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SENATE

STANDING COMMITTEE ON ECONOMICS

ESTIMATES

(Budget Estimates)

TUESDAY, 29 MAY 2007

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BY AUTHORITY OF THE SENATE

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**SENATE STANDING COMMITTEE ON
ECONOMICS**

Tuesday, 29 May 2007

Members: Senator Ronaldson (*Chair*), Senator Stephens (*Deputy Chair*), Senators Bernardi, Chapman, Hurley, Joyce, Murray and Webber

Participating members: Senators Adams, Allison, Barnett, Bartlett, Boswell, Bob Brown, George Campbell, Carr, Conroy, Eggleston, Chris Evans, Faulkner, Ferguson, Fielding, Fifield, Forshaw, Hogg, Kemp, Kirk, Lightfoot, Ludwig, Marshall, Ian Macdonald, Sandy Macdonald, McGauran, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

Senators in attendance: Senators Carol Brown, Carr, Sherry, Ronaldson, Bernardi, Chapman, Fifield, Joyce, Murray, Nettle, O'Brien, Watson and Webber

Committee met at 9.01 am

TREASURY PORTFOLIO

In Attendance

Senator Minchin, Minister for Finance and Administration

Senator Colbeck, Parliamentary Secretary to the Minister for Finance and Administration

The Treasury

Dr Ken Henry, Secretary

Outcome 1: Sound Macroeconomic Environment

Output Group 1.1: Macroeconomic Group

Mr David Parker, Executive Director

Dr David Gruen, Executive Director

Dr Steven Kennedy, General Manager, Domestic Economy Division

Mr Phil Garton, Manager, Domestic Economy Division

Ms Nghi Luu, Senior Adviser, Domestic Economy Division

Mr David Pearl, General Manager, International Economy Division

Mr Milo Lucich, International Economy Division

Mr Paul Gardiner, Manager, International Economy Division

Mr Roger Brake, General Manager, International Finance Division

Ms Bernadette Welch, Manager, G20 and Asia-Pacific Economic Cooperation Secretariat

Mr Luke Yeaman, Senior Adviser, G20 and Asia-Pacific Economic Cooperation Secretariat

Dr Paul O'Mara, General Manager, Macroeconomic Policy Division

Mr Graeme Davis, Principal Adviser, Macroeconomic Policy Division

Mr Tony McDonald, Senior Adviser, Macroeconomic Policy Division

Mr Greg Coombs, Manager, Macroeconomic Policy Division

Outcome 2: Effective Government Spending Arrangements**Output Group 2.1: Fiscal Group**

Mr David Tune, Executive Director
Mr David Martine, General Manager, Budget Policy Division
Mr Jason McDonald, Manager, Budget Policy Division
Mr Rob Heferen, General Manager, Social Policy Division
Mr Peter Robinson, Principal Adviser, Social Policy Division
Ms Peta Furnell, Principal Adviser, Social Policy Division
Mr Michael Willcock, General Manager, Commonwealth-State Relations Division
Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division
Mr Geoff Francis, Manager, Industry, Environment and Defence Division
Mr Michael Burton, Chief Financial Officer, Corporate Services Division

Outcome 3: Effective taxation and retirement income arrangements**Output Group 3.1: Revenue Group**

Mr Mike Callaghan, Executive Director
Mr Blair Comley, General Manager, Business Tax Division
Mr Mark O'Connor, General Manager, Individuals and Exempt Tax Division
Mr Martin Jacobs, Manager, Individuals and Exempt Tax Division
Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division
Ms Louise Seeber, Manager, Superannuation, Retirement and Savings Division
Mr Nigel Murray, Manager, Superannuation, Retirement and Savings Division
Mr Nigel Ray, General Manager, Tax Analysis Division
Mr Damien White, Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Tax Analysis Division
Mr Colin Brown, Manager, Tax Analysis Division
Mr Anthony King, Tax Analysis Division
Mr Paul McCullough, General Manager, Tax System Review Division
Ms Brenda Berkeley, General Manager, Tax Design Division
Mr Matthew Flavel, Business Tax Division

Outcome 4: Well Functioning Markets**Output Group 4.1: Markets Group**

Mr Jim Murphy, Executive Director
Mr Patrick Colmer, General Manager, Foreign Investment and Trade Policy Division
Mr Chris Legg, General Manager, Financial System Division
Ms Vicki Wilkinson, Manager, Financial System Division
Mr Trevor King, Manager, Financial System Division
Ms Kerstin Wijeyewardene, Manager, Financial System Division
Mr David Love, Manager, Financial System Division
Mr Andre Moore, Manager, Financial System Division
Mr Geoff Miller, General Manager, Corporations and Financial Services Division
Ms Marian Kljakovic, Manager, Corporations and Financial Services Division
Mr Matt Brine, Manager, Corporations and Financial Services Division
Ms Ruth Smith, Manager, Corporations and Financial Services Division
Mr Bede Fraser, Manager, Corporations and Financial Services Division

Mr Jorge del Busto, Senior Adviser, Corporations and Financial Services Division
Mr Steve French, General Manager, Competition and Consumer Policy Division
Ms HK Holdaway, Manager, Competition and Consumer Policy Division
Mr Glen McCrea, Senior Adviser, Competition and Consumer Policy Division
Mr Aidan Storer, Senior Adviser, Competition and Consumer Policy Division
Mr Brad Archer, Manager, Competition and Consumer Policy Division
Mr John Karatsoreos, Senior Adviser, Competition and Consumer Policy Division
Mr Michael Johnston, Manager, Competition and Consumer Policy Division
Ms Jane Melanie, Senior Adviser, Competition and Consumer Policy Division
Mr James Chisholm, Senior Adviser, Competition and Consumer Policy Division
Ms Jacky Rowbothom, Senior Adviser, Competition and Consumer Policy Division
Mr Peter McCray, General Manager, Financial Literacy Foundation
Ms Linda Rosser, Manager, Financial Literacy Foundation
Mr Peter Martin, Australian Government Actuary

Australian Accounting Standards Board

Professor David Boymal, Chairman
Mr Angus Thomson, Technical Director

Australian Bureau of Statistics

Mr Brian Pink, Australian Statistician
Mr Peter Harper, Deputy Australian Statistician, Economics Statistics Group
Mr Denis Farrell, Acting Deputy Australian Statistician, Services Group
Ms Teresa Dickinson, Acting First Assistant Statistician, Corporate Services Division
Mr Mark Whybrow, ABS Chief Financial Officer

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman
Mr Brian Cassidy, Chief Executive Officer
Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division
Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Division
Mr Scott Gregson, General Manager, Adjudication Branch
Mr Nigel Ridgeway, General Manager, Compliance Strategies Branch
Ms Rose Webb, General Manager, Enforcement and Coordination
Ms Lee Hollis, General Manager, Cartels and Criminal Enforcement Branch
Mr Tim Grimwade, General Manager, Mergers and Assets Sales Branch
Ms Helen Lu, General Manager, Corporate
Mr Adrian Brocklehurst, Chief Financial Officer
Mr Michael Cosgrave, General Manager, Communications Group
Mr Michael Carnahan, General Manager, Information, Research and Analysis

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer
Mr Michael Bath, Director, Financial Risk
Mr Andrew Johnson, Head, Compliance and Reporting
Mr Pat Raccosta, Chief Financial Officer

Australian Prudential Regulation Authority

Dr John Laker, Chairman
Mr Ross Jones, Deputy Chairman
Mr Brandon Khoo, Executive General Manager, Specialised Institutions Division
Mr SG Venkatramani, General Manager, Central Region, Specialised Institutions Division
Dr Steve Davies, General Manager, Statistics

Australian Securities and Investments Commission

Mr Tony D'Aloisio, Chairman
Mr Jeremy Cooper, Deputy Chairman

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner of Taxation
Ms Jennie Granger, Second Commissioner of Taxation
Mr Bruce Quigley, Second Commissioner of Taxation
Ms Margaret Crawford, Chief Operating Officer
Ms Raelene Vivian, Deputy Commissioner
Ms Sally Druhan, Assistant Commissioner
Mr Greg Dark, First Assistant Commissioner

Corporations and Markets Advisory Committee

Mr Vincent Jewell, Acting Executive Director

Financial Reporting Council

Mr Charles Macek, Chairman
Mr Jorge del Busto, Secretary

Inspector-General of Taxation

Mr David Vos AM, Inspector-General of Taxation
Mr Rick Matthews, Deputy Inspector-General of Taxation

National Competition Council

Mr John Feil, Executive Director
Mr Ross Campbell, Director

Productivity Commission

Mr Bernard Wonder, Head of Office
Mr Garth Pitkethly, First Assistant Commissioner
Mr Michael Kirby, First Assistant Commissioner
Ms Su McCluskey, Executive Director, Office of Best Practice Regulation

Takeovers Panel

Mr Nigel Morris, Director

CHAIR (Senator Ronaldson)—I declare open this meeting of the Senate Standing Committee on Economics. The Senate has referred to the committee the particulars of the proposed expenditure for 2007-08. The particulars propose supplementary expenditure for 2006-07 and certain other documents for the industry, tourism and resources and Treasury portfolios. The committee is due to report to the Senate on 19 June 2007. It has fixed Friday, 27 July 2007 as the date for the return of answers to questions taken on notice.

Today the committee will begin its examination of the Treasury portfolio, starting with Treasury output group 3.1 revenue and the Australian Taxation Office and continuing in the order shown on the agenda. I remind everyone to switch off their mobile phones or render

them inaudible. Under standing order 26, the committee must take all evidence in public session. This includes answers to questions on notice. I remind all witnesses in giving evidence to the committee that they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee. Such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

The Senate, by resolution in 1999, endorsed the following tests of relevance of questions at estimates hearings. Any questions going to the operations or financial positions of the departments and agencies which are seeking funds in the estimates are relevant questions for the purpose of estimate hearings. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise. The Senate has also resolved that an officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. If a witness objects to answering a question, the witness shall state the ground upon which the objection is taken. The committee will determine when it will insist on an answer, having regard to the ground which is claimed. Any claim that it would be contrary to the public interest to answer a question must be made by the minister and should be accompanied by a statement setting out the basis for the claim.

Senator Minchin—No, thanks.

[9.03 am]

Australian Taxation Office

CHAIR—Thank you, Minister. We now turn to the first item on today's agenda, which is an examination of Treasury output group 3.1, revenue and the Australian Taxation Office. I understand that Senators Carr and O'Brien have questions for the Taxation Office.

Senator O'BRIEN—I will start the ball rolling this morning. I wanted to ask some questions about the settings for managed investment schemes. Firstly, was there an analysis undertaken on the impact of ending non-forestry managed investment schemes in relation to investment in jobs in rural and regional Australia?

Mr D'Ascenzo—Could you repeat the last part of the question, please.

Senator O'BRIEN—I want to know whether an analysis had been undertaken in relation to the impact of ending non-forestry managed investment schemes on investment in jobs in rural and regional Australia.

Mr D'Ascenzo—Again, the role of the Commissioner of Taxation is to apply the law. The question of policy as to whether or not the arrangements procured employment or otherwise is outside our scope. We would have worked with Treasury in relation to government

considerations of this matter, but the role of the Commissioner of Taxation is merely to apply the law.

Senator O'BRIEN—So any of that work, if it had been done, would have been done in Treasury?

Mr D'Ascenzo—We have done work generally in relation to understanding the industry. But it is not a question of trying to work out an economic position in policy terms.

Senator O'BRIEN—Are you saying that if it were done, it would have been done by Treasury?

Mr D'Ascenzo—I am not sure. Treasury officers are here on that matter. We did do some research in relation to the industry. I am not sure whether that is the same as the question you asked, which was whether we have a full-blown analysis of the economic impacts of what a change in our position in applying law would amount to.

Senator O'BRIEN—What is the impact on revenue?

Mr D'Ascenzo—There would be arrangements that would be entered into that under a different view would not be entered into. So there would be a favourable impact on revenue. But that would be dependent on how many arrangements there are.

Senator O'BRIEN—So what is factored into the forward estimates on revenue and forgone revenue?

Mr D'Ascenzo—I think Treasury might know what is factored into it. Basically, there is no change in the sense that there would be no arrangements that had deductions disallowed out of MIS agricultural business. Our ruling only applies from the following years, so nothing would have been in this year's estimates.

Senator O'BRIEN—What about the out years?

Mr D'Ascenzo—I am not sure whether that is calculated.

Senator O'BRIEN—Are you saying that are you not aware of any calculations?

Mr D'Ascenzo—I am not aware of the calculations. There may be some done. All I can say is that, from the tax office perspective, our main focus is to determine what is the correct application of the law in relation to these arrangements. That has been our prime focus. In the application of that view of the law, we have had extensive discussions with agribusiness. Their concerns are that they need some transition. On 27 March, we agreed to provide them with a one-year transitional period.

Senator O'BRIEN—So does that mean that the one-year transitional period will lead the scheme off into 2008-09 in terms of operation? In other words, product can be sold in the lead-up to the tax year—

Mr D'Ascenzo—In 2007-08, we will be applying the same view that we held in our earlier public ruling. But we have a draft new public ruling circulated in the marketplace which indicates that our view of the law has changed given a number of court decisions in this area. To allow the industry some time to transition, we have said that we would not change our view for that 12-month period. So you are correct in saying that there would be an opening opportunity between 2007 to 2008 for people to seek to enter MIS agribusiness schemes in

accordance with the way that they have been doing it in the past. At the same time, we are working with the industry to bring to the courts as soon as possible a test case. If that test case confirms our new view of the law, we would then say from that point on that we cannot apply the law other than as the courts prescribe.

Senator O'BRIEN—So any future savings are contingent on the outcome of any challenge?

Mr D'Ascenzo—Very much so.

Senator O'BRIEN—Are you able to tell me what projected amounts would not be forgone revenue in the form of tax deductions from forestry managed investment schemes?

Mr D'Ascenzo—It all depends what sort of applications were in the courts. So it is not one that has been looked at from the tax office perspective as to how much revenue is involved or not involved. It is a question of having had some dicta in two cases, one a Supreme Court case—*Environs*—and another one in two Federal Court cases, *Vincent and Puzey*, both of which suggested that our previous approach might be wrong, we reviewed that. We think that, on balance—it is not clear-cut—our view is wrong. We propose to change it. But because it is on balance, we give some transitional period and we seek to run a test case to have the matter clarified by the courts.

Senator O'BRIEN—In terms of the revenue measure on page 14 of Budget Paper No. 2, forest managed investment schemes statutory deduction for investments, it is noted in the text of this measure there will be a cost to revenue of \$246 million in the 2010-11 financial year. Could you tell me the methodology for arriving at that amount?

Mr D'Ascenzo—I think that is a matter for Treasury. This is a new government measure of afforestation. Treasury would have worked with my Revenue Analysis Branch people to examine that.

Senator O'BRIEN—So when would the appropriate officers be before this committee so that the questions can be asked? Is an officer here who can answer it?

Mr Callaghan—The revenue estimates that appear in the budget are undertaken by Treasury when they are measures documents. The one you are referring to, as you will see, when it is costed over the forward estimates—it is the budget year and the four years—there are no revenue implications there. Because this is a long-term measure—it is dealing with investments in property that continue for a long time—there is what is the estimated impact in those out years beyond the forward estimate period. They were undertaken within Treasury.

Senator O'BRIEN—What is the basis of that calculation? Is it assuming that the measures taken together—that is, the non-forestry and the forestry measures—will see an increase in investment in forestry?

Mr Callaghan—First of all, there has to be a separation on these things. On the non-forestry there is not a measure. What you are dealing with is what the ATO is interpreting is the law now. When we come to a measure, we are talking about a decision taken by government that has an impact on what the revenue would be. On the non-forestry, the ATO indicate in their ruling that they considered the investors in a managed investment scheme are not carrying on business and they are not entitled to an upfront deduction. The government

came out and said that it would not be doing anything to alter that interpretation of the ATO's current change in its interpretation of the law. So as such there is no measure. There is no measure that is a result of a government decision.

Senator O'BRIEN—No, there is not. There is not a measure in these papers.

Mr Callaghan—That is separating that one. On the other one, when we come to it, yes, the ATO has changed. What the government has said with respect to forestry is that they will introduce a statutory deduction regime. So, in that sense, if the government did not introduce the statutory reduction regime, by doing that, the money would be coming in. There is now a measure that says it will cost revenue because it is different to what the interpretation of the law is. The government has taken a decision. We are just talking about forestry here. We are not talking about non-forestry.

Senator O'BRIEN—Well, that is what the measures on pages 14 and 15 are talking about. I understand that. What I am trying to ascertain is, taken together, what is the impact of the decision of the tax office, if it can be called that, and the budget measure? In particular, I want to know about the two figures, basically—an increase in revenue of \$44 million in 2009-10 and the reduced revenue by \$246 million in 2010-11.

Mr Brown—The costing that appears in the budget is the cost of the forestry managed investment regime and is the cost of providing a statutory deduction. It has been costed against what was already in the forward estimates. What was in the forward estimates already was the prepayment rule for forestry, which was due to end on 1 July 2008. Under that base scenario of that rule ending in 2008, the anticipation was there would have been a reduction in the level of forestry investments with the ending of the prepayment rule. There would have also been an ending of the rule which brought forward the payment of company tax on the amounts invested, which aligned it with the deduction available to investors. In the year that the rule ends, that would have resulted in a revenue loss. Company tax would not have been paid in that year because it had already been paid the prior year. That gives rise to the transitional revenue gain. If you do not end the rule, you do not have the revenue loss. After that, the costing reflects mostly the difference in the level of deduction available to investors. If the rule under the statutory deduction is anticipated, there would be a higher level of investment into forestry than would be the case without the prepayment rule deductions.

Senator O'BRIEN—So an assessment is made on the level of investment, I take it, in forestry managed investment schemes in those years.

Mr Brown—An assessment was made, and the assessment was made on the basis of discussions with the industry.

Senator O'BRIEN—So what are the amounts which it is estimated will be invested in forestry managed investment schemes in the coming financial year and the out years which is the basis for these calculations?

Mr Brown—I do not have those investment figures with me. I would have to take that on notice.

Senator O'BRIEN—If you would, thank you. Are they hard to ascertain?

Mr Brown—As I say, I would have to take the question on notice. The estimates are ones which are based on consultations and the like.

Senator O'BRIEN—They must be a number, an amount of investment, to base the calculations of tax or costs to revenue out of the schemes.

Mr Brown—That is correct, yes.

Senator O'BRIEN—I am just saying that somewhere the numbers already exist, don't they?

Mr Brown—There is a number which underlies the costings. As I say, that is a projection. It is based on actual levels in the past and then assumptions regarding where it would go.

Senator O'BRIEN—In relation to the non-forestry managed investment schemes, do I take it that the numbers in years eight, nine and beyond are zero? That is the amount of investment?

Mr Brown—That is not a measure.

Senator O'BRIEN—I know it is not a measure, but it is a decision which we are told Treasury has done the work on and would know what the out year outcomes are of that decision.

Mr Brown—At the moment, it is in fact not a variation either because the actual final ruling has not come out.

Senator O'BRIEN—Okay.

Mr Brown—It is one of those things. It is something we are keeping an eye on.

Senator O'BRIEN—When will that be done? The final ruling is not due until the end of next year—is that what you are saying—and therefore you will not do any work on it until then?

Mr Brown—I am not saying that. What I am saying is that at this stage, until the final ruling comes out, we do not have something which is an actual variation.

Mr D'Ascenzo—We have a draft ruling in the marketplace, as I mentioned beforehand, and are in consultation with the agribusiness industry. We have agreed to provide them with the shorter of a 12-month transitional period before we change our view or hopefully the conclusion of a test case within that period of time. So until either the test case or the 2008-09 year, nothing changes from the past in terms of agribusiness. People can enter these arrangements—

Senator O'BRIEN—Until the test case is determined?

Mr D'Ascenzo—That is right. Or the end of the 2007-08 year.

Senator O'BRIEN—Whichever comes first?

Mr D'Ascenzo—Whichever comes first.

Senator O'BRIEN—So there are no changes factored into the out years pending that outcome?

Mr D'Ascenzo—That is right.

Senator O'BRIEN—In terms of the measure on page 15 of Budget Paper No. 2, did Treasury develop the secondary market model that is being used for the forestry managed investment schemes?

Mr Callaghan—There was extensive consultation with the industry in advising government on the secondary market trading scheme. Treasury undertook with the department of agriculture extensive consultation.

Senator O'BRIEN—There are amounts factored into the forward estimates on page 15. What level of activity in financial terms are those numbers based on?

Mr Brown—Again, they are based on mostly historical levels of investment into the industry. There has not actually been trading taking place so you have historical levels of investment as well as assumptions regarding the amount of trading that would take place once a trading regime has been allowed. That reflects the fact that the decision is to allow trading in respective interests in the industry.

Senator O'BRIEN—So what are the assumptions that are made on the level of trading?

Mr Brown—I would have to take that on notice. Off the top of my head, I cannot give you the exact figures.

Senator O'BRIEN—It seems that you are predicting a fairly stable level of trading over the out years, judging by the numbers certainly in the first two years but then dropping to \$20 million in 2010-11. Can you explain that?

Mr Brown—That reflects two things. One is the level of trading, which is, as I recall, fairly steady. But also once you allow the trading and the interests have traded, the amount of tax that you get on harvest will decline because you have already taxed some of the value.

Senator O'BRIEN—So that is a bringing forward of income you would otherwise have received.

Mr Brown—Because you have a bring-forward effect, the amount of revenue you get from trading does decline.

Senator O'BRIEN—Can you explain the basis for the four-year period—holding the initial investments for four years before they can be traded?

Mr Callaghan—Essentially it was to stop what you could call arbitrage very early on—that you would be taking advantage of manipulating it to be able to take really a tax advantage. Again, it was done in consultation with the industry. The industry certainly wanted a slightly longer period, but the agreement that came out was a four-year period.

Senator O'BRIEN—The industry agreed, or that is the determination?

Mr Callaghan—As I said, the industry were seeking a longer holding period. But it was a compromise between reaching what is the right balance between facilitating the trading and having the necessary integrity.

Senator O'BRIEN—Has Treasury undertaken any consultation that included discussions on applying a secondary market to non-forestry managed investment schemes?

Mr Callaghan—No.

Senator O'BRIEN—There is reference in the measure on page 14 to a 70 per cent rule, if I can call it that. How was that figure arrived at?

Mr Callaghan—Well, that was the government's decision. That was the policy that was handed down by the government.

Senator O'BRIEN—Was it the subject of negotiation or a determination of government—

Mr Callaghan—There was an extensive period of consultation on this that goes back to the 2005-06 budget, when a review was announced and there was extensive consultation. I have not got the dates in front of me, but there was an initial release by the government indicating one possible direction it was going in terms of putting a dollar cap on the amount that would be deductible. That led to further consultation with the industry that derived with this arrangement that I believe is broadly acceptable to the industry.

Senator O'BRIEN—In relation to these measures regarding forest managed investment schemes, has there been a consultation with the forest industry and the forestry managed investment industry after the December 2006 announcement of the changes to forest MIS?

Mr Callaghan—On forestry? Yes, indeed. Very extensive consultation.

Senator O'BRIEN—What issues were the subject of that consultation?

Mr Callaghan—This is after the 70 per cent, did you say?

Senator O'BRIEN—After the December announcement of the 70 per cent.

Mr Callaghan—In preparing the legislation. The government has announced that on all substantive matters of legislation we go into extensive consultation with them. We had a very extensive consultation with the industry on preparing the legislation.

Senator O'BRIEN—What issues were raised by industry in relation to the legislation?

Mr Callaghan—Well, the matters that industry would go through are in developing and identifying what is the nature of the expenditure that would count for the 70 per cent. That is one thing in particular that it is very interested in. And then all the other aspects that are associated with the detail in developing it. So it is very widespread on all aspects of the legislation. We prepare. We prepare discussion papers. We go through. In this case, they saw exposure drafts of the legislation. They commented on the detail and went through it in a great deal of detail.

Senator O'BRIEN—In relation to the matter of the non-forest managed investment schemes, has Treasury undertaken any analysis of the impact of ending non-forestry MIS to investment and jobs in rural and regional Australia?

Mr Callaghan—Sorry?

Senator O'BRIEN—Have we undertaken any analysis on what the impact of ending non-forest MIS would be to investment and jobs in rural and regional Australia?

Mr Callaghan—Again, there was consultation on the non-forestry arrangements. As a result of those consultations, all aspects were covered.

Senator O'BRIEN—So you did not undertake an analysis, but there was some consultation with the non-forest MIS sector?

Mr Callaghan—I think in May the government indicated that it would be undertaking further consultations on the application of the then announced new arrangements for the forestry industry and its application to non-forestry. This was following from that consultation on this matter.

Senator O'BRIEN—I am trying to ascertain whether Treasury has done any work on that subject. Can you enlighten us on that?

Mr Callaghan—The nature of the work we would be doing is the advice that we would give the government. You are on to areas of the general policy advice that we would be giving the government. What I can say is that what was announced was that there would be consultation on the application of what was announced for the forestry arrangements to the non-forestry. We undertook consultations. Obviously there would be advice going to the government as a result of those consultations.

Senator O'BRIEN—Over what period were those consultations and with whom?

Mr Callaghan—Because the forestry industry is a very large component of the non-forestry agribusiness investment, a lot of the consultation was undertaken with the same people—those who are involved in forestry and non-forestry. They are very diversified across both sides of the agribusiness.

Senator O'BRIEN—So were there other groups seeking consultation? Were they consulted?

Mr Callaghan—If other groups were seeking to come forward to us, yes, we would speak to them.

Senator O'BRIEN—You would or you did?

Mr Callaghan—We did.

Senator O'BRIEN—Are you certain of that?

Mr Callaghan—Of those who came forward. There was not a call for submissions on the agribusiness, so the industry have referred to the consultations arrangements. But as I said, the government had indicated it would be consulting on the application of the forestry to the non-forestry. We did consult on that. You could say it was targeted very much on the main players, who are also those involved in the forestry business.

Senator O'BRIEN—So we should understand that to mean that the companies that promote and organise these managed investment schemes were all consulted, should we?

Mr Callaghan—I could not say whether every company was consulted. Certainly the main players were consulted and very active.

Senator O'BRIEN—Could you advise us on notice exactly who was consulted with regard to the non-forest managed investment schemes?

Mr Callaghan—I would have to take that on notice. I do not have that information.

Senator O'BRIEN—Thank you for doing that. Could you also advise the period over which that consultation took place?

Mr Callaghan—Certainly I can say that the starting date was May 2006.

Senator O'BRIEN—But you said in relation to the forest managed investment scheme decision that there was a consultation which took place. I am interpreting that answer to mean that you are talking about a consultation post December 2006.

Mr Callaghan—Sorry, no. What I was talking about was that it was announced in the 2005-06 budget that there would be consultation on forestry. There was a time limit for the pre-payment rule and it was announced that there would be consultation dealing with the forestry industry. The government in May 2006 made an announcement regarding the forestry and proposed new arrangements for the forestry business. In May 2006, it indicated that it would be consulting on the basis of the application of these new arrangements for the forestry to the non-forestry business. From May 2006, then, was a period when there was consultation on the application of what was announced for the forestry to the non-forestry business. I cannot remember the exact date—I have not got them in front of me—when the government indicated that it would not be applying the same arrangements for the forestry business to the non-forestry business in the light of the change in the ATO's interpretation of the carrying on business rules.

Senator O'BRIEN—Most people who come to my office about that issue claim that there was no such consultation, that indeed they were told to wait until after the forestry decision was announced and then afterwards there was no effective consultation. I am very interested if you could advise us who was consulted about non-forestry and when that consultation took place.

Mr Callaghan—As I said, I would have to take that on notice. I do not have it in front of me.

Senator O'BRIEN—I will await those answers. I will allow Senator Carr to ask some questions.

CHAIR—Senator Watson has a question on this matter.

Senator WATSON—The decision is that 70 per cent of the fees in a forestry scheme must be applied in the form of direct agricultural type costs. How will the legislation overcome what I perceive to be a Cecil Brothers decision, which in the past has provided a limitation on the ATO's ability to drill down in the accounts on cost allocations in an audit trail? Perhaps Mr D'Ascenzo might like to respond.

Mr D'Ascenzo—I am not sure about the provisions in the law. I do not believe the provisions have a non-arm's length dealing test.

Senator WATSON—Sorry?

Mr D'Ascenzo—I do not believe that the provisions have a non-arm's length dealing test, which would mean that Cecil Brothers would still apply and people can still pay an amount provided that it is not grossly excessive.

Senator WATSON—You do not think the Cecil Brothers decision could be argued to nullify the effect of that 70 per cent requirement?

Mr D'Ascenzo—I think the law just puts a cap on the deduction. The question is whether it is deductible in the first place. Cecil Brothers would apply to that earlier question about

deductibility. If someone pays an amount to someone else for a business purpose, unless it is grossly excessive, we are bound by it.

Mr Callaghan—I will just add that within the way the bill—it is not law yet—has been developed, it expressly includes what is the nature of spending that can be within the 70 per cent. It is covering the planting, tendering and harvesting of trees et cetera. There is a range of expenditure which is expressly excluded from the direct forestry expenditure. It covers such things as marketing, insurance provision, financing, lobbying and general business overheads et cetera. So the law makes it quite specific the nature of the expenditure that does come within the direct forestry expenditure category.

Senator WATSON—So you are referring to direct costs rather than indirect costs, are you?

Mr Callaghan—That is right. The definition is direct forestry expenditure. The bill catches what is direct forestry expenditure and what is explicitly excluded.

Senator WATSON—But you can envisage that what includes direct forestry expenditure could include a proportion of head office overheads in that allocation.

Mr Callaghan—As I said, there are types of expenditure expressly excluded from direct forestry expenditure. One of them is general business overheads but not the overheads directly attributable to the forestry operation.

Senator WATSON—Thank you. Thank you, Mr Chairman.

Senator CARR—I would like to ask some questions with regard to the research and development tax concession for the tax expenditure statement of 2005 and the tax expenditure statement of 2006. I am not certain; are these matters for the ATO or matters for Treasury?

Mr Brown—They are Treasury.

Senator CARR—I want to take you to the table identified as B53 in the TES for 2005 and B57 in 2006. This is on page 95 for 2005 and page 100 for 2006.

Mr Callaghan—We do not have 95 with us.

Senator CARR—What it shows is that there has been a considerable downgrading in the revenue forgone estimates between the 2005 report and the 2006 report. For instance, in the current year, 2006-07, it was downgraded from \$520 million to \$380 million. I can give you copies of these tables if that is helpful to you.

Mr Brown—Yes. That would be helpful.

Senator CARR—You have 2006 there. We will just wait for the officers. So that is B53.

Mr Brown—Yes. The changes in those numbers reflects two things. The first, a relatively minor part of the change, is because the data is updated from year to year, it is based on actual tax return data and claims for the concessions. The second is that there was a change in the methodology between the two years. The change in methodology corrected an error in the earlier calculation.

Senator CARR—Can you explain to me what the change in the methodology was?

Mr Brown—When the concession is calculated, the concession is calculated on the basis of the value of the claim for the R&D concession. The actual tax concession in this case is the

extra 25 per cent deduction that a taxpayer is able to claim for that. In determining the amount of the tax expenditure, you need to start from the claim and divide by a factor that gives you the tax concession amount. The factor that was being used was incorrect.

Senator CARR—So does that help me explain how you did that retrospectively?

Mr Brown—Well, the error was made in previous years. It was a difference between basically dividing by four as opposed to dividing by five to derive the amount of the tax expenditure. There was an incorrect formula being applied.

Senator CARR—Was there any change in the take-up rate of the taxation concession? Was that part of the new data that you had?

Mr Brown—The new data will reflect the actual take-up rates that applied in those years. As more tax return data comes in for earlier years, there will be small changes in the take-up rate, but I would not expect them to be significant.

Senator CARR—If I look at B54 and B58, they show an increase in the estimated costs of that \$175 premium concession over the entire period. What has led to that reassessment?

Mr Brown—I cannot give you an exact answer to that. I think that that would mostly reflect changes in return data, but I would have to take that on notice.

Senator CARR—There are quite substantial changes. Again, the way I read those tables, they are retrospective changes at that.

Mr Brown—Changes in the past, as I say, will mainly reflect changes in information that comes through in tax returns. As more information comes in, numbers will be updated.

Senator CARR—Going back to 2002-03?

Mr Brown—The change in 2002-03 was relatively small. That is a \$5 million change. In that case, that could reflect quite a small change. In part, there is also rounding in those calculations. So a change of \$5 million in that case is not particularly significant. Sorry, it is \$85 million. It is the same thing in 2003-04. It is only a relatively small change. For 2004-05 it is larger.

Senator CARR—I want to take you to line item B23 for the statement in 2006. The second paragraph under the table states that the refundable R&D tax offset is treated as an expense item and accordingly does not appear as a tax expenditure in its own right. Am I right to presume that the offset is actually paid out to eligible companies each year?

Mr Brown—That is correct. The purpose of the offset is that it is paid to companies that are in a non-taxable position. So they would not be able to benefit from a tax deduction. As a result, that is why it is a refundable offset. It gives them a payment.

Senator CARR—I will take you now to the 2007-08 Treasury PBS on page 205. In the ATO section there is a line item called R&D refundable tax offset for small companies. For 2006-07, it is estimated to be \$290 million and for 2007-08 it is \$320 million. Am I right in thinking that this line item represents estimates of the funding that is actually paid out to companies under the offsets each year?

Mr Callaghan—Sorry, which document are you referring to? The portfolio budget statement?

Senator CARR—The PBS.

Mr Callaghan—The portfolio budget statement?

Senator CARR—Yes. For 2007-08 on page 205 under 2.5, Special appropriations.

Mr Brown—Yes. What is in the tax expenditure statement is not the tax offset amount. What is in the tax expenditure statement is the tax expenditure that arises because the offset, which is an outlay, is not taxable.

Senator CARR—Yes. But in the PBS figure, we are moving from \$290 million to \$320 million. I take it that represents an estimate of the funding that will actually be paid out to companies under that offset program.

Mr Brown—That is the estimate of the amount that will be paid, yes.

Senator CARR—Is it possible for you to give me the estimates for each year for the current forward estimates?

Mr Brown—I do not have those estimates.

Senator CARR—Who does?

Mr Callaghan—I do not think they are published on a forward estimates basis.

Senator CARR—Why is that?

Mr Callaghan—Well, it is a breakdown of an ongoing program. Certainly in terms of the documentation we are looking at here we do not have the breakdown of every component of ongoing programs over the forward estimates and all the details of them.

Senator CARR—But you have the figure here for 2007-08.

Mr Callaghan—Yes. That is in the tax office's budget statement.

Senator CARR—So do I ask the tax office whether they have got the forward estimates?

Mr D'Ascenzo—We do not have that information. We can go back and see where that information came from and see what we can provide.

Senator CARR—If you could, please. I will go back to that tax expenditure statement line B23 of the 2006 report. Can you explain to me just exactly what those figures represent.

Mr Brown—They represent a combination of several factors. One is the non-taxation of the expense amount, which is a positive tax expenditure. The second part of it is the denial of deductions for amounts that were subject to the offset in future years. That is a negative tax expenditure. The negative tax expenditure in that case, because the denial of deductions has a direct tax value, is larger than the tax expenditure that relates to the offset amount. The actual amounts balance to zero in aggregate terms. But because we are looking at tax expenditures, we are talking about variations from a benchmark. So what we are looking at there is the sum of the variations from the benchmark. As a result, the numbers go from a positive tax expenditure when the program was relatively young and the main tax expenditure related to the non-taxation component. As the program matures and companies that receive the offset would have been taxable and claimed deductions, the tax expenditure goes negative. A negative tax expenditure basically means that we are taxing the taxpayer at a level higher than

under the benchmark. The point to note here, of course, is the taxpayer in this case has had an upfront benefit from the tax offset.

Senator CARR—I want to be clear about this. If I wanted to estimate the net costs of the tax offset for a single year, would I need to add a line item from the PBS, which represents here the expense element, and the line item in the tax expenditure statements, which represents the revenue forgone? I will give you an example. In 2007-08, I take the \$320 million from the PBS and subtract \$90 million because the figure in the TES is negative so that the net cost of the offset for 2007-08 would in fact be \$230 million.

Mr Brown—It would depend on what you are trying to get at by net cost of the offset. Are you referring to the amount that the Commonwealth actually pays out to taxpayers?

Senator CARR—I would like to know what the total cost of that particular item would be. How would you cost the total cost of that item? The net cost of the tax offset for a single year, how would you do it?

Mr Brown—We would need to look at the amount of the offset that was actually being paid, which is the amount in the PBS. Then you would need to look at in the future years the amount of tax deduction that was being denied. The number in the TES is a combination of two other things because it also includes the amount of tax on the offset that is not being paid, which is the positive tax expenditure component. I would not take that into account again necessarily because if I were looking at it against the forward estimates, I would not be using the tax expenditures methodology.

Senator CARR—I will try to understand what you are saying. Which years, then, if you would not use that?

Mr Brown—What I would be looking at would be the historic cost of the offset payments, which are what are provided in the PBS. We would then need to know or assume that those amounts which would have been tax deductible would have been clawed back over some period in the future as companies became taxable. We would apply an assumption or a profile of that deductibility in the future to work out the clawbacks.

Senator CARR—Can you explain to me where this profile comes from.

Mr Brown—The profile comes from the experience that we have of taxpayers who go from being taxable to non-taxable over a period of time.

Senator CARR—So it is an educated guess?

Mr Brown—It is based on past experience.

Senator CARR—When I talk to the people at industry, they tell me that not one of the years in recent times has been right in terms of their estimates. So how good is your profiling to assess the cost of these offsets?

Mr Brown—I am not sure what their comment relates to.

Senator CARR—Let us just go on. It does strike me that every year you adjust these estimates and they tell me they adjust them based on figures provided by Treasury every year.

Mr Brown—We certainly do the tax expenditure estimates. We revise them each year, yes.

Senator CARR—Could you provide me with the sources of information that you use to estimate the expenditure by firms on eligible R&D in the out years. What information would you need to calculate the estimates in the TES?

Mr Brown—We need the historic data on expenditures and the trend that we would use going forward. Trend is based on a growth parameter. A growth parameter generally reflects growth in the economy.

Senator CARR—So you apply that index as a general rule, that growth figure?

Mr Brown—Sorry?

Senator CARR—Do you apply a general growth figure, or do you look at a growth figure industry by industry?

Mr Brown—We would normally apply a general growth figure.

Senator CARR—Let me take 2005-06. How many firms claimed the 125 tax concession? Do you know that?

Mr Brown—I would have to take that on notice.

Senator CARR—What was the total research and development expenditure on which the 125 expenditure was paid?

Mr Brown—Again, I would have to take that on notice.

Senator CARR—Is it possible to get that information relatively quickly?

Mr Brown—For years up to 2004-05, that information is published in the taxation statistics.

Senator CARR—Yes. I have that. I want 2005-06.

Mr Brown—I do not think that information is available yet. Again, I would have to take that on notice.

Senator CARR—And, in the 2005-06 year, are you able to tell me how many firms claimed the premium R&D tax concession?

Mr Brown—Again, I would have to take that on notice.

Senator CARR—When would that information normally become available?

Mr Brown—That would normally become available when the commissioner publishes the taxation statistics in the online version for that year. I think we are up to 2004-05 in the most recent, so it would be in about 12 months.

Senator CARR—So when it comes to calculating the costs for expenditure in 2005-06, we have to rely upon this methodology that you have outlined a few moments ago—historic data, trend line assumptions and the growth forecasts? Is that right?

Mr Brown—That is correct.

Senator CARR—That is why it has to be adjusted every year?

Mr Brown—Well, we would adjust it in light of the actual information that has come in. So there would be revisions to take account of more recent return data.

Senator CARR—I have some other questions I will put on notice as well, if I can. But there is no way I can get that information today? Is it possible to come back to the committee and advise whether or not that information in 2005-06 is available within the department?

Mr Brown—I would have to check on that and get back. But I do not think that information is available yet.

Senator CARR—Thank you. I might go to the question of the changes to the premium concession that have been announced. That is particularly in relation to allowing access by international firms to hold their intellectual property in the so-called beneficial ownership tests. The industry department told me last night that Treasury is responsible for determining the costings on this change. Is that correct?

Mr Brown—That is correct.

Senator CARR—The global integration brochure says that the industry minister's media release—I draw your attention to the media release of the minister on budget night—indicated that 300 more companies would use the concession annually as a result of the change. Can you explain to me where that figure came from? How have you reached a conclusion that 300 firms would use that additional benefit?

Mr Brown—That was an assessment of the number of firms that were undertaking research and development expenditure but which were not eligible to claim the deductions. So it looks at the number of firms that are in a potential benefit position.

Senator CARR—You have said that that number of firms will continue—that 300—for every year for the next 10 years.

Mr Brown—The 300 was an assessment of the number of firms that could potentially benefit. The projection over the 10 years is a projection based on the budget numbers of \$50 million per annum over four years. The projection beyond the forward estimates period is simply that—a projection.

Senator CARR—But that is what it says in the documents—\$50 million per year for 10 years. That is per year. Where did that come from? Did you calculate, what, 300 firms, divide by the equivalent rate for 175 and get \$50 million? Is that how it works?

Mr Brown—We looked at the potential number of firms that could benefit and the potential levels of expenditure. We applied take-up assumptions to those firms. So it is not assumed that all of them would necessarily benefit at once. The \$50 million was the estimate that we arrived at taking account of the range of possible outcomes. It is the most representative possible outcome.

Senator CARR—I see. You have said there would be an additional business R&D investment of \$222 million per annum. That is the figure that is used. Is that your figure as well? \$222 million per annum. I raised this with the industry officers last night and they told me that it came from you. It is the figure that appears in the minister's statement on budget night. The change is estimated to cost \$50 million per annum and result in additional business R&D investment of \$222 million per annum. Where did that figure come from?

Mr Brown—I would have to take that one on notice. We certainly would have estimated that the potential expenditure was greater than \$200 million. But I am not sure about the precise figure you are quoting.

Senator CARR—Well, it is very precise in the ministerial statement. Do you want a copy of that as well? I can show you a copy of it.

Mr Callaghan—No. I do not think we need a copy of it. I think what Mr Brown is saying is that you have asked us where the figure comes from within that industry statement. As we have said, he is sitting here now. We cannot answer your question. We will have to take it on notice to find out the basis. We cannot recall where the figure comes from.

Senator CARR—Yes. The other problem I have is that it is the figure, presumably, that gives you the \$50 million per annum, the costing. The impression I am left with is that you worked back from a costing and got a figure as distinct from doing it the other way around. Is that possible?

Mr Brown—My recollection of this costing was that there was a range of possible take-up rates that was looked at. We would have looked at a level of potential expenditure by companies and then looked at the possible take-up rates to arrive at the \$50 million.

Senator CARR—Then why have you got \$50 million in the forward estimates of the initiatives for every year?

Mr Brown—We had \$50 million in the forward estimates period reported in the budget for each year as the most representative estimate for that period.

Senator CARR—Not up or down? A range of factors, you said to me before. A range of possibilities. But you have come down with \$50 million every year for four years.

Mr Brown—As the most representative estimate.

Senator CARR—Your best guess?

Mr Brown—Essentially. It is not a guess. It is based on an analysis of the data. But there is a range of possible outcomes, and \$50 million is reported as the most representative of those. To present a more precise set of numbers would have been spurious accuracy.

Senator CARR—Spurious accuracy, yes. I think that is a term that applies here more generally. I ask, then: how reliable are the estimates of \$50 million and \$22 million per annum in additional R&D for the periods in the six years outside the forward estimates?

Mr Brown—Those figures for the six years outside the forward estimates are a projection of the numbers from the budget period.

Senator CARR—So how accurate do you think they are?

Mr Brown—As I say, they are a projection based on the same analysis and the same figures. But as you go further out, any estimate beyond the forward estimates period becomes less reliable.

Senator CARR—Yes. Let alone 10 years.

Mr Brown—Certainly in this case you are talking about a program which is entitlement based so it depends on taxpayer take-up rates. Actually predicting the exact amount of take-up and the exact expenditure is in fact quite difficult. It depends on what taxpayers do.

Senator CARR—Yes, indeed. That is the point. It is a behavioural question.

Mr Brown—Certainly.

Senator CARR—Is that another case of spurious precision?

Mr Brown—I would not say we applied spurious precision to those estimates. We published a number of \$50 million as the most representative estimate of a range of possible outcomes.

Senator CARR—Could you provide me with details of how Treasury came up with the estimate of that take-up in R&D spending and the cost to the budget?

Mr Brown—We would have to take that on notice.

Senator CARR—I am confused as to why it is assumed the policy will cost \$50 million in revenue forgone in the first year. I take you to that first figure.

Mr Brown—In the first year?

