the detriment of taxpayers. It is a change that has been recognised, and it is around a principle of change of basis. There is no doubt, from where just about everyone else sits, that there should have been uniformity in translating that through the rewrite of both the general income and the deductions areas that sit within this very bill. But a decision was made not to go that extra step, and we regret that.

Senator SHORT—Mr Chairman, my name was brought into all of this earlier on in the reference to the Assistant Treasurer. I therefore just want to ask a couple of questions to get the record straight. Mr Nolan, you said that I approved something as Assistant Treasurer. What was that?

Mr Nolan—It was the general proposition of how to deal with trading stock items being taken out for personal or other kind of trading stock use, or how things that were not

previously being bought into trading stock should be dealt with. There were submissions put to you at the time reflecting a range of views. You actually selected the view that was the consultative committee's one at the time: that there would be a cost price adopted. It did not rest with you alone, of course.With any changes that are made to the law, firstly, we ask the Assistant Treasurer for a view and for a decision. But that is then generally confirmed, if it is a sufficiently important issue—as this one was—with the Prime Minister. That is what happened on this occasion as well. So your decision was conveyed as one that the Prime Minister might endorse and agree with—and in the event he did.

Senator SHORT—He did? Right, I am pleased he did. Now, given that he did, are you saying that there were changes subsequent to what the Prime Minister and Assistant Treasurer endorsed?

Mr Nolan—No. Regarding the issues that we have been talking about as to whether the definition of trading stock got a last minute alteration, and whether that changed the world, that was something we regarded as purely a drafting matter where we do not believe that any change was being made—certainly it was not our intention. In issues of drafting detail, it would be quite impossible to ask you, the Prime Minister or anybody else to deal word-by-word with the redrafts.

Senator SHORT—Sure. Was that particular issue, on which we signed off, the issue that we have been talking about for the last hour?

Mr Bradshaw—It included that, but it covered the whole field of change of uses, both in and out.

Senator SHORT—There is a difference of view, as I understand it, between the project team and the consultative committee as to whether there was a significant change. Is that right?

Mr Nolan—There is now. There was not at the time. At the time that you were looking at the matter these were not issues that were on the table—the matters we have been talking about today, about whether there was a change in the definition.

CHAIR—The Prime Minister would not, off his own bat, decide to visit that issue. It must have been referred to the Prime Minister by someone. I would be interested to know.

Mr Nolan—Let me just make this correction: when I said that the Prime Minister approved the matter, it was probably the parliamentary secretary.

Senator SHORT—Yes, that is due process. What I am trying to get at is whether, once the Parliamentary Secretary to the Prime Minister, or the Prime Minister himself, and I had signed off on it, there were changes made which were of a significant nature which did not then subsequently come back—presumably to my successor because I had probably gone by then—for approval of the subsequent changes that had been made.

Mr Nolan—I believe that what is in the bill reflects accurately what you decided and what the parliamentary secretary confirmed. What we are talking about today is whether there should now be some changes to that decision—in effect, whether the bill, which currently

reflects what you decided, should now say something different. That would require taking those issues back and getting a different set of decisions.

Senator SHORT—Given that I endorsed what was a unanimous view of the consultative committee, are you saying that what we are talking about here today is a different view by the consultative committee? Has the consultative committee changed its mind?

Mr Bryant—Can I answer that by saying that the nature of our response, certainly from where I sit, would have been different had it been dealt with against the backdrop of the definition we have now got. That was not in play at that time. Using the old definition it is true that, as Rick Krever has said, it would be extremely rare to have the circumstance arise of someone with this land, or some other asset that they had for some other purpose, fall into the category of trading stock. We believe that by changing the definition, which was done around November, that has substantially changed and would have influenced, I believe, the representations that would have gone back around the formulation of the brief.

Senator SHORT—Do you agree, Mr Nolan, that there was a significant change to the definition of trading stock at around November?

Mr Nolan—There were changes to the words. Whether that resulted in a change in meaning of significance is what we have been debating today.

Senator SHORT—Yes, that is right.

Mr Nolan—There are differences of opinion. We do not think so but, given the strength of feeling on the issue, what we are saying is that there is probably a way, in a drafting sense, in which we can resolve the difference. On that particular issue, nobody around the table wants a different outcome. It is just a question of whether we have achieved the outcome which is basically to stay with the previous meaning of the law. That does not get into the area that you decided.

Mr BEDDALL—Mr Nolan, it comes back to this view of what is government policy that you mentioned right at the start of this debate. My contention has always been that government will endorse a view put to it rather than government policy. I think it is important for us in our deliberation on this that we know where that advice is coming from—be it Tax, Treasury, Finance—because in many ways it really reflects the views of those departments rather than of the government. The government may endorse it, but it is not necessarily government policy.

