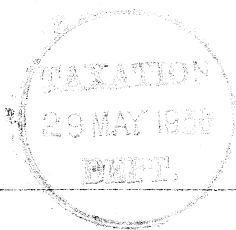


1922.

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA.



REPORT

OF THE

ROYAL COMMISSION ON TAXATION.

THIRD REPORT.

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COMMONWEALTH OF AUSTRALIA.

THIRD REPORT OF THE COMMISSIONERS.

To His Excellency the Right Honorable HENRY WILLIAM, BARON FORSTER, a Member of His Majesty's Most Honorable Privy Council, Knight Grand Cross of the Most Distinguished Order of St. Michael and St. George, Governor-General and Commander-in-Chief of the Commonwealth of Australia.

MAY IT PLEASE YOUR EXCELLENCY :

We, the Commissioners appointed by Royal Letters Patent to inquire into and report upon the incidence of Commonwealth taxation, and into and upon any amendments which are necessary or desirable with a view to placing the system of taxation upon a sound and equitable basis, having regard generally to the public interest, and particularly to—

- (1) The equitable distribution of the burdens of taxation ;
- (2) The harmonization of Commonwealth and State taxation ;
- (3) The giving to primary producers of special consideration as regards the assessment of Income Tax, particularly in relation to losses resulting from adverse weather conditions ; and
- (4) The simplification of the duties of taxpayers in relation to returns and in relation to objections and appeals,

have the honour, in continuation of our First and Second Reports, dated respectively 27th October, 1921, and 13th April, 1922, to report hereunder upon the following subjects coming within the Terms of Reference :—

- (16) Comments upon various sections of the Commonwealth Income Tax Assessment Act and Related Matters.
- (17) Administration.
- (18) Taxation of Interest on State Government Securities and the Income of State Organizations.

SECTION XVI.

COMMENTS UPON VARIOUS SECTIONS OF THE COMMONWEALTH INCOME TAX ASSESSMENT ACT AND RELATED MATTERS.

438. **Co-Operative Societies (Section 3—Definition of Income).**—The *Commonwealth Year Book*, No. 14, 1919–1920, shows that returns had been received from 148 co-operative societies in Australia. The Commission was urged by witnesses to recommend that co-operative societies should not be taxed upon undistributed profits, except so far as those profits include profits from trading with non-members. With regard to trading with their own members, it is usual for the societies to allow a rebate or deferred discount proportionate to the purchases made by the member within each accounting period. The *Commonwealth Income Tax Assessment Act* 1921 amended the definition of “income” in the Principal Act by providing that income shall—

“not include any rebate received by a member of a co-operative company based on his purchases from that company, where the company is one which usually sells goods only to its own members.”

This provision will have a very limited application, as the evidence shows it to be the exception rather than the rule for a co-operative company to confine its sales to its own members. In any case, the provision does not touch the main contention of the societies with regard to the taxation of their undistributed profits. For the purposes of such taxation, the Act makes no

distinction between a co-operative and a limited company. The same contention as to the exemption from taxation of co-operative societies' profits was urged before the British Commission on the Income Tax 1920. That Commission came to the conclusion that—

“any part of the net profits of the societies' transactions which is not actually returned to members as dividend or discount is a profit which should be charged to Income Tax.”

439. With regard to cases where the societies deal merely with their own members, that Commission remarks that—

“when the discount or rebate on purchase price has been returned to the purchaser, we are of opinion that the surplus remaining in the hands of the society is a true trading profit.”

With this view we concur.

440. We recommend—

- (1) That the amounts carried to reserve by a co-operative society, that is, a society which usually sells goods to its own members, should be taxed as at present—that is, in the same way as are the undistributed profits of a company.
- (2) That upon so much of the amount carried to reserve as is subsequently rebated to the members based on their purchases from the society, the society shall be entitled to a refund of the tax paid thereon.
- (3) That where a member of a co-operative society is allowed to deduct the amount of his purchases from the society from his assessable income, he shall be required to bring into account the amount of the rebate received in respect of such purchases.

441. Annuities (Section 3—Income from Property).—At present an annuitant is liable to Income Tax upon the whole of each year's payment of the annuity. It was represented to us that this involves taxation of capital. The case was put thus by a witness on behalf of the Life Offices' Association for Australasia—

“Where an annuity has been purchased from a life assurance company, every payment of annuity contains an instalment of capital as well as an amount for interest, and to tax the whole payment is to tax capital as distinct from income. It has been settled by judicial decision that capital, when it can be identified, is not taxable as income. In the case of the purchase of an annuity certain, *i.e.*, an annuity payable for a fixed term of years, the individual actually receives in each annuity payment repayment of part of his own capital, together with interest on the capital remaining unrepaid, and the amount of capital and interest in each annuity payment can be actually determined. In the case of the purchase of a life annuity, the annuitant pools his capital with that of other life annuitants, and in effect agrees to a common distribution of capital out of the pool on a basis which, according to the expectation of life of each individual when he purchases the annuity, would secure to him the repayment of his capital during his life-time. The essential fact is that the annuity payment is not solely income; in part it is return of capital, in part true income; and in any individual case the amount of the part which is capital is the amount of the annual premium which the individual would have to pay to secure, by means of life assurance, repayment at his death of the amount of capital he applied in purchase of his annuity.”