Senator CARR—Yes. In the first year. I am sure you would be aware that the R&D concession at the moment requires three years. That premium rate requires a service record of three years before you can claim the money. I take it that it would be agreed that companies often plan their R&D spending more than a year ahead. I am wondering whether or not you would normally expect that a decision like this would have a slow burn effect in terms of the take-up rates. It will take them a little while to actually shift activity. Therefore, I am asking if you could explain to me why it is that you have calculated the \$50 million for 2007-08.

Mr Brown—Probably the first part of the explanation to that is that companies, when they are claiming this, will be able to vary their tax instalments. That will mean that the financial impact will be able to be shown, once they start claiming, pretty much in the same year. So that is part of the explanation.

Senator CARR—So they will no longer be required to show the three years of service?

Mr Brown—No. All I am saying is that once they start claiming, they do not have to wait until they put in their tax return. They can make a variation of their company tax instalments in order to be able to make their claim.

Senator CARR—Is that a change?

Mr Brown—No. That is just administrative practice that companies are able to do that if they have a basis for a variation.

Senator CARR—Are there any other changes that you are anticipating which would allow that calculation to be realised—the \$50 million in the first year?

Mr Flavel—I think your question is why, as I understand it, there is not a requirement to establish a three-year history.

Senator CARR—That is the current practice.

Mr Flavel—Yes.

Senator CARR—I think you have changed that.

Mr Flavel—The intention of the measure would be to give multinational enterprise subsidiaries access to this concession from the date of 1 July 2007. As part of the development of the legislation we are looking at ways of enabling that to happen through the entry history rules.

Senator CARR—Sorry?

Mr Flavel—Through the entry history rules.

Senator CARR—I see. So you are changing the criteria?

Mr Flavel—I would not say changing the criteria. Some firms, as you know, may be increasing their R&D, particularly pharmaceutical companies, for instance. So those who are accessing grants under the P3 program will have a history. That history, which extends beyond two years—

Senator CARR—Or commercial ready or something like that?

Mr Flavel—Yes. So it is really a question of balance about saying, ‘Well, why would we necessarily allow those companies to access this straightaway and for others, who may be locating in Australia and increasing their R&D effectively from 1 July, denying them that benefit until three years down the track?’

Senator CARR—They currently cannot demonstrate a record of investment, can they?

Mr Flavel—Well, there is an open question there—and this really gets to the development of the legislation—about the most appropriate way to ensure that it is limited to those genuine cases where they are in fact increasing their R&D.

Senator CARR—Can I ask you this: how many multinational subsidiaries are there in Australia that could potentially benefit from the changes in the longer term if they did choose to increase their spending?

Mr Flavel—My understanding is that the figure of 300 firms that was used is an amalgam of a number of different sources. There will be those subsidiaries who may be increasing their R&D currently and holding the IP offshore who, as a result of the relaxation of the beneficial ownership test, will now get access to this concession. There would be subsidiaries of multinational enterprises who are not increasing their R&D but who as a result of these measures may now increase their R&D and retain the IP offshore.

Senator CARR—How many of those?

Mr Flavel—I do not know the exact breakdown. I would have to take that on notice. And the third component, which is an important component, would be those multinationals who now decide to locate a subsidiary here and conduct the R&D in order to access this concession.

Senator CARR—Again, how many of those are there?

Mr Flavel—As I said, I would have to take on notice the breakdown. I am just giving you the—

Senator CARR—I understand the point you are making. Does the Treasury have access to that sort of information as to companies that are thinking about setting up in Australia?

Mr Flavel—No. But I think the point would be that in making this estimate there is that amalgam of those three components. Clearly, some firms we would know about, such as those in the pharmaceutical industry. Others will be making a reasonable estimate about those who may choose to locate here.

Senator CARR—Can you tell me what R&D expenditure you would expect these companies currently account for? How much money are they spending on research and development at the moment?

Mr Flavel—In total, I do not know. I would have to take that on notice.

Senator CARR—But you are able to establish that?

Mr Flavel—Are you talking about those companies who are currently located here and looking at R&D?

Senator CARR—I find it extraordinary that you can identify precisely that 300 companies for 10 years—not 299, but 300—every year produce this benefit, which you then put through at \$50 million per annum. I am just fascinated how you can get that figure. I would like to know, therefore, how much these companies currently spend on their research and development.

Mr Flavel—Just in relation to the point about the 300 firms, my recollection is that it says more than 300 firms. It does not say around 300 or exactly 300. It is a subtle point, but it is establishing, if you like, a minimum of those who would be expected to take up this measure.

Senator CARR—But if it is more than 300, presumably the estimated cost of \$50 million per annum would have to change, wouldn't it?

Mr Flavel—It is more than 300. I guess I am making the point that it is not a straight line relationship saying that it is 302 firms.

Senator CARR—I accept that. But the cost in these papers is a straight line estimate.

Mr Flavel—Mr Brown has articulated the reason why that is the case.

Senator CARR—And the figure of \$222 million per annum is a straight line estimate.

Mr Flavel—I do not know that we have established the source of the \$222 million.

Senator CARR—Finally, did Treasury do an assessment of the cost of extending the removal on IP ownership, the beneficial ownership test, to the 125 concession?

Mr Flavel—No, we did not.

Senator CARR—Thank you very much.

Senator BERNARDI—I have some questions for Mr D'Ascenzo. Is it fair to say that the agency heads have a fair degree of flexibility in their work conditions and work environment and their remuneration?

Mr D'Ascenzo—Yes.

Senator BERNARDI—And what sort of flexibility does that normally entail for your senior executives?

Mr D'Ascenzo—In relation to certain commissioners, they are bound by an independent tribunal. So it is within certain bands of that tribunal at that level. Otherwise it is a question of whether or not people are in the category of ongoing employment on an ongoing basis with some level of tenure or whether they are on a non-ongoing basis, in which case you can do AWAs and the like. All the SES in the tax office are on AWA arrangements.

Senator BERNARDI—That is interesting. How many lower level or mid-level executives are on AWAs, do you know?

Mr D'Ascenzo—A much smaller number than that.

Senator BERNARDI—A much smaller number?

Mr D'Ascenzo—I do not have the precise figure with me.

Senator BERNARDI—I happen to have a figure from last year's report. It says EL2s—is that the type of executive band we are talking about?

Mr D'Ascenzo—That would be an EL2 right below the SES level.

Senator BERNARDI—In June 2006 there were 13, which is not very many.

Senator SHERRY—Congratulations.

Senator BERNARDI—The question is: are these AWAs offered, available widely and encouraged, with the flexibility, given that all of your senior executives are on them?

Mr D'Ascenzo—All the SES are on them. That is the area that we focused on. We have a view in terms of the framework of trying to see those areas of the organisation that require greater levels of flexibility. Some of those areas are in, for instance, IT or forensic accounting. So a lot of the AWAs you see there relate to specialist skills.

Senator BERNARDI—Would that be the same with general employees, of which there is a much more significant number? I understand as a proportion it may not be reflective. But general employees is assuming—

Mr D'Ascenzo—It is not exclusive, but basically we have run normal employee work agreements that cover the bulk of our employees.

Senator BERNARDI—But AWAs are available, then, broadly to mid-level management?

Mr D'Ascenzo—They are available. The way that we have been using them has been in relation to specific areas of expertise. Generally we have been going through more general agreements. For instance, we have an agreement with EL2s that cover the EL2s as a group. Within those arrangements you have some level of flexibility in that people can take up a range of salary sacrifice options. There are options in those agreements. But generally they are broad based agreements. The same applies to people below the EL2 level.

Senator BERNARDI—Is there a definitive policy document about who is available and who can access AWAs?

Mr D'Ascenzo—We have a policy document, and I can provide that to the committee.

Senator BERNARDI—I would be interested if you could identify how it is made available to employees as well, if that is okay. Apart from the specific skills, which you mentioned, how do you identify what specific skills are warranted the offer of an AWA?

Mr D'Ascenzo—I think it is where we have major activities. It is really very much an identification of the person or skills that we want to either retain or look at arrangements to remunerate relative to those skills.

Senator BERNARDI—Sure. I happened to be browsing your website a bit earlier. It talks about the benefits and the flexibility of AWAs for your senior executives and for use within the ATO. Would you consider an internal program to promote the benefits of AWAs more widely and fulsomely?

Mr D'Ascenzo—Again, we have started from what we think are the critical areas of the organisation, which is the SES and some within the EL2. You will find there are a few below the EL2 level as well. We are looking at specific areas where a degree of flexibility could be useful. For instance, in our client contact areas, we are looking at the potential use of AWAs there. So we actually have focuses in the organisation where greater levels of flexibility could be advantageous to the organisation rather than just a general spill of AWAs, which would be more difficult. We are looking at a more targeted approach.

Senator BERNARDI—I understand that and I accept that. But I find it interesting that less than one per cent of your mid-level people, according to your report, EL2 employees have been employed under AWAs—the figures precisely were 13 EL2 employees and 1,413 were on certified agreements—yet for your general employees it is closer to twice that, at two and a half per cent or thereabouts. It is 444 of your 19,900 employees. I am just trying to see why general employees are able to avail themselves of more flexibility than your mid-level executives.

Mr D'Ascenzo—I think you will find that the mid-level executives—the EL2s—have actually had an agreement which has been worked out with them. So it actually includes some of the features you would find in AWAs. In other words, they have been packaged into a more general agreement rather than at an individual level. The other side of it is that a lot of the 440 below the middle range go in terms of keeping some IT capabilities associated with our change program.

Senator BERNARDI—Thank you. Do you mind if I ask you a couple of questions on the AVO briefly?

Mr D'Ascenzo—Sure.

Senator BERNARDI—I would like to reference some material from Senator Fifield, who cannot be with us today because he is ill. He asked me specifically to follow up on a couple of issues related to his previous questions. Do you recall the substance of the conversation at estimates about Dr Parker and his removal from his office?

Mr D'Ascenzo—Yes. I remember those questions.

Senator BERNARDI—It was also referenced in a *Financial Review* article about Dr Parker's departure from the AVO, which is what prompted Senator Fifield's questions. My

question specifically relates initially to how long you retained Dr Parker as a consultant to the AVO after his removal as head.

Mr D'Ascenzo—We had arrangements to maintain Dr Parker's expertise as a consultant. To my knowledge, I am not sure we have used those services so far.

Senator BERNARDI—So he would not have been paid anything in that time?

Mr D'Ascenzo—That is right. That is to the best of my knowledge, but if that is incorrect, I will correct that too for you.

Senator BERNARDI—I would be interested if he has been retained and used. You referred to perhaps a half a day a week or something.

Mr D'Ascenzo—Yes. I was hoping to maintain some of the skills, but I am not sure whether we have actually made use of those skills as at this time. But I will confirm that.

Senator BERNARDI—And if you have, I would be interested in what tasks he performed, the remuneration and those sorts of things that go with it. Following Dr Parker's removal as the general manager, Senator Fifield asked whether it was in response to the Cooney and Associates report. Has the Cooney and Associates report been tabled or is it a public document?

Mr D'Ascenzo—I do not think it is a public document. It is a report that indicates whether or not, in their view, the ability to get the AVO people more on board could occur under Dr Parker's leadership or whether a change of leadership would be beneficial to that end. It concluded that the level of difference between Dr Parker and some of the AVO staff members was such that it would be desirable and advantageous for a new beginning from someone who has made significant changes to the status quo to someone who could then move it on to the next level.

Senator BERNARDI—That is a very diplomatic answer. Since the removal of Dr Parker, has the stability of the employment relationship within the AVO—40 employees out of 150 moved on in the space of 12 months—improved?

Mr D'Ascenzo—The rate of change has decreased markedly.

Senator BERNARDI—And the retention of skills and the attraction of new employees?

Mr D'Ascenzo—We have certainly retained skills. We are still in the market in terms of new employees.

Senator BERNARDI—So how many employees are there now within the AVO, approximately?

Mr D'Ascenzo—I do not know. One hundred and fifty.

Senator BERNARDI—So it is around the same mark as it was previously?

Mr D'Ascenzo—That is right.

Senator BERNARDI—Has a permanent replacement been appointed for Dr Parker?

Mr D'Ascenzo—Yes. We had a senior tax officer appointed to Dr Parker's position. It was John Ryan. John Ryan recently was promoted to a position in our change program. I have

since moved into that position another senior tax officer, Steve Vesperman. So Steve Vesperman at the moment is the general manager of the AVO.

Senator BERNARDI—And how long has he been in that position?

Mr D'Ascenzo—He has been there now for the last three months and John Ryan was there for the previous period.

Senator BERNARDI—But it is a permanent appointment?

Mr D'Ascenzo—That is right.

Senator BERNARDI—That is fine. I am just interested in that. Within the AVO, there is an incentive bonus system that operates for AVO employees. Is that correct?

Mr D'Ascenzo—There is. It is one that I have asked the general manager to review so as to align the AVO more closely with the general ATO remuneration package and framework. But there is one at the moment. That is part of the surplus of AVO profits.

Senator BERNARDI—And quite a number of the ATO employees are actually eligible for access to the bonus system in the ATO?

Mr D'Ascenzo—We also have a performance bonus system in the ATO, but that is based on different criteria. That is a performance criteria based on how well a person performs both in terms of what they do relative to their job description and how they do that relative to our values and APS values.

Senator BERNARDI—Why was there a difference in the assessment basis between the AVO and the ATO?

Mr D'Ascenzo—It is historical. AVO was originally part of the ATO and then it moved to DAS. It then grew up its own level of rules of operation, particularly under the mantle of trying to create an environment of competitive neutrality. That led to the AVO really doing very much its own design of the sort of business models it adapted. We inherited some of that from DAS when they came back to tax. Over the last 12 to 18 months, we have been seeking to align the AVO activities to the more general ATO infrastructure.

Senator BERNARDI—Can you then briefly explain how the current bonus system within the AVO operates or the one that you are seeking to change or has been referred to a remuneration tribunal?

Mr D'Ascenzo—I think it had to do with the AVO having to, first, compete on market terms—turn a profit, return part of that profit to finance. Out of the remainder there was a division of whatever surplus pool arose, if any arose. I am not quite sure how the split occurred.

Senator BERNARDI—So you do not know how it was allocated? Perhaps you could follow up that and advise us accordingly.

Mr D'Ascenzo—Sure.

Senator BERNARDI—I would be interested—

Mr D'Ascenzo—Typically at the same level, the level of remuneration of the AVO was slightly below the level of remuneration of the ATO.

Senator BERNARDI—What, then, would be, say, the maximum level of remuneration or bonus remuneration that an AVO employee could achieve?

Mr D'Ascenzo—I think in terms of the ATO it is something in the order of \$20,000. The AVO would be less than that.

Senator BERNARDI—It would be less than that. Would you mind following that up with a figure for us as well.

Mr D'Ascenzo—Sure.

Senator BERNARDI—The other question, I suppose, with regard to bonus systems—it is applicable across both the agencies—is that within the AVO what safeguards are there in place to ensure that the performance bonus is appropriately or fairly assessed?

Mr D'Ascenzo—Well, they still have to work through a range of remuneration committees. That has to be agreed all the way up to my level for senior bonuses. So the same level of checks and balances occurs in the AVO as occurs in the ATO.

Senator BERNARDI—You mentioned that the AVO is operating in a quasi-commercial environment—they have to be competitive. Some jobs would be much more lucrative than others within external responsibilities. Could there be an opportunity for senior executives to choose the most attractive jobs that may reflect on their bonus system?

Mr D'Ascenzo—I do not think people have that level of discretion. I am not sure there is a variance among the sorts of jobs in the AVO. I think they have a much more mundane, structured application of that bonus. It has not been a significant bonus over many years. But we can provide more information about how that works out.

Senator BERNARDI—So it is not based, then, on specific income generated or anything of that nature?

Mr D'Ascenzo—No. Just as in the ATO income or revenue, in the AVO the profits are not necessarily the driver of it. In fact, it is not really part of the performance model that we drive. It is about how the AVO performs. It is then broken up in terms of levels mainly and how the people have performed in those levels and generally the way they have carried out their responsibilities. We are not in the private sector for the AVO and ATO, where it is the bottom line dollar. We are looking at longer term sustainability and a whole range of issues. If we were doing that, then you would have a disparity between people at the front end of, say, profit generation and people up the back end, who would be ignored but whose work is just as important to ensure that we have a good outcome in our business models.

Senator BERNARDI—And how do you manage the situation with employees who do not receive bonuses when the bulk of their colleagues do? A brief examination of your website shows that a significant number of your employees, particularly at the senior levels, receive performance bonuses.

Mr D'Ascenzo—It runs off often on how well the organisation has performed. That is usually a good guide as to whether there is a general level of bonuses or not. So if you have done well in terms of meeting the whole range of portfolio requirements, some of that is passed on to the people in the organisation who have produced those results for the organisation. But it is still a question of performance. Some people are performing not as well

as others. Those few people have to get the frank feedback that they need to lift their game. We are happy to help them lift their game. But this is one reflection that they are not travelling as well as the vast bulk of our people. Some take it constructively and some are very disappointed by the outcome.

Senator BERNARDI—And the bonuses are determined by a remuneration tribunal?

Mr D'Ascenzo—That is right.

Senator BERNARDI—Is that independent or is it made up of internal ATO staff?

Mr D'Ascenzo—No. It is internal. They are internal tribunals.

Senator BERNARDI—Within the AVO they have their own internal tribunal? It is not consistent? It is not the same tribunal that sits on the ATO?

Mr D'Ascenzo—No. They have an AVO tribunal, but that is then brought into the ATO moderation processes. So it is looked at certainly by me. I am not sure whether or not the broader remuneration committee does. The senior ATO remuneration committee also looks at that as well.

Senator BERNARDI—And it comes back to you for the final sign-off?

Mr D'Ascenzo—Sign-off on recommendation from the remuneration committees.

Senator BERNARDI—Do you have any contribution to the design of it or the design of the bonus system?

Mr D'Ascenzo—In the sense that, for instance, in last year's EL2 agreement process, I put to the EL2s that if they wanted to redesign the bonus system, I was happy to consider it. Ultimately after they consulted amongst themselves, they thought that the status quo was probably the best option. So I do have a say in the course of setting out those systems for the organisation through our normal wage and salary determination processes. Basically, once it is in, I have remuneration committees that provide recommendations. Unless something seems to be out of kilter, that is the way it works.

Senator BERNARDI—In the case, then, of the AVO, Mr Parker would have had an input into the design of the remuneration system, albeit it grew out of DAS, as you mentioned earlier?

Mr D'Ascenzo—I think just from memory there was no significant change to the remuneration system in terms of the bonus processes under Dr Parker's leadership.

Senator BERNARDI—Would you be kind enough to confirm that as well for us?

Mr D'Ascenzo—Yes. By all means.

Senator BERNARDI—In the event there was some change.

Mr D'Ascenzo—I will document whatever change there might have been.

Senator BERNARDI—That would be great. Thank you very much for that. I have no further questions.

Senator SHERRY—I want to make a couple of points on the same issue. When was DAS transferred? Can you recall the approximate time?

Mr D'Ascenzo—It is a lot of years ago. It is near on a decade, I think.

Senator SHERRY—1996, was it?

Mr D'Ascenzo—Fairly close.

Senator SHERRY—1996 or 1997?

Senator Minchin—1997.

Senator SHERRY—Who was the head of the department then?

Mr D'Ascenzo—I do not know.

Senator SHERRY—Could you take on notice to disaggregate the bonus, the levels, the quantum paid and numbers paid. Obviously I do not want names.

Mr D'Ascenzo—I understand.

Senator SHERRY—You said earlier that you have a say. In response to Senator Bernardi, you have made a suggestion that they re-examined the structure of the bonus scheme and the parameters. They went away and came back and said no. It does not seem to me you had much of a say. You make a suggestion and then they veto it.

Mr D'Ascenzo—No. They asked whether or not consideration of our performance system was out of scope in terms of the consultations we were having with them. I said, 'No, I'm happy to take on board your thoughts as to how that can be a very effective lever to foster good performance in the ATO.' They discussed it and they thought it was operating well overall, albeit there are always different views about how these systems could be structured.

Senator SHERRY—I return to my earlier question that you have taken on notice about the historical data over the last 10 years so that we can see what the trends have been. Thanks.

Mr D'Ascenzo—I am not sure whether I have data over 10 years, but I will provide what I can.

CHAIR—I think that is a good time for a break.

Proceedings suspended from 10.37 am to 10.57 pm

CHAIR—We will resume the hearings.

Senator JOYCE—I have a question with regard to the Tax Laws Amendment (Measures No. 4) Act 2006, which for the record covers capital gains tax exemptions for foreign companies for shares inaction. For the record, the passage of this legislation was supported by Labor. Did you give any advice on what would be compromised with regard to tax revenue on the passage of this legislation and the effect of foreign companies becoming capital gains tax free for majority non-real property assets which they show as inaction shares? Did you give any advice to Treasury on what that cost would be?

Mr Callaghan—The measure has now passed passage into legislation. There was a costing associated with that.

Senator JOYCE—It was \$245 million over four years?

Mr Callaghan—Yes.

Senator JOYCE—That is \$65 million in the first year and \$50 million in the proceeding years after that. Would you feel that those figures are still relevant?

Mr Callaghan—Are still relevant? They were the best costing we had on the information available when the measure passed through parliament, yes. Certainly circumstances will change just as much as the economy changes now and over the forward periods.

Senator JOYCE—Bearing in mind the event of private equity firms and the \$11 billion possible takeover of Qantas, which is still on the table, do you think that those figures are grossly underestimated?

Mr Callaghan—It is not possible to say. You are raising the issue of the range of private equity which would affect many aspects of the collection of revenue. In terms of looking specifically at the CGT measures as they apply to non-residents going forward, it all depends what is going to happen in the economy—what takeovers happen, when they choose to sell and what happens going into the future.

Senator JOYCE—Can we just look at the \$11 billion in isolation. Of that \$11 billion, 49 per cent is domestic, so let us talk about the 51 per cent foreign. That is roughly \$5 billion. Let us say they get a 20 per cent increase, which would be stock standard for capital gains tax sales. That is a \$1 billion capital profit for which in the past there would have been a 30 per cent tax. So we would have been looking at \$300 million into the Australian coffers. After this, the passage would be zero. How do we comprehend \$65 million, \$50 million and \$50 million when one event in isolation—

Mr Callaghan—I think we went through this costing before. It all depends on whether the investors are portfolio or non-portfolio to start off with and whether CGT is applying now. If it is the case when the measure was introduced I think, as we explained, it could be avoided. For example, if a foreigner does not want to pay CGT, all they have do is hold their investment through a corporate entity overseas and when they want to sell their investment they just sell their corporate entity overseas and no tax is collected here. The way you are doing it, I think, does not take into account all of the variations that can take place. That is, I think, the important point that you have to remember. It was easy to construct an arrangement so that you did not have to pay the CGT.

Senator JOYCE—At the time it was stated that there was a trade-off. There were other countries that have a like—

Mr Callaghan—Yes.

Senator JOYCE—Obviously you cannot take into account the countries that already have that process in place because they would be part of your figures. You cannot gain a saving from a position that already exists. You can only gain a saving from a position that is intended—that is, an intended change in the tax rules in another country which is a predominant Australian investment target. For instance, if you are talking about your costings, you cannot take into account the position of England because they should already be in your costings. You cannot take a saving. Is there another country that is a predominant Australian target that intends to change its capital gains tax rules to effect a saving for Australian investors?

Mr Callaghan—I am sorry, I am not quite with you. But what we were talking about before was that the international norm—and the OECD model tax convention—does not apply the CGT to other than real property. Its focus is on real property. What we talked about before when you raised this was that in our treaty negotiations we were in effect to maintain our arrangements or at least extend it beyond real property—we had to give concessions. So this was the reality that was occurring. We were going against the international norm. Yes, there are some countries that are still looking at trying to tax the capital gains of other than real property, but the international norm—

Senator JOYCE—Which countries are they?

Mr Callaghan—The OECD ones that I am aware of are France, Germany and Japan. Can I just finish? If you look at it, foreigners were paying tax in their jurisdiction, so in one sense it is where the taxing rights lay. It does not apply in Australia, but if the foreigners—the foreign company if it was involved—made the gain, they would be paying tax in their own jurisdiction.

Senator JOYCE—So the belief was that there would be changes overseas and they will be sending their tax home and we would be taxing here. Just like they would be taxing it in their place of residence, we would be taxing our investment gains overseas in Australia. Is that correct?

Mr Callaghan—That is right.

Senator JOYCE—That would presuppose that if the costings of \$65 million, \$50 million and \$50 million were correct, the intended changes overseas would bring about that savings, because otherwise they would be part of your costings already. What I am saying is you cannot—

Mr Callaghan—Yes, I agree. We were costing it on the basis of not what other countries were doing, but on what we were doing. We were costing it on the basis of removing the CGT from other than real property or land-rich companies. This was what we estimated was going to be the cost. As I say, the cost was relatively small compared to what you are thinking about because it could be quite easily avoided by just setting up an interposed company.

Senator JOYCE—It could be avoided now. All I have to do is set up in New Zealand, where they do not have capital gains tax, siphon any capital gains I made in Australia into New Zealand and not pay tax at all.

Mr Callaghan—If it is on real property here, they would be paying tax on it.

Senator JOYCE—But if I were to wave my magic wand, buy Qantas and in a few years time sell it—and if my entity was based in New Zealand—I would not pay capital gains tax, would I?

Mr Callaghan—Not in New Zealand; no.

Senator JOYCE—So I would be tax free.

Mr Callaghan—If you were based in New Zealand and if you were a New Zealand resident.

Senator JOYCE—I am not very clever, but I am sure there are other people out there who are. Surely they would have thought of that.

Mr Callaghan—To base themselves in New Zealand?

Senator JOYCE—To base themselves anywhere—the Bahamas, New Zealand or any one of those other small islands.

Senator SHERRY—New Zealand is not a small island!

Mr Callaghan—You are talking about broader issues there of corporations trying to evade tax—for instance, are they truly established in the Bahamas—and there are arrangements in place to combat such evasion of tax.

Senator JOYCE—Part 4A.

Mr Callaghan—Not simply part 4A, but the exchange of information and where the substantial head office lies.

Senator JOYCE—This is not a trick question. What are the arrangements of the United States on capital gains tax on shares? If I invest in the United States, are their arrangements an exact reflection of our arrangements?

Mr Callaghan—I would have to double check. I believe that, from the information I have been given, within the OECDs the exemptions were France, Germany and Japan.

Senator JOYCE—Can you take that on notice?

Mr Callaghan—The United States arrangements—certainly.

Senator JOYCE—I turn now to negative gearing through private equity buyouts and the position there. Referring back to that \$65 million, \$50 million, \$50 million and \$50 million, do you still stand by those numbers or do you think they need updating now?

Mr Callaghan—Once the measure is given, the cost is given to that. As we go forward, it is no longer a measure; we are looking at the fundamental base. That is always changing as the activity and the economy are changing.

Senator JOYCE—Are you still looking at that?

Mr Callaghan—We forecast, we estimate the expected revenue by changes that are taking place in the economy. We do not go back and publish a revision of the estimate.

Senator JOYCE—Are you reinvestigating that amount?

Mr Callaghan—We are always looking at the future tax base, the expected tax revenue and all the components that make it up.

Senator JOYCE—So the answer is yes. With the negative gearing of these entities and thin capitalisation rules, what is the position of the Taxation Office with regard to possible revenue compromise by private equity firms' investments in such things as Qantas, Coles, PBL and other potential targets? What is the tax compromise by the higher gearing of these entities and the effect on the Australian tax take?

Mr Callaghan—There are many components to look at. You have focused on one—the gearing. Any corporation certainly has its level of gearing and its level of interest deductions.

If it increases its borrowing, it has high interest deductions and it will be claiming that off its income. If we are looking at a private equity or any takeover arrangement, if the financing came from Australia then, yes, there would be those interest deductions, but then the income would be accruing to an Australian entity and they would be paying tax on that. If it comes from overseas, certainly what we would be claiming is probably the interest withholding tax that comes from that that goes overseas.

Looking at any nature of gearing, companies gear for a purpose. If they expect that they are going to be able to perform the company better and are borrowing and investing in assets, potentially they are going to be increasing their profitability and that would flow through into your tax revenue. To complete the picture, when there is a changeover, if there is a sale of the asset, a CGT event will be realised and there will be an increased gain to revenue from the CGT. So there are many aspects involved.

Senator JOYCE—Hang on. We have just exempted them.

Mr Callaghan—No. We are talking about foreigners, and we are talking about domestic too. If it is a takeover of an Australian entity, the foreigners are buying it off Australian and they are realising the CGT event.

Senator JOYCE—That is a one-off event. Once the foreigner buys it, then that capital gains tax remains overseas. Unless they sell it back to Australians, it is not going to come back into the loop. There is an inherent disadvantage in being Australian and investing in an Australian company. I would rather live in New Zealand and do it, because there is a cost advantage in doing it from there.

Going back to the tax effect of the negative gearing: with your income stream you have a tax deduction that is going to an overseas entity so you cannot tax it in Australia, and when that same overseas entity sells its investment it is capital gains tax free. So it is out of the loop in two sections. Have we done any investigations? I am not blaming you, because this is a new advent. Private equity firms have only arrived in recent times, but are we doing a strong analysis on what the effects will be because, if we need to change laws, we need to change them on what the effect will be on the Australian tax take. About 40 per cent of our tax revenue is corporate, is it not?

Mr Callaghan—It is a little less than that. We are watching it very closely. The Treasurer has announced that we are watching developments overseas in terms of the whole impact of private equity on tax revenue. For example, a few months ago there was an announcement in the UK that they were looking at the nature of the mezzanine financing arrangements that were taking place in this. The question was: were there arrangements in the financing of this where essentially you had what was an equity type operation financing it where a deduction should not be allowed; was that being packaged up as if it were a debt instrument where a deduction was allowed? These are the types of things that we are watching very closely. We are looking at developments. In many respects we are looking at hypothetical situations of what might happen. But what we are looking at is the overall arrangement of the tax system. These private equity deals you are talking about are not taking advantage of something special in the system; it is something that is available to any structuring arrangement. What you are trying to ensure is that you have the tax system overall that is appropriate.

Senator JOYCE—The instrument of debt becomes an instrument of control when it is so prescriptive that it actually tells the organisation how it is going to work. Therefore, it may be nominally in debt but it is implicitly in an equity position. It has more fundamental items of control than the nominal shareholding position. Coming from my five years in banking, all I have to do is to say: ‘I will lend you the money. These are the key performance indicators and this is what I expect of you. These are your cost structures and this is how you will operate.’ Inherently I now have, by ipso facto, an equity position. Do we need to concentrate on that and look at potential amendments in the future to take that on board?

Mr Callaghan—The issue we are looking at in terms of the debt equity is not related to control; it is to repay what you put into the entity. For example, is it totally contingent on the performance of the company like an equity position, like buying a share, or is it more like debt that you have an obligation to repay, regardless of the profitability? They are the arrangements that you are looking at for tax purposes to see the distinction between debt and equity.

Senator JOYCE—Do you, under your taxation department powers, get to examine of those debt documents to determine if they are, by default, really not so much a debt instrument but an equity instrument?

Mr Callaghan—This is Treasury on this side of the table, Senator. The current arrangements and the application of the law are matters for the Commissioner of Taxation.

Senator JOYCE—I refer my question to Mr Michael D’Ascenzo.

Mr D’Ascenzo—It really depends on whether or not the parties seek private rulings from us, in which case we would ask for debt information and debt instruments to see whether or not they are debt rather than equity packaged up in some other way. We may, if we were to audit people, seek to procure these documents. That would depend very much on whether they are available in Australia or whether they are overseas via a third party that we may not be able to reach. It really depends on that, but certainly, if we were to investigate the issue, we would be looking for that sort of information.

Senator JOYCE—When you see these private equity players in the market, do you actively investigate their debt instruments so as to ascertain whether they are ipso facto controlled instruments?

Mr D’Ascenzo—Not so much from the sense of control, but from the sense of whether or not they fall within the Australian definition of debt or equity.

Senator JOYCE—How do you determine that without investigation of them?

Mr D’Ascenzo—You have to do that.

Senator JOYCE—Are you doing that?

Mr D’Ascenzo—We are in relation to major ones, yes. But again, it depends on whether the debt instrument is sourced in Australia or is available to us.

Senator JOYCE—Let us say it is sourced overseas. I am talking about it being sourced overseas.

Mr D'Ascenzo—Many times, when we have approached the parties, they will provide that information to us. But if they do not and they are not situated in Australia then we do have some limitations on our ability to procure them.

Senator JOYCE—I am talking about overseas instruments. I am looking at ways, if I were cunning and shrewd, to get around the foreign Investment Review Board guidelines.

Mr D'Ascenzo—The issue is that if we were to investigate, under our risk profiling, large private equity arrangements of the type that you speak of, they would come up as a risk area for us to consider. In considering that, we would be seeking to work with the parties to have an understanding of how the arrangements work, including the financial arrangements. In fact, financial arrangements are quite a key part of most of our large business examinations. Normally, the parties will provide the information to us and we will determine whether or not they meet our debt equity requirements and the three to one thin capitalisation rules—a whole range of considerations.

Senator JOYCE—Talking about thin capitalisation rules: do we investigate people who think when they approach the thin capitalisation laws that the way they will get round them from now on will be to incur certain fees and structures that are not determined to be debt but that are fees and management structures which, likewise, are just a mechanism of shifting income to another entity overseas?

Mr D'Ascenzo—That is one of the things we look out for. In fact, that is one of the reasons we are there. On the face of the account it might show—

Senator JOYCE—You are there so I do not have to pay too much tax.

Mr D'Ascenzo—that you have so much debt and so much equity. Our examination is all about going behind that to see whether or not what is on the account reflects a fair description of the dealings of the company.

Senator JOYCE—In your investigations so far, without being particular and breaching any confidence, have things come to light which have caused you some concern and have given you reason to look further or deeper?

Mr D'Ascenzo—We have made public the sorts of things that we would be looking at in the area of general mergers and acquisitions. The sorts of questions are: is it really debt; is it equity in relation to our rules; do people meet the debt equity requirements of three to one debt to equity; and are there capital gains tax issues for the Australian resident and are they disclosing those? They are the sorts of issues that we are going to look at in relation to major transactions that have a potential impact on the Australian revenue.

Senator JOYCE—Obviously you cannot disclose policy, but do you foresee changes that we may need to be made in the future?

Mr D'Ascenzo—As we get that intelligence by getting some practical experience in relation to these matters and if there are obvious loopholes or questions about the policy, our process, as it is across a whole range of tax matters, is to consult with Treasury and see whether or not matters need to be taken to government. Part of our role is to keep an eye on the system to make sure it is operating as intended. If the policy dials need to be changed, that is a matter for Treasury and government to decide.

Senator JOYCE—Is there any section of either Treasury or the taxation department that is exclusively looking at the tax consequences of the capital gains tax exemptions in the Tax Laws Amendment (2006 No. 4) Bill 2006? Is there any section that is dedicated to the potential of income loss through negative gearing of private equity firms?

Mr D'Ascenzo—We would not necessarily have a specific team working on that GST measure, but we have a CGT area. Part of that work would be to monitor the effectiveness of those arrangements and to feed back to Treasury some experience that we see on the ground. In relation to public equity, we have a team and we have a meeting with the public equity industry later this week.

Senator JOYCE—In that feedback, if there is a review of the figures or costings that were inherent in the explanatory memorandum of that bill, will that be brought forward? Will that be a public document?

Mr D'Ascenzo—I am not sure about that. I think that, as was explained, it will probably just be picked up in our forward estimates of revenue.

Mr Callaghan—That is right.

Senator JOYCE—So it will or it will not?

Mr Callaghan—No, it is exactly as we said before. We do not go back and publish a revision of a costing of a measure, but going forward we are always estimating what the tax revenue is. So we are looking at all the revenue heads and all the influences on it.

Senator JOYCE—Can I ask you in the future if you would like to update those figures? You might come up with some different ideas about how much that capital gains tax exemption costs.

Mr Callaghan—As I said, the government's practice has not been to republish the costing of measures that were announced in previous budgets.

Senator JOYCE—Thank you.

Senator SHERRY—On the same issue of the private equity deals, in your earlier responses, Mr D'Ascenzo, you seemed to be indicating that, in examining overseas based structures, there is a greater level of difficulty in examining those, gathering intelligence and investigating. Is that correct?

Mr D'Ascenzo—That is why we work hard to create a very good environment through our treaty networks with other countries in trying to get information from them through our exchange of information procedures.

Senator SHERRY—But you say 'trying to get information'. Is it more difficult to gather information in those circumstances?

Mr D'Ascenzo—It depends on where the information is held. There might be countries that have bank secrecy provisions, or they might have no double tax agreement with Australia or no exchange of information agreement with Australia. In those situations, unless they have someone who is resident, domiciled or permanently established in Australia, we have great difficulties in procuring that sort of information.

Senator SHERRY—If you have great difficulties, isn't there then a greater risk to revenue?

Mr D'Ascenzo—Yes.

Senator SHERRY—Yes? I am sorry; you are nodding.

Mr D'Ascenzo—Yes.

Senator SHERRY—So there is a greater risk to revenue. To date, have either the ATO or Treasury been able to identify any potential or real adverse impacts on revenue from so-called private equity deals?

Mr D'Ascenzo—I think Mr Callaghan explained that it is hard to work that out in a net figure.

Senator SHERRY—I am not looking at the monetary loss yet; I am looking at potential monetary loss—the areas where there is potentially an adverse impact.

Mr D'Ascenzo—I have outlined in my response previously the sorts of areas that need to be considered. They are not peculiar to private equity.

Senator SHERRY—No, I understand that.

Mr D'Ascenzo—That is why I framed it in the whole context of mergers and acquisitions. There could be private equity or public processes where the sort of thing you look at is various compliance with debt equity requirements. As Treasury have pointed out, one of the things you are always on guard for is equity disguised as debt to get a deduction. That is why, when you see a range of hybrid security processes, you have to look very carefully at them.

There is the question of money flows. If there are fees going overseas, are they arm's length fees? Transfer pricing provisions come into play. In terms of Australian shareholders who make a profit on the sale of their assets, capital gains tax comes into play. The thin capitalisation rules says three to one, so you have to make sure they are not circumvented by whatever it might be—a whole range of inappropriate and abusive structuring. We have outlined those publicly in speeches and on the public record. Those are the sorts of things we would look at in terms of any major acquisition of substantial property in shares in Australian companies and assets in foreign branches here.

The other side of it is that we have been anticipating for many years now the increasing globalisation of the world economy. We have been trying to create very good relationships with our treaty partners. We have done well in the context of not only promoting through the OECD the use of exchange of information provisions, both in name and in practice, but also creating closer bilateral and multilateral arrangements with those countries.

Ms Granger—We did mention that in this year's compliance program we will be increasing the level of work we are doing in this area. I think it is fair to say, in terms of the risk assessments already done, that we have very good cooperation from the corporates and their associated private equity partners who we have been to see. There is an issue in international information but, in dealing onshore, there has been quite good information provided to us. In terms of the risks, probably the only other one to add to what the commissioner has already mentioned is that we are also looking specifically at performance

bonuses or fees that resident directors or principals may receive and what is happening to those—how they are characterised; are they flowing offshore or onshore; and do they come within the rules.

Senator SHERRY—These are performance fees by Australian-based taxpayers, or overseas, or both?

Ms Granger—It could be either, as long as it is relevant. It will be in relation to something received here in Australia and whether it is covered.

Senator SHERRY—Why is that a particular area of interest? Is it because some of these performance fees we read about are massive?

Ms Granger—The issue for us is whether it is appropriately characterised. As the commissioner mentioned, if there are management fees flowing to a related party overseas, we would look at whether that is appropriate within the transfer pricing rules and also if it is appropriately characterised as income or how it has been characterised. That is the issue for us.

Senator SHERRY—I have some questions for the revenue section. I notice that in Treasury there is a projected total loss of 37 employees. Are there any employees to be lost in your area?

Mr Callaghan—Are you taking that from the portfolio budget statement?

Senator SHERRY—Yes.

Mr Callaghan—And the number is for the aggregate?

Senator SHERRY—Yes, the aggregate.

Mr Callaghan—If you have a look within output 3 in the portfolio budget statement, I think there is a small decline in the average staffing level.

Senator SHERRY—I will look at that. I recall that we have discussed the issue of revenue forecasts at most previous estimates committees. I wanted to have a look firstly at table 2 on page 2-4. Can you explain the reason behind the changes to the revenue forecasts that are shown in that table?

Mr Callaghan—Sorry, could I have that again?

Senator SHERRY—It is Budget Paper No. 1, page 2-4, table 2, the reconciliation of the 2006-07 budget.

Mr Callaghan—Broadly, if you go further into revenue statement 5 it explains in a nutshell the short story, that we have seen a stronger economy, stronger employment, stronger company profits and a stronger nominal economy.

Senator SHERRY—I want to go to some of these factors in detail but I was interested in what the justification, at least in the aggregate, is for yet again—and we have discussed this at previous estimates committees—the significant underestimation of revenue forecasts. We see it again in this year's budget papers.

Mr Callaghan—The short story is that, as I say, we have seen a stronger economy. We see stronger employment growth than was anticipated. If we are looking at 2006-07, the

employment outcome was much stronger. We have also seen stronger growth in the nominal economy and revenue comes off the nominal economy—the amount of income that is flowing throughout the economy. We have seen stronger company profits and I should also add that we have seen stronger capital gains.

Senator SHERRY—I want to go to some of those factors one by one.

Senator MURRAY—With reference to the general question, I have seen statements that the average undercalculation of the surplus in the last 11 years—which mostly flicks back to the revenue undercalculations—is \$4.5 billion. That is a very high average undercalculation. The underestimate has been apparent, according to the reports I saw, in 10 out of the 11 budgets.

Mr Callaghan—I am sorry. It is an underestimate. The outcome turned out to be higher in terms of revenue than the estimate.

Senator MURRAY—The surplus has been higher by an average of \$4.5 billion, which principally relates back to an underestimation of revenue. In the general sense it is very concerning because now, when I look at your figures or I hear the government talking about what is going to be available come election time, I automatically assume there is money in the pot because of an underestimation. If I have that view, everyone who watches these figures has that view. So your rational explanation, I am afraid, does not counter what is now an established expectation that you have underestimated your figures. I assume you are aware of that.

Mr Callaghan—Yes, certainly, we are aware of that. If we go back to 2006-07, as I recall, when that budget forecast was introduced, there were some commentators believing that we were perhaps a little aggressive on the revenue side and wondering whether it would be achieved. As it turns out, like any forecast, if you are spot on, it is by good luck rather than being a very good forecaster. There is always going to be a range of error around this. We are dealing with the unknown; we are dealing with the unpredictable. We have seen events occur within the economy that things have turned out much stronger than we had anticipated. I think these are factors that are always influencing it.

If you look more generally around the world on the question of the underforecasting of revenue, it is not unique to Australia. There have been studies where a number of other countries are experiencing the same circumstances. For our case, yes, we have seen a very strong economy continue for a long time. In that I think it almost becomes a degree of arithmetic that you are inclined to underestimate that. That is the trend in forecasting as it goes forward. If it were turned around the other way you may have the other problem—that you are continuing to chase the numbers down—if the economy were declining. But we have had a very strong economy which continues to improve strongly. It is a simple explanation. We have to say: why are we out? The economy turns out to be stronger than we thought it was.

We have talked about previously that there are other aspects of this. It is us improving our understanding of the relationship between what is happening in the nominal economy and what is happening on the revenue side. We have a system that is changing and we have a tax

system that has been changing, so some of those relationships have broken down. We have invested extra time and resources in trying to improve our revenue forecasts.

Senator SHERRY—Perhaps I could come back to table 2. If we go down about two-thirds of the way there is a heading ‘Effective parameter and other variations.’ Since MYEFO, revenues have been revised up by \$3,670 million, \$9,615 million, \$13,345 million and \$14,728 million. Taking that heading ‘Effective parameter and other variations’—the revenue—is it correct to say that the revisions in underlying revenue between MYEFO and the budget are best summarised in that line item?

Mr Callaghan—Yes, I think so.

Senator SHERRY—You have given an overall reason justification for the stronger than initially forecast from MYEFO revenue growth. Are you sure that the reasons you have outlined are all that accounts for the spectacular increase that we have seen, and not just since MYEFO last year? This does go back many years now.

Mr Callaghan—The one additional reason is that in some respects it becomes a compounding exercise because if your base year turns out stronger than you anticipate, if you revise up your base that flows through into your out years.

Senator SHERRY—What are the underlying economic fundamentals that have changed since MYEFO last year to justify these significant revisions?

Mr Ray—If you look at page 5-4 in statement 5, there is a similar reconciliation table, table 2. Underneath that there is an explanation for the variations. We say there:

Since MYEFO, estimated total revenue for 2006-07 has been revised up ... largely reflecting stronger than anticipated growth in company profits and employment, and strong capital gains realised by superannuation funds.

Senator SHERRY—I want to get to some of the individual components. Let us just deal with the employment issue. To the extent that there have been stronger employment outcomes than anticipated at the MYEFO, is that adequately reflected in the sensitivity analysis that is published?