Mr Nolan—In this particular case, what Senator Short had in front of him were some different views—conflicting views in some respects—and he adopted the view of the consultative committee, but he did have a range of views in front of him.

Mr BEDDALL—It would be interesting to see the minutes because I have had those sorts of things, too. They say, `We recommend this one. If you don't take this advice, the consequences will be this.'

Ms Morton—I think that is a very important point because it has been stated a number of times the unanimous view of the consultative committee. I was president at the meeting where the representative from Treasury attended. In that meeting there were, in fact,

three scenarios that were put forward as alternate arrangements. My recollection is that it was a combination of both Alan Blaikie and myself who said that there is not just one scenario. Where, say, a company moves something out of trading stock into its fixed assets on its own balance sheet—and clearly there is no recognition of an asset in that situation—it is just moving something on your balance sheet. You should not be taxed on a non-realised economic gain. But there are other scenarios where things might move in and out of legal entities and maybe you need a difference scenario.

I remember quite clearly that three different scenarios were explained. I accept that maybe there were further papers that were presented that I may not have read through thoroughly, but you have to understand that we are here on a voluntary basis and we cannot always read everything that is put before us. A couple of members did attend and make representations to Treasury on that basis.

To say that the representations that were made were unanimously supported by the consultative committee was right to a limited extent. There were other sections that were not, I do not think, fully represented. What happened was that the portion that got implemented for that scenario was right but there were other scenarios that got left out in the cold. I think that is how we got left with this imbalance.

CHAIR—What is Treasury's role in TLIP?

Mr Nolan—They do have a person who is a permanent member of the project team but, in most respects, that particular person just works as a member of the project. But when questions of the policy boundary emerge—whether there are changes that should be made which are of a policy kind—Treasury, as the predominant source of bureaucratic advice to the government on tax policy matters, has a role. If there are changes being proposed, either by the project team or sponsored by others, which we think should be considered, Treasury is asked for its view. That is Treasury's legitimate role as policy advisers on tax.

Senator WATSON—Mr Chairman, can I ask a question? We have a very extensive definition in 70-10; but the consequential amendment act has a further modification that says:

Trading stock has the meaning given to it by 70-10 as modified by sections 124ZO and 124ZQ of the Income Tax Assessment Act.

Can somebody throw some light on that? Does that overcome the Bob Bryant problem?

Mr Reid—No. It is dealing with a different issue, Senator. When you look at the notes to 70-10 itself in the main bill, you will see a description of what 124ZO and 124ZQ do. They deal with a very special class of shares—PDFs—which have a particular treatment which takes them out of the trading stock regime; but it does not really impinge on this question of things moving in and out of trading stock.

Senator SHORT—It just relates to PDFs, does it?

Mr Reid—It just relates to shares in PDFs. It is a signpost to a series of special rules about that.

Senator WATSON—Although we have got that `pooled development funds' means

PDF, perhaps we really should say 'pooled development fund' rather than 'PDF' in 6 and 70, because a lot of people would not really know what it is.

Mr Reid—Yes, that is true.

CHAIR—I think we will conclude our discussions on this.

Senator SHORT—I have one more question. From your initial opening comments, Mr Nolan, did I hear you right as saying that trading stock changes in the bill are the one item where there is a revenue positive effect? If that is the case, what is the revenue implication?

Mr Nolan—Yes. It is in the EM. It is in the vicinity of $30 million annually. The revenue gain comes from the fact that, currently, the commissioner puts out guidelines, industry by industry and occupation by occupation, for what values would be acceptable without challenge where people take goods out of trading stock for personal consumption—for example, the butcher and baker and so on. Those values are not so much out-of-date as currently below either cost or market. By bringing in a cost price basis, we are recognising that this is an increase on what is currently an undervaluation in those commissioners' lists. When those lists are updated—which they could have been anyway, and would have been at some point—there will be an increase across the board in the amounts that would be returned as the value of goods taken out of stock for personal consumption. It is because the current lists are somewhat below a true cost figure.

Mr Langford-Brown—Mr Chairman, that only addresses that one particular issue. If there are other implications, such as have been suggested, the growth to revenue is much higher.

Senator SHORT—I would assume so.

Mr Bradshaw—The revenue estimate given is $30 million in 1999 and $25 million in each year thereafter. The revenue analysis people were unable to quantify the figure on the other changes or, indeed, to place a direction on them. If Ian is implicitly saying there would be a gain to revenue, they were unable to reach that conclusion based on the policy.

Senator SHORT—Are you saying that there is no revenue effect intended out of the change to the definition of trading stock?

Mr Bradshaw—The definition? That is so; yes.

Senator SHORT—No revenue effect?

