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Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir

Submission in relation to Tax Laws Amendment (2007 Measures No. 2) Bill 2007 – Charter Boat Provisions

We set out below our submission in relation to the amendments set out in the *Tax Laws Amendment (2007 Measures No. 2) Bill 2007*, in particular, the introduction of new laws governing the taxation of boating activities.

We wish to address two matters in relation to this issue:

a) we wish to support the proposed amendments as providing a "safe harbour" to charter boat operators; and
b) we wish to propose that this safe harbour be provided retrospectively rather than just prospectively.

Proposed changes

We submit that the new laws as set out in *Tax Laws Amendment (2007 Measures No. 2) Bill 2007* provide greater integrity and equity to the tax system. The Australian Taxation Office's ("ATO") interpretation of the current law is such that a person who is not considered to be carrying on a business of operating a charter boat but who receives income from letting their boat cannot deduct any expenses in relation to a boating activity, but is compelled under the tax law to include all income they generate as a result of that boating activity (which *Tax Laws Amendment (2007 Measures No. 2) Bill 2007* seeks to rectify).

We believe the measures in the Bill are an appropriate rectification of the above situation as the current provisions require in many cases taxpayers to pay tax in situations where they have a commercial loss. This is particularly of concern as the question of whether a taxpayer is carrying on a business is a question of fact, but one which is in practice only determined in hindsight by the ATO. Consequently while a taxpayer may believe they are carrying on a business, deriving

assessable income and incurring expenses that are allowable deductions, if ultimately the ATO determines (as they have on many occasions) that the ATO does not believe the activities constitute a business, the consequences for the taxpayer can be dire with all deductions denied but all receipts made assessable.

We therefore commend the amendments as providing a safe harbour protection to these taxpayers by confirming they cannot be taxed on income received while making a commercial loss. At the same time, the Bill protects the revenue by only allowing losses from business operations to be offset against other income. That is if in fact the operation falls short of being a business, losses cannot be offset against other income, but can be offset against the income derived in future years from the letting of the boat.

Extending the safe harbour to existing situations

We wish to submit that the *Tax Laws Amendment (2007 Measures No. 2) Bill 2007* should be amended to include provisions making these changes to the law retrospective.

For many years the ATO took no action in the charter boat space, however in 2002 they issued a ruling which fundamentally changed the way in which most of the industry operated. Following this many taxpayers left the industry, but others who saw it as containing commercial upside remained in the industry and altered their operations in a manner which they believed meant they complied with the ATO requirements. Many of these taxpayers have subsequently been subject to ATO audit activity. A current theme we see in this audit activity is for the ATO to dispute the taxpayers' business plans and expectations, and for the ATO to then recast these in a way which produces a loss. On the basis of these recast losses the ATO concludes then that the taxpayer is not carrying on a business.

A consequence of the above approaches is that not only are tax losses denied (which often arise because the ATO depreciation rates exceed significantly the true decline in value of the craft) but the taxpayers are required to return all income without any deductions being allowed to offset against the income. The ATO have further sought to apply the general interest charge on amendments made, which is significantly higher than the bank bill rate (incorporating a penal element to the taxpayer).

The courts have recognized the inequity of this as can be seen in recent comments made in *VCK and Commissioner of Taxation* [2006] AATA 1073, where at paragraph 24 it was provided:

> *It is appropriate to note an apparent anomaly in the application of s26-50 of the Assessment Act which the respondent had applied to disallow all deductions claimed in relation to the boat while including the whole of the income derived. It is difficult to believe that Parliament intended this result by the enactment of that section...*

Clearly the court was of the view in this circumstance that at a minimum a deduction equivalent to the income should be allowed. To that extent we submit that this new legislation should be retrospective in order to ensure taxpayers are not unfairly taxed on amounts that reflect something that in the ordinary course, the Australian tax law should never sought to tax. In other words we

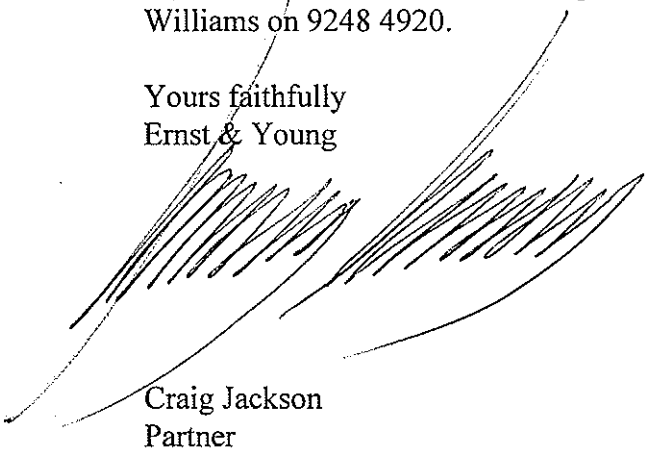
ask that parliament follow the guidance of the court and make it clear that they did not intend to tax this income without allowing matching deductions as a minimum.

Ultimately assessing income and denying deductions in respect of expenses that are incurred in deriving the assessable income is clearly inequitable and does not correlate with the principles of which Australian tax law is based upon.

We request the committee to consider amending these provisions to give them retrospective effect.

If you wish to discuss this further please feel free to contact either myself on 9248 4905 or Glenn Williams on 9248 4920.

Yours faithfully
Ernst & Young



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