Mr Ray—I believe we have been through this before. The sensitivity analysis is quite partial in that the way it works is that it takes the variation in a particular item—in this case employment—and only looks at the effect of that change on revenue. It does not take account of any interactions with other revenue hits.

Senator SHERRY—I want to look at the other factors, and we have been doing this at most previous estimates because we go to the issue of the various factors in that sensitivity analysis. But even if you add them all up, I would contend that it does not explain why we see such significant revenue improvement on the MYEFO from the year before. Let us look at the employment outcome. In the sensitivity analysis it shows in 2007-08 \$1.9 billion and then in 2008-09 almost \$1.7 billion. These figures are in table C1 under ‘The sensitivity of fiscal expenses and revenues.’

Mr Ray—That is the sensitivity to a one percentage point change in the level of employment.

Senator SHERRY—Correct, yes, and we look at that sensitivity forecast estimate in the employment area and then we look at the outcome projected forecasts for revenues from MYEFO. I go back to my question: to what extent has the stronger employment outcome from MYEFO at the end of last year adequately reflected in this sensitivity analysis? The sensitivity analysis, as you have said, Mr Ray, suggests a one per cent point increase would increase revenues by \$1.9 billion as part of the additional revenue. What has been the increase of employment since MYEFO?

Mr Ray—I do not have that with me.

Senator SHERRY—Has it been one per cent?

Mr Callaghan—Senator, it has been significant compared to the estimate at MYEFO shown for 2006-07.

Senator SHERRY—Sure, but do you have an approximate figure?

Mr Callaghan—We will check it now but I think it was a one per cent growth and 2.5 per cent growth. Is that right? Yes, it is going from one to 2.5 per cent growth.

Senator SHERRY—So if it is 1.5 growth would we expect logically that 1.9 plus about .8 would be the impact of the employment growth?

Mr Ray—It is not as simple as that, Senator.

Senator SHERRY—Explain why it is not as simple as that—I know there are other factors and I want to get to those—in terms of employment.

Mr Ray—Because there would be effects—for example, people who are newly employed would spend money in the economy and all those sorts of things—that would work their way through the economy.

Senator SHERRY—Then there would be higher tax collection in other areas—

Mr Ray—Like excise or whatever.

Senator SHERRY—GST, excise—yes, I understand that. But in terms of the employment factor, the 1.9 per cent is a factor that you will identify?

Mr Ray—Under the analysis that is set out in the sensitivity attachment, appendix C to statement 2, that is the change as a result of the one per cent change in employment, assuming everything else remains constant.

Senator SHERRY—Yes. Just coming back to that employment forecast, is it not the case that employment forecasts have been increased by just 0.25 per cent in the 2006-07 year between the MYEFO and the budget?

Mr Ray—We think that is correct.

Senator SHERRY—And is it not the case that employment forecasts have been increased by just 0.25 per cent in the 2007-08 year between MYEFO and the budget?

Mr Ray—We would need to check. I do not have the MYEFO forecast in front of me so I am at a little bit of a disadvantage.

Senator SHERRY—In examining this is it not also the case that it is unchanged in each of the projection years from 2008-09 onwards?

Mr Ray—That would be correct. That is because of the methodology used for projections.

Senator SHERRY—Would you expect tax revenue increases of the order we have seen in this budget from just a 0.25 per cent increase in employment growth?

Mr Ray—I did not say that that was the only factor, Senator.

Senator SHERRY—I know you didn't, but would you expect it?

Mr Ray—The factors we have in this budget from MYEFO are a change in the employment growth that was higher than we were anticipating at MYEFO, a change in company profits that is considerably higher than we were anticipating at MYEFO, and very strong growth in capital gains, particularly realised by superannuation funds.

Senator MURRAY—Is this from integrity measures, activity measures or from both?

Mr Ray—From activity measures, Senator.

Senator SHERRY—I will come to the superannuation component in perhaps a little more detail later. I want to deal with the sensitivity impacts on revenue in the economic parameters. You have acknowledged 0.25 per cent in 2006-07 year between MYEFO and the budget, you are checking on the figure for 2007-08, and that it is unchanged in the projection years from 2008-09 onwards. Yet we go back and look at that table C1, the sensitivity analysis, the one per cent change, and we see the impact of higher employment. If you take the other factors into account on the revenue side, it does not seem to explain why consistently revenues are being revised up from the MYEFO so consistently.

Mr Ray—Consistently we are seeing stronger economic activity in each period.

Senator SHERRY—Let us look at the heading, 'Stronger activity'—stronger employment, stronger wages and, obviously impacting on tax revenue, private final demand. If you look at those factors in C1 and add them all together, it just does not seem to explain, given the revision change in parameters of one per cent, the significant revision of revenue upwards from MYEFO over such a long number of years.

Mr Callaghan—As Mr Ray said and as outlined quite clearly, you cannot do that on an aggregate basis. It is not capturing the interaction of all these components as you do a forecast going forward.

Senator SHERRY—Are you saying—because we explore this year after year at budget estimates—that if we aggregate the figures for 2007-08, add them all up, there is a compound on top of that? Is that what you are saying?

Mr Callaghan—It is. As you say, we have been doing this for a long time in estimates. If we go back and have a look, we see that the revenue has increased and we see what the actual is. This is looking at history. If you look at what the forecasts were for change and look at the outcome there, you are not going to be able to add them up to get that because it is the whole dynamic that goes on. I think what you are trying to do here is saying, 'I want to add these.' That is very natural. Because of the way it is identified by each line item, you think, 'I am going to aggregate it.' It is presented as just one item.

Senator SHERRY—Sure.

Mr Callaghan—The way to do it, I think, is to go back and try to see if you could reconcile history. You would be looking at it and saying, ‘I cannot reconcile history because I cannot see these adding up to the actual outcome.’ That is because the economy turned out all the dynamics that were taking place.

Senator SHERRY—We have an X factor, if you like, to add on top, which you do not seem to be able to quantify.

CHAIR—The X factor is built in, is it not?

Mr Callaghan—The X factor is the fact that, at a very macro level, you can look at what is happening into the nominal economy. That is going to be picking up many of the components that are here. What we are looking at here are the variables, the parameters that are identifying particular heads of revenue as you go forward. The X factor is that you deal with an interactive economy where one thing pushes on the other. It is just as Mr Ray says: you employ more people; they spend more money; there might be more GST money and more excise money. It flows through in a dynamic sense. That is the nature of having a dynamic economy and the way even the forecasts are done.

Senator SHERRY—We have this interaction which I have described as the X factor. Do you not think it is about time, given the ongoing revisions of revenue significantly upwards since MYEFO—and we have seen this over a number of years and I have questioned about this—that there was a fundamental re-examination of these parameter assumptions?

Mr Ray—Which parameter assumptions? The sensitivity analysis?

Senator SHERRY—Yes, in the sensitivity analysis.

Mr Ray—We review that analysis each time we do it. I think that, if you look back through time, you will see that there are some quite considerable differences over the years.

Senator SHERRY—Yes, but also the way in which you are attempting, at least in your economic modelling, to aggregate all these figures together and obtain a more accurate revenue forecasting projection.

Mr Ray—We do not forecast revenue from the sensitivity analysis.

Senator SHERRY—You do not?

Mr Ray—We use individual revenue head models to forecast revenue.

Senator SHERRY—Let us go to another individual revenue area—corporate profitability. Can you outline what changes in corporate profitability have occurred between MYEFO and the budget?

Mr Ray—While Mr White is doing that, I can confirm what you said earlier—that employment in 2007-08 has gone up by a quarter of a percentage point between MYEFO and budget.

Senator SHERRY—It is a quarter of a per cent. The sensitivity parameters show one per cent.

Mr Ray—It is 1.9 per cent, yes.

Senator SHERRY—Do we have anything on corporate profitability?

Mr White—We do not have the exact changes in corporate profitability, but they went up in both 2006-07 and 2007-08. In 2007-08 they went up by I think two to three percentage points. We can get the exact numbers for you.

Senator SHERRY—Going back to that sensitivity analysis in Budget Paper No. 1, what increases in revenue would you expect from an increase in corporate profitability since MYEFO? Where would that be contained?

Mr White—We have a profit line in the sensitivity analysis. It is the last line in the sensitivity analysis and it is called 'profit'.

Senator SHERRY—That is solely related to corporate profitability?

Mr White—Yes.

Senator SHERRY—To what extent have changes in commodity prices in the terms of trade impacted on revenue estimates?

Mr White—Can we go back to the last question? It is not just corporate profitability; it also includes non-incorporated profitability.

Senator SHERRY—To what extent have changes in commodity prices, the terms of trade, impacted on the revenue estimates?

Mr Ray—Since when, Senator?

Senator SHERRY—Since MYEFO last year. Have they contributed to the increase in revenues that have been identified since MYEFO?

Mr Ray—This is 2007-08?

Senator SHERRY—Yes.

Mr Ray—Certainly underlying strength in the mining sector is contributing to the profit strength in 2007-08 directly. The other way mining sector profitability is contributing to the strength in the revenue estimates is through capital gains tax. There is also some employment growth and wages growth et cetera.

Senator SHERRY—We have discussed before the two-step down approach. Can you update the committee on any adjustments to that forecasting methodology in respect of the commodity boom between MYEFO and the budget?

Mr Ray—There is an update to the forecast by our colleagues in the macroeconomics group for 2007-08 since MYEFO but there is no change to the underlying methodology. So it is still a two-step wind-down of bulk commodity prices over the first two projection years.

Senator SHERRY—The timing effect has not changed at all since MYEFO?

Mr Ray—Not since MYEFO. The timing effect is the same as MYEFO.

Mr Callaghan—Just to clarify, it is not the timing effect, but of course where it is starting from changes as you go forward. The timing effect is in a projection period. If, in your forecast year, it is higher than you are allowing for in the downturn you are starting off from a higher base.

Senator SHERRY—There has been no rollover in respect of the timing of that reduction?

Mr Callaghan—It starts in the projection period. What comes is a forecast.

Mr Ray—If you look back through time, the rollover of that assumption occurs at MYEFO because that is when we change the projection and forecast years.

Senator SHERRY—Apart from the disclosures in the budget papers—we touched on some of them—what other work has Treasury done in the last year to explain the change in revenues?

Mr Ray—We are analysing our forecasting performance all the time. As part of that we are analysing past movements in revenue all the time.

Senator SHERRY—Have you come to any conclusions yet that any changes are needed?

Mr Ray—In terms of our methodology?

Senator SHERRY—Yes.

Mr Ray—Yes. As we have discussed a number of times, we have made changes to our methodology in the past couple of years.

Senator SHERRY—Such as?

Mr Ray—We have made changes to a number of our revenue head models, and we have been examining a range of alternative parameters that we could use.

Senator SHERRY—What concerns me is that you have been doing this work, ongoing. We have discussed it pretty continuously for certainly the last few years of estimates, and yet we see significant revisions from the MYEFO year after year in the revenue forecast. You have not got it as accurate as you would like to date.

Mr Ray—All I can say is that the forecasts we present in this budget are the best estimates we have at the moment.

Senator SHERRY—But every year we are confronted, in recent times, with a significant variation upwards of revenue.

Mr Ray—Correct. And each year the economy is continuing to surprise us on the up side.

Senator SHERRY—The revenue revisions over the past few years have been larger in the period between MYEFO and the budget than between the budget and MYEFO—the second period, if we can call it that. Can you explain why that is the case?

Mr Ray—That is because when we come to do the budget forecast we have a lot more information about the current budget year. If you are looking at a revenue forecast, it is effectively our base year. If you take the current budget, 2007-08, we do not yet have information on that. Indeed, we have only incomplete information on 2005-06. As you go through time you get more information. When we come to MYEFO we have quite partial information about the current year, which is the most critical year for the base, which is the base year; whereas when we come to budget we have 10 months of collections data so we have much better data.

Senator SHERRY—That would explain why, particularly in the last two years, the tax revenue variations in the five months to budget from MYEFO have been more than double

the variations seen in the seven months since budget to MYEFO on the analysis we have carried out.

Mr Ray—I would need to check those sorts of things. When we come to do MYEFO we only have three or four months of the current year, whereas when we come to do budget we have 10 months.

Senator SHERRY—The difference I have referred to seems to have been much larger than it has been in the previous two years. Let me give you some figures, changed from some analysis. If we look at MYEFO May-December 2003, the change from the previous statement was \$18.8 billion. Then for budget 2005-06, for the period December to May 2004, it was \$21.7 billion. The MYEFO for the period May-December 2004 was \$26.5 billion, and budget 2005-06 for the period December-May 2005 was \$37.5 billion. The MYEFO for the period May-December 2005 was \$18.4 billion. Then the budget 2006-07 for the period December to May 2006 was \$40.8 billion, and the MYEFO for the period May-December 2006 was \$13.8 billion. The budget 2007-08 for the period December-May 2007 was \$41.4 billion. So we are seeing a pattern of the budget figure being more than double the figure revision upwards compared to the MYEFO in the last couple of years. Can you account for the changing pattern?

Mr Ray—Through time?

Senator SHERRY—The last two years versus the previous two years. That is as far back as we have done the analysis.

Mr Ray—We have not gone back and had a look at it and done those sorts of analyses, so I cannot really account for the change in the pattern through time.

Senator SHERRY—There is not a big jump in that MYEFO budget outcome for the second six months in those two years. There is some jump but not a big jump. But the jump in revenue in the last two financial years MYEFO to budget has been very significant.

Mr Ray—If you take the last year, the 2006-07 budget to now, my recollection is that the outcome for 2005-06 in the final budget outcome was lower than we had estimated in the 2006-07 budget. So we had a lower outcome for 2005-06 and we had some partial collections data for 2006-07, which led us to revise the current year forecast, by not very much, at MYEFO. Since then we have seen very strong growth in collections.

Senator SHERRY—I am still puzzled. If you look back over the last three financial years and include 2007-08, the proportionate allocation on the total revisions by fiscal year is roughly even in the first two financial years. We are then seeing a significant shift between MYEFO and the budget in the last financial year and the 2007-08 year.

Mr Ray—As I said, we have not gone back and analysed the pattern of revisions like that. It is more that we are analysing why we are revising each time.

Senator SHERRY—Are the revenue figures Treasury's or the government's?

Mr Ray—They are the government's forecasts.

Senator SHERRY—Have specific briefings on revenue forecasts been provided to the Treasurer and the Treasurer's office?

Mr Ray—We discuss revenue forecasts with the Treasurer, yes.

Senator SHERRY—Has the Treasurer or the Treasurer's office ever asked for any of the revenue assumptions or figures to be altered?

Mr Ray—Ever is a very long time.

Senator SHERRY—Let us take the last two years.

Mr Ray—I think the short answer to your question is that, while these are the government's forecasts, we agree with them.

Senator SHERRY—That is not an answer to the question I posed.

CHAIR—It depends whether these communications were in the form of advice to government. On that basis I do not think the witness is required to answer the question.

Mr Callaghan—That is precisely the concern that is running through our minds. I think Mr Ray was trying to say that, yes, they are the government's forecasts, and we provide the advice to the government to the best of our ability but we do not go into the detail as a matter of course as to the nature of the advice we give the government or the communication that takes place between the government and ourselves in giving that advice.

Senator SHERRY—Do you do you stand by revenue forecasts?

Mr Ray—Yes.

Senator SHERRY—But why are they so consistently out year after year? You are consistently underestimating in revenue without an adequate explanation. If this were the first year or the second year—but it is year after year that we are fronting up to these estimates committees seeking an explanation.

Mr Callaghan—Senator, go back to a point you raised earlier about whether we are happy with these forecasts in the sense of whether we would like to do better. Most definitely we would like to do better. Are we happy with things? To the extent that they are the best we can do at the time, yes they are the best we can do. To the extent that that proves that we are out, just as much as the economic forecasters would like to be closer, we would like to be closer.

Senator SHERRY—Sure. I think you know me by now. I am a reasonable man. You know my approach in estimates. I would not expect you to get to the nearest hundred million or even the nearest billion.

CHAIR—That is a decision for the chair, I think.

Senator SHERRY—The nearest hundred million or nearest billion. I understand and appreciate the difficulties, but the underforecasting and estimation projection of revenues is getting worse year by year.

Mr Ray—I am not sure that that is correct. I think that, if you were to look at the current year from the 2006-07 budget forecast to the current estimate of it, the revisions are certainly no larger than in recent history. They may even be smaller.

Senator MURRAY—Is it reasonable for us to expect you will underestimate it again?

Mr Callaghan—That is an impossible question to answer.

Senator MURRAY—The statistical background is that you consistently underestimate. If you were a statistician you would therefore say that, based on the statistical record you have provided, you should now build in an expectation that you have underestimated.

Mr Callaghan—It is the same as saying, ‘Do you expect the economy is going to perform much more strongly than you believe it is now?’ If you expected it was going to occur, you would build it into your forecasts. Certainly, like everything, there can be a risk around it. You can identify some factors that may turn out to result in a much stronger forecast, and there are others that may result in a lower forecast. There is always a risk element around forecasts, but you are giving it your best forecast and that is what it has to be. To say you would expect that it is going to turn out stronger than you are expecting now so why don’t you build it into the forecasts would be the follow-up from that question. These are the best forecasts that we can give now. Taking into account all the uncertainties and the changes that are taking place, these are the best.

Senator SHERRY—We discussed earlier the outlined sensitivity impacts. I accept what you say. If we then look at the individual sensitivity factors, compact them together and add in this so-called X factor—whatever the impact of that is—it still does not account for the significant underestimation in revenue in the last few years. Stronger economy, stronger employment, stronger wages, stronger prices, stronger profits and this X factor—with the compounding aggregate of all these factors on top of it, it just does not seem to be accounting for the additional revenue.

Mr Callaghan—I do not know what more we can say. As I say, this is looking at it in terms of what we believe is given from our macro colleagues as to the direction of the economy and what we believe is the relationship between the revenue and those underlying economic variables. This is the best outcome we can give. Going back and looking at the sensitivity—as we have said before, I think you are trying to apply literally what you call the X factor in an aggregate sense. If you go back and have a look and ask if you can make the same calculation in history in the sense of, ‘Can I look at each of those variables and can I add them up,’ the problem is that it is the dynamic nature of it that is always going to get you. I really do not know what more we can say.

Senator SHERRY—You keep referring to this dynamic factor. Maybe we should have a dynamic X or a dynamic Y and add that in. If there is a dynamic factor that is changing year after year and adding to revenue, why has that not been incorporated?

Mr Callaghan—It would make it very complicated to go back and provide different things. Essentially what you are saying is: if the economy turned out differently, having ranges of forecasts for the economy, what might be the implications of this as it all works through on revenue. You could do that if you wanted to, if that was what the government wanted. They could have a range of forecasts out there.

CHAIR—I think Senator Sherry is jealous of the fact that you have the crystal ball and he has not.

Senator SHERRY—Not particularly. Year after year we are \$3 billion to \$4 billion out. Let us add \$3 billion to \$4 billion onto all the factors once we have finished. Statistically, if

you took that approach it would be more accurate than the figures we are getting year after year. We will have a top up Y factor of \$3 billion to \$4 billion and we will be close.

CHAIR—You cannot possibly run the economy on that basis. It is impossible.

Senator SHERRY—Why do you not do that, because it would be more accurate? Based on the history of the last few years, that adjustment would have produced a much more accurate probability.

Mr Callaghan—I really do not think it is a good basis on which to do budgeting. That is all I can say.

CHAIR—It is a belated way of budgeting.

Senator SHERRY—The problem is, Mr Callaghan, that the figures you are producing are consistently inaccurate year after year by that sort of factor.

Senator Minchin—I think that is rather pejorative. The fact is that, as the Treasury officials have indicated, this Treasury is as sophisticated as any in the world in anticipating revenues from the Australian economy for the federal government. They have given evidence that the continuing strength of the Australian economy continues to surprise even the best economists that we can buy in the Treasury in relation to its strength. Therefore, despite their best estimates and the best system available to us, there is a small underestimation. I would remind the committee that we are talking about an underestimation of some one to 1½ per cent of revenue. We are talking \$230-something billion in revenue with an underestimation of some one to 1½ per cent.

Senator MURRAY—In 10 out of 11 budgets.

Senator Minchin—Of course all governments would like revenues to be spot on. It is as much in the interests of the government as the opposition for the revenue forecasts to be spot on, but I would say that I would always, certainly as finance minister, prefer to have a situation where there is a slight underestimate of the revenues than an overestimate. To the extent that the continuing strength of the economy is producing a situation where there is a small underestimate of some one to 1½ per cent, then the Treasury of course should use its best endeavours to narrow that range. I think this is a highly skilled Treasury using the best available models and estimate procedures, and I think to accuse them of inaccuracy is unfair.

Senator CHAPMAN—Have you looked at or made any comparisons with how your revenue estimates compare with equivalent economies around the world—the treasuries of the UK, the United States or Canada, for instance—and their accuracy of estimates?

CHAIR—And their methodology?

Mr Callaghan—The international organisations have done this. The one that comes to mind is one that the IMF did, and we performed very well compared to other countries. Other countries have a different approach to this of course. For example, Canada explicitly incorporates a conservative bias into its forecasts, for the points that Senator Minchin has made, that they explicitly say they want to underforecast. When you do an international comparison, someone like Canada is always going to have a significant underestimation because they explicitly include that. The studies that I have seen say that we do perform quite well and that is going back over a long period. The study that I saw was well over 20 years

and it said that on the whole they could not detect that there was a particular bias one way or the other in terms of our forecasts, looking at it from the way the economy had gone.

Having said that, there are a range of countries that are all looking at this same question to see whether they can get a better estimate of revenue. For example, New Zealand have recently done a study and they have published it, where they point to a number of other countries that are all experiencing this same underestimating of revenue. They are looking to try and explain how can they do it better. They are all doing what we are doing: trying to get a better understanding of what is happening in the economy and a better understanding of the relationship between what is happening in the economy and to revenue.

Senator MURRAY—You see, Mr Callaghan, people like Senator Sherry and I know the quality and calibre of our Treasury office is very high. So if your estimations do not include an explicit bias of conservatism, my judgement is that there is an implicit bias of conservatism: namely, that if people of your calibre consistently produce an underestimation it would indicate to me that there is a conservative bias which, whilst not explicitly in your figures is implicitly in your figures, because if you are in a situation where normal statistical errors are apparent, over time it should be apparent both up and down, and over the last 11 years it has not swung on that basis except one year.

Mr Callaghan—The one qualification I would make is that we are looking over a period when the economy has continued to perform very strongly and, as I say, there is an inherent bias in here. If over the last 11 years we had seen a number of cycles occurring in any economy where you had growth declining, even going negative, I am sure you could say that on average it perhaps looked very good, because I think that we would see that, as economies decline, experience is that any forecasting—and this is around the world, not just Australia—you are inclined to chase it down in the sense that things are occurring and you have not anticipated them, and so the economy might be declining faster than you think and the actual outcomes turn out to be lower than you thought. That can be offsetting what is happening when the economy is growing strongly.

If you have cycles going on there and you have taken an average, you can say, ‘The average looks very good.’ If you are at one side of what is happening in that, I think that it is the same for any forecasting. Regardless of whether it is revenue or looking at any macroeconomic variable, you are inclined to be chasing it to some extent. I think, looking across the world, that is what happens. Maybe it is human nature, it is not an explicit—

Senator MURRAY—It is human nature, I think that is the point—that anyone who is in your circumstance is likely to have the same consequence. Unless you were subject to a requirement from government that had been spelt out to you, which you are not, that you should estimate conservatively, in my view what you are exhibiting, because I have watched this carefully now over a long period, is an implicit conservative bias, which is resulting in underestimation.

Mr Callaghan—I can only say, Senator, we try to give the best forecasts we can. There are aspects of this. There is the one we talked about, which Senator Sherry raised—the two-step wind-down of the terms of trade. That is a prudent assumption. To the extent that that wind-down does not occur as expected—the outcome, the terms of trade, turn out to be

higher—it turns out that there is more income in the economy than we allowed for over those projection periods. In that sense I would say that is a prudent assumption. We are looking at what happens over the forward estimates period and we have entered a prudent element into all of that. To the extent that we do not see that decline, yes, the outcome will turn out to be stronger than what was incorporated with that prudent assumption.

Senator MURRAY—This will be my last comment, because I am interjecting into Senator Sherry's time. I have also sensed over time, as you know in these discussions, that I think Treasury underestimates the effect of integrity measures to the law. I think the improvements in technology, integrity and so on have delivered a higher rate of compliance than you have been prepared to recognise. That is my sense of things. I have not seen any analysis which justifies that, but that is the sense I have.

CHAIR—To take up Senator Chapman's point, with the methodology you are using, benchmarked against other international economies, are we recognised as best practice in relation to our methodology?

Mr Callaghan—The study that I recall was not identifying best practice but it was looking to see whether there were particular biases in the revenue forecasts of various countries over a long period. The outcome was that they did not identify a particular bias in Australia's revenue forecasts. It was not going in to look at the methodologies of what is best practice; it was looking at forecast projections and outcomes. On that basis we performed comparatively well with the other countries that were considered in the study.

CHAIR—That was an independent assessment?

Mr Callaghan—The International Monetary Fund.

Senator NETTLE—I want to ask about the recent decision by the ATO to remove charitable status from AID/WATCH, the independent overseas aid watchdog. In the decision the ATO inferred that AID/WATCH had a political purpose behind some of its activities because they promoted a particular point of view. In the decision 'political activity' is defined as 'any attempt at promoting a point of view.' I understand that in the AID/WATCH case the ATO cited three activities that they believed were not consistent with the charitable status, one of which was 'urging the public to write to the government to put pressure on the Burmese regime.' Another was to deliver a 60th anniversary birthday cake to the World Bank. The third example was raising concerns about the developmental impacts of the Australia-US Free Trade Agreement. I want to ask whether that is all correct in terms of a view that these activities disqualify AID/WATCH as a charity. Then I want to ask what the implications are for other charities in Australia if expressing a particular point of view is seen as a political activity and therefore means a ruling is made to remove their charitable status. Is there somebody who can address those issues?

Mr D'Ascenzo—I have no specific details in relation to the matter but, generally, to be a charity you have to meet the test of charitable purpose, and that is actually to do things directly related to helping to relieve poverty, to promote education—all those sorts of concepts that underline the Statute of Elizabeth that postulate what a charitable purpose is. Our view, which is in public rulings, is to the effect that indirect ways of achieving an outcome, including specific lobbying activities, do not fall within those specific purposes.

Senator NETTLE—I had the opportunity to ask some questions of AusAID last night about their interactions with developmental NGOs. They have a series of activities where they consult with those NGOs about the development and the formulation of their aid policy—AID/WATCH is one of those. Last night in the Senate estimates committee they talked about the importance of that process of consultation in formulating government aid policy. We have seen a number of government policy changes to how our aid policy is implemented, most recently in the white paper around the removal to tied aid. It is actually an initiative that AID/WATCH has led in pushing for change. In the last two days in the *Sydney Morning Herald* there has been a range of information provided about the way in which the government aid program is operating, and that is precisely as a result of the reports that AID/WATCH are doing.

I understand the definitions of charity, but certainly the comments that were made by AusAID last night I took to be an indication that the contributions to formulating Australia's aid policy are appreciated and important, and that they have been quite influential in the way in which the government regime operates. To refer to the particular example about the government's pressure on the Burmese regime, maintaining pressure on the Burmese regime is a government position. The foreign minister issued a media statement yesterday calling for the release of Aung San Suu Kyi, so it is not as if the activities of the organisation are in conflict with government policy. In fact, they have been quite helpful and influential in changing that. I appreciate that you may not be aware of this particular organisation and the detail there, but what are the implications for charities who are routinely involved in public debate as a part of government processes and development?

Mr D'Ascenzo—I understand, and that is why I tried to make the point that the question of deductibility under the charitable status depends on them fitting within specific purposes, and that actually means the direct provision of assistance that would further those purposes. In other words, if someone is old to organise arrangements that help the old directly, if someone is hungry the provision of food, if someone is destitute the provision of shelter, if someone is lacking in education the provision of education, so the definition of charity at law is really related to those direct activities.

Over the years, a number of people have said, 'Well, we do things indirectly that are useful rather than the provision of a specific direct service, we may do more by influencing government policy.' Our position is that, the way we interpret the common law, it does not define charitable purposes that widely. Therefore, whatever the merits of people's efforts in terms of trying to procure different policy outcomes, the weight of authority, as we read it, is that it does not fall within the charitable pool status. That is not a question about whether one is good or bad. It is just a question whether you fall within those criteria that have been there and interpreted by the courts over a long period of time.

Senator NETTLE—I understand that the new ATO decision states that charities cannot engage in any activity designed to change Australian government laws, policies or decisions.

Mr D'Ascenzo—That is just our explanation of what the cases have said over time—in other words, it is not the ATO making a rule by any sense but it is just interpreting and applying what it believes to be the tenor of the common law.

Senator NETTLE—So that is your interpretation of the position we are at at the moment. I question that because you talk about there being a difficulty if somebody is trying to change a government position, and yet of the three particular examples cited in relation to AID/WATCH, one of them was about the government's position in Burma where AID/WATCH's position is actually the same. They are not trying to change the government's position, they are actually supporting it. I do not understand why—

Mr D'Ascenzo—The question is not so much whether it is to change or to maintain or support; the question is whether they are providing direct assistance that falls within the charitable objects.

Senator Minchin—The issue goes to charitable status for the purposes of tax deductibility. There is another class of statutory tax deductible organisations where donations to specific organisations are granted tax deductible status, one of the reasons being that—in some cases—they do not fit within the general charitable rule. I do not know the position with AID/WATCH but, as you know, there are a number of other community organisations whose main activity is advocacy that attract statutory tax deductible status for the purposes of donations. That is a separate class from the charitable function.

Senator NETTLE—Yes, I understand that.

Senator Minchin—It may be that the organisation to which you refer does not fit into the charitable rule. If it does not have statutory tax deductible status—and I do not know—then that would be the avenue it would need to pursue.

Senator NETTLE—Are you referring to the registered environment organisations?

Senator Minchin—Yes, there are a number of environment organisations in that tax deductible status that are not charities.

Senator NETTLE—I understand that. I am well aware of a number of those that are listed there, but this is the one area that I am asking about here—I will be asking about the other areas elsewhere—to try to understand what the implications are for charities, be it this one or others, in being able to have a position on a government law or a government policy and the impact of that on the people they service as part of their charity. It is concerning that the government does not think that charities should have a view.

Senator Minchin—That is not the position. A number of charitable bodies express views from time to time on government proposals, policies and positions but then do not lose their charitable status. One does not follow from the other. The primary issue is: are they a charity for the purposes of tax deductibility? There is not a separate test that says, yes, prima facie they are a charity but they have said things about the government or public policy and therefore they are not. There are, I am sure, any number of charities with charitable tax deductible status that from time to time comment one way or the other on public policy matters that does not affect in any way their charitable status because they are, in terms of their actual activities, charities.

Senator NETTLE—It is important to be clear on what the government's position is. When these kinds of rulings are made in relation to this organisation and other organisations, I am inferring that the message from this is that these charities should not be speaking out about a

particular political view because they are getting a letter which says that their activities are designed to change government law, policy or decisions. I would have thought it was a legitimate role for charities to have a particular point of view; and yet the letter they receive says that, 'Neither can a charity engage in propagating or promoting a particular point of view according to the ATO ruling.' That is the letter they get. That is why I am here asking the question. It is of concern if the view of the government and the ATO ruling is that charities cannot have a particular point of view.

Mr D'Ascenzo—Firstly, the interpretation is an interpretation from the tax office, not an interpretation from the government. Secondly, if the letter were only in those terms one could understand why you might take it in the way you have. I was trying to explain that you have to meet the charitable purpose tests. If you do that, then you are able to have other minor de minimus activities, including expression of views, that do not necessarily rule you out. To try help people in that area, on our website under 'charities' we give 41 examples of ways in which political activity, lobbying and advocacy can occur without a charity's status being jeopardised. The charity probably knows that what it might be doing is solely related, or dominantly related, to trying to develop or confirm policies rather than the actual provision of assistance that falls within a charitable purpose.

Senator NETTLE—I accept what you say about it being an interpretation—the letter is the ATO's interpretation of what the government policy is. So perhaps I should ask you, Minister, about whether saying that charities cannot engage in propagating or promoting a particular point of view is a correct interpretation of what the government view is.

Senator Minchin—As the commissioner said, it is the ATO that interprets and applies the law; it is not a matter of a sort of vague notion of government policy. The law is a combination of statute and common law so far as charitable status is concerned, and the commissioner has said that charitable status per se is not wiped out or dissolved merely as a result of advocacy of one kind or another. The test, I presume from the tax office, is the extent to which the core activity is charitable or merely advocacy. From a government policy point of view, the government is satisfied with the current arrangements through which genuine legitimate charities have tax deductible status. The line has to be drawn somewhere as to what is genuinely charitable and what is on the other hand advocacy, public policy debate or seeking to change the government attitudes in one class. Then in another class there is the statutory mechanism by which community organisations of one kind or another can attract tax deductible status to the extent that they may have sought and not received tax deductible status through the charity mechanism.

Senator NETTLE—Is it correct that the government's position is that charities cannot engage in propagating or promoting a particular point of view?

Senator Minchin—No, that is certainly not the position. As the commissioner has just said, the website offers 41 ways, I think he said, in which a charity can participate in public debate and public advocacy of positions without jeopardising the charitable status. The test I guess—to speak colloquially—is: what is the core activity? But it would be completely wrong to say or to suggest that a genuine charity which engages in public policy debate loses charitable status by virtue of that engagement. People like the Salvation Army and other public policy groups that I suspect are charities for the purpose of tax deductibility do often

engage in public policy debate and points of view that they express publicly for or against government policy, but it does not jeopardise their charitable status. No, it is certainly not the position that charities should not engage in public policy debate—they are more than welcome to.

Senator NETTLE—In this instance, AID/WATCH's core activities are around doing research and partnerships with government, community and particular programs; they provide input into carrying out government aid, trade and debt policies; they provide information and they are involved in community education and community outreach. They are the core activities that you are saying the assessment would be made on.

Senator Minchin—Yes, it is not for me to give a legal opinion as to whether that qualifies them for charitable status. That is something the tax office does.

Mr D'Ascenzo—Having done that, if a group that seeks that status is not happy with our decision, ultimately they can seek to go to the court on a private ruling and have that tested.

Senator NETTLE—Thank you, I am happy to leave my questions there.

Proceedings suspended from 12.34 pm to 1.37 pm

CHAIR—We will resume these hearings.

Senator Minchin—With your permission, we would like to table something pursuant to the conversation this morning.

CHAIR—Yes.

Mr D'Ascenzo—I table the draft tax office remuneration policy and the non-SES Australian workforce agreements guidelines for our national program managers, which addresses one of the senators questions earlier today.

CHAIR—Senator Bernardi.

Senator Minchin—That is right.

CHAIR—If you table those we will have them distributed.

Senator CAROL BROWN—I would like to ask some questions about the debt legal units. Can you tell me how many debt legal units you have around the country?

Ms Crawford—I do not exactly know, but we do have debt legal teams in most of the capital cities, with the exception that there is not one in the national office here in Canberra. We have recently taken the decision to not operate out of our Hobart office.

Senator CAROL BROWN—Can you outline how that decision came about, who was involved and when the decision was taken?

Ms Crawford—Yes. I do not have the precise date, but it is a quite recent decision. The decision came about by virtue of the fact that we are looking, from an efficiency perspective, to not have staff spread out and isolated from other members of their team. In Hobart there were only four members of the debt legal team. Normally a team would consist of at least 15 people.

Senator CAROL BROWN—How many team members were there in Hobart?

Ms Crawford—There were four members of that particular legal team. Those four people have been provided with other roles that suit their skills and abilities. As I said, normally a team would comprise of at least 15 and the caseload that they would do would be considerably higher than the caseload that was happening out of Tasmania.

Senator CAROL BROWN—Can you tell me who was involved in the decision?

Ms Crawford—Ultimately the decision was made by the executive of the debt business line. They were in consultation with staff and unions for some time around proposals to strengthen the teams and the potential of moving that function elsewhere.

Senator CAROL BROWN—Were the affected staff members consulted and, if so, when?

Ms Crawford—Yes. I do not have the specific dates, but my understanding is that the staff members were spoken to about that proposed change and then were advised by their management as soon as the decision had been taken.

Senator CAROL BROWN—Can you tell me what the caseload is in Tasmania at the moment?

Ms Crawford—The information I have is that there are approximately 200 Tasmanian legal cases. I can compare that with other offices. A team of 15 would normally be working on between 800 to 1,000 cases at any particular time.

Senator CAROL BROWN—A team of how many?

Ms Crawford—Of 15.

Senator CAROL BROWN—You obviously have performance indicators of some type to see how a team is working and how efficient they are. How did the Hobart team measure up?

Ms Crawford—There has never been criticism of the work of that team or the measures of that team.

Senator CAROL BROWN—They were efficient and effective?

Ms Crawford—Yes, to my knowledge they were all good workers.

Senator CAROL BROWN—Do you know exactly in what form they were consulted about taking their jobs away?

Ms Crawford—The information I have with me today states that the matter had been discussed with the debt legal teams and unions and staff over a period of time. That is the extent of the information that I have with me today.

Senator CAROL BROWN—I would be very interested in knowing the timeline and exactly what consultations were held with the staff and unions. Did you have any discussion with any of the external stakeholders? You obviously have accountancy firms working closely in Tasmania with your debt legal unit?

Ms Crawford—I do not have that information with me here, so I cannot say whether that occurred. We do not intend to have any reduction in the level of service offered to the people of Tasmania. Whenever there is any face-to-face involvement required, we will ensure that there are appropriately qualified legal staff to undertake that work.

Senator CAROL BROWN—How is that going to work?

Ms Crawford—We would envisage that would be staff out of the Melbourne office, but there is also a full legal team, not a debt legal team, still in Hobart that already carries out most of the legal work that the tax office does there, so that is unchanged.

Senator CAROL BROWN—What was the cost of running the debt legal team down in Hobart?

Ms Crawford—I do not have that with me. All I have is that there were four staff based in Hobart.

Senator CAROL BROWN—Do we have any idea of how much revenue they recovered for the Australian government?

Ms Crawford—I do not have that.

Senator CAROL BROWN—Have all the current clients of the debt legal team been notified of the changes and that they will now have to call Melbourne to discuss their cases?

Ms Crawford—Again, I do not have that specific information. If there are cases that are on foot they will continue to be managed.

Senator CAROL BROWN—Did you not say there were currently 200?

Ms Crawford—Yes, 200 legal cases in Tasmania at present.

Senator CAROL BROWN—We do not know whether any of those clients have been told?

Ms Crawford—I do not have that information, but I can get that.

Senator CAROL BROWN—Do they just ring up the number that they previously had to talk to the Hobart based team, and is there a recording or something?

Ms Crawford—I am certain they would get an answer. There is obviously a large workforce in Tasmania and those cases would be transferred to officers who would be case managing those.

Senator CAROL BROWN—If I were to ring that number now, I would be getting a real person there to talk to me and not a recording?

Ms Crawford—Yes, there would be.

Senator CAROL BROWN—You said all the staff were found alternative positions?

Ms Crawford—That is correct.

Senator CAROL BROWN—Where are those positions?

Ms Crawford—Again, from the information that I have, all four staff have been assigned work in other parts of the tax office. Their new roles suit their qualifications and skills, as well as the organisational needs, but I do not have the specific positions that they are in.

Senator CAROL BROWN—They would have been transferred at the same salary level?

Ms Crawford—I am aware of one instance where a person was on higher duties, and I understand that person has been transferred at their substantive level and not necessarily on the higher duties.

Senator CAROL BROWN—No salary maintenance?

Ms Crawford—I do not think so.

Senator CAROL BROWN—That person is probably not too happy. The concern I have is about Tasmania again being singled out and services being taken away from Tasmania. I have had dealings with this unit and been very happy with the level of expertise and advice they gave a constituent of mine, and it is very concerning to me that the face-to-face contact will be curtailed.

Ms Crawford—I do not believe the level of service will be curtailed. I agree with what you are saying. I also met personally with the four people when I was visiting Hobart, and I found them to be excellent officers. This is not a matter about their performance. It is more about how we manage our staff and the overheads that are attached to that. In fact, in Tasmania, while we are making this change, we are also expending in some other areas down there. So it is not in any sense reducing staff in Tasmania.

Senator CAROL BROWN—My understanding is that it was an efficient and effective unit that was recovering about \$7.5 million a year, and the cost of running that unit was around about \$1 million. They were obviously doing a very good job for the Australian government. These areas can be very sensitive, and it helps to have knowledge of the Tasmanian community and environment. The ability to see an officer quickly needs to be maintained. Are you telling me that face-to-face meetings will be available without any cost to the client?

Ms Crawford—Yes.

Senator CAROL BROWN—Will any calls to Melbourne be at a local call rate?

Ms Crawford—I will look into that. I am not sure of the answer, but I will certainly look at that.

Senator CAROL BROWN—I would appreciate it if you could come back with that information.

Ms Crawford—Yes.

Senator SHERRY—I have a couple of questions on the same issue. Why should Tasmanians have to put up with fly-in, fly-out loss mitigation officers coming down from Melbourne?

Mr D'Ascenzo—As we pointed out, we had some very good officers in that unit. The point is that, when you do not have a critical mass and you have people who go on leave and you have four covering a small group of people, it is hard to manage that effectively. There is an issue of having specialisations in areas where you can have more of a critical mass in, say, Melbourne. On the other hand, we are trying to build Hobart as a centre for a lot of our superannuation work, and you will have to find people in Melbourne who will have to put up with people from Tasmania going there on some of their superannuation processes. When you run a large organisation across the country and you have a system that is nationally based and not regionally based, you have a whole range of those issues. What you have to do is try to make sure that you have a number of bases covered. One base is of course the level of service you can provide, and that has to be satisfactory. Secondly, you also have to make sure that you

have a critical mass to go forward. You have to have some sort of succession planning and some level of specialisation. And the smaller the group the harder it is to provide that, even in terms of their own training and development.

Senator CAROL BROWN—That is a little hard to understand. We know that this unit was recovering quite a large amount of money compared with the cost of running the unit. I particularly see it as a deskilling of the workforce down in Hobart.

Mr D'Ascenzo—Only if you do not see compensation in terms of other areas. For example, we are building quite a large specialisation on superannuation in Hobart.

CHAIR—Perhaps you can elaborate on that?

Mr D'Ascenzo—The second biggest grouping in Hobart is in superannuation. One of the things that you could do there, for instance, is to build a provision-of-advice facility from that.

Senator SHERRY—You have said that that is being built up. Can you give us some statistics on the numbers being employed and the skills in Hobart?

Mr D'Ascenzo—We can provide that.

Ms Crawford—In the area that I look after, there are an additional 60 new staff working in our client account services area. That is looking at the administration of superannuation.

Senator SHERRY—To use the tax office's speak, there is no problem with Tasmania's isolation, but it is a problem when it comes to loss mitigation?

Mr D'Ascenzo—I have never mentioned isolation.

Senator SHERRY—You did not, but the other officer did.

Ms Crawford—I said remote, I hope.

Mr D'Ascenzo—No. What we were talking about was trying to make sure that we have a critical mass, because if you do not have a certain size in some of these functions it is hard to provide the infrastructure in terms of continuing development, succession planning and the whole range of overheads that you need to provide people to operate well.

Senator SHERRY—You did not use the word 'isolation', Ms Crawford did; it did cross her lips. It is on the *Hansard*. Is it not precisely because Tasmania is geographically dislocated by Bass Strait that we do need officers of that skill level, at least to some extent?

Mr D'Ascenzo—My view is that Hobart provides an excellent opportunity, because of the matters that you raised, to grow a level of expertise in an area where they can specialise, rather than areas with one or two persons per task; that will never grow into a viable, effective unit over time. But in the superannuation area, for instance, we are building up the expertise in Hobart.

Senator SHERRY—Let us come back to the loss mitigation group. You gave a statistic of four staff and a caseload of 200, whereas a comparable unit has 15 staff and a caseload of 800 to 1,000. From a cost effectiveness point of view, have you factored in the extra cost that will be involved in officers flying in and out of Melbourne to Hobart and presumably other parts of Tasmania as well? Have you factored in that extra cost?

Ms Crawford—Those matters were all taken into consideration. As the commissioner said, our aim is to create viable teams that have appropriate management and all the opportunities that can occur in a larger team. That is a little bit more limited when there are only four individuals. I apologise for using the word ‘isolated’. We refer in the tax office to remote management.

Senator SHERRY—Is that a euphemism?

Ms Crawford—Our aim is to reduce that occurring as much as we possibly can so that our staff are properly supported in the workplace and have appropriate management and opportunities.

Senator SHERRY—Have you had any complaints from the four staff about a lack of promotional opportunities, and a lack of opportunity to be appropriately trained, skilled, supervised—those sorts of issues which you are using as an excuse for this cutback down in Tasmania?