Mr Bradshaw—The change to the definition, we thought, was a minor consequential amendment. Others, such as Bob, are concerned that maybe it does more than that.

Mr Nolan—We did not intend to change it or its application in any way by that late change. It is now being said that we did make a change. Although we contest that and do not agree, we think there is a way of meeting that concern.

CHAIR—That change was not initiated by Treasury for revenue purposes: if that is

what you are saying, then why not say it?

Mr Nolan—Treasury had nothing to do with that, no.

Senator SHORT—The change was not initiated by the ATO for revenue purposes.

Mr Nolan—The change was a late drafting matter only. It is as simple as that.

Mr Bryant—We all totally accept that. I accept fully that there was nothing sinister or malevolent or anything in any other way untoward about that change in the definition. However, we take a contrary view and say that it is very significant and we did not get a chance until now to comment, despite an 18-month consultative process. That is our concern.

CHAIR—We will have a look at the consequential amendments.

Mr Risstrom—Mr Chairman, I have to leave to catch a plane. Thank you for having me.

CHAIR—Thank you.

Mr Bryant—To open the batting on that, I have some colleagues coming tomorrow who may be able to address some specific elements around the transitional amendments but not the consequential amendments. I think it is fair to say that we had not seen this material until it was tabled in parliament. In the relatively short time that has elapsed, we, as an organisation—I think I speak for most—have not really done justice to the impact of these consequential amendments. We have had enough difficulty with the substantive provisions of the law, bearing in mind even they, we have always said, are not controversial issues, although some controversy has arisen.

Mr Nolan—There are two exposure drafts of provisions that are now in this bill, exposure drafts 7 and 8, which did in fact contain the transitional and consequential amendments that are included in the bill. I am not saying that there has not been, again, any polishing up or minor alteration but the inference that you might draw that they had not been exposed until this bill does not actually accord with that.

The transitional provisions attempt to provide a straightforward transition to the new law. The consequential amendments really close off the application of the 1936 act provisions that have been rewritten, and amend other Commonwealth acts that refer to some of the 1936 act provisions that have now been replaced.

Mr Bryant—When was the material that is in the consequential and transitional amendments bills released for comment? Just refresh my memory, Brian.

Ms Duffy—In the case of depreciation, the consequential amendments were not in the exposure draft. They were tabled later at the CC. I did that specifically at the CC. But the transitional amendments were there. So the consequential amendments were the ones that were missing.

Mr Bryant—The trading stock ones particularly.

Mr Reid—I was just going to comment on the trading stock ones. They were not exposed in the July 1995 exposure. They were circulated at some point, certainly no later than the draft that we were referring to before. The draft of 22 November contained that material and I think an earlier version of it had gone out as well but we would need to check our records on that.

Mr Bryant—The point I am trying to make is that we have not had a lot of time, though, in reality, to consult around these.

Mr Langford-Brown—We have enough trouble, Mr Chairman, trying to come to grips with this, as Bob said, to get people to contribute, let alone look at those.

CHAIR—That is my next point. Is there any purpose in going through these without the 1936 act here? Is there any point in the JCPA having to look at these?

Mr Bryant—I think we will have some comment for you tomorrow. Watch this space, but I have not presently got it.

Mr BEDDALL—Mr Chairman, I suggest we wait.

Ms Morton—There is just a general concern that they are so extensive and that they are amending things that are already before the parliament. You have one set of legislation that is before the Senate. This here amends that there. So you cannot even look at what is before the Senate at the moment to get a complete view. It seems you have got to go into this, and what is before the Senate, to be able to understand the front section of this. I had somebody the other day who trying to work out when something was supposed to start. It was quite a roundabout exercise. I am not even sure at the moment if we got the right answer, but we are still looking at it. I think that is just a general comment.

CHAIR—Mr Nolan, would you like to make a comment?

Mr Nolan—There is a lot of material in the transitional and consequential bills. The tax law is a moveable feast. It never stays still for long and you do have to keep on trying to build into the job—

CHAIR—That is that spaghetti you were talking about earlier?

Mr Nolan—That is right. We are trying to suck out a few strands here and there and make sense of them. The reality is that this is a huge task that we are embarking on. It is dealing with a constantly moving world and there is a lot of detail and a lot of loose ends to nail down. That is why the consequential amendments, and more particularly the transitional provisions, are as voluminous as they are. It is just the nature of the beast, I am afraid.

CHAIR—Before I close the public meeting, the committee accepts as evidence and authorises for publication submissions from the Taxation Institute of Australia, the Institute of Chartered Accountants, the Australian Society of Certified Practising Accountants and the TLIP Private Sector Consultative Committee dated 18 February.

Resolved (on motion by Mr Beddall):

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 4.43 p.m.