Ms Crawford—I cannot say that I have had that specifically from these four individuals.

Senator SHERRY—How can you claim that they are factors?

Mr D’Ascenzo—They are factors organisationally. In fact, as Ms Crawford mentioned, the four there enjoyed the work that they were doing. They were good officers and we are pleased to have them continue as good officers in the tax office in other roles. The point is that, organisationally, it is a difficult management task when you have small groupings of people spread across the country.

Senator SHERRY—How long have you had the loss mitigation group in Hobart? How many years does it go back?

Mr D’Ascenzo—Traditionally we have moved from what we called ‘mirror-image’ offices, which were proven to be inefficient across the whole of the country, to more specialisation, and this is part of that progress.

Senator CAROL BROWN—Are you looking at closing any other offices around the country?

Mr D’Ascenzo—Offices? Functions?

Senator CAROL BROWN—Debt legal units.

Mr D’Ascenzo—We do that all the time. In other words, we try to rationalise our resources as best we can to produce a better outcome across the whole of the country. That rationalisation work will continue.

Senator CAROL BROWN—My understanding is that there are debt legal units in every other state except Tasmania now?

Ms Crawford—And certainly not the ACT.

Senator CAROL BROWN—How many staff are in the Perth unit?

Ms Crawford—I would have to take that on notice. I do not have that.

Senator CAROL BROWN—Are you looking at those legal units?

Ms Crawford—We are looking; we constantly look at it and review all our staffing arrangements across the board.

Senator SHERRY—Does Darwin have a unit?

Ms Granger—Not debt legals, no.

Ms Crawford—Can I also be clear that there is still a legal services branch located in Tasmania, and it is in fact the members of that branch who attend most of the debt recovery court matters. Those people will still be available for face-to-face consultation.

Mr D'Ascenzo—I had the pleasure of giving a talk to the people at the University of Tasmania's legal workshop, and tried to encourage them to join Tax because of the exciting work that we would have in Hobart and across the country.

Senator SHERRY—And that would be superannuation tax?

Ms Crawford—That is right.

Mr D'Ascenzo—We have other functions as well. We still do have a legals area. As I said before, the four people are very good people.

Senator JOYCE—Do you have a tape of that discussion? I might be able to take it home to my kids to help them sleep at night.

Mr D'Ascenzo—The point I was trying to make with that story was that I see Hobart having some opportunities because of the quality of people that can come through the universities and might like to look at Hobart or Tasmania as a place to grow and develop. We can get some high-level skills in that sort of market that we would like to keep, so they do not want to reduce—

Senator SHERRY—I think those are very accurate and perceptive comments about the quality of people who come from Tasmania.

Senator JOYCE—And they all need to grow and develop.

Mr D'Ascenzo—As I said, this was one situation where it was just a practical decision of trying to consolidate a grouping for large organisational management perspectives. It was not in any way intended to be either derogatory of the four people involved who, as Ms Crawford said—and I met them as well—were quite impressive and very loyal and really love the job.

Senator JOYCE—They must be very impressive, because years ago I applied for a job with the tax office in Tasmania and you knocked me back.

CHAIR—Not only are they good; they are also very wise.

Senator JOYCE—Very discerning.

CHAIR—Just so I am clear—

Senator SHERRY—There is no National Party in Tasmania; they were extinguished a long time ago.

Senator JOYCE—I was sent down there as a plant.

CHAIR—Don't worry; you tried.

Senator JOYCE—Williams was our first senator, I think.

CHAIR—Just so I am clear, there is not one of these units in the ACT and there is not one in Darwin?

Ms Granger—No, that is right.

Ms Crawford—No.

CHAIR—Are the 60 positions in super a reallocation of resources or are they new jobs?

Ms Crawford—They would be new in the sense of they are doing new work, and we have decided to locate them there. So additional work.

CHAIR—So they are additional positions?

Senator CAROL BROWN—Are they new jobs, though? Have they been approved?

CHAIR—Are they new jobs in Tasmania?

Ms Crawford—I think the answer is, yes.

Senator CAROL BROWN—Those positions have been approved and filled?

Senator SHERRY—You can include that as part of the answer to the questions on notice.

CHAIR—I think I would rather like the answer now, because I think I know what it might be. Do you know the answer to that?

Ms Crawford—I missed the question, I am sorry.

CHAIR—Are these new positions into Tasmania?

Ms Crawford—Yes, they are.

CHAIR—Thank you.

Senator CAROL BROWN—Are they filled positions or are they approved?

Ms Crawford—The information I have is that we are recruiting around 60 new staff to work in our client account services area.

Mr D'Ascenzo—I have asked our people to get the staffing level for Tasmania over the last three years just to indicate whether or not there is a diminution in terms of ATO opportunities there or an increase.

CHAIR—I think Tasmania has been overserved by the ATO.

Mr D'Ascenzo—That might help to see whether there is a diminution of our level of opportunities in Tasmania over the last three years.

Senator CAROL BROWN—There are 60 jobs—

Senator JOYCE—Could be a definite career after politics.

Senator CAROL BROWN—Just going back to the decision about the debt legal unit, how was that decision conveyed to the four staff members?

Ms Crawford—I am not certain of the answer to that precisely, but I will find that out.

Senator CAROL BROWN—Because it was closed down pretty quickly, was it not?

Ms Crawford—The information I have on my brief—

Senator CAROL BROWN—They were moved on pretty quickly.

Ms Crawford—says that staff in ‘Hobart and unions were formally advised about the transfer of the debt legal function on the 12th of April’. That is the—

Senator CAROL BROWN—They are no longer there? They have all been moved on?

Ms Crawford—Again, that level of detail, I am sorry, I do not have.

Senator CAROL BROWN—If you could on notice provide me with the consultation process and the dates and the people involved in that, and particularly the consultation that was held with the staff and union and the dates, I would appreciate that. Thank you. I have finished.

Senator SHERRY—Chair, that is our Tasmanian interlude. Back to equally important things, just because I go to some income tax revenue issues, I have a couple of issues about superannuation fund estimates and projections. I note that I have asked on many occasions, as Mr Ray who is coming to the table is well aware, for the disaggregated projections on contribution of earnings. I knew I would not get it; you are nodding. Eleven years on I have a rising expectation of hope that by the end of the year I will have the figures. One issue, Mr Ray, is the estimate for earnings tax in the projections. I know you are not going to give me the figure so I will not seek it. But as to the base for the estimate of the earnings going forward, is it based on a long-term historical growth in the earnings rate of superannuation funds over the last five to seven years, or do you look at the last, say, two or three years of average fund earnings and use that as the base for your projection going forward?

Mr Ray—Are you talking about the projections?

Senator SHERRY—Yes, for the projections going forward.

Mr Ray—For the projections we used long-term averages.

Senator SHERRY—How long term, though? The point of my question is this: over the last three years average superannuation returns have been very high.

Mr Ray—Very high.

Senator SHERRY—Certainly way above the long-term average.

Mr Ray—Yes. We would use a longer term than the past three years, probably over the last cycle or something like that.

Senator SHERRY—I have one other question. This is a relatively minor issue, but it stands out. Your projection of surcharge revenue going forward, obviously, is trending down. You have got 10 in 2008-09, 10 in 2009-10 and then it goes back up to 20 in 2011. Why is there a jump? This is on page 511. Why would we have a jump three years out—a doubling of the money?

Mr Ray—It is more than likely rounding.

Senator SHERRY—I thought you might say that. It sort of stands out—10 to 20.

Mr Ray—We round to the nearest 10, I think.

Senator SHERRY—You look a trifle unsure?

Mr Ray—It is such a small amount that I do not—

Senator SHERRY—In the scheme of things it is relatively small.

Mr Ray—I do not have the detail of the spreadsheet that underpins it in my mind.

Senator SHERRY—In the scheme of the figures, and the massive miscalculation in revenue figures we were talking about before lunch, you are right, but it just looks odd—10, 10, trending down on previous years and then up to 20.

Mr Ray—Because the best answer that we can—

Senator SHERRY—Take it on notice.

Mr Ray—say is that it is rounding. I will take it on notice.

Senator SHERRY—It just looks odd. Whilst I am on this issue, there is a measure in respect of judges and surcharge in the budget. I just wanted to clear that one up. Could I have an explanation as to why for judges there is a revenue loss of about half a million dollars relating to surcharge collection. Again, that stood out with no real explanation as to why judges were getting this treatment, and what the detail of it was.

Mr Ray—Mr Lonsdale will help you with that.

Mr Lonsdale—You are right; there is a measure in the budget. It is an expense measure related to surcharge and judges. It is a payment of around \$500,000 to the Attorney-General's Department, so they are responsible for that payment. I am happy to share my broad understanding of it, but you should probably direct your questions to them. As you would be aware, the way the surcharge works in an unfunded defined benefits scheme is that, if a debt account is accrued when a member first takes their benefit, the surcharge repayment is triggered. That is regardless of whether we are talking about Commonwealth or state public servants or judges or anybody else. That is how it works on the tax side. In terms of this payment, my understanding is that the actual liability is levied on the trustee of the scheme, who is the secretary to the Attorney-General's Department. This payment really just represents a timing issue where the payment is made and then subsequently judges' pensions are reduced commensurate with a surcharge debt, and so that would be reflected in consolidated revenue elsewhere.

Senator SHERRY—Has there been any effective change in the outcome for judges as a result of this measure?

Mr Lonsdale—My understanding is, no. What this measure is showing is that some judges—and I am not sure how many—are coming up for retirement who have debt accounts, and this payment is necessary for that mechanism, as I just described, to happen.

Senator SHERRY—As you suggest, for more detail I will ask AG's, but thanks for that. This stood out as a lone surcharge measure, and it intrigued a number of us as to why it was judges alone. Thanks for that. I just wanted to go back to some revenue budget issues relating to personal income tax. If we go to the personal income tax cuts in this year's budget, what is the approximate number of people who will benefit as a consequence of the tax cuts in this year's budget?

Mr Gallagher is coming.

Mr Ray—A round number is 10 million.

Senator SHERRY—A round number of 10 million. I want to explore the round numbers. Firstly, approximately how many taxpayers will be in the system in the 2007-08 year?

Mr Gallagher—We will not know the number of taxpayers exactly for some time. There is a number that we use for costing purposes, and that is different from the number in tax stats because it allows for a number of late tax returns. In general when we speak on this issue we advise the Treasurer to say 10 million taxpayers.

Senator SHERRY—What is your assessment? In terms of the work you carried out, what assessment figure did you use?

Mr Gallagher—Ten million.

Senator SHERRY—Exactly? That seems very convenient, 10 million.

Mr Gallagher—As to the degree of accuracy we can have, given that we will not know for many years—it takes many years for people in 2007-08 to submit their tax return—it is always the issue that we can have more taxpayers than we have people submitting tax returns. Some people who have tax deducted through the tax instalment method do not in actual fact submit tax returns.

Senator SHERRY—You have used the 10 million. I understand the lag time for pure accuracy on the figures. In the out years for which estimates and projections are given you would have arrived at an estimate for a number of taxpayers for each of the out years, too, would you not?

Mr Gallagher—Yes.

Senator SHERRY—Can you give me the approximate number—we have the base of 10 million here—for each of the out years?

Mr Gallagher—I do not have those numbers with me in terms of the basis of the estimate and I would prefer—

Senator SHERRY—You cannot recall off the top of your head the approximate figures you work on?

Mr Gallagher—No, I cannot recall off the top.

Senator SHERRY—You know how reasonable I am. I am not going to hold it against you if it is a little bit out.

Mr Gallagher—No, I do not know the exact number of taxpayers that we have in our forecasts.

Senator SHERRY—What is your basis for—

Mr Gallagher—The other issue is that it is somewhat of a synthetic number. It is a number used to arrive at the revenue estimate.

Senator SHERRY—It is still a number that you use for your base calculations.

Mr Gallagher—It is.

Senator SHERRY—You could describe it as synthetic, but it is the only number that we have got to go on that you have based your calculations.

Mr Gallagher—No, the other number that you have got to go on is the numbers that will be published in taxation statistics, but they will differ.

Senator SHERRY—That is a two-year lag, is it not?

Mr Gallagher—Yes.

Senator SHERRY—We have a costing of tax cuts in the budget. I am exploring how that was calculated, and clearly it is not done on the basis of statistics that are to be published in two years time.

Senator JOYCE—That is not—

Senator SHERRY—The 10 million is. If Mr Gallagher can show me the figures for the out years that are in the budget, I would be more than happy to be shown the page number.

Mr Gallagher—No, they are not available.

Senator SHERRY—You cannot give me the figure; you do not have it with you for the out years. How do you determine the growth in taxpayers? What indicators do you use to determine growth? Is it employment forecasts in the budget or some other factor or factors?

Mr Gallagher—The major determinant of growth is in actual fact the forecast of taxation revenue, because what we want to do is to maintain an income distribution so that we can do the costing and therefore we re-weight our micro simulation model so that it produces the forward estimates. The other factor that has been involved in this set of estimates is that we have allowed for the impact of the superannuation measures on the tax base, and that has taken taxpayers out of the tax base.

Senator SHERRY—Are you able to give us an estimate of the number of taxpayers that would take out, the figure that you estimated?

Mr Gallagher—I will take the question on notice.

Senator SHERRY—You cannot give me an approximate figure?

Mr Gallagher—It depends on the methodology. There is a variety of methodologies.

Senator SHERRY—How many taxpayers did you estimate would be within each marginal tax rate band in the 2007-08 year?

Mr Gallagher—The tax cuts are sufficient to maintain the 80 per cent commitment of the government; 80 per cent will have a 30 per cent marginal tax rate or less. In actual fact, more than 80 per cent of taxpayers will have a 30 per cent rate or less.

Senator SHERRY—I was going to explore that, but that is not the question I asked.

Mr Gallagher—Yes, but in terms of—

Senator SHERRY—The question I asked is: how many taxpayers do you anticipate will be within each marginal tax bracket in 2007-08?

Mr Gallagher—I will take the question on notice.

Senator SHERRY—Are you sure you do not have an idea of the figure? You have got a very large suitcase, I notice, and I expect it to brim full of information.

Mr Gallagher—I do. It is full of things that have been published and this is not something that has been published.

CHAIR—You stick to your guns, Mr Gallagher. Don't be thrown by that.

Senator SHERRY—You wait until you are in opposition. You will see what it is like to feel like sticking to your guns and it will happen one day.

Senator JOYCE—In the meantime you have got a long and fruitful life in front of you.

Senator SHERRY—Hopefully we have all got that. Did you have the data in Treasury to calculate the base figures that I have been questioning you about?

Mr Ray—We have an estimate for costing purposes, yes. As I say, the estimate is built off the data that is published in taxation statistics, historical data adjusted as Mr Gallagher explained for people who have not yet filed and then adjusted for employment and income growth.

Senator SHERRY—How does Treasury anticipate taxable income growth? Is it off the historical data and then combined with the economic growth figures?

Mr Gallagher—We have within the taxation parameters figures for wages growth and we look at the percentile distribution in terms of the variation from wages group for different percentiles of taxpayers and we fit an adjustment factor. We use a differential upgrading approach based essentially around wages growth parameters.

Senator SHERRY—Is that done within Treasury or within ATO?

Mr Gallagher—The process I have described is the Treasury process. The ATO process also looks at some components of property income and separately adjusts those.

Senator SHERRY—What is the wage measure used to inflate taxpayer income into the forward estimates?

Mr Gallagher—We use average weekly earnings as our base measure because they have both part-time and full-time workers in its base and therefore it is like the tax distribution itself. We do not take something which is only for full-time workers, such as AWOTE or MTAWTE, because obviously, we have a tax base which involves both.

Senator SHERRY—If you take average weekly earnings, does that adequately represent any shift in the growth of female employment, for example? I have not got the figures in front of me, but as I understand it, compared to males, would they be overly represented in that area?

Mr Gallagher—The adjustment that is in the distribution of taxable income is picking up those changes.

Senator SHERRY—That would pick that up?

Mr Gallagher—Yes.

Senator SHERRY—Even where there is a shift? If female employment is growing at a more rapid pace than male employments but it is still—

Mr Gallagher—We do not differentially re-weight over the forward estimates period for that purpose. We have taken the distribution of taxpayers and most of the time we do not look at whether they are male or female. They are just taxpayers.

Mr Ray—As that proportion changes through time, it is reflected in the base.

Senator SHERRY—Yes. How does Treasury anticipate deductions will grow across the forward estimates? Is there a specific inflator used or are there values that are extrapolated out using past trends?

Mr Gallagher—We operate on the basis of taxable income and the effect is essentially that we assume that deduction and income will move at the same rate.

Senator SHERRY—You touched earlier on that figure of 80 per cent of taxpayers. Does that 80 per cent include the impact of the phase-out of the low income tax offset?

Mr Gallagher—The 80 per cent with 30 per cent or less is always made in respect of the brackets, so it does not include the Medicare levy and it does not include the phase-out of the low income tax offset. It does not include the phase-out of the senior Australians tax offset.

Senator SHERRY—What is the approximate change each year with the phase-out of those measures?

Mr Gallagher—I am not sure that I follow the question. Which number are you thinking of?

Senator SHERRY—Both the low income tax offset and the seniors tax offset.

Mr Gallagher—I do not have an answer in terms of numbers. Essentially the measures in this budget involve taking the shade-out of the low income tax offset previously from \$25,000 to \$40,000 and now from \$30,000 to \$48,750. That is higher in the income distribution. I am not sure whether that means that there are more or fewer people in the shade-out because, obviously, there are a significant number of taxpayers, particularly female taxpayers, between \$25,000 and \$30,000.

Senator SHERRY—What marginal tax rate arises between \$30,000 and \$48,750 once that low income tax offset is taken into account? What is the marginal tax rate?

Mr Gallagher—The marginal tax rate, if you include the Medicare levy, is probably 35.5, so it is 30 plus four, plus 1.5.

Senator SHERRY—If it is as you describe, and I accept what you say, is that consistent with the claim that 80 per cent of taxpayers face a marginal tax rate of 30c or less?

Mr Gallagher—The claim has always been made in respect of the brackets. The use of the phrase ‘marginal rate’ in essence indicates that it is talking about the brackets.

Senator SHERRY—In essence? Will you point me to the essence?

Mr Gallagher—When people talk about their marginal rate they are talking about the tax bracket that they are in, so they are talking about the calculation of gross tax. They are not making a reference to the calculation of rebates or the Medicare levy, in general.

Senator SHERRY—You did refer to the essence of the budget papers. Can I see the essence in writing? Can you point me to a point in the budget papers where it actually says that?

Mr Gallagher—No, I do not think I can do that.

Senator SHERRY—I do not think even Mr Ray or anyone else in Treasury would want to be referring to ‘essences’—

Mr Gallagher—I would not have to bring a suitcase of papers up if I had the essence.

Senator SHERRY—Rather than essences I would just like to see the hard figures produced more often. I understand the constraints you operate under, Mr Gallagher. The budget papers claim that the increase in the top threshold will result in two per cent of taxpayers facing the top marginal rate of 45c in the 2008-09 year?

Mr Gallagher—Yes.

Senator SHERRY—How many taxpayers does that amount to approximately?

Mr Gallagher—It is two per cent of 10 million.

Senator SHERRY—Why did I think you would say that?

Mr Gallagher—It might be a bit more than that in 2008-09.

Senator SHERRY—It might be a bit more in 2008-09?

Mr Gallagher—Yes, it might be a bit more than 10 million. As a statement of order of magnitude it is two per cent of 10 million.

Senator SHERRY—But it might be a little greater. Why would it be greater in 2008-09?

Mr Gallagher—Because we have got expanding employment.

Senator SHERRY—Is the Melbourne Institute MITTSB model used in the formulation of the tax measures announced in the budget?

Mr Ray—The Melbourne Institute’s tax transfer simulator model part B was used to analyse the tax cuts in the budget, yes.

Senator SHERRY—Analysed in what way?

Mr Ray—The tax cuts were run through the model to look at the potential participation effects.

Senator SHERRY—That was after you had presumably—

Mr Ray—It was before the budget was finalised.

Senator SHERRY—Okay. It was before the budget was finalised but it would have been after you had determined a model, if you like, or changes?

Mr Ray—Over time we have looked at a number of different tax cut options using that model. It is hard to pick a particular thing, but obviously in terms of the precise tax cuts that the government decided to announce in the budget, that was put through as a package.

Senator SHERRY—It was put through the Treasury model?

Mr Ray—It was put through the Treasury version of the model and it was also put through the Melbourne Institute's version of the model. We asked them to do so after the budget.

Senator SHERRY—After the budget?

Mr Ray—Yes.

Senator SHERRY—Before the budget it was the participation impact and then you ran it through after the budget?

Mr Ray—No. Before the budget we ran it through our version of the models. For reasons of confidentiality we did not approach the Melbourne Institute until after the budget. After the budget we asked them to run it through their version of the model as a consistency check.

Senator SHERRY—Was it consistent?

Mr Ray—Yes, broadly.

Senator SHERRY—I was going to get to that. So you said 'broadly', did you, at the end there?

Mr Ray—Yes.

Senator SHERRY—It was broadly consistent. Where was it not consistent?

Mr Ray—The exact number coming out of the Melbourne Institute's model was not precisely the same as that coming out of our version of the model, but the aggregate effect on hours worked rounds to the same number, which is 0.1 hours worked, which I think was in Dr Henry's speech the other week.

Senator SHERRY—I had not had the advantage of reading Dr Henry's speech. What was the difference with the employment effect?

Mr Ray—I do not have the numbers with me, but the aggregate number out of the Melbourne Institute's model was slightly smaller. But I would not attach much to that. There are differences between the two versions of the models.

Senator SHERRY—Were any estimates made of the budget impact from the increased labour force participation for the package used in that Melbourne Institute model?

Mr Ray—You are referring to the so-called participation effect?

Senator SHERRY—Yes.

Mr Ray—That is one of the by-products of the model and so therefore it is in the model output.

Senator SHERRY—Sorry, I did not catch that last bit.

Mr Ray—It was in the model output. It is just one of the things that come out of the model.

Senator SHERRY—In the Melbourne Institute or Treasury?

Mr Ray—Both versions of the model. But we do not use those effects in our costings.

Senator SHERRY—Why not?

Mr Ray—Because we do not have a time path for that sort of effect.

Senator SHERRY—That might add to an underestimate of revenue in future estimates when we discuss that?

It could be a possible impact by the sound of it?

Mr Ray—It is likely to be swamped by general movements in the economy.

Senator SHERRY—We discussed the models themselves. In February 2007 there was some discussion with you, Mr Gallagher and I think Mr Ray as well. I just want to be clear on this. You said earlier, Mr Ray, that you run the participation effects but not the revenue effects through the Melbourne Institute model. The cost-revenue impacts were run solely through the Treasury model?

Mr Ray—I just want to be clear on this. We do not use our version of the Melbourne Institute's model or the Melbourne Institute's version of their model for costing purposes. For costing the personal tax cuts, we use our own micro-simulation model for that purpose, which I think you have discussed with Mr Gallagher on many occasions.

Senator SHERRY—Yes, that is right. I just want to be clear on this, with regard to the origin of your own micro-simulation model which we did discuss back in February, is that from the ATO and it has got add-ons or adjustments to it from the ATO, or has it been built over the years within Treasury?

Mr Gallagher—No, we have built the model based on a totally confidential and anonymous sample of unit record data of personal taxpayers. The model is something that we built. Since we constructed our micro-simulation model, the tax office has also constructed a micro-simulation model of its own.

Senator SHERRY—But as far as Treasury goes, it has its own model?

Mr Gallagher—Yes.

Senator SHERRY—Is there anyone outside Treasury who has a model that would be as accurate or as comprehensive?

Mr Gallagher—In our experience, no. The people who have tried it from ABS sample survey data have the problem that very high income taxpayers are underrepresented in sample surveys because they live in large houses behind locked gates and the interviewers cannot get into speak to them, or they are away on holidays. So, attempts to—

Senator SHERRY—That is an interesting observation, Mr Gallagher.

Mr Gallagher—Two groups are excluded generally from sample surveys around the world, the high income people and the low income people. But the low income people do not have much impact on the tax base whereas the high income people do. There is a tendency if you use a model based on an ABS survey, a model such as STINMOD, that you underestimate tax cuts. We are seeing estimates based on that. There are also issues in terms of trying to use historical versions of taxation statistics because for any given year taxation statistics which are based on tax returns in a year will fall short of taxation revenue. You need to have a model which, in actual fact, reproduces the forward estimates.

Senator SHERRY—So, in order to accurately cost personal income tax changes you are confident you have got the most accurate model?

Mr Gallagher—I think we in the tax office—

Senator SHERRY—The most accurate model that can most accurately calculate the changes compared to any others in the country?

Mr Gallagher—Yes, and part of the reason that we think that is that we have gone to special trouble to allow for policy changes such as the superannuation change.

Senator SHERRY—You have outlined those fairly unique characteristics I had not heard about before. Does the ATO have a model that matches to the same degree of accuracy the model Mr Gallagher has referred to?

Mr D'Ascenzo—I do not think our model seeks to replicate the work that Treasury does. We do work with Treasury on modelling, but I do not think we put ourselves up as a separate forecasting group.

Senator SHERRY—Do officials believe that the absence of the top quality data personal income tax change model in the public realm limits public debate in this area?

Mr Gallagher—It depends on which issue you are talking about. I think that probably generally there is an issue about how much we know about high income taxpayers. What you will find, however, is that models such as STINMOD and other models based on ABS survey data are very good at getting the impacts on wage and salary earners, and are very good at getting impacts on most of the income distribution in actual fact.

Senator SHERRY—They are very good but they are not as good as your model?

Mr Gallagher—We would not have gone to the trouble, otherwise; we would just have used Treasury's modified version of STINMOD for the tax cuts if we thought it outperformed, and we do not.

Senator SHERRY—I think we have touched on this before but if a group comes along from the private sector, or an outside organisation, and requests access to the Treasury model, is it granted?

Mr Gallagher—In neither of the superannuation models or the personal tax model have we given away access?

Senator SHERRY—Turning to a couple of other revenue ATO measures, there is a measure 'revenue forgone' from the ATO. It is headed 'Iraq, continuing funding for stabilisation and reconstruction activities'. It is in Budget Paper No. 2, page 107. Is someone familiar with that? I just wanted to ask a question about it? It is revenue forgone for 2007-08 from the ATO of some \$23 million.

Mr Ray—I think that is explained at that page.

Senator SHERRY—I know it is explained but I had a question about the explanation.

Mr Ray—If you ask a question we will see if we can answer it.

Senator SHERRY—There is no revenue forgone for 2008-09, 2009-10 and 2010-11, it is just for 2007-08. Why is that?

Ms Druhan—The revenue forgone is about taxable income received by Australian Defence Force members not being taxed while they are on eligible duty, and that is just for the one year.

Senator SHERRY—That is my point. That is the point of my question. It is only for 2007-08 but there is no revenue forgone for following years. Where is revenue forgone for following years?

Ms Druhan—I cannot answer that.

Senator SHERRY—When does the government announce that troops are going to be withdrawn from Iraq, by the commencement of the 2008-09 financial year? Therefore, why is there not a forgone revenue figure for that year and beyond?

Senator Minchin—With some reservations, and I think I will have to check this, but my recollection is that it is associated with the fact that, in reality, the decisions on deployments are made on a rolling basis, on a six-monthly or yearly basis. While there is the forward estimate in terms of the commitment, the actual deployments of who goes and for how long are made discretely. At intervals of six months or a year there is the rolling program of deployments. I think that is probably what this is about, but we can confirm that for you.

Senator SHERRY—As I say, I thought that your government's commitment was ongoing, without a foreseeable end.

Senator Minchin—Certainly the commitment is ongoing. You know what our position is. We are there while we are needed and while the Iraqi government wants us and that is why the overall funding for the Department of Defence, as an expense item, is over those three years. But this relates to military personnel on the ground as a revenue forgone item because of the special tax arrangements for those forces. That is determined discretely and specifically, depending on particular needs and deployment decisions.

Senator SHERRY—I understand why the revenue is forgone from the forces on the ground. I am not suggesting otherwise. It just struck me as odd, indeed inconsistent, that given that there is Department of Defence expenditure through 2008-09 and 2009-10, presumably there would have to be some persons on the ground.

Senator Minchin—Certain assumptions, yes.

Senator SHERRY—On that basis, why does the revenue forgone not carry through to 2008-09 and 2009-10?

Senator Minchin—As I say, I suspect it relates to the formal decisions made by NSC about deployments, but we will have to confirm that for you. We are getting that checked now. We will get back as soon as we can.

Senator SHERRY—Because, as I say, I was not aware of an announcement that 2007-08 was the end of the commitment.

Senator Minchin—No, you are quite right. But it is true that discrete specific decisions are made by NSC about specific deployments. We will check.

Senator SHERRY—As I say, my concern would be that we have a cost being claimed by the Department of Defence. I mean we have to watch the Department of Defence, as you well know.

Senator Minchin—Quite right.

Senator SHERRY—We have a cost going forward over those three years and a loss to revenue for only one year. It just strikes me as being a bit inconsistent, whatever the pull-out date is ever going to be.

Senator Minchin—On the face of it, you point to an inconsistency which I will seek to clarify.

Senator SHERRY—I have another matter for the ATO. There is a new business intensive assistance program on Budget Paper No. 2, page 306. What is this measure designed to do? It does not seem to me to be particularly clear from the description.

Mr D'Ascenzo—It is basically there to help new businesses understand their rights and obligations in relation to tax and superannuation. We like to contact—

Senator SHERRY—Tax and superannuation? This is the business activity statement, face-to-face visits.

Mr D'Ascenzo—The specific budget allocation is for activity statements. We have a much wider program that covers both tax and super and again the aim is to try to ensure that employers understand their rights and obligations early in the piece rather than after and then fall into some error.

Senator SHERRY—I am referring to the measure on 306. There is another measure on page 304, 'Debt Collecting Enhancement', which I was actually going to go to as well.

Mr D'Ascenzo—No, I was referring to the help, and that is specifically related to activity statements but is part of a wider initiative that we have been running for some time in trying to help those new to business understand their rights and obligations. What we are concerned about both in the tax and super position is if the new business does not know their rights and obligations and it falls behind, then it becomes a very difficult spiral for them to work out of.

Senator SHERRY—Is that based on a level of dissatisfaction that new businesses have expressed over the last few years in this area?

Mr D'Ascenzo—It may come from that. It also comes from our consultation with business and our concern about businesses that perhaps are not aware of their rights and obligations early in the process of carrying on a business. So it is not so much a direct response to criticism but really an insight that we could do more to help those new to business understand those rights and obligations and, if that were the case, to set up a good basis for good compliance going forward.

Ms Granger—Perhaps I could add some more detail for you. I know you are aware that we have been for a number of years conducting a new-to-business program, particularly focused around educating businesses at the point of their enrolment in the tax system about rights and obligations and also about record keeping practices. We have developed a number of products to assist with that. We run a special call centre service for them and we also do on

request face-to-face visits. This program allows us to expand that program. It will allow us to potentially, at least, double the number of visits we can do. We will, in addition to on-request visits, actually target and go out to some small businesses where we think they might be struggling and we will try and follow them through their first year at particular points to remind them of particular obligations they have at that time because, as you probably know, one of our big concerns, particularly in the micro market, is the number of small businesses who very early in their life cycle get into debt and then struggle from there on in. So it is a combination of factors: some experience we have had with small businesses about what might be of more assistance to them but also us wanting to be able to expand the level of service we provide. We have not set in concrete all of the factors around that yet because we do want to do some co-design with small business representatives about what would work best.

Mr D'Ascenzo—This is an enhancement of an ongoing commitment. We have had information products tailored at new businesses. We have had a dedicated outbound phone service. In fact, last year we did 34,000 phone contacts and 6,000 face-to-face contacts with new businesses to help them understand their rights and obligations. This year we have already done 20,000 phone contacts and 1,400 face-to-face visits. We have provided online tools. We have provided record keeping tools and we do tax basics seminars for small business. The whole aim of this initiative is to enhance that. One of the enhancements, for instance, is to help people hook up onto our business portal; again, that is not only to help them facilitate and reduce their costs of compliance but also to encourage more online business activity by Australian businesses.

Senator SHERRY—Is it a redesign of a current program and then its expansion or just the expansion of a current program?

Mr D'Ascenzo—I think it is a bit of both. I think it is an expansion of our current program but we want to take the opportunity to stand back and do some more co-design with business about what will help them at this critical early stage of their development.

Senator SHERRY—Why could the measure not be met from existing resources?

Mr D'Ascenzo—Because we already have resources planned to operate in that area. This will allow us to actually enhance that by the further budget allocation that has been provided.

Senator SHERRY—What would be the additional staffing that will flow from this service, approximately?

Mr D'Ascenzo—108.

Senator SHERRY—Approximately 108 new staff. On the general staffing, I notice the ATO is to have a cutback in its total staffing by 116. So we have 108 we have identified as growth in this area—I am sure there are some details in the budget statements—but which other areas would receive a significant cutback? Something is going to have to give with the total cutback.

Mr D'Ascenzo—It works out. I can give you the specific details. Let me give you an overview first. As part of our agency agreement processes we have to fund pay rises. That comes out of productivity, so if we have a pay rise of say four per cent, I have to pay that extra four per cent out of productivity increases. We have the normal efficiency dividend of

1.25 per cent, so you have a 5.25 per cent reduction in terms of our resources that has to be driven through productivity increases. Our attrition rate is around four per cent, which means that you are still looking at a dip of 1.25 per cent, just to balance. We have some new funding from government in specific areas and this is usually tied funding. So you net that all out and you find that you end up having a slightly reduced base. So what happens is that we have to find efficiencies in our base out of that net equation. We also have a higher percentage of tied funding to base funding.

Senator SHERRY—It is by the by, but I notice the Productivity Commission is getting an increase of two per cent in its staff, from 204 to 218, but we will explore why the Productivity Commission needs an increase in staff later.

Mr D'Ascenzo—We can provide specific details, if you wish. I can give it to you now or if you would like it—

Senator SHERRY—I do not want to run through the stats at this time.

Mr D'Ascenzo—We will provide the stats to the committee.

Senator SHERRY—If you could, thank you.

Mr D'Ascenzo—Including the increase in the Tasmanian workforce.

CHAIR—You can highlight that if you like.

Senator JOYCE—Chair, can I just quickly ask two questions just to—

Senator SHERRY—I just have one more question and then I am happy to—

CHAIR—We will just finish this off and then we will come to you.

Senator SHERRY—Also, do you have any figures to hand on the additional resourcing that is being provided to the ATO since the introduction of the GST?

Ms Granger—Only since it was originally introduced?

Senator SHERRY—Yes.

Ms Granger—We would not have that with us, I do not think.

Senator SHERRY—Okay, but you can take that on notice.

Mr D'Ascenzo—Just in round terms though, from memory we had reduced significantly through efficiency dividends over a period of over a decade and I think that got us to a point of about something like 16,000 FTEs or thereabouts. Then we had something like a 6,000 increase with the GST side of it overall. So that is the sort of ratio. But we will get more specific details in our answers to the committee.

Senator JOYCE—My question is what I was asking before. I am back on private equity, not in particular, but just as a concept. If a company is purporting to make its money from buying something with the hope of selling the company at a profit, if they do it over and over and over again and if they structure it in such a way as to need to regear it whilst they own it so that their intention of a profit is not truly apparent whilst they own it, would there be a case to say that the purchase is not a capital acquisition and sale of the assets, it is actually income in nature?

Mr D'Ascenzo—I think there are certainly arguments where there is repetition on activity. It becomes more difficult where these are often done through special purpose entities. Even in those situations it is arguable, if there is a controlling entity in relation to all those special purpose entities, that that group as a group is undertaking something on a revenue account. So the answer is that argument is open in those circumstances.

Senator JOYCE—Does the Australian Taxation Office have the power now to look at these entities? We know prima facie we can see them and say, well, this entity buys and sells companies and that is how they make their money. In fact, that is how they advertise that they make their money. That is how they gain investors into what they do. Therefore, inherently, their project aim is the purchase and sale of capital assets for profit, which intrinsically means that they are income.

Mr D'Ascenzo—You often find, as I mentioned, that they actually do it through special purpose companies, so they argue the corporate veil but it is not—

Senator JOYCE—Can we lift the corporate veil and—

Mr D'Ascenzo—Well, I think there is an argument where there is a controlling entity that sets up a range of subsidiaries or special purpose companies and provides sufficient influence over those companies to direct their activities to sheet back to that company the income character of those activities, but I mean that is going to be dependent on the evidence and the influence that that controlling entity can play over the directors of a separate entity. These are not easy arguments to develop and succeed in courts, but they are open and we would not shy away from that if we had the evidence.

Senator JOYCE—Obviously, as an accountant you inherently always have share traders who want to claim their trades as income and not as capital gains.

Mr D'Ascenzo—I think the fact is if someone repetitively does something they move into a trader categorisation rather than investor. As I said, the difficulty is that people often do it through special purpose companies and then you have to sheet home some level of control over the directors of those companies to indicate that there is one.

Senator JOYCE—You could say to them, 'You prove to me that you are not a trader and we will let it call you capital, but if you cannot we are going to presume prima facie that you are a trading company, you are not owning these assets.'

Mr D'Ascenzo—I think we need to have the evidence to put that proposition to the companies.

Ms Granger—I think the difficulty with your example is you are talking specifically about non-residents, are you not?

Senator JOYCE—Yes.

Ms Granger—And it might only be one special purpose vehicle used within our jurisdiction.

Senator JOYCE—But we know we can search and find—

Ms Granger—But establishing an income-producing purpose within Australia.

Senator JOYCE—Yes. With the nature of their related entities and the overall business plan of what they intend to do, we should be saying, ‘Well, we will leave the onus with you; we are going to deem it income unless you can prove to us it is capital; that is the way it is going to work.’ If it is a related entity—you know what I am saying anyhow.

Ms Granger—I do.

Senator JOYCE—Has an attempt been made to fully model the tax outcomes associated with private equity investments? Is this analysis publicly released to facilitate an informed debate about the fiscal impact of private equity investments?

Mr D’Ascenzo—We have not done that.

Senator JOYCE—Is that envisaged at some stage?

Mr Callaghan—As I said before, it is impossible to do. It is a very general thing you are talking about. We went through the range of circumstances affecting each transaction and how it may translate through, so it is not possible to do it the way you have described it.

Senator JOYCE—I am just saying, because it is so complicated, were these issues taken on board as an analysis prior to the 2006 tax amendment bill measure No. 4?

Mr Callaghan—There was an analysis that was taken against what we expected would be the arrangements that were taking place on the CGT measure alone. As we said, if you are looking at private equity there is a range of different revenue implications that come from it, both plus and minus to the revenue from a particular transaction.

Senator JOYCE—But it just seems that it is *obscurum per obscurius* as to what those outcomes are going to be. We cannot seem to identify them now. It seems hard that we would have ever been able to identify them.

Mr Callaghan—As we discussed before, you are looking at the overall tax system. The monitoring that we are doing closely now in the context of private equity is that we are watching what is happening overseas. As the ATO have said, they are looking at some of the particular transactions that are occurring. What we are doing is monitoring very closely what is happening overseas as people look at this. As we mentioned before, specifically what has been announced is a review in the UK on a particular aspect of it. I know that there is a review in the United States. I know there is a review in Germany on different aspects of it. We are looking closely at their aspects of it to see if there are any implications that it may have for our system. Sometimes our systems may be more robust than theirs. For example, things like the distinction between the debt and equity; we may have a more robust system than they do. They are finding some loopholes in terms of some things that have been disguised as a debt where really it is equity and they are claiming deductions. We will have a look at our system to see if we think it is robust.

Senator JOYCE—Thank you.

Senator MURRAY—I wanted to ask you about share buy-backs but before I do so I will ask Mr Callaghan where we are up to with the Treasurer’s share buy-back review?

Mr Callaghan—It was referred to the Board of Taxation, so it is with the Board of Taxation.

Senator MURRAY—When will they report?

Mr Callaghan—I do not think that they have given a specific date on when they are proposing to report.

Senator MURRAY—I assume the Treasury is providing the secretarial services?

Mr Callaghan—We provide the secretarial services to the Board of Taxation in the context that, as they conduct a review, it can sometimes be done by engaging private consultants in preparing their own work and where we can assist we do provide assistance. In this case we are providing assistance.

Senator MURRAY—As you have inside knowledge, do you believe that this matter can be resolved this year with a report?

Mr Callaghan—I really could not speak on behalf of the Board of Taxation. It is very much within the hands of the board. They are determining the extent of the inquiries, the nature of how it is going forward and when they can report to the government.

Senator MURRAY—In theory it could take many years?

Mr Callaghan—No, I would not say many years but to be precise as to when, I could not be specific.

Mr D'Ascenzo—As an ex officio member of the board, I can say the schedule is for a report this year.

Senator MURRAY—That is what I was after.

Mr D'Ascenzo—In fact in the near future the board is organising further consultation with some selected parties on buy-back arrangements.

Senator MURRAY—I look at investment newsletters as one of my interests and I saw something in one of them which I thought I would quiz you on. I will quote the relevant passage. It said:

Now, as to Santos—what a crafty little deal this one is ... Having come through the turmoil of the disaster in Indonesia (which saw us suggest selling out of STO a couple of months back) the board now comes up with an offer to buy-back your shares for about 8-10% less than they're worth on market, BUT with some nice tax goodies thrown in—such as a tax-loss rather than a taxable gain and about 70% of the price will be by way of a fully franked dividend.

That effectively means that anyone who receives the payment will either get some extra tax dollars or at the very least some relief from paying tax on other taxable income. I've calculated that for most shareholders the offer will put about 8-10% extra in their hand, over and above selling on market—despite the discount, simply because of the ratio of franked dividends included in the offer price. It's a cunning stunt.

In fact ... It's so cunning you'd hardly think it could be legal. Everyone wins—except the Tax Man ... and perhaps also the STO shareholders that remain, who will have had some of their franking credits ripped out to pay off departing shareholders.

This is not an unfamiliar scenario to you?

Mr D'Ascenzo—No. Recently we issued a practice statement to our officers that we made public that outlined the processes that we take. Firstly, we would have to look at the facts and

circumstances of each case. Normally we give what is often a 14 per cent tolerance. The reasoning of that is that anything over 14 per cent suggests that you could have a significant purpose of franking credit streaming, whereas anything under 14 per cent does not suggest that because it reflects the normal turnover of affairs. Basically, we have put the practices and procedures that we take in that area and that in no way limits or circumscribes the Board of Taxation's review about the merits from a policy perspective of those arrangements.

Senator MURRAY—As you know, I have taken a long interest in this and have raised it at several estimates over time. Santos just happens to be in the quote, but it is the principle that I am concerned with, not that particular taxpayer. It does indicate a view of some of the investment community that this is just a lark and needs to be tightened up more than you have been able to do so to date within the existing law. My question to you is: is the Board of Taxation review important to the tax office in enabling you to further determine principles in this area, or do you regard it as just an extra policy input?

Mr D'Ascenzo—Our position has been put forward in the practice statement. That is how we look at these issues in administering the current law. The Board of Taxation would then look at the issue as to whether or not there needs to be any change to the policy parameters that are reflected in the law and that would provide a report to the Treasurer and government as to whether or not they recommend that change or not. If they do recommend a change then we will change our processes to reflect the law that eventuates and if they do not recommend a change then our current practice remains.

Senator MURRAY—I know what your answer will be but, just for the record, can you advise if the Board of Taxation is actively consulting with you on this matter?

Mr D'Ascenzo—Yes, and with Treasury and with other stakeholders. We have an opportunity to have an input in the Board of Taxation deliberations, but I know the board is very keen to hear from and take on board the comments of people who might be interested in this area.

Senator MURRAY—I doubt anyone at the table can help me but I would be surprised, given the increase in activity in this area, if the tax expenditure statement in its next version does not pick up a cost post-facto of over \$1 billion. It is big money at stake here. That is so, is it not?

Mr D'Ascenzo—Yes. Basically our position is to apply the law as we have outlined in our practice statement and to have input into the Board of Tax review.

Senator MURRAY—I will move to another topic. Can you give me your periodic updates on Wickenby, without revealing any operational matters as usual? Can you provide those matters which are appropriate for the public record?

Mr D'Ascenzo—The period since the last estimates is approximately three months. During that time there has been a fair bit of work inside the organisation without a lot of public outcomes. With the change in the law in terms of the ability of Wickenby agencies to share information, we have worked to develop joint IT platforms that allow us to do that more efficiently. The ACC and the Director of Public Prosecutions are progressing with a number of persons of interest. They have some 10 cases under consideration. ASIC and ourselves have commenced audit activity on a range of people. There are over 100 such cases covering

something like 220 people which are under examination in relation to this matter and next month we expect to have one person attend the Victorian court, which we understand is to plead guilty to criminal charges in this area.

Senator MURRAY—I have seen media commentary, and no doubt you have too, which is critical of ATO and ASIC for progress made in the Wickenby matter. I must stress to you I tend to be more on the side of the ATO and ASIC because I think these particular matters, because of the cross-border jurisdictional legal issues, are amazingly difficult to unravel. So let me indicate where my bias is: it is still on your side of the table. But nevertheless, the criticism that needs to be responded to by you is that it is too slow, there have been too few outcomes and the expectations of higher returns are overstated. That is my summary of what I have read. I will stress that I do not agree with it, but I think you should respond.

Mr D'Ascenzo—As I said, we have been busily working below the public profile in relation to these matters. I suspect after next month when we have the matter before the Victorian court that might prompt more public views of what we are doing in the Wickenby project. I am certainly very comfortable about the level of endeavour and cooperation and still very optimistic about the outcomes that it promises in sending a clear message to the community that the Commonwealth will work together to use its arsenal of sanctions in relation to these matters. What the public will see will increase progressively as the hard work up front is done and brought to fruition.

Senator MURRAY—What is the government investment in this matter?

Mr D'Ascenzo—\$305 million over four years.

Senator MURRAY—Are they going to get a return on that?

Mr D'Ascenzo—At the moment the whole Wickenby project has spent about \$30 million and we have recovered about \$30 million. We are still on par with what was expected in terms of costs and returns but, as I said, the snowball effect will start to take hold in the next six to 12 months. The outcome of all of this hard work will start to show some more public profile.

Senator MURRAY—Is it your view that the activities of ATO and ASIC in this area and the legal and investigative actions have had a chilling effect on conduct of this kind which should be discouraged?

Mr D'Ascenzo—As part of the steering group for Wickenby one of the matters that we are trying to work on is measures, including the chilling effect that sending the message can provide to the community. We have not yet pursued, brought to fruition or tested that perception, so I would only be giving an opinion as to whether or not it does have that effect. I still think that more public action and outcomes will have that effect and at this stage we are still very early in the piece of making that occur. I am not sure that we have done as well as we could in terms of having that chilling effect on the community, but I am confident that as that snowball increases that will become more evident.

Senator MURRAY—I would like to move on to another topic. Chair, do you want to talk about Wickenby?

CHAIR—Senator Watson had a couple of quick questions.

Senator WATSON—My question is directed to the Taxation Commissioner. ATO are sanctioned in taxing corporate rights issues and from observation I note that the issuing share price generally falls following a rights issue. That reduction does not appear to have been recognised in the ruling and thereby the taxing of the rights may create an artificially high price. The second part of the question is: if shareholders allow the rights to lapse through ignorance or other reasons, given that by virtue of the fact that they have not accepted the offer, can you confirm that no tax will be levied on such situations?

Mr D'Ascenzo—Are you referring to share buy-backs or are you referring to rights issues?

Senator WATSON—Rights issues.

Mr D'Ascenzo—I am not sure about the question.

Senator WATSON—It is an ATO class action. It is tax and corporate rights issues.

Mr D'Ascenzo—We have been in consultation with the industry in relation to the outcome of the High Court's decision in the McNeil case. Out of that process there are some situations where if it is a non-renounceable right you have a certain outcome and if it is a renounceable right you are likely to have another outcome. And those outcomes will vary depending on your circumstances and there will be circumstances where there seem to be anomalies in the treatment of rights, and that is a matter that we have raised and are discussing with Treasury in terms of possible legislative approaches. But at this stage we are in the course of consulting with people to see how it applies. One rule does not apply across all rights issues. It really does depend on the circumstances of those issues.

Senator WATSON—As it originally stood, would it give rise to a consequence of double taxation for capital gains purposes or would you get a deduction for tax paid on the rights issue?

Mr D'Ascenzo—The newspapers got it wrong in terms of supposing that there is one rule that applies in all of these circumstances. You have to find out what the situation is in terms of the nature of the rights issue, whether it is renounceable or non-renounceable, and also the position in terms of whether someone sells the right or does not sell the right, and then the position of the capital gains tax on top of that. So it does vary.

Senator WATSON—Could you give the committee a schedule of all of those options or situations?

Mr D'Ascenzo—Yes, we can do that.

Senator WATSON—Because a lot of people are a little bit worried about the number of unintended consequences that may flow from that original tax ruling. If that can be clarified that would be good. I understand you said that you are still in consultation, so the book is not necessarily closed on that?

Mr D'Ascenzo—Yes. I am not sure if there are any unintended consequences that come from the ruling. If there are unintended consequences it might come from the impact of the High Court decision.

Senator WATSON—Can you clarify that, too?

Mr D'Ascenzo—Our ruling interprets the law and if there are unintended consequences in relation to how the law operates then that is a question for a legislative fix.

Senator WATSON—Could you also give the committee a summary of that High Court ruling that led to your class action? That might provide us with a bit more background as to what could be their personal liabilities for the future.

Mr D'Ascenzo—We will provide a summary of the impact in this area. As I said, we have been in consultation with the professional bodies. As far as the professional bodies and the advisers are concerned, there is no misunderstanding of how the law operates or could operate.

Senator WATSON—It does not seem to have been reported that way in the popular press.

Mr D'Ascenzo—That is right.

Senator WATSON—Deferred university fees and HECS, or HELP debts as they are now known, are adjusted to the CPI annually. Is it not rather inequitable that HECS and HELP debt repayments are not credited when they are received or when they are paid? For example, we have lots of public servants repaying HELP debts by salary deductions every fortnight. It appears that they only get the benefit of that by an annual deduction, and is there not a loss of interest on those early deposits paid by particularly public servants or others who pay earlier or more frequently than annually?

Mr D'Ascenzo—In theory that sounds right.

Ms Crawford—I thought, Commissioner, this one would be better for you than for me. However, I will try. My briefing starts off by saying that the law requires that the employer take into account any accumulated higher education loan program debt of the employee when determining the amount to be withheld from the individual's income, but similarly the law does not allow that that amount be directly credited to the individual's HELP account. How it has been explained to me is that in the same way as a certain amount of tax is withheld from salary and wage earners progressively throughout a period and that amount is adjusted annually on the lodgement of a return, the same applies to the HELP amounts. We are not in a position really to know until the end of the year and the lodgement of the return whether in fact that taxpayer has that obligation or in fact has not reached the threshold.

Senator WATSON—In terms of meeting that obligation, that is one which the Tax Office assists the employer in determining, but a number of public servants, for example, agree to pay off their HELP debts by an amount higher than the mandatory deduction and as such get no benefit from that annual calculation rather than the weekly or the monthly deduction from salary.

Ms Crawford—I can see the point of that, but equally—

Senator WATSON—Is that a policy decision that you have to look at?

Ms Crawford—My advice is that it is a matter of the law that we cannot make those adjustments until the lodgement of a return.

Senator WATSON—I understand that that may be the time, but maybe the taxpayer should be given the opportunity of outlining a schedule to which you can refer in terms of the calculation of interest?

Ms Crawford—I cannot comment.

Senator WATSON—Because the calculation of interest will be different for those who pay off the mandatory amount as compared with those who pay it off at an accelerated rate.

CHAIR—We are verging on asking these officers to comment on a policy, I think.

Senator WATSON—They have only told us that it may be a policy issue. I am not sure if it is a policy issue. Does it say that in the legislation?

CHAIR—My take out of that is that the witness gave evidence that it was her understanding there was a law and, therefore, any changes to that are going to be policy matters that the officer would not be able to comment on.

Senator WATSON—My understanding is that the law prescribes certain amounts that must be deducted in terms of discharging the HECS debt. We had another scenario where taxpayers actually pay off at an accelerated rate, which appears to not fully be recognised. I am not sure that the law does cover that situation.

Mr D'Ascenzo—We are happy to take that on notice and investigate the issue. My understanding from Ms Crawford's example is that we think that we are bound by the law in this area, but we will certainly explore it. As I said, when you asked me the question I said that in theory what you suggest is right.

Senator WATSON—Thank you.

Senator SHERRY—I have a question about HECS. What is the average HECS debt for persons aged 20 to 25?

Ms Granger—I would have to take that on notice.

Senator MURRAY—I would like to ask you about the Australian National Audit Office *Report into the administration of capital gains tax compliance in the individuals market segment*. That is audit report No. 16 of 2006-07. As you know, Commissioner, the ATO has the capital gains tax project, which commenced in July 2004 and is a four-year project focusing on capital gains arising from real property and share disposals. My take on that is that essentially the tax office felt, and the government supported you in that feeling, that you were being duded; people were not coughing up all the tax they should. Page 61 of that report, paragraph 3.46—you probably do not have it before you, so I will read it—refers to a figure. It states:

Figure 3.1 indicates that during 2005-06 approximately 70 per cent of individuals with real property disposals in the data sample used had their identities partially matched with ATO records and were subsequently available to be risk assessed for administrative action (although consistent with 2004-05 these individuals were only matched to a low or medium level of confidence). Of these, a significant proportion, approximately 74 per cent, did not warrant further action and were being risk assessed at the time of the audit.

I think that indicates that we still have a long way to go in this matter. What I would like from you, if you would not mind, is a brief encapsulation of where we are and what the weaknesses are that still need to be addressed, and then we can ask some further questions.

Ms Granger—We do not have the specific information with us here. In very general terms in relation to the data-matching projects that that was reviewing, from memory, one of the issues for us is the quality of data from the various registries and land titles acts.

Senator MURRAY—Are you referring to the states and territory registries?

Ms Granger—Yes. We have been working through a process of refining and improving that. It is one of those areas where we expected that, as we went along, we would be able to improve it.

Senator MURRAY—Are there any states that are much better than others?

Ms Granger—I do not have an answer to that question here. We would need to do you a response more generally, but working through that has been part of the issue. There have been some results, which I can also tell you about. Again, I would like to provide you the detail on notice and give you the outcomes of that. It has been difficult, as I said, to get quality data, but we believe that is improving now.

Senator MURRAY—To use a phrase Senator Faulkner likes, my sense of things is that there is a motza of money out there to be raised in this area. Is there any limitation on how far you can go back? Is this one of those circumstances under part 4A where you can go back as long as you like? Or are you restricted back six years or what?

Ms Granger—The normal restrictions would apply in most of these cases without generalising it, absolutely. We started this project after we realised we needed to do a lot more work to bring to people's attention their capital gains tax responsibilities. But there still is a fair bit of a belief out there that these things are not taxable. While it is reasonably well known around rental income, for example, that sale of property does not necessarily attract tax, we did find there was still a reasonable level of misunderstanding about that. I am not sure that we would be applying part 4A, for example, in many of these cases, although there are penalties in some. You are right in terms of the level of income. I am just looking at sale of investment properties here. This is for the individuals market, so this does not include businesses. We had out of 6,000 risk reviews and audits 40 million in revenue raised.

Senator MURRAY—Sorry, can you repeat that?

Ms Granger—In 2006, 6,000 risk reviews and audits resulted in \$40 million in revenue being raised. In 2007 we are conducting a further 6,000 risk reviews and audits. That is in that market. That does not include the micro business market, which we are also looking at as well.

Senator MURRAY—When you say 'risk review', that sounds to me as if it is targeted, it is not a random sample.

Ms Granger—This is targeted, correct.

Senator MURRAY—Is that less or more money than you would expect? Six thousand is a lot of people for raising \$40 million.

Ms Granger—I do not know how that went against our estimate of targets. I would have to check that for you. I do not have that information with me.

Senator MURRAY—I do not recall seeing in either your annual report or in budget figures—I might not have remembered—an estimation of expected revenue increases from this project. Is there one out there?

Ms Granger—I would have to check.

Senator MURRAY—When you come back to the committee, I wonder if you could come back not with just a paragraph but a decent summary of the whole area. I tell you why I am asking. When I read these reports I get a sense of things; I read the polite language of the audit office and I think they are reflecting real concern. There are seven recommendations that you agreed with. But the substance of the report indicates that you have a long way to go. If part 4A does not apply, to me that means a massive loss of revenue, because these problems go back a long way. The question to me would be whether the ATO might want the government to look at any legislative measures to address this area. I think compliance is very low. That is my sense of it.

Mr D'Ascenzo—The difficulties that the ANAO alluded to is a question of data quality and we are making some progress there. We think the whole idea of third party matching can be a very successful strategy in this area, provided we have good data. It is an area that we have focused on for some time, and while no-one pretends that there is 100 per cent compliance levels, our whole strategy is to allocate our scarce resources in a way that reflects what we believe to be the revenue risk.

Senator MURRAY—That is why I asked about the relationship between the 6,000 and the \$40 million.

Mr D'Ascenzo—I totally agree.

Senator MURRAY—I have no idea whether there is at all.

Mr D'Ascenzo—What we have found in the individuals area is that that is a reflection of our direct efforts, but in a more macro sense the level of capital gains tax being paid by that segment has increased greater than the CPI margin. We are having some indirect effect as well as a direct effect in that area. But having said that, I think without trying to do this from memory, we will do what you suggested and provide a good picture of what we are doing in this area and whether we think it is hitting the mark or not.

Ms Granger—If I could just add one thing. I was just reflecting on your remark about how far back we are going in terms of the data we are acquiring. That is because we are trying to get information on the purchase as well as the sale. The sales will be recent, so it is not that the capital gain is going to be a long time ago. The capital gain will be in the last year or so. But we are trying to get the purchase data as well as sale data.

Senator MURRAY—That is right. The capital gains has triggered the sale end, yes.

Ms Granger—That is correct. So the timing is around the sale.

Senator MURRAY—Apart from my being concerned when I read this report, one of the reasons I wanted to raise it with you is that I have seen, as you would have, an acreage of

reports on the effect of the government's superannuation reforms on a very high sale of assets and their shifting into superannuation funds. That must trigger capital gains in huge quantities, if the reported sales are as large as they indicate. You need to be able to marry together inflows, I would have thought, into the super funds with capital gains events, and of course pick them up going backwards as well as to when they were originally purchased.

Ms Granger—We will be increasing our level of alerting the community about things we will look at this year from the compliance program perspective for individuals, particularly individuals in small business, around sales of property they may have made for exactly that purpose, to remind them that they need to include, if it is an investment property, the capital gain in their return. That is something we have identified as a concern and we want to alert people prior to that. You are absolutely right. We are also looking at how we might be able to track back from that ourselves.

Mr D'Ascenzo—In fact, on our website we have a superannuation myth busters page, which brings that very point to the attention of people; if you sell your home, you will lose the CGT concession for that. There are a lot of things. There are capital gains tax consequences if it is something that is subject to capital gains tax. That needs to be offset against your perceived benefits in terms of superannuation.

Senator MURRAY—Do you have the resources to deal with this expected surge in activity? The surge has happened; it will now be a surge for you.

Mr D'Ascenzo—The reality is that we are always working on a risk management basis. So in the individual areas the amount of risk there is relatively low compared with, say, a more high-profile larger transaction. Our level of coverage in the individuals area is not large and a lot of that has to do with help and education strategies rather than the active enforcement. So the answer is we can always do with more resources, but it is a question whether or not you use the resources as wisely as you can across the whole gamut of tax and super administration. That is what we try to do.

Senator MURRAY—Because the records are so frequently held with respect to asset purchases in state registries, what incentive is there for them to help you? Why would they invest moneys on improving their data availability for your purposes? Has the federal government provided money to the states and said, 'Do this for us. Here is the money', knowing of course you will get a better return if you do so from a capital gains perspective?

Mr D'Ascenzo—I think there is a real issue in terms of seeking the cooperation of other agencies, particularly state agencies, and their concern about the funding of those activities. But whether the government has made any allocation is really a matter for government.

Senator MURRAY—But it is not in the budget, is it?

Mr D'Ascenzo—No.

Senator MURRAY—The government has consistently and properly, in my view, done a cost-benefit analysis. To use Wickenby as an example, they have said, 'Here is x amount of money', because we expect to get so much money back. Never mind all the extra benefits; there is a direct cost-benefit relationship. They have done that in other areas with the Tax Office that I can recall. Would you consider—and I am making this as a request to you—

thinking about whether that proposition should be put to the federal government? Frankly, I cannot see why the states would bother to invest resources when there is no return for them. So they need a helping hand. It would seem to me there is an awful lot of revenue to be gained through this mechanism.

Mr D'Ascenzo—We have had reasonable cooperation from the states and territories in this area, and some of the problem—not so much their lack of cooperation—is just that there is no unique identifier in the state registries.

Proceedings suspended from 3.38 pm to 3.55 pm

Senator SHERRY—This question is for both revenue and the ATO. As to advertising expenditures, campaigns that are planned and underway, market research, attitudinal research, public opinion polling and the like, is there anything being undertaken in revenue, firstly? Is there any market research, public opinion polling, campaign communication services currently under way or planned to be under way in revenue?

Mr Callaghan—No.

Senator SHERRY—What about in the ATO? If we start with—and this may end very quickly—non-superannuation specific research, with respect to campaigns, advertising et cetera, is there anything going on?

Mr D'Ascenzo—We have the normal tax time, which is an annual process where we advise the community of a range of tax rights and obligations associated with annual reporting.

Senator SHERRY—What is the extent of that program? Can I have some detail, please.

Ms Granger—I do not think we have detail of it here. We will have to respond to that on notice. I am just trying to think how much I have been told at the moment. It is the usual round of campaigning we do where we do things like notify which occupations we are looking at more closely and what is new in *Tax Pack* or e-tax this year. There will certainly be some education around the pre-filing initiative and its expansion, and in general what risks we have. We roll it out progressively. The early phase of it is just reminding people that tax time has started. There will be a number of focuses this year on educating people, including around offshore bank accounts, the use of offshore credit cards and those sorts of things, as we go through the compliance risks that we are seeing; what things we think people are not getting right around their work related expenses and those sorts of issues.

Senator SHERRY—So what you are describing is nothing out of the ordinary from previous years?

Ms Granger—No.

Senator SHERRY—Will there be any public advertising expenditure between now and the end of the financial year and then in the six months following?

Ms Granger—I do not have detail with me. There will be some, I am sure, but we would have to take that on notice to be able to give you that detail.

Mr D'Ascenzo—I have some handwritten information that I would like to tender in relation to ATO staffing by head count for Tasmania relative to the ATO generally, and also the GST administration budget over the last seven years.

Senator SHERRY—Thank you.

Mr D'Ascenzo—For Hobart, Tasmania, this is a head count and would include non-ongoings as well as ongoing. But it does indicate no diminution of resourcing to Tasmania.

Senator SHERRY—Thank you. I turn now to superannuation-specific issues. We have discussed at previous estimates superannuation advertising campaigns. Can you refresh my memory of the amount that is budgeted to be spent this year and in the next financial year. Can you update me on that.

Ms Vivian—I think at previous estimates I talked to you about an overall figure over four years that was about \$43 million. As I pointed out at that time, that was an estimate. Since then the figure has changed. So I will give you the figure over four years—is that what you would like?

Senator SHERRY—Broken down in each year, thank you.

Ms Vivian—What we plan for 2006-07 is about \$32.3 million; for 2007-08 it is about \$32.6 million; for 2008-09, \$4.7 million; and for 2009-10, about \$1.3 million.

Senator SHERRY—And that makes a grand total of?

Ms Vivian—That comes to a grand total of around \$71 million.

Senator SHERRY—From the last time I talked we have gone from \$43 million over four years to \$71 million over four years?

Ms Vivian—Yes.

Senator SHERRY—Let us just deal with this financial year firstly. So \$32.3 million is the budgeted expenditure?

Ms Vivian—Yes.

Senator SHERRY—What has been spent to date, based on the last figures available?

Ms Vivian—What I can give you is what has been spent on the media buy in terms of other resources. I can break it down for the year, but I just do not have the amount of the spend to 30 April. Would you like the media buy one?

Senator SHERRY—Yes, thank you.

Ms Vivian—The sum of \$15.8 million is committed at the moment.

Senator SHERRY—That is committed through to when?

Ms Vivian—That is through to 30 June. That is what is committed in terms of signed up placements. What I have in the budget at the moment for that is roughly \$16.1 million.

Senator SHERRY—Sorry, for?

Ms Vivian—For 2006-07, the budget I have at the moment is about \$16.1 million. It is fairly close to what is—

Senator SHERRY—It is going to be very close to the budgeted figure. What have you got in the budget for the media buy in 2007-08?

Ms Vivian—I do stress that this is an estimate at this point in time. There are no formal commitment. Around about \$23.4 million.

Senator SHERRY—When is it estimated that will be spent? What parts of that financial of that year?

Ms Vivian—I think recently the Treasurer mentioned that we are doing the super simplification ads over three bursts. Some of them are what is happening now, May-June, and then what we anticipate will be July, and then I think there is some a bit later on in the year. I will just get it for you. Probably at this point in time, July-August 2007, the third burst is planned for around about April 2008. But, again, I do stress that they are just plans.

Senator SHERRY—No, I accept that qualification. What is the planned burst in July/August likely to involve, a similar figure to the \$15 million to \$16 million.

Ms Vivian—We have an overall bid. At this point in time the plan is that it will involve similar channels in terms of radio, television and the press. But in terms of the scope of that, it is really an overall budget I have at this stage.

CHAIR—Senator Sherry said July-August. I thought you had said July. Did I miss the—

Ms Vivian—Sorry, no, I did correct that. I started off saying July, but then looked at the information here. At this stage this is just a plan, and it certainly has no formal government approval yet.

Senator SHERRY—The overall budget of \$32.6 million in 2007-08 is very similar to the 2006-07?

Ms Vivian—That is a point, yes.

Senator SHERRY—You have given me the media buy figure for 2006-07. What are the other categories of expenditure in that \$32.3 million?

Ms Vivian—For this year other categories would be research, public relations—

Senator SHERRY—Sorry, can give me the breakdown for research?

Ms Vivian—The breakdown? Again, in giving you these breakdowns, I just want it on the record that these are not finalised and are certainly changing on a daily basis. This is currently what I have at this point in time. Research is around \$915,000 and public relations is around \$396,000. We have some consultants coming in to assist with our non-English speaking and Indigenous strategies. That is around \$150,000. And I have an allowance for some other specialist consultants of about \$311,000. The advertising agency is around \$2.5 million. The creative productive costs are around \$2.1 million. I mentioned the media buy of about \$16.1 million. For direct mail I have an allowance of about \$7 million. For printing and distribution, there is about \$1.65 million. And for some ATO staff costs and other costs there is around \$1.036 million—around \$1 million.

Senator SHERRY—That is an approximate total of \$32.3 million with a similar budgeted total figure for 2007-08. Would the breakdown of categories be broadly similar?

Ms Vivian—The breakdown of the categories would be broadly similar, but there are some different amounts against some of the categories.

Senator SHERRY—Who is carrying out research? What firms are carrying out research in this area?

Ms Vivian—The consultant carrying out the research is DBM Consultants.

Senator SHERRY—What research are they carrying out?

Ms Vivian—They undertake four types of research with a campaign like this. There is developmental research, which we do at the start, which is just to do some benchmarking and look at the need for education. Then we do research around the creative concepts as they are developed, and then we do tracking research as we start implementing the campaign. We track how it is going. Then we also do various research about specific products that we might produce in the campaign.

Senator SHERRY—Just on the tracking research, does that involve a focus group?

Ms Vivian—Yes. We have used both qualitative and quantitative research. It varies between the different types there, but across it you would say there was qualitative and quantitative research.

Senator SHERRY—Obviously, you or your officers receive that research?

Ms Vivian—Yes.

Senator SHERRY—Is that research passed on to anyone outside the ATO?

Ms Vivian—Yes. Treasury and Financial Literacy are involved in this campaign. Certainly the research is discussed and used with them. There is the government communication unit, the MCGC. The relevant minister's officers also see the research.

Senator SHERRY—The relevant minister's officers?

Ms Vivian—The Assistant Treasurer and the Treasurer.

Senator SHERRY—I move to public relations; we have dealt with research. Who is doing the public—

CHAIR—Sorry to interrupt. Ms Vivian, you are not required to provide information that is forming advice to the government. I am sure you are aware of that.

Ms Vivian—Yes.

Senator SHERRY—Public relations?

Ms Vivian—Public relations appointed Royce Communications.

Senator SHERRY—Sorry, who?

Ms Vivian—Royce Communications.

Senator SHERRY—What does that involve?

Ms Vivian—The sorts of things that the public relations agency would help us with would be developing, producing, distributing and supporting campaign and information materials. There might be information kits, help with some of the scripts for some of the radio activities,

some of the editorials, liaising and helping with some of the publications that we are developing, and helping out without some of the direct mail-out—a whole range of things.

Senator SHERRY—Who is the consultant for non-English?

Ms Vivian—Sorry?

Senator SHERRY—The consultants for the non-English category that you indicated? Who is the consultant there?

Ms Vivian—The consultant that has been appointed there is the Multicultural Marketing Group.

Senator SHERRY—You mentioned a category titled Specialists. Do you have any appointments there?

Ms Vivian—Not that I am aware of at this stage. That will probably be as the campaign progresses and we see a specific need.

Senator SHERRY—Agency? Who is that? Who is in the agency category that you listed?

Ms Vivian—Sorry, the advertising agency. I will just check that and make sure I get the right name. It is Whybin\TBWA.

Senator SHERRY—And the creative personnel category that you listed?

Ms Vivian—Sorry, it was the agency there that I was talking about; that is the agency.

Senator SHERRY—They are one and the same. You gave me two figures, \$2.5 million and \$2.1 million.

Ms Vivian—Yes. In terms of producing some of the campaign, I think the other material is actually the production costs. So they would be appointed through the creative agency.

Senator SHERRY—When is the current burst that is in the media at the moment, the May/June burst, scheduled to finish approximately?

Ms Vivian—Approximately 9 June, although I think we will have some information still going in some of the newspapers and magazines for a bit longer.

Senator SHERRY—You mentioned direct mail, \$7 million. What does that involve?

Ms Vivian—I think the Treasurer has already mentioned that we are looking to do a household mail-out. That is what that direct mail would be about.

Senator SHERRY—When is that likely to be sent out?

Ms Vivian—At this stage, again, we are still just finalising it; I am envisaging that it will start to be sent out towards the end of June.

Senator SHERRY—Will that involve a ‘To the Householder’?

Ms Vivian—Yes, it will be ‘To the Householder’.

Senator SHERRY—What will your database be for that—the electoral roll or the ATO itself?

Ms Vivian—My understanding is that we employ people who do the delivery and they literally take it out to every household.

Senator Minchin—It is not personalised; is that what you mean?

Ms Vivian—It is not personalised.

Senator Minchin—It is not personalised, it is just—

Senator SHERRY—My wife and I both got not an ATO super campaign but another campaign. It is a bit hard to avoid the flood of campaigns at the moment, of course. But I got two sent to my home, one to my wife and one to myself, which is fine, but it just seemed to me to be a bit of waste of money. We ended up with two rather than one. Are we going to be having households getting two or three, depending on the number of taxpayers?

Ms Vivian—My understanding is that what we have committed to is doing what we call a household drop, and that means that we take out one product per house.

CHAIR—The ‘householder’ is unaddressed, is it not?

Ms Granger—Yes.

Senator Minchin—Normally there would only be one per household.

CHAIR—Personally addressed?

Senator Minchin—‘To the Household’.

Senator SHERRY—We got two personally addressed, but that is another campaign. It has nothing to do with this.

Senator Minchin—When it is ‘To the Householder’, there is only one to a house.

Senator SHERRY—I thought it was a waste of money ending up with two at the one household. We will not be getting two at one household; it will be one per household?

Ms Vivian—That is certainly the intention.

Senator SHERRY—The printing presumably is the printing of the direct mail?

Ms Vivian—That would be some of the printing costs.

Senator SHERRY—What other printing costs could there be?

Ms Vivian—Included in that figure I have given you is the work that we do with the campaign, but we are also about to do an employer mail-out that will happen, I think, during June. Some of the printing costs would also be included in that figure.

Senator SHERRY—Why would you be mailing to the employer? What aspects of this do you need to communicate to them?

Ms Vivian—This one is a very specific mail-out telling the employer what they need to do differently from 1 July.

Senator SHERRY—Will it be reminding them about their SG obligations?

Ms Vivian—Yes, it will certainly be doing that.

Senator SHERRY—I will get to that issue a bit later. I will return to the direct mail. What form is the mail-out to householders going to take? Is it a letter signed by the Treasurer saying this is Australia’s greatest superannuation reform? What is going to be in it?

Ms Vivian—That is still a matter for government. That is still being discussed with them what will be in it.

Senator SHERRY—Will there be a letter and a pamphlet or just a pamphlet?

Ms Vivian—It is still under discussion.

Senator SHERRY—Will there be a specific direct mail to the self-employed?

Ms Vivian—Certainly not at this stage. One of the things that we will be looking next year is how the campaign is running. If you are asking if there is a direct mail-out plan to a self-employed person, that would only probably be to the extent that they are caught up in the employer mail-out.

CHAIR—Did you say that the second half of the 2007-08 spend was next year?

Ms Vivian—At the moment the plan is for some additional campaign to be undertaken in April next year.

CHAIR—What was the cost of that?

Ms Vivian—None of that has been formally agreed with government. All I have got is the budgeted figure for the year.

CHAIR—Do you expect that to be a similar spend to the first-half spend?

Ms Vivian—Overall for the next year the budget that we have got at the moment is about \$23 million. At the moment they are looking to do some in July-August and some in April. I would also say part of doing the research and the tracking research is to evaluate how it is going, so they would be some of the elements that we would be looking at for next year.

CHAIR—Is it planned that the spend in April next year would be half of the budget expenditure?

Ms Vivian—That has not been agreed yet. Part of that will come down to what are the formal placements that government agrees to do.

CHAIR—Thank you.

Senator SHERRY—Has the placement of advertisements to date been varied at all in light of competing advertising campaigns, if I can describe it as such?

Ms Vivian—That would be a question you would need to address to the government communication unit.

Senator SHERRY—Are you not aware of any change to placement scheduling in the last few weeks?

Ms Vivian—Certainly. The advertisements have been developed and then they have been placed, so that is done through the government communication unit—MCGC. I really think they would be aware of those questions.

Senator SHERRY—Would it come to you as news? Are you aware that the government has had to ease back on the placements of the superannuation advertisements because there have been so many other government advertisements coming in—for example, industrial relations—that in order to maximise the effectiveness of the superannuation campaign they

have had to drop some of the placements to accommodate the flood of government advertising?

CHAIR—I do not think this witness is able to comment on what has been happening in other areas.

Senator SHERRY—If you are not aware of it, then you are not aware of it.

Ms Vivian—As I have stated, our discussions and directions for placement have come through GCU and MCGC. I am not quite sure what I can add to that.

Senator SHERRY—Are Crosby Textor involved at all in any aspects of this campaign or any other campaigns?

Ms Vivian—Not to my knowledge with this campaign. I could not speak for other campaigns.

Senator SHERRY—That is 2006 budget changes. I will move on to other campaigns. Are there any others at the present time that are underway or planned in the superannuation area?

Ms Vivian—This is a major campaign and probably most of the work that we are doing in terms of educating the public would fit in underneath it.

Ms Granger—In addition to that, we do incorporate messages around superannuation as part of *Tax Time* as you know, so in addition to that there would be the usual campaigns.

Senator SHERRY—I was specifically asking a question not in your area and not in respect to the detail that we have been discussing in respect to the 2006 budget changes, but any other superannuation campaigns that we have not yet discussed. So there is nothing else at all at the present time or planned?

Ms Vivian—No, not at the present time.

Senator SHERRY—While you are at the table I wanted to advise that I did send via the committee a series of questions running to superannuation compliance. Perhaps we can deal with those at this stage because the matter has had some public attention recently. Could you give us an indication of the approximate uncollected superannuation guarantee over the last five years?

Ms Vivian—I can give you the figures for the collectable debt over the last five years. At 30 June 2003 it was \$122.46 million; 30 June 2004 it was \$155.3 million; 30 June 2005 it was \$237.28 million; 30 June 2006 it was \$287.33 million; and as of 31 March 2007 it was \$299.69 million. The point I need to make is that those figures are a point in time and the debt may cover amounts from a number of financial years.

Senator SHERRY—Yes, there is a flow-on over by the nature of outstanding SGs. Can you provide the number of employers owing SG and the number of employees owed SG in each of the years?

Ms Vivian—It is probably best that I just work from the figure of \$299.69 million for the number of employers involved.

Senator SHERRY—Yes.

Ms Vivian—There were 25,926 cases. We are not in a position to give you the number of employees because the way our systems work the debt is registered to the employer. In trying to understand the impact that we are having on employees, we use a rough rule of thumb of about 14 employees to that employer but, as I said, there is no science to that. That is just to give us a bit of an estimate.

Senator SHERRY—I accept that caveat. Just to refresh my memory, did you say 25,000 employers?

Ms Vivian—It is 25,926, so approximately 26,000.

Senator SHERRY—So applying approximately 14, or if we are conservative and we use ten, we are looking at about 250,000 employees.

Ms Vivian—Potentially. There are a couple of things to note here. One is that there is about \$46.3 billion that APRA advise flows into the system, paid by employers, each year. One of the points we would make is that we often find that the employers that owe us money on superannuation guarantee actually resist engaging with us.

Senator SHERRY—When you say ‘resist engaging’, is it a bit hard to engage because of the secrecy provision?

Ms Vivian—I am talking about the employers. That is the ones that we are trying to get the money from.

Senator SHERRY—Yes.

Ms Vivian—They are quite difficult to engage. Often the age of the debts can contribute to this. One of the real issues that we have is that we find in about 75 per cent of the cases the employee complains after they have left the employment.

Senator SHERRY—Yes.

Ms Vivian—It often requires quite a lot of tracing and it is challenging work.

Senator SHERRY—Why do you think that is the case?

Ms Vivian—I can only give you that anecdotally. We have people that ring up and sometimes they are afraid of what the employer may do. What we would also say anecdotally is often the employee is leaving. Frequently it is because the employer is starting to have some monetary problems and a whole range of things.

Senator SHERRY—With the figures that you have given me for each of those financial years, do they relate to complaints by individual employees or figures gathered by someone inspecting or checking an employer’s records, or both?

Ms Vivian—It is a mixture. They probably relate in relation to a complaint in that when we get a complaint from someone we do not just look at that employee, we also look at a number of the other employees in that firm. So those other employees may not be aware that we are looking at it. That is why I said it is a bit of a mixture. We also do some proactive work as well, so it would be a range.

Senator SHERRY—Let us just deal with the proactive work as distinct from the complaint to the employer. What level of proactive work have you been doing in this area?

Ms Vivian—I am looking over last year. If I took out the work that we do in looking at other employees that are caught up with those employees that may have made the complaint or somebody else may have made a complaint on their behalf—

CHAIR—Will the mail-out that you were referring to before make reference to employers' obligations in relation to SG?

Ms Vivian—Yes.

CHAIR—Is that part of the education campaign for employers?

Ms Vivian—We use it as an opportunity to remind employers of their key obligations. There is also a change coming up for employers from 1 July 2008 about a swap to ordinary time earnings, so we mention that as well. It is probably only about three per cent at the moment.

Senator SHERRY—What is that in raw numbers?

Ms Vivian—It is about 300 visits.

Senator SHERRY—Has that changed at all in the last few years?

Ms Vivian—It has varied. We have been trying a range of different things, ranging from ringing up and reminding some of the employers about their obligations to using some of our field force in doing checks when they are out with the employers as well in order to focus on high-risk cases.

Senator SHERRY—Can you refresh my memory of when the secrecy provision is scheduled to be removed in this area?

Ms Vivian—The legislation is in place.

Senator SHERRY—Yes, that is what I thought.

Ms Vivian—The actual change comes into place from 1 July this year.

Senator SHERRY—What does the change to ordinary time earnings from 1 July 2008 involve?

Ms Vivian—It will involve for some employers using a different base for the calculation of their superannuation.

Senator SHERRY—Can you outline in what way the base changes?

Ms Vivian—Some employers for the calculation of their superannuation may have had amounts that are tied up with old awards and those sorts of things, so it brings everyone in line to use the current base award and the time earnings.

Senator SHERRY—This is not too much for my benefit but for those who will be listening or examining the transcript, is that base rate of pay, which excludes overtime, but includes weekend penalties and shift arrangements?

Ms Vivian—I would prefer to respond to that formally. It does depend on the employer's circumstances.

Senator SHERRY—But the commonly understood definition of ordinary time earnings for superannuation guarantee purposes is the base rate of pay, plus weekend penalties,

usually—I am not saying in all cases—plus night penalties outside ordinary penalties, but excluding overtime.

Ms Vivian—What we are writing out to people and saying is that this is the amount an employee earns for their ordinary hours of work, not including overtime. It includes over-award payments, shift allowances, commissions and paid leave up to the maximum contributions base for the quarter.

Senator SHERRY—Commissions is an interesting one. For example, have you given real estate commissions any active consideration? Certainly some real estate agents I know do not pay SG on commissions, so is it an extension in that area?

Ms Vivian—We have to often look at it in terms of what their contract is, and that can vary.

Senator SHERRY—You mentioned that approximate three per cent, 300 visits. Has that level changed much over the last couple of years?

Ms Vivian—It has, because it has varied. In the year we implemented Choice we did a lot more visits out there where they were very simple checks. They were looking at whether people were paying their relevant SG and Choice but at a very simple level. What we have really tried to target this year is on some of the more high-risk employers.

Senator SHERRY—Can you give me an example?

Ms Vivian—The area that you were just talking about. Real estate is one.

Senator SHERRY—Hospitality and construction?

Ms Vivian—Labour hire and some of the sporting associations. They are some of the ones that we have been targeting?

Senator SHERRY—What is the issue with sporting associations?

Ms Vivian—Some of the issue is just getting them to understand their obligations of SG.

Senator SHERRY—What is the overall level of resourcing, both budget and staffing, at the present time?

Ms Vivian—Do you mean undertaking superannuation guarantee work?

Senator SHERRY—Yes.

Ms Vivian—To keep it simple I am just going to focus on our staff doing the compliance work. The overall resourcing for there is about 217 staff.

Senator SHERRY—Is that this financial year?

Ms Vivian—Yes, that is this financial year.

Senator SHERRY—What about approximate staff members going back?

Ms Vivian—Going back last year it was roughly about the same numbers. The year before we had a big injection by government so it was about 133, say, in 2003-04, so there was a big jump up from 2003-04 to 2004-05.

Senator SHERRY—Is that why the amount is jumping up significantly from year to year? You gave us a figure of 133 in 2003-04 and then the figure you gave me at the start of the questioning for the year 2005 was \$237 million. In 2006 it went to \$287 million.

Ms Vivian—That was the amount of collectable debt. The amount of collectable debt would be going up because we are increasing our compliance activity. They are simply related to that.

Senator SHERRY—What about the average time between a complaint being made and the finalisation of a case?

Ms Vivian—I will break that up a bit for you and will talk a little about where we have moved from, where we are and where we are going to be. In 2005-06 we were taking about an average of 309 days. I need to preface this, too. This is to the point of time where the assessment is raised. So there is another period of time if we have to actually collect the debt. That was in 2005-06, however in 2006-07 we have been focusing very much this year on our older cases, so the average age of those cases has been taking about 340 days to complete.

Senator SHERRY—When you say ‘to complete’, they are not actually completed. That is assessment.

Ms Vivian—Yes.

Senator SHERRY—It does not mean that they have got the money.

Ms Vivian—That is right. I wanted to make the point, because I will come back to the debt collection in a moment. I am trying to give you a sense of some of the difficulties with these cases. They are the really old cases but we have made some improvements to our processes so the more recent ones that are coming in are taking about 138 days. Where we are working to is that by 30 June next year we would be aiming to have 50 per cent completed within four months, with about 90 per cent in 12 months.

Senator SHERRY—That is assessment. What about actual average payment or clearance of the debt?

Ms Vivian—At the moment we do not have any hard and fast statistics on that, but in talking to the debt area what they said is that a case that requires some debt intervention generally can take around about six months to complete.

Senator SHERRY—From the assessment?

Ms Vivian—From the point of time of assessment. I will try to give you a sense of some of the employers that we are dealing with, because it is difficult. We had some older cases on hand at the beginning of this financial year and we have been monitoring them through to see how they are moving to finalisation. We have found that, of the cases, only 12 per cent pay without any debt action involvement. That means 88 per cent of these assessments that we raise have to have some form of debt involvement.

Senator SHERRY—Have there been any difficulties with the ATO’s computer IT systems ongoing? We have discussed difficulties at previous estimates but where are we up to with that aspect of this?

Ms Vivian—In terms of those previous problems with reporting of the super guarantee, there are no difficulties there. The backlogs that we had tied up with the work have now been removed. With regard to this year, though, I think our commissioner has talked about our change program. One of the really positive things that is helping us here is that we have moved across to a new computer system. I think we have mentioned to you before that these super guarantee cases were really being done on paper files and they have now been moved across to the new computer system, which is certainly making a difference. But during the implementation of that, there was the odd hiccup with the system. In terms of your question about the older problems, there are no issues there.

Senator SHERRY—You know I have referred cases from time to time to you. I have not necessarily referred them to you specifically but I have referred cases probably from the more difficult category to the ATO. How many cases have you actually referred for legal prosecution in the last financial year, because probably a year or two has gone by and there is no payment, only part payment or a breach of the arrangement that has been entered into?

Ms Vivian—I suppose generally what I would say is that when I looked at all of those cases that had been referred through to us, in many cases the employers were insolvent. And there had either already been an insolvency or the debt has been placed with the liquidator. Again, just to give you a sense, I suppose, you know I spoke about 88 per cent of those cases requiring action. What I am finding is that where I said 12 per cent pay with no debt action, six per cent of people dispute them, seven per cent we find are insolvent or written off, 11 per cent will enter into some form of payment arrangement, 12 per cent did pay after some debt action, two per cent have got legal action underway and 50 per cent still have some form of debt action. That is out of about 3,600 cases. So that gives you a sense of the challenges that we find with a number of these employers, apart from those who come in under voluntary arrangements, who really do not go out of their way to engage with us in terms of paying their debt.

Senator SHERRY—The figures you gave me right at the beginning are after the amounts that have been written off that we have been given at previous estimates; that is, the accrued debt after write-off?

Ms Vivian—No. The figures I gave you at the beginning were what we call collectible debt, so that is debt that has not been written off.

Senator SHERRY—That is what I am getting at. It is excluded debt—

Ms Vivian—Sorry, it is after debt.

Senator SHERRY—You have given me either directly or on notice written-off debt each year, although it does not necessarily correlate to that year, but you have given me the figures for each year?

Ms Vivian—Yes.

Senator SHERRY—That is on a previous occasion, so that is not included in there?

Ms Vivian—No.

Senator SHERRY—I do have some other superannuation issues but I think I will go back to specific revenue. We touched on the SG base earlier. I have heard a number of complaints

about when an employee makes a salary sacrifice—which is one of the focuses of the current campaign, I note. When an employee makes a salary sacrifice, in some cases the employer is adjusting their superannuation guarantee base down. So, if you have, say, \$50,000 with a salary sacrifice of \$5,000, the SG is not paid on the \$50,000; it is paid on the \$50,000 minus the \$5,000, which is \$45,000. Is that legal?

Ms Vivian—That is how the law works.

Senator SHERRY—And that will not change as a consequence of the 1 July 2008 changes?

Ms Vivian—No, not in terms of—

Senator MURRAY—I have just a quick question while Senator Sherry is collecting his thoughts. I had a complaint from somebody who had discovered through the Lost Members Register their name on an outfit called BT Lifetime Super Personal Plan, and they rang them and said: ‘My name has appeared on this. Can you tell me if it is me?’ And the person at the other end said, ‘What’s your plan number?’ They said, ‘Well, if the super is lost I do not know my plan number.’ And they said, ‘Then we can’t help you.’ Now, that seems a pretty miserable outcome for something that people have invested time and money in creating the website and you have found the right thing and then you can get no result.

Ms Vivian—I have certainly heard the odd complaint from people about that. Part of what we are doing in trying to make some improvements to the Lost Members Register and link people up to their money is about working with some of the funds and the professional associations. To my knowledge it is certainly not across the super industry that they would get a response like that, but there are some issues I hear where people say because they have not got the specific number, or whatever it is, of the plan that sometimes there are some difficulties.

Senator MURRAY—So this is not uncommon?

Ms Vivian—I would not say it was common, but I have heard anecdotally that. I think most funds have quite a rigorous proof of identity process. To my knowledge, most funds would work through some other level of proof of identity to help identify the person and link them to the money.

Senator MURRAY—I presume you have a liaison officer who deals with the various funds?

Ms Vivian—I am happy to follow it up with the funds as well.

Senator MURRAY—Yes. I will not give you the specific name but perhaps your liaison officer could just mention it to BT and they can improve their training. That would be useful.

Ms Vivian—Certainly.

Senator SHERRY—I have a similar issue. You are obviously responsible for regulating self-managed super funds. You have got a joint publication with, I think, ASIC. It is entitled *Is self-managed super right for you?* Is that correct?

Ms Vivian—That is right.

Senator SHERRY—Would you believe it appropriate that a warning about compensation—or the lack of compensation in this case—in the event of theft and fraud should be contained in that?

Ms Vivian—You are implying that we do not have that warning in there and you are asking me—

Senator SHERRY—Yes, you do not have the warning there.

Ms Vivian—I am certainly happy to have a look at it.

Senator SHERRY—If you could. The reason that I raise it is that part 23 of the SI(S) Act provides compensation up to 90 per cent in the event of theft and fraud, but it is not available in the case of self-managed super funds. You may not have picked this up but there was compensation payable—I forget the name of the super fund—and ASIC issued a press release on this last week. At one of the—unfortunately pretty sad—meetings I have attended of Westpoint investors, we discussed this and my concerns about ATO activity with self-managed super funds. What struck me was that approximately a third of these people invested through self-managed super funds. I attended a meeting in Sydney a few months ago and I asked them how many had invested in Westpoint through self-managed super funds. And about a third of the hands went up. I understand from ASIC it is about a third of the Westpoint investors. Then I asked how many of them knew that in the event of theft and fraud, unlike other superannuation products, they were not able to be compensated under part 23, and not one of them knew that. It would seem to me to be appropriate, given the level of problem, that it is appropriate to have a clear warning that they are not compensable in the event of theft and fraud?

Ms Vivian—We review those publications on a regular basis, so we would be happy to have a look at that.

Senator SHERRY—You might have a discussion with ASIC about it in the context of Westpoint and some of the other issues that they track in respect of self-managed super funds.

Ms Vivian—Yes.

Senator SHERRY—I have looked at the ATO website and this morning I made passing reference about this to the commissioner. Is the publication *Statistics on self-managed super fund market* new?

Ms Vivian—This committee and other people were raising with us that we should put up more up-to-date statistics. So we try and put them up each quarter. They went up today for the 31 March quarter.

Senator SHERRY—Is this the first time you have been posting them quarterly?

Ms Vivian—No. I think we put up the first round just before Christmas and updated them at the end of December.

Senator SHERRY—I have to describe it as an advance. I have been raising these issues of data, or lack thereof, in the self-managed super fund sector for some years. This is a vast improvement on what we had prior to December last year, which was very little. One area that I was interested in was the range table of SMSF total assets on pages 5 to 7. There is no data

yet for 2005-06. You have the figures by category, which I think is very useful, the asset range and then the proportion of SMSF members in each asset category, but there is nothing yet for 2005-06. When do you believe you will have data for that category in that year?

Ms Vivian—I would have thought in the next quarter, 30 June. The issue is that most of those funds come up to 31 March, so there would not be enough lodged to provide anything sensible or meaningful.

Senator SHERRY—Mr Lucy of ASIC has given evidence at previous estimate committees, which I would not expect you to be aware of, very bluntly questioning the value of an SMSF for an amount less than \$200,000. I note from your statistics in 2003-04, 40 per cent of SMSFs had up to \$200,000. In 2004-05 it is about 35 per cent. Have you been liaising with ASIC at all on this matter?

Ms Vivian—We certainly work with ASIC. I do not think we have had any recent specific discussions on this matter. I think I have mentioned to you before that we are having a look at funds under \$200,000, but as I mentioned there it is interesting to note that over a year they had moved from 40 per cent to 35 per cent. Some of these funds have been set up for a long period of time. We are going to have a look at them in audits but at the moment they are certainly not coming up in our risk modelling as a high risk.

Senator SHERRY—It is not only the level of risk that I am concerned about. It is also the level of cost-effectiveness, given the evidence we have had from ASIC about the base cost of operation of an SMSF. That is an observation; it is not a policy or enforcement issue that the ATO can frankly do anything about, as I understand it.

Mr D'Ascenzo—That is right. That is the reason we had that booklet, to indicate to people that there are quite a lot of obligations on the trustee of self-managed super funds and that, unless people are prepared to put that sort of effort in, maybe self-managed super funds are not for them.

Senator SHERRY—Just in the same area, you have given a figure for operating expenses on an annual basis, which as I say, is an improvement, but could you consider giving a breakdown of operational expenses in greater detail? What are the operational expenses we are dealing with here?

Ms Vivian—One of the issues we have when we look at those breakdowns is that we can only collect what is recorded at that label. I think there may be some questions about the data that gets recorded there, but I am happy to provide some further breakdown.

Senator SHERRY—If you could take it on notice. I know the pressures you are all under, but, in terms of future publications, what are operational expenses? Do they include or exclude some level of commissions or fees? There are a considerable range of fees charged aside from the base operational fee. There are accounting fees, record-keeping fees, exit fees, entry fees, transaction fees, investment fees; you name it, there is a fee.

Ms Vivian—How about we look at the end-of-year statistics that we publish and look at what gets recorded as management expenses, and we can give some description around that. Certainly we have got the description of what we ask people to put down as management expenses, and we provide that as part of the annual statistical database.

Senator SHERRY—I am looking for a more useful alignment between the fee categories that APRA publishes, which I suspect you have seen—they give a quite detailed breakdown by category—comparing those types of fees which even they struggle with, I have to say, and just the broad category of operating expenses. The other thing is the level of operating expenses by asset range. That would be very useful data for the obvious reason that the lower you go down the asset range, the higher the percentage cost, which, again, I think is useful for the ongoing debate in this area. Could you give due consideration to that.

Ms Vivian—As you would be aware, to do anything along those lines there is a compliance costs for the self-managed super fund.

Senator SHERRY—You could do a representative survey. I am not suggesting that you do every 320,000—or is it 330,000 now that we are up to?

Ms Vivian—That is where we pull this data from, the returns that are lodged. That is how we collect most of our data.

Senator SHERRY—Yes, it was 337,902 as of March 2007. But I have to say it is a useful advance. We are getting there. I know you needed to leave, Mr D'Ascenzo. We are not going to finish before you leave.

Mr D'Ascenzo—My apologies. I can stay for another half an hour or so.

Senator SHERRY—Okay. I just want to come back to a couple of more general revenue issues. There is a measure set out in Budget Paper No. 2, page 13, titled 'Excise and Excise Equivalent Customs Duty, Enhancing and Streamlining Eligibility for Refunds, Remissions and Drawbacks'. What does this measure do? It is a little difficult to tell from the measure description contained in the budget paper. It talks about aligning excise and customs legislation to establish consistent eligibility conditions across excise and equivalent customs product classes for taxpayers seeking a refund, remission or draw back of duty. I am just after a more plain English explanation as to what the outcomes are as a consequence.

Mr Callaghan—I can only give it in a very general sense; it is in the circumstances of when you can get duty remitted. You are paying duty on the good at sale when it can be consumed. There has been inconsistency in the law in when duty has been paid and when, if it is damaged product and you want to get your duty back, it is streamlining and making sure there is consistency as to when duty can be remitted.

Senator SHERRY—How is there a lack of consistency when it is a damaged product?

Mr Callaghan—I have not got the details with me at the moment. It is a small item here. Just going on recollection, I know there can be circumstances where, for example, I think it was where beer has been damaged. If it is draught beer as opposed to packaged beer there are inconsistencies. In one instance, you can get the duty back and the other you cannot. But Mr Brown may have more detailed input.

Mr Brown—An example of the inconsistency was that beer that came in kegs—draught beer—was eligible for a return of the excise, but if the beer was bottled beer then it did not qualify.

Senator SHERRY—Sorry, how can draught beer be damaged?

Mr Brown—It goes off if it is not sold by a certain time. Beer can also go off if it is not sold by its best-by date or whatever if it is in a bottle.

Senator SHERRY—Can't bottled beer go off? I understand that sunlight can change the composition of beer in glass.

Mr Brown—I understand that, yes, it can go off. Obviously you are more of a connoisseur of beer than I am.

Senator SHERRY—I did a bit of work with breweries in an earlier career.

Senator MURRAY—I can assure you that it can go off.

Senator SHERRY—So we have had these different excise treatments. Are there any practical issues here? Is it just a matter of simplicity?

Mr Brown—The goods do need to be returned in substantially the same state as they were supplied. If it is beer in a bottle, it needs to be returned in the bottle. There are also issues about just verifying the return and arrangements for that.

Senator SHERRY—Where is it returned to, in the case of beer—to the manufacturer or the supplier?

CHAIR—Or an office of the ATO.

Senator SHERRY—Or the ATO, yes!

Mr Brown—I think there are arrangements that need to be finalised for that, which I think were mentioned. I think there are some details like that that the legislation will clarify—regulations, basically.

Senator SHERRY—Is there legislation to come to the parliament or regulation in this area?

Mr Callaghan—I am not sure.

Senator SHERRY—Perhaps you can check and let us know. I will have my colleagues pose some suitable questions at the legislative hearing. I turn to the issue of the revenue implications of emissions trading schemes and carbon tax regimes. Has Treasury conducted any analysis or modelling on the likely revenue consequences of emission trading schemes or a carbon tax?

Mr Callaghan—No, not of the revenue consequences.

Senator SHERRY—Are you aware of any modelling being done in this area that is not of a revenue consequence?

Mr Callaghan—Within output 3.1, which is dealing with taxation, no; more generally the work is being undertaken within the Treasury in other outputs. This is best referred to those. I think the fiscal group would be the one this is best referred to.

Senator SHERRY—I have gone to them with questions in this category before. I just was not sure whether Revenue had examined anything in this context. I also wanted to go to an area of tax expenditure—A5, exemption of income earned by Australians working on approved overseas projects. In relation to tax expenditure A5, exemption of income earned by Australians who are working on approved overseas projects, does this tax expenditure include

Defence Force personnel or is there an exemption from income tax when overseas included in another tax expenditure?

Mr Brown—We will need to check that. Tax expenditures for Defence are at the start of A8. I think these are likely to be civilian, but we would need to check that.

Senator SHERRY—I anticipate with a fair degree of certainty that we will be going beyond the dinner break, so you could come back after the dinner break if that is possible. I know it is five o'clock, and it may not be possible. If it is yes, what percentage of the TS relates to Defence Force personnel? Can government employees qualify for this exemption? What major projects have been approved in the past 12 months for this exemption? And do all Australian staff in foreign embassies automatically qualify for this exemption?

Mr Brown—We might need the list again just to make sure I get those down.

Senator SHERRY—If the answer is yes to the first question, which I take it you have, what percentage of the TS relates to Defence Force personnel? Can government employees qualify? What were the major projects approved in the last 12 months? And do Australian staff in foreign embassies automatically qualify for this exemption? Superannuation tax collection from departed temporary residents was a measure introduced in Taxation Laws Amendment (Superannuation) Bill (No. 1). Do we have a revenue estimate of the collection from this measure in the last full financial year?

Mr Gallagher—I am not aware of a revenue estimate for this measure from the last full financial year. I will take that on notice.

Senator SHERRY—Are you aware of any revenue estimate?

Mr Gallagher—We have discussed this in the past over many—

Senator SHERRY—We have.

Mr Gallagher—In those previous years I have discussed with you the fact that we have varied the revenue estimate.

Senator SHERRY—That was because of the dismal failure to collect the revenue that was projected.

Mr Gallagher—That dropped below my radar, and I—

Senator SHERRY—It never dropped below mine; I can tell you that.

Mr Gallagher—I will need to take the question on notice, I am afraid.

Senator SHERRY—I presume that the revenue for that measure is included in the contributions and earnings tax. It is not with the surcharge; that would seem to me to be the only place it could be contained. Or is it coming in in general income tax?

Mr Gallagher—As withholdings from superannuation funds—that seems likely. I do not think that is a personal tax.

Senator SHERRY—Have you received any information concerning the numbers of temporary entrants completing the departure cards, as distinct from the revenue? If you have departed the country recently, you would have noticed a little section on the back of the card.

Mr Gallagher—I have not received the information about those responding in respect of superannuation on those cards. There has been a recent ABS revision to the migration estimates based on data linked across those cards, but I am not aware of the superannuation data.

Senator SHERRY—Wouldn't that data be useful in evaluating the level of claim or transfer out of the country and therefore the level of tax being collected?

Mr Gallagher—Very likely.

Senator SHERRY—Yes, I would have thought it would be very useful. I am just surprised, given your thorough approach to everything, that you have not been able to utilise that data, apparently.

CHAIR—Can I just interrupt briefly. With respect to general taxation law, would we be reaching those officers before dinner?

Senator SHERRY—No, I do not think so.

CHAIR—Are you happy for those officers to be excused until after dinner? Are there any tax officers that we can release or would you like them to stay?

Senator SHERRY—It is a bit difficult at the moment, simply because we have been—not only me but others—shifting from one to the other.

CHAIR—IGT will not be required before 8 o'clock, if that is of any assistance. No-one seems terribly excited about that.

Senator SHERRY—There is no movement at the station!

CHAIR—They are no doubt listening in; they will not be required back before 8 o'clock.

Senator SHERRY—I will just come to a couple of other revenue areas. I am trying to get it down so that we can finalise the revenue area. As to R&D tax concessions for small business, what led Treasury to increase the original estimate on the expense of the R&D refundable tax offset for small companies from \$342 million in the 2006-07 financial year as per the 2006-07 portfolio budget statement?

Mr Callaghan—Is this the material we covered with Senator Carr?

Senator SHERRY—I think it may overlap.

Mr Callaghan—I think we went through all of this with Senator Carr.

Senator SHERRY—I was not here for most of his questioning.

Mr Callaghan—We spent quite a bit of time going right through this.

Senator SHERRY—I am willing to accept your indication. I have some questions about assumptions and economic year-to-year factors that the Treasury took into account in upgrading or downgrading the estimate figures. They were the areas covered by Senator Carr?

Mr Callaghan—They are the areas we went through with Senator Carr.

Senator SHERRY—I have some questions on entrepreneurs tax offset. Could I have outlined to me how the original ETO policy was costed—the basis/assumptions behind the costing?

Mr Callaghan—I will have to call on Mr Brown again.

Senator SHERRY—Do we have Mr Gallagher in this one as well?

Mr Gallagher—With respect to the entrepreneurs tax offset, as I recall it, we attempted to find the number of entrepreneurs who fitted the description in terms of throughput with their business in terms of taxable income. This is a 2004 costing.

Senator SHERRY—Yes.

Mr Gallagher—I remember that we attempted to cost it from tax microsimulation models from the data that we had. I also recall that this is, I think, a 2004 election costing, and the costing details are actually published with the election costing details and they are probably still on the Treasury website.

Senator SHERRY—Good. That will be useful.

Mr Gallagher—I would refer you to that. I do not have a copy of that material with me, because it is a 2004 costing.

Senator SHERRY—But I still want to keep testing your memory, Mr Gallagher, I hope not unfairly. At the time of your involvement in the costing of that, what was the expected STS take-up rate in the various ranges nought to 25,000, 25,000 to 50,000 and 50,000 to 75,000?

Mr Gallagher—I do not know that we had an expected take-up rate by those ranges. We may have subsequently attempted to look at the distribution in those ranges, but I do not think initially that we would have described it that way.

Senator SHERRY—In terms of the forward estimates and the growth rate, can you recall what the growth rate was over that forward estimates from 2004?

Mr Gallagher—No, I cannot recall it. It is three years ago. We do a thousand costings a year. This slips into the background.

Senator SHERRY—So there is nowhere on the public record that the costs have been published then, since the initial costing? What were the forward estimates and now past historic costs?

Mr Gallagher—In the taxation expenditure statement 2006, page 88, tax expenditure B30 gives an estimate going forward of the costs.

Senator SHERRY—Of the STS?

Mr Gallagher—Yes.

Senator SHERRY—Thank you. As to the simplified tax system, I think last year Mr Konza said that at 31 December 2005 there were more than 620,000 businesses using the simplified tax system. Do we have an updated figure, approximately?

Ms Granger—Yes. According to my briefing we now have over 850,000 involved in that.

Senator SHERRY—As at when?

Ms Granger—I will just find that for you. This was at 31 December 2006—about 850,000.

Senator SHERRY—Mr Konza said last year that 28 per cent of eligible businesses used the STS. Is that still the same approximately figure?

Ms Granger—Sorry?

Senator SHERRY—You said that 28 per cent used it. Do you have a percentage update?

Ms Granger—It is over 35 per cent. I will come back to you with that answer before we finish this session. I will just check some figures.

Senator SHERRY—You said that it was over 35 per cent approximately?

Ms Granger—Yes, I think it might be even higher than that so I just want to check some figures.

Senator SHERRY—We have a raw figure for 31 December 2006. If you have a percentage for that figure—if it has gone up and you have got some later data since December 2006, maybe the quarter—that would be useful. Do you know what the annual growth in the STS users has been since the entrepreneurs tax offset was introduced?

Ms Granger—I will just find that briefing for you and I will be able to confirm that.

Senator SHERRY—There is an impact of the effect of the ETO on the use of the STS.

Ms Granger—I have just found the figures. These are later figures. As at 29 March 2007 about 41 per cent, or 886,000, have elected into the simplified tax system.

Senator SHERRY—Do you have any information on the effect of the ETO on the use of the STS?

Ms Granger—No, I do not.

Senator SHERRY—It has been put to me that the growth would increase as a consequence of the ETO; that it would impact and compound the growth.

Mr D'Ascenzo—When you say the ETO, that is the entrepreneurs tax offset?

Senator SHERRY—That is correct.

Mr D'Ascenzo—And that was in the year 2004?

Senator SHERRY—For 2004.

Mr D'Ascenzo—We can indicate to you that from 30 June 2004 there was 20 per cent. Since then it has grown: 2005, 25 per cent; 2006, 29 per cent; and, as Ms Granger said, 41 per cent with the latest changes. So there has been an impact.

Senator SHERRY—There has been an impact, but you cannot break it down into—

Mr D'Ascenzo—No. There was a range of changes.

Senator SHERRY—Yes.

Mr D'Ascenzo—For example, you did not have to opt for cash accounting, you could go for accrual. I think that was a significant influence.

Senator SHERRY—It did have an impact, but you cannot determine the precise impact?

Mr D'Ascenzo—Yes.

Senator SHERRY—Of those who were receiving the full ETO, up to \$50,000 turnover, how many of those businesses are using the STS?

Mr D'Ascenzo—We certainly do not have that break-up here. I am not sure that we have it at all. We can check and, if we do have the break-up, we can provide it; if not, we can advise that we do not have that break-up.

Senator SHERRY—As to the phase-out of the ETO between \$50,000 and \$75,000, how many businesses are using the STS? Could you provide us with a raw and a percentage figure there? Could you take that on notice.

Mr D'Ascenzo—If we have that break-up we will certainly provide it; if not, we will advise that we do not have that information.

Senator SHERRY—Could you take on notice the percentage take-up for those STS eligible businesses that do not receive any ETO, that is, those with over \$75,000 in turnover?

Mr D'Ascenzo—If we can do that.

Senator SHERRY—Do you have any figures on the take-up figures of the STS of those with between \$75,000 and \$250,000 in turnover? Your nod is not recorded on the *Hansard*.

Mr D'Ascenzo—No, we do not have it here. Again, if we find that information, if we do have those break-ups, we will provide them in the answer to you.

Ms Granger—The figures we have given are all we have with us.

Senator SHERRY—I will put this on notice now; that is easier. Can I have the annual growth rate in the take-up of the STS by these businesses in those income categories I have given you, and factors identified to encourage small business and contractors to join the STS? Do you have observations to make there?

Mr D'Ascenzo—Sorry, that question?

Senator SHERRY—What factors would encourage small business and contractors to join the STS system?

Mr D'Ascenzo—I think the changes that occurred. There was the difference between having to opt in terms of cash or accruals; now you have a choice. That was one that was a significant influencer. There are other options that were available. There is also continuing marketing and communication; we kept trying to explain this to the tax agents. Tax agents became more comfortable with the STS after they were able to better understand the GST and other obligations. I think very early in the piece, in trying to come to grips with the new tax system, they perhaps did not know as much as they could have in terms of the STS.

Senator SHERRY—Has the ATO examined the impact of lifting the threshold of compulsory GST registration from \$50,000 to \$75,000?

Mr D'Ascenzo—We have not specifically looked at the impact other than to note that it reflects some concerns by businesses that have to fall into the more regular reporting of GST within that range. On the other hand, there is a range of enterprises below the threshold that do choose to enter into the system.

Senator SHERRY—Is that threshold indexed?

Mr D'Ascenzo—No, I think it was a \$50,000 threshold in the original period, and it has now changed to \$75,000 under the announced measure.

Senator SHERRY—So you did not do any analysis of what the impact of that change would be? I must say that I am a bit surprised.

Mr D'Ascenzo—As I said, there are two different views on this. One view is that there were businesses that were concerned that they had to incur additional compliance costs through the regular reporting of GST. On the other hand, there are a number of businesses that see that regular reporting as beneficial to their cash flow and their dealings with other businesses.

Senator SHERRY—As to the expectation of businesses leaving GST registration as a consequence, did the ATO examine what that number of businesses would be?

Mr D'Ascenzo—No.

Senator SHERRY—What about your area, Mr Callaghan—did you do any work in this area?

Mr Callaghan—Yes. The measure was a budget measure and it was costed.

Senator SHERRY—Was any analysis carried out of the impact of the lifting of the threshold from \$50,000 to \$75,000?

Mr Callaghan—Certainly there was an analysis carried out. The impact is that it will have an impact on GST receipts.

Senator SHERRY—I understand that.

Mr Callaghan—That was provided in the budget papers.

Senator SHERRY—But what about other analysis aside from the GST receipts; the number of businesses, for example?

Mr Callaghan—In order to gain that, there have to be estimates of the amount that was affected. More broadly, the other analysis, as you say, was the feedback that came out in the Banks report on regulation. As the commissioner has said, there have been requests in terms of the more general impact it may have on the business sector. This is something that has been under discussion for some time. In terms of quantifying the impact of it, yes, an analysis was taken and the measure costed.

Senator SHERRY—Given the costing occurred, what was the estimate of the number of businesses that were projected would leave?

Mr Callaghan—I do not have that information. I do not know if Mr Brown has. No.

Senator SHERRY—Mr Gallagher does not?

Mr Callaghan—This is Mr Brown's side of things.

Mr Brown—It is one of my costings. But, no, I do not have that number on me.

Senator SHERRY—Presumably that work would have been done?

Mr Brown—The estimates were based around the take-up rate assumption.

Senator SHERRY—Could you take that on notice?

Mr Brown—Yes.

Senator SHERRY—The budget also announced that the simplified accounting method would be extended for many small businesses that had a mix of GST and non-GST sales for purchases, and a small business could apply to the tax office to obtain its own specific ratio that it could apply in future GST calculations. What steps has the ATO taken, or will it take, to enable businesses to obtain a specific ratio? Is there no-one here who can help us?

Ms Granger—No.

Senator SHERRY—What resources are being put in place to process the applications?

Ms Granger—I am sorry, I am not familiar with this.

Senator SHERRY—I have a number of questions and, as we are going past dinner, if there is someone who can be contacted to help that would be useful. I have some general questions on employee share schemes that you may be able to assist me with. Is there a unit still in DEWR dealing with this? I think there was a unit for employee share schemes. Do you have any idea?

Mr Callaghan—I do not know.

Senator SHERRY—Have there been any recent measures to encourage the growth of employee share schemes? There was nothing in this last budget. Was there anything in the last year or two that anyone can recall?

Mr Callaghan—I cannot recall.

Senator SHERRY—Has the ATO done any work around the possible abuse of employee benefit arrangements for company employees, particularly executives?

Ms Granger—Again, I do not have detail, but we have certainly been looking in the last year at remuneration for high-salaried individuals, and that does include looking at employee share arrangements in that.

Senator SHERRY—I just missed that last part?

Ms Granger—And that includes looking at employee share arrangements in relation to them. I am talking about high-salaried individuals. We are talking about million dollar-plus salaries. It is still fairly early days in the evaluation of it, but I know as part of that we are looking at employee share arrangements.

Senator SHERRY—What about access to information on employee share ownerships?

Ms Granger—I am not sure.

Senator SHERRY—Is there a difficulty in accessing either individual or collective data in this area?

Ms Granger—The information that we have been looking at is what has been published in the annual reports of public companies. We have had to do some analysis there and we have been matching it back to what has been returned in their tax returns.

Senator SHERRY—Is there any collection of ESS data in the aggregate?

Ms Granger—Not that I am aware of.

Senator SHERRY—I have some issues relating to withholding tax. And I was just checking whether Senator Murray covered a couple of these issues. As to the consultation that took place on schedule 2 of TLAB No. 7 of 2006, who was consulted on this legislation?

Mr Callaghan—Schedule 2, TLAB No. 7 of 2006, and which measure?

Senator SHERRY—This is in relation to withholding tax provisions or some aspects of—

Mr Callaghan—Which withholding tax? There are measures on withholding in TLAB No. 3 of 2007.

Senator SHERRY—You are right, but schedule 2 of—

Mr Callaghan—Is this dealing with withholding of interest?

Senator SHERRY—Yes, I believe so.

Mr Callaghan—That is also in TLAB No. 3 of 2007.

Senator SHERRY—Yes. And TLAB No. 7, schedule 2, which was debated in February 2007; there are some aspects there.

Mr Callaghan—That have been withdrawn?

Senator SHERRY—Yes.

Mr Callaghan—Yes.

Senator SHERRY—In reference to that, are you able to outline who was consulted on that schedule?

Mr Callaghan—In general the financial sector was consulted on it, because it has obvious implications.

Senator SHERRY—Are you able to give me an indication of the—

Mr Callaghan—I think there are submissions on the public record when this was referred to the economics committee. They are on the public record even for the hearing on this measure this coming Friday. The Australian Bankers Association is the one that comes to mind; I cannot remember the others.

Senator MURRAY—There is an accounting firm—

Mr Callaghan—There is an accounting firm. There is Pacific Finance Group. But similar to all of these measures, there has been very extensive consultation.

Senator SHERRY—Was an independent departmental consultant appointed?

Mr Callaghan—Going back, we engaged a consultant to help with the definition of 'debenture'.

Senator SHERRY—Do you recall who that was?

Mr Callaghan—I cannot recall the name.

Senator SHERRY—Could you take that on notice?

Mr Callaghan—We will take it on notice. If we had the name, we could obviously look at the schedule at the back of the annual report.

Senator SHERRY—Could you also take on notice how long they were engaged for and the quantum for the contract? Will the report of that consultant be made public? I understand that it has not been to date.

Mr Callaghan—No, it will not be made public. It was a specific aspect to help us with developments in the financial market in just testing around the definition of a debenture, which is a key feature of the bill. It was a technical consultancy to help us in forming the legislation and also to help us with the consultations that were underway.

Senator SHERRY—We touched earlier on some staffing level issues in the ATO. I am fairly sure that you do not have these issues to hand, but could you take on notice the areas where there is to be a decline in tax office employees, other than the identification in more detail than that identified in the PBS?

Ms Granger—Yes. So, where there is a reduction, you are asking us to give an explanation of that?

Senator SHERRY—Yes. It was reported in the *Age* in March 2007 that criminal syndicates had stolen more than \$5 billion since 2003—that was a real headline grabber—from the ATO by setting up false companies and submitting fake BAS forms to claim refunds. This allegedly occurred because of weaknesses in the BAS system, which is vulnerable to tax fraud as it requires only a PO box number and a phone number as contact points for these companies. It was an exclusive by the *Age* investigative unit. Is the figure of \$5 billion accurate; that you have actually had \$5 billion stolen from the ATO since 2003?

Ms Granger—No, that is not our estimate at all.

Senator SHERRY—What is your estimate?

Ms Granger—I am not sure that we have an estimate precisely. I do not have the figures to hand. This is the area of identity fraud and identity crime in particular. We certainly have, on a number of occasions, raised concerns about people keeping their information close, and we have seen a number of instances where there has been an organised attempt to commit BAS fraud on the system. These are ones we have detected and dealt with. In relative terms compared with other kinds of adjustments we have made for other compliances issues, the numbers are relatively low; the amounts involved are relatively low.

Senator SHERRY—You say they are relatively low; what are they?

Ms Granger—I do not have the analysis in front of me. I will just see if Ms Crawford has it for us.

Ms Crawford—I do not, not on the matter of identity fraud. The issue that was raised in that media was more around the use of ABNs and companies; the level of proof of identity that we undertake on people applying for an ABN. In that regard I have a response that I could give.

Senator SHERRY—Thank you.

Ms Crawford—We do have wide-ranging controls in place to stop and detect fraudulent activity statements and income tax refunds. We are constantly monitoring and updating those controls. We also use analytical tools and have various risk models that look to assess likely

fraudulent activity in this area. But specifically in relation to the identity issues, applicants are required to meet proof of identity tests and provide business addresses prior to them being issued with an ABN. If an applicant for an ABN is a company, the tax office confirms those details with ASIC; that the company in fact does exist and is active. The applicant can also satisfy proof of identity by providing their TFN, and we have already, of course, assessed their identity prior to issuing that TFN. That is how we would respond to that article in the newspaper.

Senator SHERRY—Here is your chance. A \$5 billion figure is claimed. You seem to be indicating that it is significantly less than \$5 billion?

Ms Crawford—What we are indicating is that we have significant controls, or serious controls, in place to attempt to detect and stop fraudulent activity. We constantly monitor that and modify it as required.

Senator SHERRY—Have you ever attempted to determine a figure? Obviously, as is the nature of fraud, it is difficult to identify. Have you ever been able to assess the level of this activity?

Ms Granger—Again, in relation to what I was talking about earlier, which is refund fraud that you were asking about, we do not have a figure per se. But we can tell you what we have detected so far and what the value of that has been, both in terms of what might have occurred and what actually flowed out. I do not have those figures in front of me, but I can get them for you.

Senator SHERRY—Other than the measures you have outlined, are there other security procedures in relation to BAS lodgements?

Ms Granger—There is a range of risk filters in our system, and we continually update those as we detect different attempts on the system, and we vary them, anyway; for those who become familiar with the system you can after a while pick some of the patterns. I will just give you one example that I am familiar with, which changed the pattern for us. The behaviour we had seen over a number of years tended to be an attempt to get one big refund out of the system and; the change in behaviour that we saw in the last one to two years is where they have started to try to claim a number of small claims by taking over the identities of existing taxpayers. That led us to change our approach in terms of risk filters, so that it was not just at monetary levels or particular risk occupations but also other unusual features. For example, without going into too much detail, there is obviously a common pattern of change of addresses, and those sorts of things if you think about those. As we learn more, we adjust those risk filters as well.

Senator SHERRY—You mentioned people taking up the identity of other taxpayers. I understand that there is a vulnerability with, for example, people who have died; people are able to access information in a variety of ways. Is that an area of vulnerability?

Ms Granger—It can be, and Ms Crawford again can probably give you more detail. We do quite a bit of work around our registers to look at what we call—and this is not euphemistic, because there can be a range of reasons—inactive file numbers. For example, that is certainly the case where people have died but they are also inactive for other reasons. They may have left Australia et cetera. There is quite a bit of work.

Ms Crawford—In essence it boils down to data matching that we do with other agencies and the like. We are constantly refining the numbers that we have registered in the system and matching them against other sources of information. For instance, you mentioned people who have died. We check with the registers of births, deaths and marriages to identify deceased individuals and then match that with any TFNs that we hold in our system. That is the sort of checking that we do regularly to cleanse our records.

Senator SHERRY—Do you have interlinked data with the registers? I think we have discussed this before. Has that been resolved?

Ms Crawford—It is a bit mixed, I think is probably the answer. In some cases we have and in other cases we have not.

Senator SHERRY—Presumably it would be more effective if there was an automatic referral on to the ATO of a death notice registration by the state agency?

Ms Crawford—Certainly, and I think progressively that is the way we would want to head, but there is obviously a cost issue and other issues involved in that.

Senator SHERRY—As to the issue of temporary entrants who come into the country, receive a TFN and then obviously leave the country and the TFN is redundant, it would seem to me that this is an area of vulnerability for accessing TFNs.

Ms Crawford—Again, one of the checks that we do on a regular basis is with the Department of Immigration and Citizenship to identify nonresidents who have left the country.

Senator SHERRY—They would cross data with you the name of the individual off the card and then you would crossmatch the name of the individual who has left the country with the TFN and remove it from the system?

Ms Crawford—I do not know exactly how we do it.

Senator SHERRY—I do not know, either. It seems that it just chronologically followed from how you would try to do it.

Ms Crawford—Yes, it sounds logical. I am not 100 per cent sure of the actual mechanism we use.

Senator SHERRY—Just coming back to the article, the *Age* believes:

... recommendations to tighten procedures around BAS fraud made by specialist ATO anti-fraud staff from 2004 onwards have yet to be acted upon by the Tax Office.

What does that refer to? Firstly, was there a specialist anti-fraud staff examination, it says, from 2004? Secondly, did it make recommendations, if it existed? Thirdly, if it did exist and recommendations were made, have they been implemented?

Ms Crawford—I do not think I could answer that precisely. Could we take that on notice?

Ms Granger—Could I just clarify with you, ‘specialist anti’—I did not quite get the term?

Senator SHERRY—I do not know whether you put out a specific release to respond to that. I have not found one—it is on page 3 of the *Age*. You cannot respond to everything, I

suppose. It says \$5 billion has been lost to crime gangs and franchise tax fraud methods. These are fairly spectacular claims, but part of it was that there—

Senator MURRAY—It is bigger than the drug trade.

Senator SHERRY—It is bigger than the drug trade, as Senator Murray points out to me.

Senator MURRAY—The estimates of the drug trade.

Senator SHERRY—Yes, the estimates of the drug trade. It does say that this area had been examined by specialist ATO anti-fraud staff, and that there had been recommendations to tighten procedures that had yet to be acted upon by the tax office.

Ms Granger—Firstly, I am aware that the commissioner made some statements in relation to that. I was not here at the time, which is why my memory is a little bit vague on this. In particular, the \$5 billion estimate was not an ATO estimate, yet it was portrayed in the article that it was. In relation to specialist ATO anti-fraud staff, I think that is referring to the serious non-compliance area, which is in my area of responsibility. We routinely have that area, with the operations area, reviewed where we have seen instances of fraud to see what lessons we have learnt from that, whether we can detect that or not, and then refine our systems. I was talking about that process earlier. As a result of that, they will make recommendations on what changes ought to be made in the system. Those are recommendations. Whether we choose to go ahead with those or not is decided by a refund integrity committee that we have that is set up across the office about whether those are feasible and practical—

Senator SHERRY—You are yet to receive recommendations?

Ms Granger—No, I think the answer on the \$5 billion issue is that it is not our assessment. In relation to a range of recommendations serious noncompliance might make on changes, we have implemented a lot of them but not specifically on this one. That is the extent of what I can tell you about that.

Senator SHERRY—The articles states:

Confidential Tax Office documents seen by *The Age* estimate that at least \$1.4 billion a year is being siphoned out ...

Do you not have any idea where that figure came from?

Ms Granger—We have not seen the document, as I understand it; the *Age* has seen this document. We believe that it may have been prepared by an ex-tax officer. We think the calculation may be based on simply using five per cent of the GST refund base as a reasonable estimate. I hesitate to take it any further than that because, as I said, I have not seen what the *Age* has seen.

Senator SHERRY—You mentioned that it may have been a former officer who prepared some document.

Ms Granger—It may have been, yes.

Senator SHERRY—Is there an investigation into this document? Are you able to identify anything that has occurred here?

Ms Granger—Again, this is a document that the *Age* has rather than we have in—

Senator SHERRY—They claim that it is an ATO document.

Ms Granger—Yes, they do.

Senator SHERRY—You have obviously searched for it and you cannot find it?

Ms Granger—I am not sure what investigations—

Senator SHERRY—Is there an ongoing investigation to try to get to the source, if any source exists, within the ATO?

CHAIR—The witness has said that it is an article from a newspaper; they are not aware of its existence and nothing further has been done in relation to it.

Senator SHERRY—There is nothing further to add on this one? I am just giving you an opportunity. I found it a bit hard to believe, I must say, when I read it.

Ms Granger—All I can say, again, is that where we do detect attempted frauds or, in fact, have identified frauds, we review our systems and learn what lessons we can to strengthen them, and will continue to do so. We take it seriously. We certainly do look at allegations in the newspapers and elsewhere to see if there is anything that would require us to seek assistance.

Senator SHERRY—Just more generally on the issue of TFNs that are in the system, do we have an approximate number at the present time?

Ms Crawford—We do. I have a table. The total is now 24 million—24,075,000.

Senator SHERRY—And 75?

Ms Crawford—And 75,919.

Senator SHERRY—How does that compare with the figure for this time last year?

Ms Crawford—I do not actually have that with me. I could get that for you, though. It would be in our annual reports, I think.

Senator SHERRY—Yes. Is this coming down, because that is a figure much greater than our population, by some millions?

Ms Crawford—It is not just an individual—

Senator SHERRY—Adult population certainly, sorry.

Ms Crawford—Tax file numbers are acquired by individuals, companies, trusts, superannuation funds, partnerships, and government organisations. I think we can reconcile that number by looking at all of the crosschecking that we do.

Senator SHERRY—Have you done that?

Ms Crawford—Yes. We do not actually get rid of tax file numbers altogether. Once they are in the system, they are in the system and then we go through a process of elimination with deceased—

Senator SHERRY—Sorry, the distinction between getting rid of and elimination—‘elimination’ seems to be—

Ms Crawford—We still keep the record, but then we reconcile that against deceased persons, departed individuals, inactives, and locked down ones, where we have crosschecked and found that they should not be in existence, and so on until we get to the total of what we consider to be active records. That is the figure that I provided.

Senator SHERRY—The 24 million?

Ms Crawford—That is correct.

Senator SHERRY—I just wanted to go to another adverse headline, this time in the *Australian Financial Review*, on 26 April this year. I would never condemn anyone on the basis of a headline, but it reads ‘ATO regularly fails to meet deadlines’ and states:

The Australian Taxation Office has consistently failed to meet its six month time limits for issuing and finalising public rulings and has given up monitoring its performance, a report has found.

That is the review by the Inspector-General of Taxation, Mr Vos. He may throw some light on these alleged failings in the tax office a little later. Does the ATO accept that it has been failing in this regard?

Ms Granger—I perhaps could come back to that later this evening. I do not have briefings on that issue here.

Senator SHERRY—I do not want to rely on the *Fin Review* for your response, but it does say that—

Ms Granger—No, I certainly would like—

Senator SHERRY—The ATO disagreed with his recommendations.

Ms Granger—We will see if we can get some briefings over during the—

Senator SHERRY—Yes, that may be useful, particularly as we have Mr Vos himself appearing a little later. I would want to give you a chance to defend yourselves. Another article on 14 May, again in the *Fin Review*, is headed ‘Tax Office puts cloud over rights issues’. This relates to the McNeil case. Do we have anyone who can throw some light on this matter?

Ms Granger—No, again, we do not, I am sorry. If you could tell me the questions, I will see if we can get answers for you.

Senator SHERRY—I am sure anyone who is familiar with the case would be able to at least respond to most of the questions. Did the ATO consider the repercussions of their arguments in court in respect of the case? Has the ATO had any discussions with Treasury in respect of challenging the accepted principle? Does this open up—

Mr Callaghan—This is related to what Senator Watson was talking about.

Ms Granger—Some of it is.

Mr Callaghan—As the commissioner said, there is this discussion taking place between ourselves and the ATO.

Senator SHERRY—I missed most of my colleague Senator Watson’s questions. It makes my life a bit easier in that area of questioning. Turning to scam emails, a parliamentary colleague of mine has referred on a scam email on ATO letterhead which states: ‘After last

annual calculations of your fiscal activity we have determined you are eligible to receive a tax refund of \$173. Please submit the tax refund request and allow us six to nine days in order to process it. A refund can be delayed for a variety of reasons. For example, submitting invalid records or applying after the deadline. To accept the form for your tax refund, please click here. Regards, Australian Government.' Has the ATO had scam emails drawn to its attention in this financial year?

Ms Granger—There are a few nods coming from the back of the room. Each tax time we detect a number of scams. I am not personally aware of ones relating to scam emails. In fact, I would love to have a copy of that one if that were possible. We do heavily alert in the press and to tax agents whenever we are aware of scams. You are probably aware that in previous years we have had people doorknock saying they are from the tax office, et cetera. We promote as strongly as we can that you should contact us to verify the identity of people who are claiming to be from the tax office, and we certainly do not send links to people to click on.

Senator SHERRY—No. Similarly, we regularly see scam bank requests for information.

Ms Granger—Yes.

Senator SHERRY—What puzzled me here is that there is no request for information.

Ms Granger—Yes.

Senator SHERRY—It is the 'click here', and I am just wondering what—

Ms Granger—It is probably what happens after you have clicked.

Senator SHERRY—Yes, fill in—

Ms Granger—If someone could forward that to us we would be more than happy to publicise it.

Senator SHERRY—I will get my office to send it on.

Ms Granger—Thank you.

Senator SHERRY—Is the ATO aware of any cases specifically where people have been caught by scam emails with its—

Ms Granger—Not as far as I am aware.

Senator SHERRY—I have a copy that looks official or certainly the letterhead looks official, but the rest of it is rubbish. Do you have any security measures that enable you to get this sort of material removed?

Ms Granger—I am not sure where people are finding it.

Senator SHERRY—The official letterhead certainly looks like the letterhead.

Ms Granger—Yes. If we can we will follow that up.

Senator SHERRY—I will refer it on. It did come from Hobart. In view of our earlier discussions it might be interesting, given the changes that have just occurred down there.

CHAIR—Perhaps we should talk about Tasmania while we are there.

Senator SHERRY—Did you want to do something on Tasmania?

CHAIR—I would like to go through these figures looking at the ATO staff numbers, which indicate that there has been an increase in Hobart from 421 to 518. Is that right?

Ms Granger—Yes, it is. Would you like me to talk about the activities?

CHAIR—I am sure the parliamentary secretary at the table is interested in this.

Senator SHERRY—He missed the earlier conversation.

CHAIR—Tasmania as a whole has gone from 595 to 577. Is that correct?

Senator SHERRY—I think the parliamentary secretary and I would be more interested in the growth outside Hobart?

Senator Colbeck—I would be interested to hear what is in Burnie.

Ms Granger—I am sure that we can get you those figures. There are two cautions about this data. It is head count as opposed to full-time equivalents, so the mix of ongoing and permanent staff I do not have in here. I cannot tell you, although I do know, that some of this growth is not what we call non-ongoing, so it is not permanent. A couple of observations about analysing ATO staffing numbers is that there are ons and offs each year as new policy comes in obviously and as the commissioner mentioned earlier, also with pay rises, whilst the budget may stay steady the numbers do decrease. The observation that I would make overall about Hobart compared to ATO overall is, with the exception of the June 2006 year, the expansion was higher than ATO at the general level. You will see underneath the numbers we have given you proportions of increase.

CHAIR—Was the head count criterion the same in 2007 as it was in 2004?

Ms Granger—It will vary year to year. For example, if we have particular marketing campaigns we may engage more call centre people on a non-ongoing basis to be able to handle that, so the levels are not entirely predictable. There is not a call centre in Hobart. I am just using that as a generalised example; it could be other things that require more seasonal work. The comparative picture to the rest of the ATO is quite healthy. This does not address the questions that you were asking around the composition of work. This is just simply raw numbers and we will come back to you with the composition of work.

Senator SHERRY—You may not be aware but I do not reside in Hobart; I reside in Devonport. So what I have picked up, and I am sure the parliamentary secretary will pick this up, is that despite on the face of it the impressive figures of increase in staff numbers in Tasmania, at 30 June 2004 there were 74 ATO staff members outside Hobart but unfortunately as of 3 April 2007 that had declined to 59. Do you have any explanation for that?

Ms Granger—No. As I said, these are just raw numbers. We can come back to you with a breakdown generally.

Senator SHERRY—I wanted to turn to the program of pre-filing of tax returns on which there have been some announcements in the budget and there was some fairly extensive commentary around this in the week following budget. Does the ATO have an estimate of the number of taxpayers who would use the system in 2007-08 and 2008-09?

Mr Dark—There are two ways a taxpayer may take advantage of pre-filled information. One is through using the e-tax product, which is a vehicle for supplying pre-filled

information. The other is that if they are a client of a tax agent, the tax agent has access to that same information via a different product, the tax agents portal. Last year we had a bit over 1.6 million taxpayers using e-tax. Something in the order of seven million were lodged via a tax agent. Because the tax agent accesses this information via a report on the portal, we are physically not able to count the number of times that is accessed by the agent. So it is very difficult to give you a straight number.

Senator SHERRY—There has been a \$20 million allocation to the ATO. What is the basis of this allocation?

Mr Dark—In the budget before last there was a \$10 million allocation to essentially start work on this process, so we are into the second year of the \$5 million per year.

Senator SHERRY—I did not recall a specific figure. I certainly recall the issue being discussed, but it may not have been with you.

Mr Dark—Essentially what we have done with that money is to pilot various data sources to make sure that they are useful to clients and that we can get them reliably and present them reliably. The \$20 million allocation in the last budget was essentially to take the next step with that pilot program and turn it into a full production program available to everyone with the expanded set of data that we have now established.

Senator SHERRY—You have gone from pilot to production. What does that specifically involve?

Mr Dark—There is a whole range of work involved in doing that, things like changes to our e-tax products. For instance, payment summary data needs to be received by us electronically rather than on paper from employers. So we are upgrading the facility that employers have to lodge the payment summary data electronically. There are a number of products that are associated with this that we provide via ato.gov, so there is the personal tax record keeper and e-record, which is a product that employers use also to produce payment summaries. So there are updates of those products. There are capacity upgrades at our mid-range servers to supply this data to e-tax. It is not actually one chunk of money; it is about 10 different small efforts that are involved.

Senator SHERRY—That is useful. While we are discussing the breakdown of the moneys, is there going to be any advertising involved?

Mr Dark—It did not include anything for advertising. Every year we do have a general tax time process that we go through.

Senator SHERRY—Yes, we have talked about that.

Mr Dark—We expected it to be included in that message.

Ms Granger—We find in this area, particularly with e-tax, it is relatively easy to get those messages out. In fact e-tax users themselves strongly promote its use. In addition to the things I mentioned before, obviously for tax agents we will be promoting the availability of this facility to them through some special marketing we do to them during tax time and we have newsletters et cetera that go to them separately.

Senator SHERRY—What is the estimated number of Australian taxpayers for whom the system will be available on 1 July 2007?

Mr Dark—The scheduled time for the production version is 1 July 2008. But in 2007, for instance—for anyone who either uses e-tax or uses a tax agent—we plan to have bank interest and managed fund distributions from over 25 financial institutions; dividend distributions from the companies who use three major share registries; Centrelink, DVA and Department of Education, Science and Training payments; and information that facilitates claiming the child care rebate. We continue with the out-of-pocket medical expenses link to Medicare Australia. And we do plan to pilot payment summary details from a payment summary bureau.

Senator SHERRY—What you have outlined there is by no means the full gamut of information that will be required, is it? In order to be comprehensive, wouldn't there still have to be individual taxpayer placement of information from other places?

Mr Dark—Certainly. In some cases, once we do get payment summary data on there, there are a substantial number of taxpayers who essentially report their income and a bit of interest, sign the form and send it in. It would cater for the total return for those taxpayers in that category, but it certainly would not take away the need for them to verify that that information was complete.

Senator SHERRY—You mentioned 1 July 2007 and what is available then. What is anticipated to be available from 1 July 2008?

Mr Dark—It is misleading to say 1 July because a lot of this information in pre-filled terms will not be there until around the middle of August.

Senator SHERRY—August 2008 or August 2007?

Mr Dark—They come in tranches. With the financial year ending on 30 June, we are usually starting to get the bank data around the start of August, so we basically load the stuff in. Payment summary data is not due until 14 August, so as we get it we will load it in. The facility itself is available from 1 July and some of the information is available from then, but the full range of information is probably not going to be there until later in the lodgement season.

Senator SHERRY—I think it was the Treasurer himself who stated that nine million of the 10 million taxpayers will be able to use pre-filling. Who are the million who cannot use pre-filling?

Mr Dark—They are people who do not use e-tax or do not use a tax agent.

Senator SHERRY—How many staff will be required to build—because it does seem to be in the building construction phase—and then to maintain and support the new system?

Mr Dark—It is not actually a new system. It uses components of systems that we already have.

Senator SHERRY—I accept that.

Mr Dark—In terms of differential, it is very difficult to know. For instance, the information that we get from banks and share registries et cetera about dividends and interest, we have been getting for many years. So we have been processing it. It has been a matter of

timing and actually getting this stuff ready to re-present to taxpayers in time. Although it is not an absolute increase in people doing the work, because they were already doing it, you do get increases in things like computer hardware because you have a lot of stuff arriving at the one time.

Senator SHERRY—Has this project had any staffing implications at all? There is a budget allocation for it.

Mr Dark—It is a very small number of people working on it at present. In that \$20 million allocation, I had looked at about \$1 million worth of salary cost being in there. The rest is all upgrades to things.

Senator SHERRY—So it is really a handful of staff?

Mr Dark—And they work very closely with the current e-tax development team.

Senator SHERRY—I will go back to these articles in *The Financial Review*. There was an article on 10 May which reported that the \$10 million announced was to assist with e-tax and pre-filing, to pay for trials in 2007-08 and 2008-09. We have discussed this in some detail already. What is the status of that expenditure to occur, given the Treasurer's announcement that taxpayers will be able to download dividend information from 1 July 2007?

Mr Dark—The facility will be available from 1 July 2007.

Senator SHERRY—But the information is depending on the input source?

Mr Dark—That is right. In 2007 we are only going to have information from three major share registries. In 2008 we plan to have it from all the registries operating in Australia. There is a scale difference, if you like, in terms of the amount of data that is available.

Senator SHERRY—What are the checks to ensure that you have reliable data provided to you?

Mr Dark—We do a variety of checks, not only around making sure we have got the identity of the person to whom we are ascribing the data correct, but also that the data itself looks sensible. For instance, we would not just use TFN as a way to direct the data. We would use TFN and other attributes such as name, date of birth or whatever is suitable for that data. With amounts we do some obvious scrubbing, like looking for included cents. You can build an algorithm around the numbers to know whether the things look sensible or not. The other issue is that most of this data, for instance with dividend or interest data, is actually the same information that has already been sent by that financial institution to the taxpayer, so you get a second filter as to whether they look reasonable or not.

Senator SHERRY—One example that I have been given is that of child-care centres which did not provide information until they had the client's TFN number, which meant the data provided for the year was not complete. The data also failed to pick up information where parents had paid for more than 40 hours a week. That is an example of some difficulties in gathering data. Are you conscious of this potential problem from some source data?

Mr Dark—We certainly are, and we do alert people that this is there as an aid rather than replacing their need to make sure it is correct and complete.

Senator SHERRY—The onus is on the individual to ensure information provided is correct. Is that correct, that they do have to check the information for themselves?

Mr Dark—Yes.

Senator SHERRY—Isn't there a risk that a person using the system could say, 'It has already been prepared for me so it is all okay,' and be less vigilant about the data? Isn't that a risk?

Ms Granger—There is a risk, and one of the things Mr Dark and his colleagues will be doing in the next year is designing what prompts we need to give to people and learning from that. That is why we have done this in pilot mode. The other thing probably worth noting here is that there has been, certainly for as long as I can remember, a groundswell of interest from the community and from the tax profession for us to use this data, which we get and then check as audits and then provide as a prompt upfront, which is what this is designed to do. But we agree with you that we need to look at the design to make sure that we are saying to people quite clearly, 'This is here to help you, to prompt you, and you need to just stop and think to make sure that it looks sensible or accords with the records you have received.'

CHAIR—This information from individuals, where they are relying on others, would come in many forms wouldn't it? With the old group certificate people were relying on the information provided to them that they are submitting to you. I presume there is a level all the way through where information is provided where the individual must have an element of good faith in relation to a large amount of the information that is provided to them?

Ms Granger—That is right.

Senator SHERRY—Will the ATO accept any level of responsibility with regard to the data placed through its conduit?

Mr Dark—We currently have, associated with the products that we use, a thing called the commissioner's guarantee which essentially says—and Ms Granger might like to correct me—that if you diligently follow the process then you will not be penalised as a result of making a mistake. There would be no reason for that level of safety net, I guess, to operate over this because it already does operate over the tax environment.

Senator SHERRY—If there were some incorrect data put in for whatever reason, the ATO is to take an understanding approach?

Mr Dark—Absolutely, but I think it—

Senator SHERRY—If the individual does not pick that up?

Mr Dark—Yes. It is a matter of individual circumstances, so if a bank has recorded an incorrect amount of interest, I think that is completely different from saying no, I only had one job rather than having two.

Senator SHERRY—Yes, I understand that. The Assistant Treasurer, in an article published in the *Canberra Times* on 26 May, said, 'Completing e-tax would take less than an hour.' Presumably he had some material from the ATO about this. Completing in less than an hour would not hold true for those with more complicated tax affairs, would it? It certainly would hold true for most cases—maybe the majority, but not all.

Ms Granger—I think it is going to depend on the level of complexity in the affairs, that is true. At the moment one of the things that takes time is not actually the filling out of e-tax, if you like, but the gathering up of information for that process. This has the potential to streamline a lot of that, certainly.

Senator SHERRY—You are effectively becoming the conduit and partly replacing either the individual's gathering of the data or their tax agent's gathering of the data?

Ms Granger—Absolutely.

Senator SHERRY—Just in theory it is more efficient. You are cutting out a middleman. In the case of a middleman you are potentially reducing their role in information gathering and potentially reducing the information gathering of the individual?

Ms Granger—The costs in time and otherwise of pulling together various bits of paper and reconciling that. The other thing, of course, it allows to happen is not only to pre-populate but to add automatically and do those sorts of things that again can take you some time.

Senator SHERRY—It is somewhat similar to the approach that the ATO has finally adopted—and it is not a criticism of the ATO, because it is a consequence of government policy—of the tax file number solution, sending out the forms for superannuation, automatically notifying people's tax file number, lost superannuation account, here is the form and the transportability; it is somewhat analogous to that. The ATO is gathering the data from the funds and will report it to the individual. Whether they do anything with it is another thing, but it is somewhat analogous to that approach, cutting out the middleman or reducing their role?

Ms Granger—I think that my comments were more directed to what individuals need to do to pull together their records, and whether you are going to a tax agent or whether you are preparing your own return there is a bit of work in putting—

Senator SHERRY—I know what your comments were. Are you familiar with the new approach with the lost superannuation and the TFN numbers?

Ms Granger—Not particularly.

Senator SHERRY—It just seems to me it is somewhat analogous to that—an individual or someone else gathering the material from them from the website.

Mr Dark—When we first conducted our Listening to the Community initiative, that I am sure you heard about ad nauseam I think in 2002, this is one of the messages that individuals gave us, saying, 'You have this information about us. We know you get the bank interest. We know you get copies of payment summaries. We know you get this, this and this. Why do we have to tell you again?' So essentially you are right. It is just cutting out the middleman where we hold the data, and we are giving it back.

Senator SHERRY—Cutting out the middleman—I still have quite a few complaints from tax agents about this and accountants predicting doom and gloom and then in one of my local papers a local tax agent/accountant was wanting compensation for being done out of a job. What has been the response from the practitioners to this; have they been positive or negative? Are they being cooperative or are they worried?

Mr Dark—We have been doing work on this for a couple of years now and we have spoken on occasions to practitioner forums. I would not say there has been universal concern. There has been certainly universal interest in it, in how they might be able to use it to improve their practices, but there have been some expressions of concern and recently with the last announcement I know I saw a comment from one of our forum members wanting to talk about it, so he is obviously concerned, but there were no specific concerns raised. I might mention though, I spoke at a New South Wales CPA conference on Friday to a roomful of CPAs and they did not bring it up. It was not sort of high on their agenda at that stage.

Ms Granger—The main concern that I have certainly been aware of, raised from reading of the same press you did, was around the concern we have already talked about, about whether people just took at face value what was there and did not think about other things they might need to put into their tax returns, which is one of the main values, of course, of seeking tax practitioner advice and that, as I said, is something I think in the design of this and the pilots we will continue to do this year. We need to look at what prompts there should be. One of the things I would be keen to have in the design of the system if we can is, where we become aware of a particular thing that people are getting wrong, we get a little message into the system about that. I would like there to be that capacity. At the same time we want to keep things simple, so if we start putting messages in there about every possibility it undoes the process. It is not intended to replace the value of good tax advice and also judgement, but it can make things a lot simpler.

Senator SHERRY—On a related issue of tax agents, the ATO established a complaint line in February 2007 to allow tax agents to report either unethical or unlawful behaviour by their clients or other tax agents. Do we have any report on what has occurred to this line to date?

Ms Granger—According to my brief there has been, up to and including 12 April, 110 calls. These have been risk assessed and 48 have been escalated for further investigation. Most callers were tax professionals or professionals working in the industry. Their concerns ranged from potential fraud or evasion to an unregistered preparer acting as a tax agent and refusing to release documents without a lawful reason. That is between practices.

Senator SHERRY—Yes.

Ms Granger—Indeed this one again comes under the fraud heading: falsifying details in an income tax return or activity statement.

Senator SHERRY—If somebody goes to a tax agent and they are aware of being given incorrect, false information for whatever reason, would they not have a duty or obligation to report that to the ATO anyway, without having the hotline?

Ms Granger—Yes. This particular line is a specific one for tax practitioners themselves to report issues. We have a general line where you can report your concerns either about an agent or somebody else if you want to.

Senator SHERRY—No, I understand that. How much is it costing?

Ms Granger—I do not have that information.

Senator SHERRY—Is there an evaluation that will be made as to the ultimate worth, the cost effectiveness, of this after a certain period of time?

Ms Granger—We will do an evaluation. The other thing I know you will be interested in, and this is according to my brief, is that we will be putting the findings in a quarterly newsletter as well as on our website, so that will be what comes out of this.

Senator SHERRY—Obviously it is early days, but if there is a report about either unlawful or unethical behaviour by a tax agent, obviously if it is unlawful you have got your own remedies, but if it is unethical—a possible breach of the ethical standards of one of the accounting professions—how would you deal with that in terms of the secrecy provision?

Ms Granger—We are constrained by secrecy provisions in relation to tax affairs. Talking off the top of my head, I think the issue there is that we would need to encourage the caller to contact the professional association, but that is off the top of my head. I can confirm that further.

Senator SHERRY—Yes. It just seems to me there is an issue there with secrecy.

Ms Granger—Yes.

Senator SHERRY—Prima facie you might come to a conclusion: look, this agent has acted unethically; it has been reported to us; prima facie it is a breach of the professional standards of whatever the association is. How you would then convey that is the question. You just do not have a capacity to convey it, it seems to me.

Ms Granger—To professional associations, no. If it is a matter that comes within the tax agent registration, of course the board is available as a context. But, no, we do not have the ability to disclose information to professional associations related to tax affairs.

Senator SHERRY—I have still got a few more questions to ask. Is this a convenient time to break?

CHAIR—It seems like a very good time to break to me. We will resume at eight o'clock.

Proceedings suspended from 6.28 pm to 8 pm

CHAIR—We will resume the hearing.

Ms Granger—Senator Sherry was asking us earlier about an email scam that he had come across. We think we have located the one that you were referring to and in fact there has been a press release out about it. It happened back in March, and Mr Dark can give a little bit more detail on that.

Mr Dark—The release was No. 8 of 2007. It is on the website, if you would like to get it. When we detected it, we firstly prevented access to our website from the spurious one, and then we worked with the high-tech crime commission to have that site shut down and a permanent bar from that site to ato.gov installed, and issued the press release. From memory, it was picked up widely, especially in the regionals.

Senator SHERRY—The one I have received was referred by Duncan Kerr, our federal member for Denison in Hobart. I think he shares a building with the ATO. Were you able to identify the source of the site and the individuals behind it?

Mr Dark—As far as I know, the site was identified. I do not have any detail about whether the perpetrators were identified.

Senator SHERRY—I wanted to come back and clarify a discussion we had earlier about the new e-system for pre-populated tax returns. Is it the case that taxpayers will be able to go online to access an income tax return prepared by the Commissioner of Taxation, including income from salary and wages, interest, dividends, information on private health insurance and any benefits paid from the government, including the family tax benefit?

Mr Dark—I do not believe the family tax benefit information is there. The 30 per cent childcare rebate information will be there, but I do not believe family tax benefit—correct me if I am wrong—is part of an assessment.

Senator SHERRY—What date does the ATO envisage an individual taxpayer will be able to go online and access a tax return that is pre-populated with this information?

Mr Dark—For all of those data sources the facility will be in place from 1 July 2008, but the data itself will be populated from 1 July to the middle of August or whenever we get the particular amounts of data.

Senator SHERRY—It will be, at some point in time after 1 July, all of the areas that I have read out?

Mr Dark—Yes. Perhaps there was one thing to be clarified. With payment summaries, it will only be when the payment summaries have been supplied to us electronically by employers or by bureaus or whoever.

Senator SHERRY—That will vary from supplier to supplier?

Mr Dark—It will. Currently, I think there are about 15 million payment summaries all up and about 2.8 million of those come in as paper. So a lot of them are already electronic.

Senator SHERRY—But it will be various dates from 1 July?

Mr Dark—Yes.

Senator SHERRY—It could be July or September. I have a further issue. I just wanted to examine the scope of data matching that occurs between the ATO and Centrelink. Can any official from the ATO describe what data matching occurs between the ATO and Centrelink at the present time?

Ms Granger—I will have a go. My memory of this is a little out of date.

Senator SHERRY—I have a number of specified questions.

Ms Granger—Perhaps it would be better if we take those on notice and get precise answers for you.

Senator SHERRY—I just wanted to clarify a couple of my earlier questions to Mr Gallagher on the data in respect of the personal income tax cuts. I wanted to clarify so that it was clear for the *Hansard*. Do you recall the conversation that we had earlier involving a series of questions about numbers of taxpayers?

Mr Gallagher—I do.

Senator SHERRY—Could you take those questions on notice for me please?

Mr Gallagher—I will.

Senator SHERRY—I wanted to deal with some issues relating to compliance generally by the ATO. What is the progress on the ATO's compliance programs in dollar terms? Can you give us an update?

Ms Granger—I do not have those figures here with me, but I am happy to take that on notice and provide them to you.

Senator SHERRY—We did have a reasonably detailed conversation about this in the last estimates, so I am a bit surprised that there is no-one here that can deal with it in a bit more detail.

Ms Granger—It would normally be me, but I have literally been back in the country one day, and I have not had a chance to get together some of the briefs I would normally have available.

Senator SHERRY—Would the same apply to the questions about the high-wealth individuals tax compliance area?

Ms Granger—There is a brief in here on that, so I will be able to give you some information on that.

Senator SHERRY—I will just put on notice those questions. What is the level of activity at the moment in respect to pursuit of high-wealth individuals?

Ms Granger—Mr Konza gave you an update in the last estimates, and you were discussing the profiling that we were doing in relation to high-wealth individuals. What I can add to that is where we are up to year-to-date in terms of liability and collections. On liabilities raised: we have already met the target amounts for this year. A little over \$250 million has been raised. Collections are \$137.9 million, and we have conducted 107 risk assessments. I am not sure on the number of audits; I will just check.

Senator SHERRY—Do you have an update on revenue, while you are looking at your brief?

Ms Granger—The liabilities raised are \$257.2 million and collections are \$137.9 million.

Senator SHERRY—As at what dates?

Ms Granger—It just says since 1 July 2006. I am sorry; I do not have a further date on that. This briefing is dated early May so I am assuming that it is end of April, but I will confirm that for you.

Senator SHERRY—What is the high-wealth booklet that the ATO is planning on developing?

Ms Granger—You are probably familiar with the approach we have taken in relation to large corporates, where we have developed a booklet that includes a range of features. It talks about the kinds of areas we would like large corporates to pay attention to in terms of risk and what our approach is to dealing with that and also outlines some of the ways in which we can assist. We are looking to do a similar approach to high-wealth individuals and their associated entities. So it will be a combination of areas of concern that we have and the kinds of questions we would like them to ask their advisers so that they are understanding and appreciating the level of tax risk in various ventures they may take and also outlining our

processes. We want to develop that booklet with advisers to high-wealth individuals in the same way that we developed the large corporate book with tax advisers to large corporates so that it works at a practical level from both their perspective and ours. There is another value in developing booklets like that. It helps us communicate overall the approach we take to compliance with various areas of the community to the community. We are looking at being able to consult on it fairly soon. We have been working on it for a little while now.

Senator SHERRY—When you say ‘consult’, would this be distributed to some high-wealth individuals for feedback before final publication?

Ms Granger—It would go to their advisers more than to high-wealth individuals themselves.

Senator SHERRY—Do you have any idea of the cost of development of the booklet?

Ms Granger—No, I do not.

Senator SHERRY—Perhaps you could take that on notice.

Ms Granger—Yes, certainly.

Senator SHERRY—There has been a great deal of public debate about the tax treatment of water rights. Has the ATO examined and can it provide an update on the tax treatment of water rights?

Ms Granger—I am sorry, we do not have anyone here tonight who can talk to that. Perhaps we can take that one on notice?

Senator SHERRY—Yes. Just briefly, it goes to the issue of the buyback of irrigation licences and the application of capital gains tax in those circumstances. I understand there are some practical difficulties about how it would be calculated and applied. Can anyone here respond to the issue of the ATO’s record on public rulings, because I do intend to raise it with Mr Vos? I did touch on it before.

Mr Quigley—I will be able to address that.

Senator SHERRY—According to the ATO:

Public rulings are the primary means of publishing and disseminating advice on the interpretation of the laws administered by the Commissioner of Taxation ...

A public ruling is one of the possible strategies for resolving a priority technical issue.

A review by IGT found that the ATO has consistently failed to adhere to its six-month limit.

CHAIR—By whom?

Senator SHERRY—IGT. Does the ATO monitor its performance on public rulings and, if so, what are the outcomes?

Mr Quigley—Yes, we do monitor our progress on public rulings. In fact we do that on a monthly basis through what we call our Priority Technical Issues Committee. It is chaired by the Chief Tax Council, and one of the main aims, certainly in recent times, is to improve the timeliness of our rulings. It is true to say that we have not always been issuing the rulings in the self-assessed time frames that we put for ourselves, but we are putting in place and have put in place strategies that will more closely monitor the rulings and also streamline the processes including through the rulings panel processes.

Senator SHERRY—What is your self-imposed deadline?

Mr Quigley—We have a rule of thumb, if you like, that came out of an ANAO recommendation back in 2001-02 and that is, for taxation determinations, that a draft would be issued within three months of being notified on the public program and a final would be issued in three months.

Senator SHERRY—A final after the three months?

Mr Quigley—Yes, after the three months. For a public ruling, which is a much more complex and complicated document, which usually covers a number of different issues, the time frame is six months for a draft and six months for a final. The important thing to bear in mind is that what we are trying to stress and what we are trying to achieve is good project management of the rulings. There are some that are so complicated that basically when you look at them they would exceed those rule of thumb time frames. There are obviously others that are not as complicated, and we certainly strive to issue those earlier than the stated time frames.

Senator SHERRY—What is the approximate proportion that do not meet the three and three months, and the six and six months?

Mr Quigley—In the report to the National Tax Liaison Group there were 55 rulings that were delayed. There were 71 on the program and there were 55 that were delayed, based on that general time frame that I mentioned—38 to issue as a draft and the remaining 17 to issue as final rulings.

Senator SHERRY—That is a fairly high rate of not reaching the cut-off date.

Mr Quigley—It certainly is, and we are taking it very seriously. There are a number of reasons why that is the case, which we could provide to the committee if they so wished.

Senator SHERRY—It just does beg the question: why did you set the parameter at that level?

Mr Quigley—As I said, we followed a recommendation by the ANAO back in 2001-02.

Senator SHERRY—What are the rulings? Obviously there is a complexity around some of them, but what are the reasons?

Mr Quigley—A lot of it is due to the amount of further consultation that we have on the rulings. There is always a balance that we have to come up with between the degree of consultation that we do with the community and also the timely issue of the rulings. We expect that the figure that I mentioned will be significantly improved over the next 12 months. We have got to get through backlogs first and then implement the new strategies that I have spoken about.

Senator SHERRY—Have you had discussions with Mr Vos, the Inspector-General of Taxation, on this issue?

Mr Quigley—We had some discussions on Thursday of last week in general terms and we have follow-up discussions that are scheduled in the last week in June. We did not specifically go down to what rulings are delayed and why. It was a very useful meeting where the inspector-general and the commissioner signed a protocol between the two agencies, and we

are confident that we will continue to work and share a common goal in improving the administration of the tax system.

Senator SHERRY—It seems a bit like a peace treaty to me. Do they sit in their office and agree to disagree, do their best and have witnesses?

Mr Quigley—Are you talking about the protocol?

Senator SHERRY—Yes, the protocol.

Mr Quigley—The protocol is a document that has a common-sense approach about the different rights and responsibilities of both parties and how we will communicate, how we will work together, as I say, to improve the administration of the tax system for the whole of the community.

Senator SHERRY—I would have thought that was a given, frankly, from the ATO's perspective. It would certainly seem to be an underlying claimed approach at every Senate estimates I have been at for a long time.

Mr Quigley—It is, Senator. I am not saying it is not.

Senator SHERRY—Pardon?

Mr Quigley—It is, Senator.

Senator SHERRY—Exactly. That is why I am wondering why there is a sort of peace protocol between Mr Vos, as the inspector-general and—

Mr Quigley—It is not—

CHAIR—You can answer that question on the basis of protocol, not a peace protocol.

Senator SHERRY—There is certainly a protocol. I am entitled to insert the odd adjective.

Mr Quigley—It is important and it is not unusual that we actually document what we agree on as far as processes and communication, and the like, are concerned.

Senator SHERRY—That is probably right in this case, I suspect. You mentioned this meeting took place last week, but there was a report in the *Australian Financial Review* of these issues on 24 April, about four weeks ago. Was there any public document issued at that time that led to this article as to the public dispute coming to the attention of the *Financial Review*?

Mr Quigley—My recollection is that it probably was the tabling by the minister of the inspector-general's report on service trusts where those sorts of issues were touched on. I might add—

Senator SHERRY—It does not make that clear in the article.

Mr Quigley—That is my understanding.

Senator SHERRY—I thought there might have been a leak somewhere.

Mr Quigley—I do not think that was the case.

Senator SHERRY—It just does not source the details of the disagreement between Mr Vos's office and your own office.

Mr Quigley—I am sorry but, if I may, I have the article here. In the article it says ‘the report’, which I think is the service trust report—

Senator SHERRY—Sorry, where is that?

Mr Quigley—It says, ‘From page 1’.

Senator SHERRY—I am looking at page 4; that is my article.

Mr Quigley—It probably is page 4. It is from page 1. It is a 26-page—

Senator SHERRY—Okay. I have only got page 4.

Mr Quigley—I have got 1 and 4 on the one page, Senator, I am sorry.

Senator SHERRY—Is this dated Thursday, 26 April, the one you are looking at?

Mr Quigley—It is. And I think it is on page 4 in the first column, and about three-quarters of the way through it says, ‘Report released by Revenue Minister Peter ...

Senator SHERRY—Sorry, you are right. It is late in the evening and I had not picked up the ‘report says’. Thank you. We will get Mr Vos’s views on this shortly, I am sure.

I want to go to the issue of total tax debts. I notice that it got a reasonable degree of media coverage yesterday and some in the electronics today. There is a program in the budget where the ATO has been given an extra \$125.7 million over the four years to improve the collection of tax debts. Can you give me an outline as to how these additional moneys will be utilised? In which areas—resourcing, staffing, focus, those sorts of things?

Ms Crawford—I guess fundamentally the focus of the funding is on age debt and the collection of super guarantee charge debt. I think we have discussed before that our strategy at present has been relatively successful in focusing on early intervention, actioning new escalating and high value debt. However, while we think that has been relatively successful in getting a large number of taxpayers to work with us, there are still debts that remain outstanding over time. So, as I said, this funding will be used to target age debt and outstanding super guarantee charge owed by employers. The funding will also assist us to continue to use the new approaches that we trialled last year, including referral of debt and also the use of dialler technology.

In terms of more detail, it is \$125.7 million over four years. That is broken down as follows: \$32.8 million in 2007-08; \$32.7 million in 2008-09; \$32.4 million 2009-10 and \$27.8 million in 2010-11. Do you want further breakdowns in terms of the spending of that money? I can give you staff numbers and—

Senator SHERRY—Perhaps just the staff numbers at this stage.

Ms Crawford—In relation to targeting age debt, about \$40 million of that total will be spent in that area and that will mean that in the first year we will employ an additional 35 staff, increasing to around 150 in year two and continuing on. It is intended that in the first year we will do a lot of work around breaking down the data so that we can really be very targeted in our actions. A lot of the work in year one is really in analysing our cases so that we can focus on those over the following three years. In relation to super guarantee charge debt, there is an amount of \$29 million to be spent in that area. Our intention there is to increase our

staffing of specialist super debt collectors by 139 in year one and then 75 for each of the following three years.

Senator SHERRY—Sorry, I am not quite following that. The staff numbers, increasing by 75—

Ms Crawford—Increasing by 139 in year one and then an ongoing level of 75 in each of the following three years. That is additional to the staff that we currently have employed in that area. The reason for that is that in year one we will be targeting both new super guarantee charge debts as well as older debts. That is why there is additional staff in the first year. It is really trying to tackle that early debt in that area and then focus our effort on the older debt.

Senator SHERRY—How will they be targeting it—in the traditional ways we were discussing earlier or are there new approaches?

Ms Crawford—As I said, we will be extending the approaches that we trialled last year, in particular the referral of debt to external agencies and also extending the use of the dialler technology. In relation to super guarantee charge debt, our intention—because we are not there yet—would be to refer some of that to external collection agencies. In that way we will be able to extend the coverage to lower amounts of debt that we are really struggling to get to today. Our intention is to go down to amounts exceeding \$100.

CHAIR—Historically have you send this work out to external agencies or is this new?

Ms Crawford—It was a new initiative trialled last financial year, which we have reported on to this committee previously, and the trial was quite successful. We were talking about low-value debt. It really is debt that normally our own staff would not probably get to because we tend to focus on the high-value debt. It helps us to extend coverage. But it is relatively simple and so the arrangement with the external debt collector is really just to make the contact and then the payments are actually made to the tax office.

CHAIR—Is it to simplify the question enough to ask what the success rate of the external aggregate is compared to internal, or are they different markets with different dynamics?

Ms Crawford—We consider that that trial was quite successful. It is difficult to compare the two things because we are talking about a quite low level value of debt. But we have found that the payment arrangements, for instance, that were entered into had been quite sustainable, I guess, relative to some of the other arrangements that we have entered. We are not exactly sure why that is, but it has been quite successful.

Senator SHERRY—You mentioned the extension to the superannuation guarantee debt?

Ms Crawford—Yes.

Senator SHERRY—That has not occurred yet?

Ms Crawford—No.

Senator SHERRY—But it will occur? Do you have any idea of the timeframe for that extension?

Ms Crawford—That funding is for the period commencing 1 July of this year.

Senator SHERRY—The arrangements are being discussed at the moment and presumably kick in in four or five weeks?

Ms Crawford—We have a tender out at the moment for external collection agencies and we would hope to have arrangements in place early in the new financial year. That is not just for super guarantee charge debt; it is for debt collection generally. But our intention is to use that, at least in part, to help us to get to the smaller value of super guarantee charge debt. There is also funding available of \$9 million to extend the dialler pilot that we also initiated last year. That money is, in part, capital, but it is also for some additional staff to support that. The dialler technology, again, has also been successful in extending the number of taxpayers we can contact within our staff resourcing. In essence, I think that is the plan.

Senator SHERRY—Following on from your outline, I have a number of questions in this area which require a fair amount of detail, so I will put them on notice. In the area of outcome appropriation and each output, can you provide details of the unspent funds against the 2006-07 budget, including the 2006-07 additional estimates and funding requests?

Ms Granger—We will take that on notice.

Senator SHERRY—What happens to unspent amounts? Do they lapse at the end of the financial year or are they rephased or reallocated across the forward estimates?

Ms Druhan—They do not lapse at the end of the financial year.

Senator SHERRY—So what happens?

Ms Druhan—They remain effectively unspent.

Senator SHERRY—Are they carried over?

Ms Druhan—They carry over to the extent that an agency could request to run at a loss in a subsequent year, but that requires the approval of the Minister for Finance.

Senator SHERRY—Are you able to provide me with an approximation of the current list of the 10 biggest underspends?

Ms Druhan—I would have to take that on notice.

Senator SHERRY—Do you have any idea of the figure of the approximate total underspend?

Ms Druhan—For the 2006-07 financial year?

Senator SHERRY—Yes.

Ms Druhan—We are anticipating an underspend at this point which could be in the order of \$50 million. We have written to the Minister for Finance on that.

Senator SHERRY—Okay. I will put the rest on notice. Has the ATO carried out any investigations into overstating income on loan application forms, particularly so-called low doc application loans?

Ms Granger—Yes, we had a project we started, from memory, either two or three years ago. I do not have details here of that, but we found a few interesting things out of that process. We mainly found it was useful to target nonlodgements in the system altogether. In terms of omitted income of those who had lodged, it was relatively low numbers for that but

we did, as I said, identify nonlodgement as an issue. We also found that we were better off getting information not so much directly from banks but from the loan brokers who would assist you with that. I think we had moved onto looking at collecting information that way in relation to it. I do not know what the current status of that is. If you would like the current status, we would have to take that on notice.

Senator SHERRY—Mr Carmody had made a number of comments on the record about aspects of this area back in 2005.

Ms Granger—It was part of a broader approach we have been developing about other sources of information and other data matching we can do to identify those who are out of the system, or partially out of the system. For example, another project you may have heard about is some of the matching we are doing around luxury cars, or registration of boats et cetera?

Senator SHERRY—Yes.

Ms Granger—It is a similar principle, so we do tend to switch that around a little bit. And it is intended, as I said, to identify those who are outside the system or potentially cash economy type activities by looking at, if you like, sources of wealth or other means of identifying that people had income or assets available that are not commensurate with how they are filing their returns.

Senator SHERRY—Have you had any liaison with either ASIC or state regulators in the area of mortgage brokers who, in many cases, provide low doc loans?

Ms Granger—I am not sure if we have had specific discussions in relation to that. I would have to check.

Senator SHERRY—But you are obviously aware of the general issue of overstating income on loan application forms?

Ms Granger—Yes. I would make another observation—this was again back to that period of two years ago and last year—certainly in a number of cases the overstating of income on the forms was not an understating of income for tax purposes.

Senator SHERRY—Does the tax office have any observations on the repossession rates on homes in this sector?

Ms Granger—I am not aware of any analysis on that.

Senator SHERRY—The reason I raise that is that Australia's biggest private debt collector, Prushka, is reported in the *Australian* as saying:

... three-quarters of sales forced by bank and non-bank lenders were co-ordinated with the consent of home owners, meaning they were not recorded in court repossession figures.

The default repossession is not an issue that you have had any experience of in this area?

Ms Granger—I am not aware of any analysis we have done in relation to that.

Senator SHERRY—I have a couple of questions in the revenue area of retirement income. I just wanted to go to a couple of issues relating to the proportioning rule. Is anyone able to help me with that? It arises from the 2006 budget changes.

CHAIR—Mr Lonsdale, would you mind moving your name tag slightly to your right? Thank you.

Senator SHERRY—I think it was turning you into ‘Lionsdale’, not ‘Lonsdale’.

Mr Lonsdale—It could be worse.

Senator SHERRY—We will see how the lion roars. There are some issues of contention around the proportioning rule. Are you aware of the issues of contention? I did raise them in the public sector super area of finance last week.

Mr Lonsdale—There are a number of issues around on the proportioning rule. Are there particular ones that you wanted to address?

Senator SHERRY—Firstly, on 10 April Mr Dutton put out a press release reassuring Defence personnel that:

These Regulations will not change existing benefit options currently available to DFRDB members or the tax treatment of any commuted lump sum benefit from 1 July 2007.

Are you aware of that press release?

Mr Lonsdale—Yes.

Senator SHERRY—Following on from that press release, does that mean that DFRDB members are exempt from the effect of the proportioning rule? What is their status going to be?

Mr Lonsdale—If I can just address it at a higher level?

Senator SHERRY—Sure.

Mr Lonsdale—The proportioning rule governs how benefits are to be drawn down, and when you are looking at untaxed schemes, or tax for that matter, there will be different components. There will be a tax-free and a taxable component. When a member draws down those components, they must be drawn in proportion. That will happen regardless of whether we are talking about public servants or Defence Force personnel or anybody, so that proportioning rule applies right across the board. In respect of Defence Force personnel, there might be specific fund issues that are areas of contention and I am not sure that they relate directly to the proportioning rule.

Senator SHERRY—After the application to DFRDB members after 1 July, will they be any worse off in respect of their tax treatment of superannuation?

Mr Lonsdale—The application of the 10 per cent rebate, and that is on pensions being drawn down, will make people in untaxed schemes better off than they are at the moment.

Senator SHERRY—Yes, I understand that. Will the proportioning rule still adversely impact on them despite that change?

Mr Lonsdale—The minister put out a press release. I think that was pretty clear on the issue of that particular scheme. There are a lot of schemes that are quite different in how they operate.

Senator SHERRY—Just before we go to any other schemes, just conclude on this DFRDB area. Have there been investigations to examine individual circumstances of DFRDB

members to ensure that none of them are disadvantaged? Did you go to the scheme and obtain information and have liaison with them about possible misunderstandings in this area?

Mr Lonsdale—We have had discussions with a number of untaxed schemes.

Senator SHERRY—Including the DFRDB?

Mr Lonsdale—I would have to check that, but I would be surprised if we have not.

Senator SHERRY—Have the regulations in this area been finalised?

Mr Lonsdale—Yes.

Senator SHERRY—They were, were they not? Yes. Coming to the questioning in the finance committee last Wednesday, the 23rd, Mr Markovic of ComSuper stated that under these new regulations:

... for earlier payments there will be a higher amount of tax paid ...

Do you agree with Mr Markovic's assessment?

Mr Lonsdale—I would have to have a look at his remarks.

Senator SHERRY—You have not had them drawn to your attention at all before tonight?

Mr Lonsdale—We have been in discussions with ComSuper and also the tax office as well in relation to the application of the proportioning rule, but I have not read the transcript that you are referring to.

Senator SHERRY—Because he is saying that where earlier payments occur in some circumstances there is effectively a higher amount of tax paid.

Mr Lonsdale—As I said, we are examining a range of issues and I think at the heart of it it does very much depend on how the law is applied and particular circumstances of different schemes.

Senator SHERRY—There is still ongoing discussion around this issue; it is not finalised yet?

Mr Lonsdale—We are speaking, as I said, with the tax office and with ComSuper, firstly to establish whether indeed there is an issue and then if there is, to see what can be done about it.

Senator SHERRY—I understand that, at least in the case of the defence forces, there have been indications that Defence Force personnel intend to retire before 3 June in response to what they at least perceive will be a higher tax treatment. Are you aware of that?

Mr Lonsdale—That people may be retiring before 3 June, did you say?

Senator SHERRY—No, it is not all I said. I said by 30 June in response to the perceived threat of a higher tax treatment. Has that issue been communicated to you?

Mr Lonsdale—As I said, there are concerns. There are issues that have been put to us around the proportioning rule, which we are examining.

Senator SHERRY—Are you able to guarantee the committee that there are no personnel who will be worse off as a result of the proportioning rule as outlined to date in its application?

Mr Lonsdale—As I mentioned earlier, it really depends on what your benchmark is. Under simpler super, people in untaxed schemes, including this scheme, will receive a 10 per cent rebate on pensions and will be better off than under the current arrangements. In relation to the application of the proportioning rule, we are examining whether any issues exist. That is not clear yet.

Senator SHERRY—It is going to be desirable to clear this up by 1 July, is it not?

Mr Lonsdale—We are working as quickly as we can.

Senator SHERRY—That does not tell me much though. It does not really give me a lot of assurance. Is it desirable to get this resolved, however it is resolved, by 1 July, so people clearly understand what their entitlement is to be?

Mr Lonsdale—We are doing our best to resolve any issues as quickly as we can with the affected parties and the earlier we can do that, obviously, the better.

Senator SHERRY—I have a couple of other issues. We have discussed the tax treatment of non-super additional income for those in untaxed schemes at a previous estimates. You are aware that the non-super income at aged 60 is different from taxed schemes?

Mr Lonsdale—Yes.

Senator SHERRY—There has been some discussion around that. I asked at a previous estimates committee, I think, for more detail as to the calculation of the 10 per cent rebate approach and was refused. Was the issue of this consideration of tax treatment of non-super income at aged 60 part of the same formula calculation for the 10 per cent rebate?

Mr Lonsdale—I am not sure I am following the question.

Senator SHERRY—At previous estimates I went to the issue of how the 10 per cent rebate was calculated.

Mr Lonsdale—Yes.

Senator SHERRY—You refused to give me the basis of the formula, the calculations and the assumptions. I cannot remember whether it was you personally, but it was not provided to me. I am not going to get it, at least not for the moment. I might get it at the end of the year. The issue has also been raised of the tax treatment of non-super additional income for those people aged 60. Was the assessment of that treatment part and parcel of the issues considered around the 10 per cent rebate?

Mr Lonsdale—Yes.

Senator SHERRY—Are you able to release publicly the consideration, assumptions and calculations around that element: the tax treatment of non-super additional income for those who are on tax schemes at aged 60? Are you able to release that publicly?

Mr Lonsdale—I would have to take that on notice and just see exactly what analysis there is. If you would like me to do that, I am happy to.

Senator SHERRY—Thanks.

CHAIR—Does that form part of any advice to the minister?

Mr Lonsdale—It could well have. It probably did.

CHAIR—On that basis then there would be no requirement for you to provide that information.

Senator SHERRY—We regularly do not get stuff that does not form part of advice refused to us, so I am not sure you are make any advances with that declaration, Chair. In this area of the tax treatment at age 60 for non-super additional income, did Treasury carry out any specific costing were that applied in respect to tax schemes, and the loss to revenue?

Mr Lonsdale—I would have to check that.

Senator SHERRY—Are you aware of the Senate Standing Committee on Economics recommendation in response to the inquiry into the Tax Laws Amendment (Simplified Superannuation) Bill that recommended non-super income be treated separately for tax purposes?

Mr Lonsdale—Yes.

Senator SHERRY—Are you aware that that was a unanimous recommendation, including from government senators?

Mr Lonsdale—Yes.

Senator SHERRY—Do we have an anticipated date for a response to that recommendation yet?

Mr Lonsdale—Not that I am aware. The government is considering its response to the committee's recommendations.

Senator SHERRY—Would you agree that the different tax treatment of military superannuation pensions compared with superannuation pensions from a tax source—

CHAIR—That is a policy question, I would have thought, and on that basis I do not think Mr Lonsdale would be required to answer.

Senator SHERRY—Let me go to the issue of the incentive impacts considered as part of the package. On the incentive impact for retirees to participate in part-time work as a consequence of the treatment of tax schemes, was it factored in that their income at aged 60 would be a reduction in incentive for retirees to participate in part-time work?

Mr Lonsdale—I am sorry, I missed the last part of the question.

Senator SHERRY—In terms of participation in part-time work, was that factored in? Effectively, it is a disincentive to engage in part-time work.

Mr Lonsdale—The way that the 10 per cent rebate was formulated was to try and get commensurate treatment with taxed funds overall. It was very difficult to deliver the same benefit for every individual on every income level, taxed versus untaxed, and that is what drove the 10 per cent rebate.

Senator SHERRY—But 10 per cent by its nature is one figure. Effectively, there had to be some form of averaging for simplicity's purposes, if you had to come up with one figure, which you did. We have not seen how it is calculated, but by definition it seems to me there must be some advantaged and some slightly disadvantaged in that approach?

Mr Lonsdale—It produces different effective tax rates for different income levels.

Senator SHERRY—Is there any data on the total or average amount of non-super income earned by DFRDB, MSBS, PSS and CSS pension and superannuants?

Mr Lonsdale—I am not aware of that data.

Senator SHERRY—There was nothing considered in the context of the issues we have been discussing in examining the package?

Mr Lonsdale—Specifically for Defence personnel?

Senator SHERRY—Not just Defence but also former public sector employees in the PSS and CSS

Mr Lonsdale—I am sure we would have looked at the untaxed sector as a whole and would not have disaggregated different schemes.

Senator SHERRY—Given what you have said, there have been no new estimates prepared on costings relating to changing the tax treatment of non-super additional income at age 60 for pension members of these schemes?

Mr Lonsdale—I think that goes to policy advice.

Senator SHERRY—No, I am not asking you for the advice. I am just asking whether or not there have been figures prepared or costed in this area.

Mr Lonsdale—We cost options all the time.

Senator SHERRY—Has this option been costed?

Mr Lonsdale—I would have to check.

Senator SHERRY—Are you sure you do not know?

CHAIR—Again, if—

Mr Lonsdale—As I said, we—

Senator SHERRY—No, if he says, ‘Yes, it has been costed’, and I went the next step and said, ‘Where is it; give it to me’, I accept I couldn’t go that far. It is just a matter of whether it has been done.

Mr Lonsdale—I am happy to check, Senator, and come back.

Senator SHERRY—Sorry, your wording, ‘I am happy to check, Senator, and come back’, still indicates to me that you do know that it has been done. Has it been done or not?

Mr Lonsdale—As I said, we do a lot of costings and I would have to check. I am happy to take it on notice and come back and tell you whether we have done a costing on that or not.

Senator SHERRY—Could I just come to another aspect. It is, to some extent, related to the *Intergenerational report* too. I just had a couple of matters I wanted to raise. Obviously the assets test—

CHAIR—Sorry, Senator. I thought there was a request that these *Intergenerational report* matters be deferred.

Mr Callaghan—The agreement was that the *Intergenerational report* matters would be done with the fiscal group.

Senator SHERRY—Just so long as I do not get caught. I notice Mr Gallagher pacing the floor. He must have some knowledge of what I am about to ask. Just so I do not get caught out in this arrangement—

Mr Callaghan—He will be here when they are all done in the fiscal group.

Mr Gallagher—I am coming to the fiscal group.

Senator SHERRY—We will leave it then. That is fine. When are we doing the fiscal group? It is not tonight, is it?

Mr Callaghan—Thursday.

Senator SHERRY—Mr Gallagher has the joy of coming back in a couple of days. I think that is about it.

CHAIR—I thank officers from revenue and the ATO.

[9.01 pm]

Inspector-General of Taxation

CHAIR—Welcome, Mr Vos. You have been here on sufficient occasions for me not to have to read out the opening statement again, I assume?

Mr Vos—That is correct, sir.

CHAIR—Do you have an opening statement you wish to make?

Mr Vos—No.

Senator SHERRY—Now, we had a discussion earlier with the tax office about the performance monitoring of rulings and the ATO outlined to me the three-month draft, the three months and then the public ruling six and six. I must say I was a bit disturbed to hear that on the three and three, of the 71 rulings, 55 have not been completed within their time frame. They were the numbers they gave us. It is a little unclear as to some of the effective time lines there, but it did seem to me to be a significant figure. You have made some observations about the ATO's performance in this area, Mr Vos. Can you just briefly outline your perspective on this challenge for the ATO?

Mr Vos—We did a review, quite some years ago now, dealing with the time taken to complete an audit. In that respect, we came across a number of cases where complex technical issues were taking too long to be finalised. So we undertook to do three case studies. One in respect of service trusts, one in respect of living away from home allowance and one in respect of R&D syndication. The service trust was the first one released by the government and that was the one that was released in April. In that, we had identified that the tax office, from the time that they had identified and announced to the public that there was a compliance risk in respect of service trusts, took something like eight or nine years before they issued a final ruling. In the case from the draft to the final, that was 12 months and there was a 12-month period, I think, before that before they issued the draft. So it was in that context that we thought if this is what they are doing with service trusts, what were they doing across the board? And the reference was made in passing, as a secondary recommendation, to identify that they needed to lift their game in respect of managing their process of dealing with public rulings.

Senator SHERRY—From your observations to date have they lifted their game?

Mr Vos—We have not had a chance to review that. I was somewhat surprised to hear the stats reported by the second commissioner. We are only reviewing at the moment the recommendations that we made up and to our litigation report, which I think was about our sixth or seventh report, and we are going back and reviewing all of the recommendations before that. We spent the last 12 months working on that and we are getting close to finishing that. It has taken, in some cases, a lot longer than I would have thought necessary for the tax office to change the obvious thing that they accepted, in whole or in part, that needed to be changed. I am not involved with the identification of resources and resource management—that is, the commissioners and the tax office across the board—but we are looking at that for the earlier reviews. We have not started to look at the later ones yet.

Mr Matthews—I think I may be able to offer some facts in response to your specific question to add to Mr Vos's response. In the 2003-04 year the ANAO report, which Mr Quigley referred to earlier, found that two-thirds of 21 rulings then had not met the six months and six-months time line standards. Our review found that for 2005 and 2006, in both of those years, only 50 per cent of draft public rulings and 50 per cent of final public rulings had met the internal time line standards. I think, while I did not actually work out the percentage, the numbers that Mr Quigley gave tonight probably would show that somewhat more than 50 per cent have not met the time lines. I think that is probably the short answer.

Senator SHERRY—You had a meeting with tax commissioner—was it last Thursday?

Mr Vos—That is correct.

Senator SHERRY—Can you just outline its nature? This was to sign some sort of protocol?

Mr Vos—That was a very small part of the total session. You may recall that there was a fair amount of press towards the end of 2006 indicating that the commissioner and I were not getting on well together. As a result of the apparent differences that seemed to be out there, the commissioner and I agreed that we ought to meet quarterly—not one on one but almost one on one, just with our main supports—to seriously consider issues that may be blocking our working together. The meeting took place, as was said, last Thursday and the next one is set for June. But they are free-ranging, open, frank and very worthwhile discussions. They tend not to get down to a lot of detail, but at least we are putting on the surface the concerns that each of us need to deal with within our office. So they are almost like a steering committee type arrangement where we are looking for risks of things falling over or not being able to get done. In reality, the relationship in getting information out of the tax office has, over the last 12 months, been quite acceptable. We are moving through and finalising a number of reviews. If you looked at our time to complete reviews over the last four years, there is no necessary evidence that it is getting worse. We are getting more complicated reviews and they are certainly taking longer. They have gone from an eight-month to a 10- or 11-month cycle time from the time we issue our terms of reference to the time we submit our report to the minister.

Senator SHERRY—You mention you have now got regular scheduled quarterly meetings with the tax commissioner. Do you pick up the phone and talk to each other from time to time, or is it just these quarterly meetings?

Mr Vos—When necessary, yes. The thing to note is that as the tax office is a very large organisation it seems more appropriate for me to interface with the particular second commissioner that is responsible for the area that I am reviewing. So if I am reviewing compliance, the second commissioner, compliance, will link in with me; if it is a legal issue the second commissioner, law, and so on.

Senator SHERRY—And you have full cooperation from the ATO and the commissioner to operate to that level?

Mr Vos—Absolutely.

Mr Matthews—In fact the protocol that was signed last Thursday sets out just that sort of thing and says that the tax office will appoint a second commissioner to be responsible for each one of our reviews and other detailed arrangements about how they will go about—

CHAIR—It was very constructive going forward.

Mr Vos—It was. We had a situation on one meeting, for instance, where a particular second commissioner attended and was able to talk on our findings, but because that person had not met with the commissioner they were not able to discuss the recommendations. That held us up because we had to then wait to find the time. Because the commissioner is very busy—he is doing a lot of travelling, doing speaking and other things—it is appropriate that I deal with the second commissioner and not feel as though I must do everything agency head to agency head.

Senator SHERRY—So you are able to go down to the next level, if you like?

Mr Vos—Correct, and he has now created in his delegations a delegation to authorise the second commissioners to act in his stead in dealings with me. So all of the niceties, if you want to use that word, have been put in place to deal with that.

Senator SHERRY—I understand the practical convenience of this new arrangement. I just wonder why it had not been arrived at earlier.

Mr Matthews—I think, having joined the inspector-general in between the two protocols, there was a protocol signed very early in the piece, I think the new protocol reflects a maturing of the relationship and a better understanding through experience of what is actually going to be involved in undertaking reviews and the best way to make them work. So, because of that, the new protocol was arrived at very swiftly and amicably because essentially it was reflecting the sorts of things we had come to understand would make things work well.

Senator SHERRY—Okay. On that happy note I might conclude my questioning. Thank you.

CHAIR—Mr Vos, I do not know whether I will be in this chair next time we have these hearings. I do not know when they are going to be, but I have had a chat to the secretary—

Senator SHERRY—Looking forward to being a minister, are you?

Senator Minchin—I was going to say you would be expecting a promotion.

CHAIR—I am actually, yes.

Senator Minchin—Let us hope it is true.

Mr Vos—I guess interstate travellers would like to be either on first thing in the morning or know that they are on at a particular time so that they can organise their day with other meetings and things if necessary.

Senator SHERRY—We do endeavour to meet those requests, do we not?

CHAIR—Yes. We are happy to do that.

Senator SHERRY—Thank you, chair.

CHAIR—The next time you meet with us one of my Liberal Party colleagues is chair or myself, then we will accommodate that.

CHAIR—We might have a short break.

Proceedings suspended from 9.17 pm to 9.30 pm

Australian Prudential Regulation Authority

CHAIR—Welcome to APRA. Do you need me to go through the normal opening statement that I give in these situations or are you sufficiently au fait with it?

Dr Laker—We are regular visitors, so I am quite happy.

CHAIR—Do you wish to make an opening statement?

Dr Laker—No. I am quite happy to go straight to questions.

Senator SHERRY—I will go straight to the two budget measures that relate to APRA. They are detailed on pages 302 and 303 of Budget Paper No. 2. The first was the \$22 million over four years to continue to support maintenance of high levels of specific industry expertise, provide a focus on regulating emerging threats to financial stability and the fundings recovered through levies. The second is \$24.1 million over four years to address the increased complexity of the financial services sector that APRA is required to regulate and monitor to continue to maintain required levels of specific industry expertise. Could you give us an outline of each of those two measures? What are these regulating emerging threats to financial stability? Secondly, could you deal with ‘continue to maintain required levels of specific industry expertise’? That may be a reference to additional staffing or salaries, but can you give us an overview of those?

Dr Laker—Certainly. The main focus is the second of those because that was a new policy proposal for which we had government support. As you know, when we have appeared before the committee before we have discussed with you the difficulty of recruitment and retaining staff in a very competitive market for financial market skills. We have found in that process that in our lower to middle level staff the remuneration we were offering was moving further away from what the market was offering. We do not attempt to match that market fully but we need to keep in touch with it. It was no coincidence then that our turnover was high as well in the junior to middle ranks of our staff. The new policy proposal is designed to give us the chance to better recruit and better retain staff, focused mainly on that lower to middle rank. Included in that is enhancing our training. We commit ourselves quite substantially to training

but we need to work very hard, given a complex and ever changing financial market, to keep our staff skills up to scratch, so part of that new policy proposal will be to enhance the skills that we have in our staff and that we acquire through this process. In a nutshell, it is about being able to retain the good staff that we have and to bring on board the skills, expertise and the industry nous that we need as well. As I said, it is a problem that we have discussed with you before. We have made good progress in the last little while in clawing back some of the losses that we experienced in the middle of last year, but it is one where we have to keep working hard all the time.

Senator SHERRY—Just on the issue of training, do you exclusively conduct your training internally or do you use any external training providers?

Dr Laker—We have a blend of both. We have developed in-house quite sophisticated and comprehensive training programs that are targeted to the work that we do so that we can bring our new staff up to speed quite quickly. We use specialist training courses run by professionals and others that meet our particular need. The training that we have developed is regarded as very high quality. We make it available to other agencies. We make it available to regulators offshore as well.

Senator SHERRY—Do you make it available to any of the private sector institutions in Australia, or you just do not compete in that space?

Dr Laker—That is not something that we have turned our mind to.

Senator SHERRY—There has been a bit of a focus recently on the ownership of private sector training providers. You may or may not be aware of some of the changes that are occurring. Kaplan are a major international provider. Which private sector providers do you use? Do you use FINSIA and ASFA at all?

Dr Laker—Not ASFA. We have worked closely with FINSIA. We are contributing to their magazine as well with a series of articles about what we do. We have had a good relationship with FINSIA for some time now.

Senator SHERRY—Are you aware of the training ownership issue that has emerged there?

Dr Laker—Yes.

Senator SHERRY—This is a side issue, but do you have any role in overseeing the regulation in any way of training providers?

Dr Laker—Training providers?

Senator SHERRY—Yes. Is it a space for APRA at all?

Dr Laker—No.

Senator SHERRY—The first area that I referred to, being the focus on regulating emerging threats to financial stability, what are the examples there? I know we have touched on this.

Dr Laker—That is an extension of a program that was provided some years ago, post-HIH, to build up the capacity of APRA. That was really the first instalment of that initiative before our time to improve our resources and to improve our diagnostic skills. It was really to

sharpen our ability as a prudential supervisor. It has been rolled over to sustain our activities at the level. As I said, my focus has been on what was the new policy proposal. The other is really a continuation of business as usual for us.

Senator SHERRY—Just coming to the powers of APRA, it was recently announced by the Treasurer that he was going to introduce legislation to curb APRA's ability to directly disqualify directors that it considers unfit to run a superannuation fund. I do not want to go through the issues because we have discussed them before. Does APRA support the response for that foreshadowed legislative change?

Dr Laker—Yes. We have welcomed that change.

Mr Jones—We publicly commented that we were informed of the changes and that we did support them. The dilemma we had was with administrative processes. From our perspective we had a few issues that we hoped this would resolve by having more open processes and that was something we supported right from the start.

Senator SHERRY—I have not seen any amendment yet. It may have been contained in a bill. Do you have any knowledge of when the legislation is to be presented?

Dr Laker—There is a package of legislation which is a response to the streamlining prudential regulation proposals.

Senator SHERRY—I saw that last week.

Dr Laker—That is fairly close to coming forward.

Senator SHERRY—Is it in there?

Dr Laker—It is one of the responses to the Productivity Commission's report, the Banks report.

Senator SHERRY—The parliamentary secretary tabled some legislation last week, a package of bills.

Dr Laker—The next stage is a second discussion paper which will go out in response to the submissions that came in, and that will address that particular change as well. The discussion paper is imminent.

Senator SHERRY—There is one issue that I want to raise. I am fairly sure it is not your responsibility, but you may be in a position to comment. In the context of Westpoint and Fincorp there has been some recent comment about the role of the trustee entity, in this case Sandhurst Trustees, who are the trustee entity. Do you have any role at all in the regulation of those trust entities? My understanding is that it is primarily, if not exclusively, a state responsibility. Can you indicate if you have any knowledge of this?

Mr Jones—Sandhurst Trustees has an RSE licence because they are a subsidiary of Bendigo Bank and they run a bank related public office superannuation fund. That is one element of their business. They have an RSE licence from us in relation to that superannuation part. The other elements of their business are unregulated by APRA.

Senator SHERRY—As I understand it, these are state regulators. Is that correct?

Mr Jones—There are. It would be state administration subject to Victorian regulation, given it comes out of Bendigo Bank.

Senator SHERRY—It has mainly been an area for ASIC. At estimates and the oversight we have looked at Westpoint and Fincorp. I am not aware that anyone has examined this issue of Sandhurst. Have you been examining the state regulation at all in this area?

Mr Jones—No, we have not, because it has nothing to do with us.

Senator SHERRY—I understand that. But in the context of the controversy around Westpoint and Fincorp, Sandhurst has been identified as the common trustee.

Mr Jones—Naturally, as part of our normal course of activities when we see these sorts of things in the newspaper we would immediately go back to the entity that we have responsibility for and have some discussions.

Senator SHERRY—Have you had some discussions with them?

Mr Jones—We have, yes.

Senator SHERRY—As a consequence of that?

Mr Jones—Yes, but again related solely to the RSE licensee and not to any other element of it.

Senator SHERRY—It is sort of an alert or question mark—we had better check where our area of responsibility lies just to reassure ourselves. Is that it?

Mr Jones—It is more a case of making certain that we have a good understanding that the activities that fall beneath the RSE licensee are still being undertaken appropriately.

Senator SHERRY—I do not know who the regulator would be in this area. Would it be the Victorian Attorney-General's Department?

Mr Jones—It is under the Victorian Trustee Companies Act. I am not quite sure which department would take responsibility.

CHAIR—The answer to the question is no if you do not know who it is.

Mr Jones—Okay.

Senator SHERRY—We have touched on the issue of offshore foreign insurers occasionally. Where are we up to with the granting of limited exemptions?

Dr Laker—The government has announced its framework for handling direct offshore foreign insurers, or DOFI, as we have called them. We are now about to produce a consultation paper for industry setting out how we would propose to implement those proposals. They foreshadow a regulatory regime which is tailored to different types of insurers. We need to talk to industry about how that would work in practice. We have had preliminary discussions with them and the intention is to put out a paper, get that right and then incorporate those legislative changes into prudential standards as we need. Now that the government has clarified the way it wishes to deal with that issue, we are in the business of implementing it.

Senator SHERRY—Practically, how do you regulate an entity that is offshore? I understand why it is necessary to do it, but how do you practically regulate an entity with

internet advertising and access, for example, if they do not want to be and they are simply not going to be a part of the regulatory approach?

Dr Laker—The heart of the government's proposals in this area is that insurance has to be written in Australia and a broker has to direct that business to an entity which is established in Australia. So if an offshore entity wants to provide insurance products to Australians it has to do so through a presence in Australia. The proposal at this stage that needs to be finalised is that that would be implemented through restrictions on the ability of brokers to direct business so they would have to direct it to an entity regulated in Australia. That is the way in which the framework would bring onshore and bring under prudential supervision services that were previously provided offshore and all the risks that that entailed.

Senator SHERRY—I can understand that approach and I think it would work satisfactorily. What about the example I gave of an individual who goes to the internet and purchases on the internet direct? I do not know whether that is offered. Is it practically possible to regulate that sort of service provision?

Dr Laker—No, and in those cases caveat emptor applies. One of the concerns that has driven the review of direct offshore foreign insurers has been the concern that Australians are taking out insurance with companies and nobody is able to vouchsafe the ability of that company to pay up on demand, because they are in a regime that we may know little about and the Australian customer may know little about. They have to take that risk, but this framework will bring a large element of that onshore.

Senator SHERRY—Last week there was an award under section 23 of SIS in relation to the Strategic Capital Superannuation Fund, and APRA disqualified the four trustees and the auditor for 18 months. After the investigation that you began in March 2003 there were several regulatory breaches. More than half the \$24 million in assets contributed by 488 members was unable to be found. The nature of the breaches were inaccurate record keeping, auditing accounts and submitting annual financial reports, as I understand it. Are you able to give us any more detail? The last report is that more than half of the funds were unable to be found. Why were they unable to be found and is there any chance of any of that being found in the near future?

Mr Jones—Sometimes it is not good to provide substantive replies to very specific elements of this. The facts are that 90 per cent of the eligible loss was recovered. Your question relates to the notion of additional moneys missing?

Senator SHERRY—Yes. The last report I have is as at 18 May, and this may have been a report referring to the initial 50 per cent missing. If you are giving us an update that 90 per cent has been recovered then that is fine. I will treat that as an update. Why did the money go missing? What was the core of the problem here?

Mr Jones—It goes back a number of years. It was a fund out of WA. The original issues were that it was acting as a public offer fund without having a licence so when we stepped in we froze the assets. This goes back a long time. Then we looked at possible breaches of the legislation—sole purpose, fraud and so on—and then had to have a look at what was missing.

Senator SHERRY—The action that you took against the four trustees and the auditor of 18 months disqualification, is that accurate?

Mr Jones—We cannot disqualify for 18 months, no that is not accurate. The only power that we have is to disqualify.

Senator SHERRY—And they have been disqualified?

Mr Jones—Precisely. We cannot disqualify for 18 months. What happens is that you are disqualified unless and until you come back to APRA and make a case to be no longer disqualified.

Senator SHERRY—I may be reading this report incorrectly in the sense that it may in fact refer to 18 months after the investigation began, rather than 18 months disqualification.

Mr Jones—It might be better if you want more detail if I take it on notice and provide more specifics.

Senator SHERRY—Yes.

Mr Jones—The issue is that we recommended 90 per cent of the eligible loss via recovery. There were a few disqualifications. They were not for 18 months. It followed an investigation into certain breaches where it appeared they were operating as public offer without a licence.

Senator SHERRY—Who was the trustee? What was the entity operating the fund in the recovery phrase, if you like?

Mr Jones—We appointed an acting trustee. It would have been one of the major firms that we would use. Actually there were five trustees and the former auditor, but somewhere along the line one of the trustees died so we finished up with four plus one.

Senator SHERRY—I suspect a few of the 488 members did not live to see their money too, Statistically that would probably be—

Mr Jones—I do not really know. It is possible. I suppose, but I am not quite sure.

Senator SHERRY—It raises an interesting issue of eligibility, if in fact they were eligible for any of the insurance components if there was an insurance component during the holding phase, if you like, while the whole thing was cleaned up.

Mr Jones—Yes.

Senator SHERRY—It is an interesting side issue. As to the issue around the disqualification of the auditor, can you effectively disqualify him as an auditor?

Mr Jones—Yes.

Senator SHERRY—From practising as an auditor anywhere?

Mr Khoo—Only in relation to super.

Senator SHERRY—Only in relation to super?

Mr Khoo—Yes.

Senator SHERRY—Yes, that was my assumption.

Mr Khoo—Our power extends only to disqualifying them as a superannuation auditor.

Senator SHERRY—Yes. Do you refer this on to the accounting professional bodies for follow-on discipline? The reason I ask that is that, here you are, you have disqualified he or

she—I do not know—and it is a serious offence in my view, and you obviously saw it as serious yourself, yet that person could continue to practise as an auditor having committed a very serious offence in the context of superannuation.

Mr Khoo—Yes, our practice has generally been to refer the matters back to their professional bodies as well for disciplinary action if that is appropriate. But if you are asking whether that happened in regard to Strategic I would have to take that on notice.

Senator SHERRY—Fine.

Mr Venkatramani—In a broad sense what happens is there is a range of penalties which we seek to apply. Very often if the range of activities is of a low order we might simply talk to the auditors and say, ‘Look, your level of training is inappropriate; you need specific training,’ and then agree with the auditor that he or she undertakes the training. The next level we might say, ‘We might refer you to your professional body so that your professional body gets involved in relation to mandating its own procedures for professional excellence or appropriate training.’ The third level is where legal action is taken. Once legal action is taken the relevant professional body, whether it is an accounting body or any other body, would, because this is public information, immediately pick it up and go through their own internal processes. Once a publicly known action like disqualification takes place, my understanding is all professional bodies including the CPA, ICA and others have their own ways for picking this up and going through their own processes.

Senator SHERRY—It raises an interesting issue, which is fascinating to me but probably excruciatingly boring to anyone who is listening. This auditor presumably could audit a self-managed superannuation fund because your regulatory powers do not extend to that. The auditor is disqualified. In theory at least they could do auditing for self-managed super funds because the ATO does not regulate the auditors; the professional organisations regulate the auditor of an SMSF.

Mr Venkatramani—My understanding is that the exchange of information between us and ATO extends to sharing that information. When we disqualify an auditor for super purposes that information is available publicly, including the ATO, and there is a process by which we share that information with ATO.

Senator SHERRY—Yes, I understand that. That is the same as sharing with a professional organisation. The point I am getting at is that, in theory at least, the individual having been disqualified by APRA in respect of its regulated superannuation entities could still audit self-managed superannuation funds until such time as the disciplinary action taken by the professional organisations, because the ATO does not directly have the power, let alone regulate auditors at SMSF. You do not agree?

Mr Venkatramani—No, I think it is broader than that. The disqualification which APRA does, even though it relates to other entities—in other words, non-SMSFs, regulated funds other than SMSFs—takes place under the aegis of SIS, and the same SIS provisions apply for SMSFs as well. Therefore, legally that prohibition applies, unless the auditor does one more offence and gets under the radar and performs the audit.

Senator SHERRY—I accept that. Thanks for that. Recently I have seen reports of access cards to enable transactions via teller machines. That seems to be a response to the

government's 2006 budget changes to come into effect on 1 July. I have to say I am not surprised at these reports. The interface between a super fund and a bank account seems to me to be an obvious point of development. Is APRA involved at all in examining these developments from the banking point of view, or is it purely an ASIC area of regulatory oversight?

Mr Jones—We have had some discussion with superannuation entities about their proposals, but at the moment they are only proposals. I am not aware of anyone who has actually set up any arrangement at this stage.

Senator SHERRY—I stand corrected. I saw a report of ANZ, I think. I know there are other reports but the report in respect to ANZ did seem to me to be a little more advanced. You meet with the funds at the moment. What are the sorts of issues you are looking at?

Mr Venkatramani—We had discussions with ASFA as soon as these new proposals came through. There has to be potential for these kind of processes to take place. We look at it from operational as well as liquidity perspectives, that trustees need to understand the additional operational risk as well as the additional liquidity requirements this entails on the part of super funds. Working with ASFA and other industry bodies, we have been providing feedback to the industry through that mechanism as to what our enhanced risk management requirements might be.

Senator SHERRY—I understand liaison with ASFA. Not all super funds are members of ASFA, of course. Have you issued a guidance note yet in this area? I cannot recall one.

Mr Venkatramani—No, we have not issued a guidance note broadly to the industry. But when our supervisors go and do entity reviews they will look at the risk management statements and look at the business plans of the relevant superannuation entity. If that includes these kinds of initiatives we will certainly be asking: 'Have you mapped your operational risks and liquidities onto your processes?'

Senator SHERRY—Does APRA become involved in examining the issue of the parameters for withdrawal, the legal parameters that apply from 1 July—that is the minimum drawdowns? Is that going to be an issue for APRA's consideration at all?

Mr Venkatramani—Only to the extent it impacts the liquidity and the underlying investment parameters and strategy. APRA does not get into that kind of intrusiveness. We would like to make sure that whatever is being done is within the parameters of the law and within the trustee's own governing rules and, within that, the investment and other risks and how they are controlled.

Senator SHERRY—The issue of liquidity seems to me to raise a much more significant issue in that there is no maximum draw-down within the new provisions. There is a minimum but there is no maximum. So, in theory at least, a proportion of people could draw down the whole lot in one year and that obviously has a liquidity impact on the fund. Are you considering that aspect of the parameters in your liquidity considerations?

Mr Venkatramani—Yes. What we would be asking the trustee, if they are minded to provide that kind of ATM or other access, is: 'Have you stress-tested your liquidity scenarios to include that? For example, your liquidity planning, what does it allow in terms of members

accessing a very large part of what they can access under the law and what would happen if that were to increase for whatever reason, market reasons, personal reasons or economic reasons? How will you cope with that? How does that align with your investment strategy in terms of liquefiable assets?' Those are the questions which we would like to run through.

Senator SHERRY—Presumably it could vary, depending on the type of fund. I could imagine an industry fund with relatively low balances compared to a corporate fund with much higher average balances where presumably—we can only speculate at the moment—there would be a much greater likelihood, where the account balances are on average lower, of them being accessed and drawn down much more quickly than a higher balance account. Therefore, liquidity issues would be different for different funds.

Mr Venkatramani—Yes.

Mr Jones—I think it is the sort of issue, though, that funds have had to look at also in the context of choice of fund. They have to take account of liquidity issues as a consequence of that and so it is really an extension of the same sort of idea, I think.

Senator SHERRY—Yes. It is an extension, but it is another issue.

Mr Jones—It is, yes.

Senator SHERRY—A new issue, really—

Mr Jones—It is.

Senator SHERRY—that they have to take into consideration.

Mr Jones—Yes. It is one more element of liquidity they now would have to take into consideration—correct.

Senator SHERRY—It just seemed obvious to me that the interface of a bank account type ATM facility with a super fund was going to be an obvious area of rapid development after the changes post 1 July, and presumably for bank-owned life companies it will be particularly appealing, I would have thought—

Mr Jones—Probably.

Senator SHERRY—given that they are banks.

Mr Khoo—Part of the risk management in that area is that, clearly, they would have to demonstrate to us that they had an appropriate liquidity management strategy that took into account potential volatility in terms of possible withdrawals; and if that was the case then we would obviously want to get some comfort regarding the fact that they were holding an adequate stock of liquefiable assets within a certain period.

Senator SHERRY—There is one other issue and that just prompted me to think of it. Would that require, as part of that account, ensuring the provision of accurate information to social security for assets and incomes means testing purposes? This is not your area, in a sense. It seems to me that, with a draw-down type of account, both the income drawn down and the asset balance are going to continually change for obvious reasons now that the age pension assets are means tested. The interface of that information with social security will mean, for people on a part age pension, almost a continually changing age pension entitlement and, for some people on no age pension, a switch-over to a part pension entitlement that is

constantly changing because of the design of the account structure. It is highly fluid and will change over time, and therefore it would seem to me critical that whoever is providing an account would have to be able to provide accurate information to the social security department, or to the individual to provide to social security for the recalculation of their pension benefit. I think it is going to be a relatively messy area. But is that going to be factored into your considerations around the account parameter provisions—ensuring that the institution is able to provide the accurate information for that?

Mr Venkatramani—To the extent that these kinds of requests are at the discretion of the individual pensioner or the member, then the initiative or the trigger will come from the member. At that point in time, if the request has been actioned, that member should be able to provide the relevant information. Quite clearly, the trustees or the RSEs which provide these should have the ability to comply with such information requests; so that becomes part of the information base. You can in a sense consider that as an extension of some of the issues which you have been talking about, including liquidity management and information management.

Senator SHERRY—We will watch that area with interest. I notice, Dr Laker, your ‘antenna was recently twitching’! That is a quote from you with respect to the lending policies of banks and a potential rise in loan defaults. Do you have any more up-to-date comments about this area?

Dr Laker—It isn’t twitching any more or less than when I last spoke to you; it is twitching steadily. I think that comment I made to the journalist was published about two months after I made it, so it was not the timeliest of interventions and it was linked tenuously to the subprime market developments in the US. I think they were trying to find a story there, but the markets are very different. We are watching constantly the evolution of impaired assets. That is one of the key litmus tests of credit quality and how our institutions are travelling. The most recent data show that there is an edging-up of non-performing loans, but they are still very, very low by historical standards and very low by international standards. Within the total there are somewhat divergent trends; non-performing loans in the corporate area are coming down. They are rising in the housing and personal areas, but it is not a strong rise at this point and it is off a low base, but the direction is clear and it does bear close watching.

Senator SHERRY—Related to this—and it is not your area of regulation—what about the activities of mortgage brokers?

CHAIR—In some respects I think you might have answered your own question.

Senator SHERRY—No, but I am sure—

Dr Laker—I might remind the senator that he asked me the same question at the last estimates and I would have to give him the same answer. Our interest is the credit assessment process and we have said to our institutions that should not vary whether the loan walks through your branch door or whether it is introduced to you through a broker. We have worked with our institutions quite closely to see the role a broker plays in introducing a lender to one of our deposit-taking institutions, but we do not regulate brokers.

Senator SHERRY—No, I know.

Dr Laker—We accept that the growth of the broker market has been one of the impetuses for greater competition and an impetus for spreading the footprint of individual deposit-taking institutions across a wider area without a bricks and mortar presence. There has been a spur to competition, but our interest is in the quality of the loans that go on the books.

Senator SHERRY—I notice a further report, and it may not be accurate, that APRA is to reduce its focus on superannuation in the financial year. That is according to you, Mr Jones, and a report in the *Financial Review* of 23 April. If that is correct, why is that the case and what is the change of emphasis in resourcing that will consequently flow?

Mr Jones—Yes, it is correct, but it is correct in a relative sense in that what I was saying is that certainly from mid-2004 to mid-2006 because of superannuation licensing we devoted a greater than normal proportion of our organisation's resources to the superannuation sector. In 2006-07 we did a fair amount of cleaning up of super. The consequence is that from now on, over the next 12 months in particular, some of those resources which had previously been looking at super are now moving back into other industries. The significance of this is also that we need to record this for our levies because the amount of money that we collect from each industry is a function of the proportion of time we spend on each of the industries. So this is a speech to the superannuation industry suggesting that the relative proportion of APRA time devoted to superannuation will in fact decrease.

Senator SHERRY—Has it yet been determined where that switch in resources will occur?

Mr Jones—It will go back into the other two sectors, into insurance and deposit-taking institutions. We will return roughly to our longer-term proportions of time of APRA resources spent across the three industries.

Senator SHERRY—It does seem to me to beg the question: if those other sectors have not required that level of resourcing—and I accept the APRA licensing of the super trustees; that has taken a lot of resources over the last few years—why would they need additional resources if they have been able to do without it in that couple of years?

Mr Jones—I am not convinced they have been able to do without it in the past couple of years. In fact, in terms of our various regulatory cycles I would have to say we are a little bit behind in some of these things as a consequence.

Senator SHERRY—They have been neglected, as Senator Murray has reminded me.

Mr Jones—I do not want to use those words: to say that they have been neglected.

Dr Laker—They certainly have not been neglected, but we set ourselves quite strict targets for visits, for follow-up and for using our specialist risk resources to go to our deposit-taking sector or our insurance sector. As the deputy chairman has explained, we had to shift those resources away from that for a time and slow those targets down so that we could get through the licensing process. We are now doing some catch-up, but I would not want to use the term 'neglect' because a lot of the institutions will be telling you they still see us and then in that period still saw us too often.

Senator SHERRY—They do. They tell me they see ASIC, too. I do get a touch concerned. The assumption seems to be: well, we have got X money; we haven't had to as much with A and B in the past because C needed greater attention, and then automatically when C requires

less attention, A and B get the resourcing. Was there any consideration here of costs and savings? I can understand the background you are working in. We have discussed it earlier with the demand on salaries et cetera. But there is not going to be any reduction in overall resourcing as a consequence of the shift?

Mr Jones—We in fact have overcollected in levies simply because of the budgetary process. In the next 12 months, according to our most recent levies paper, we are actually handing back money, so we are making a one-off return—

Senator SHERRY—Even after you have got the extra money from the two programs we talked about earlier?

Mr Jones—Correct. It is simply the way the funding was done. More importantly, we need to return money to the relevant industries in the sense that while we may look at it from an aggregate—from a budgetary perspective, the industries do not.

Dr Laker—To add to that, we have said that we would be looking to scale back the total resourcing that APRA feels it needs given the consolidation that has taken place in superannuation, and we need to look at it across all our industries where consolidation is taking place. It is an inexorable trend. It has a bearing on the level of resourcing, but it is not a mechanical relationship because what we are seeing in the Australian financial market are smaller but much more complex entities. They require a skill set within APRA, specialist resources and front-line supervisors. If we scale back it will not be anything more than around the margin because we—

Senator SHERRY—I understand that position. The number of superannuation entities has been in significant decline. That does not mean that there is any less requirement to examine them. I would have thought those that continue to exist in many cases are much more complex, larger entities providing a diversified range of facilities that you could argue require a greater degree of scrutiny for that reason.

Dr Laker—We have said, and we see it from day to day, that the supervision of our large complex superannuation entities is very similar in principle to the supervision of a large complex bank or insurance company.

Senator SHERRY—Will APRA be licensing Northern Trust? It has had a bit of attention in the media recently. For it to operate in Australia, would it require an APRA licence?

Dr Laker—Can I give you two factual answers at this point. One is that Northern Trust is not authorised by APRA, nor does it need to be authorised by APRA to act as a custodian in Australia.

Senator SHERRY—When I asked this of Mr Costello with respect to the Future Fund, it was a bit unclear as to which entity, if either, required to license it as a custodian operation in Australia. So from APRA's point of view, it is not an issue?

Dr Laker—No. The company that would operate and offer those custodial services is a subsidiary of Northern Trust, which is registered in the United Kingdom and is supervised by the Financial Services Authority there. If the only activity they wish to conduct in Australia is custodial services they can do that without a banking authority. As to your first question, let me answer that in broad terms. If an entity wants to come to Australia and offer banking

services and operate as a bank, and it meets a very rigorous assessment process we put them through, then they will be authorised to do so. But that is the choice of anyone who wants to come to Australia.

Senator SHERRY—I understand in this case there is a relationship with the ANZ Bank. Are you aware of that? I just wonder whether that has any implications for licensing or examining operations in the ANZ Bank because it is a custodian—Northern Trust or whatever the name of the legal entity which will be operating in Australia—for the Future Fund's placement of assets and funds management investments. As there is a relationship with the ANZ Bank, it would seem to me that has some implications for the ANZ Bank. That is not an issue for your consideration at all?

Dr Laker—No. You would expect that there would be a relationship with a bank that is able to operate and clear funds in Australia. They will need that link and they are not authorised to do that themselves because they are not a bank in Australia. So I see nothing unusual in that. I think that is just a normal commercial arrangement for a custodian.

Senator MURRAY—Is the non-regulation for custodians a regulatory gap?

CHAIR—We are probably verging on—

Senator MURRAY—It is directly linked to the answer Dr Laker just gave us, and that is that a custodian has direct links with licensed banking institutions to assist in the protection of those assets. It is a direct question as to whether such bodies can create a risk situation.

Dr Laker—Yes, that is possible, but that is a question you may want to put to ASIC because I myself am not sure what the role of the AFS licence is in the case of custodians. It is not something that we concern ourselves with at this point.

Senator MURRAY—Senator Sherry and I—mostly Senator Sherry—asked questions of the manager of the Future Fund, Mr Costello. He was not sure. We were not sure. So at least we can rule you out of the—

Dr Laker—I read the transcript and you can certainly rule us out in the sense that Northern Trust does not need to be a bank in Australia to do those services. That is where our role stops.

Senator SHERRY—But other operators in this space as custodians have a licence by virtue of other activities.

Dr Laker—Well, they could—

Mr Venkatramani—That is to the extent that they have a relationship with our regulated entities; for instance, if you are providing custodial services to a regulated super fund we capture that through our outsourcing standard, which is an operating standard—material activities that are outsourced—even though we do not directly regulate the outsourced service providers, administrators or custodians. Again, I think we have canvassed this issue in previous hearings. We do have a reach which was not available to us earlier through the outsourcing standard as part of the strengthening of the superannuation through the licensing regime.

Senator MURRAY—But going back to Senator Sherry's question—sorry Senator Sherry—

Senator SHERRY—You're right.

Senator MURRAY—I want to use the analogy of bank loans and the mortgage brokers. You do not regulate the mortgage brokers but you are interested in them because of the way they interact with the things you do regulate, which are the bank loans. Is there not a similar relationship, in your mind, to banking operations and custodians—that you should be interested in custodians because of their relationship with the banks, which you do regulate?

Mr Khoo—As Mr Venkatramani just responded before, we do have a reach under our outsourcing standard.

Senator SHERRY—But it is indirect.

Mr Khoo—Yes, it is.

Senator SHERRY—Every other entity in Australia, either Australian financial institution or offshore based, offering custodian services—and I think there is a Custodial Services Association; I had a look at the website; there are about 15 of them—

Mr Khoo—Yes.

Senator SHERRY—is licensed by, regulated by, APRA. If it is not to the direct custodial services it is to the other services they are providing, bank or life company or whatever.

Mr Khoo—Yes.

CHAIR—But someone operating solely as a custodian does not require any action from, or any licensing from, APRA. You can be a custodian and be doing something else that will require you—

Mr Khoo—Correct. I think—

Dr Laker—Can I just clarify that?

CHAIR—but you will not be in relation to the custodian activities.

Dr Laker—If an entity only wished to do custodian services it would not require an authority from APRA. Nor would it qualify if it were only going to do custodial services. It would not need a banking licence or a banking authority. We would not give it a banking authority because it would not be doing banking business. That is the difference.

Senator SHERRY—I think, given their track record—and that is not a reference to the Enron involvement, but to their track record in terms of the service range they offer in other countries—we could probably anticipate some further commercial activity that may require a licence application, but we will see. They are a trustee administrator as well. I think they have a funds management arm and a whole range of other activities in other countries. We will clarify the position with ASIC. I have a few other questions, Chair, as always for APRA, but I am conscious of the time and of my colleague, Senator Murray, so I will finish it there for tonight.

CHAIR—Thank you, Senator Sherry.

Senator MURRAY—Thank you, Chairman. Gentlemen, you issued new prudential standards and guidance for the life insurance industry and for friendly societies. You are aware that, with respect to external auditors, both the Corporations Law and ASIC use them to assist with the regulatory environment. They have specific requirements of what they must monitor and report. With respect to this package of prudential standards, which are principles based: do you automatically, directly or indirectly, require or expect external auditors to ensure these standards apply? Because they are principles based, and each organisation must develop its own fit into your principles, I just wonder what part external auditors play in this?

Mr Venkatramani—Perhaps I can provide perspective. With reference to life companies and friendly societies: as you would know, in addition to the role of auditors, who are there to certify the financial accounts' reliability or for the general assurances they provide, there is also a financial condition report which is required from the appointed actuary to the life insurance company. From our experience, actuaries do seek to ensure that, on an ongoing basis, relevant prudential standards are all looked at, and if they are not, or if they are at risk of being breached, then that is something about which the approved actuary would be in constant touch with the management, and it would get picked up in the financial condition report.

Senator MURRAY—That does not satisfy me.

Dr Laker—Can I just expand on that? Firstly, the standards that were introduced to the life insurance and friendly societies were part of a harmonisation process. There were standards already in place in other industries but, because of the structure and age of the Life Act, et cetera, we wanted to bring that into line with the approach that we have taken in deposit-taking and general insurance. So that was a harmonisation exercise.

Broadly, we have had discussions with the external auditors in the last couple of years about the sort of assurance that they can provide to us about the adherence to prudential standards. I might take that on notice from you because then I could give you details of the sorts of assurances. But when we looked we found we were asking external auditors in one industry to give us a stricter assurance than we were asking of auditors in the other industries, so we wanted to harmonise that and give a realistic basis of assurance. That is an ongoing matter.

We also work with external auditors through what we call tripartite arrangements, where we will ask the external auditors to address a particular risk issue, and either to sample the industry or a select number of the industry or to survey the whole of the industry. We select a topic—one that might be on our radar. For example, recently in the deposit-taking area we have done an assessment of adherence to credit policies within an institution: are they meeting their own policies? So the external auditor plays that role as well through what we call tripartite arrangements. They are one-off exercises but they take place regularly.

Senator MURRAY—I do not need you to give me detail. What I wanted to be assured of is that you are connecting to the auditors—

Dr Laker—Yes.

Senator MURRAY—as well as to the management, so that the external auditor is aware that by, I think, 1 January 2008 all licensed bodies that fall under these prudential standards

should have in place a principles-based system which is unique to each but is common in its principles across the industry, which therefore requires the external auditor of that particular organisation to be on the ball with respect to their needs and what they are doing.

Dr Laker—Yes.

Senator MURRAY—So you are assuring me that that is happening?

Dr Laker—We are certainly in dialogue. We have accepted that in the end the judgement about whether an entity is meeting our prudential requirements is one for APRA to take. We enlist the support of external auditors, but the buck stops with us. So we, particularly in a principles-based environment, need to make the judgement ourselves. But the external auditor can provide an assurance, a kind of negative assurance, that there is nothing in what they have seen that raises their concerns about the entity being in breach of our prudential standards.

Senator MURRAY—There is another question I want to ask you briefly. APRA has released the following through its bulletin:

... actuarial projections for long-term investment returns, wage growth and growth in the Consumer Price Index (CPI) reported by superannuation entities.

Your press release at the time also said:

These projections are key inputs used in assessing solvency and the recommended employer contribution rate required to fund liabilities of defined benefit funds.

Having got those projections, have you discovered that there is a proportion of defined benefit funds which are more at risk or less at risk than you thought?

Mr Jones—I think the answer to that is that on the current economic environment, unlike a few years ago, we are not having issues with defined benefit funds being at risk.

Senator MURRAY—You were not or you were?

Mr Jones—We are not. I mean that, if you had asked the question probably in 2002 or 2003, there were a number where we had some concerns.

Senator MURRAY—That is my memory, you see, so now that you have these projections out I want to know: is that still the case or is it no longer the case?

Mr Jones—It is no longer the case, but it is often no longer the case because we have had a very buoyant share market. So the types of issues that we had in 2002 are not existing in 2007.

Senator MURRAY—Is this the area that you were discussing earlier that you are interested in stress testing to ensure that, if there is a downturn, for instance, in the share markets, those that are more at the edge of solvency measures do not get into a more difficult area?

Mr Jones—We try to anticipate, and with the defined benefit funds there are particular funds rules that we work to.

Senator MURRAY—The whole purpose of a prudential mechanism is to try and forecast worst times, not better times. You do not have to worry about the better times. I just picked up—and maybe I misunderstood—the press release, but it said:

... 96.3 per cent of non-public sector defined benefit and hybrid funds reported that they had sufficient assets to meet total benefits payable ...

That to me meant that 3.7 per cent did not. That may or may not be an acceptable percentage, but I would presume that if tougher times come along that 3.7 per cent expands.

Mr Venkatramani—Perhaps I can provide a perspective on this. We are talking about defined benefit funds where the solvency is kind of targeted over reasonably long periods, depending upon the demographic nature of the fund. For example, typically, actuarial valuations are only required once in three years and one actually might say, 'Look, I will try and seek solvency if it is slightly short over a three- to five-year period by, for example, tweaking the investment policy, increasing contributions or making design changes to the benefits.' Therefore, in a normal particularly benign period like we have seen for the last couple of years, it is perfectly reasonable from an actuarial perspective for some funds to be not quite 100 per cent, even though over a period people would be targeting for 105 or 110 per cent solvency. That might be achieved by expected additional contributions in future. They are not measured on a year-to-year basis; they are measured on three-year or five-year actuarial cycles. Therefore, the 3.7 per cent you talk about, whilst if you look at it on an immediate basis might appear to be a concern, is not a concern if it can be remedied over a reasonable period without affecting cash flow or liquidity.

Senator MURRAY—I guess what is behind my question is that you have said for the first time you have these actuarial projections which give you better data to assess matters of solvency, which of course is the key element when you are looking at defined benefit funds. I just wanted to be assured that that better data does not make you more nervous than you were, that it does not expose problems that you did not realise were there or that you would rather were not there. That is what I am asking you. Does that make sense to you?

Mr Khoo—Yes. I think we can respond to that by saying that it does not make us more concerned.

Senator MURRAY—All right. Thank you. Thank you very much, Chair.

CHAIR—Thank you. That concludes these proceedings. Thank you very much for your attendance, and I thank the minister and Hansard.

Committee adjourned at 10.35 pm