442. In our opinion, the contention of the Life Offices' Association is justly based, and—

443. We recommend that so much of each payment of an annuity purchased by the annuitant as is actuarially certified to be a part return of capital be allowed as a deduction from assessable income.

444. Reciprocal Exchange of Information between Taxation Authorities, Commonwealth and State.—Section 9.—The first two sub-sections of this Section make it an offence for officers to enter upon their duties before making a declaration of secrecy, providing a penalty for breaches of this provision. Sub-section (3) of this Section reads:—

“Notwithstanding anything contained in this Section, the Commissioner, the Assistant Commissioner, or a Deputy Commissioner may communicate any matter which comes to his knowledge in the performance of his official duties to the Commissioner of Income Tax for any State who has been authorized by legislation to afford similar information to the Commissioner, the Assistant Commissioner, or a Deputy Commissioner, or to the Commissioner of Pensions for the purpose of the administration of any law of the Commonwealth relating to pensions.”

In the Acts of New South Wales and South Australia there is no corresponding provision. In Victoria and in Queensland the Income Tax Acts allow communication by the State Commissioner of information to the Commonwealth authority and other State authorities without condition. In Western Australia the Income Tax Act allows for communication to other Income Tax authorities who are authorized by legislation to reciprocate. The Tasmanian Act allows communication without condition to the Commonwealth, but only subject to reciprocity in the case of a State authority.

445. Full power of inter-communication between all Income Tax authorities in Australia for the purposes of administration of Income Tax legislation is, in our opinion, very desirable. A striking illustration (referred to in paragraph 271 of our Second Report) of the loss of revenue which may occur in the absence of such a provision was given in evidence by the State Commissioner for Income Tax, New South Wales. He stated that a certain taxpayer had rendered a return and had been assessed thereon, the tax amounting to a little over £20. The Commissioner became aware of certain facts which induced him to conduct an investigation into the taxpayer's affairs. The result of the investigation was to disclose that the taxpayer's income for the year in question had been about £280,000, and the amount he was called upon to pay was £22,500. The Commissioner, giving evidence, was asked whether he had communicated the facts and the name of the taxpayer to the Commonwealth Commissioner or his representative in New South Wales. The reply was that he had not done so, as his Act gave him no authority to make such a disclosure. **It appears to us a matter of urgent importance that as between the Commonwealth and all States and as between all the State authorities there should be the fullest exchange of information necessary for the protection of the revenue.** We suggest that this matter be pressed upon the Governments of those States in which no legislative authority exists for reciprocal interchange of information with regard to Income Tax matters.

446. **Subdivisional Sales upon Long Terms—Method of Taxing Profits.**—Witnesses representing a company whose operations consist of the purchase of lands, their subdivision, preparation for settlement, construction of roads, &c., and sale upon long terms, stated that the method of taxing income of the company from sales of such lands in the State (Queensland) is to regard the total amount represented by the sale as income of the year in which the sale is made, although only one instalment would be paid in that year. It is common practice for the company to allow payment by instalments to extend over ten years, and the witnesses urged that for Income Tax purposes no amounts should be regarded as income of any year except those actually received during that year. This is the practice of the Commonwealth Income Tax Department. It may be argued that the method adopted by the State is in consonance with that generally adopted in relation to sales of merchandise—for example, a wholesale house sells a considerable portion of its goods upon say three or six months' terms, and at the end of any financial year there will be a "carry over" of such transactions the bills in respect of which have not matured, though for purposes of the trading account the amounts represented by the sales are shown as sales of the year in which made.

447. Looking at the matter from a purely theoretical point of view, it might be said that the practice adopted with regard to merchandise is sound, and should rule all credit transactions. As far as convenience is concerned, the practice adopted with regard to merchandise is probably the best. With regard to sales of land on credit terms extending over a number of years, the convenience would lie the other way, as the books of a company conducting such business would not be kept in the same manner as those of an ordinary mercantile business.

448. In our opinion, the practice adopted by the Federal Department of accepting the profit upon the amount actually paid during the year in respect of land sold upon long terms as the income of the year is the more convenient and the more equitable with regard to the taxpaying vendor.

449. **We recommend** this practice for general adoption.

450. **Revenues of Municipal Corporations or other Local Governing Bodies or of Public Authorities.**—Section 11 (1) of the Commonwealth Income Tax Assessment Act exempts from Income Tax the revenues of Municipal Corporations, &c. Representations were made by some witnesses with regard to the profits from trading enterprises conducted by municipalities or other public bodies, and it was contended that the present statutory exemption should be repealed, in order to make such profits taxable.

451. The general objection to the present exemption of those profits from taxation put forward was that it entails unfair competition with private enterprises, the profits of which are taxable. In some cases the position is not quite accurately stated by the phrase "unfair competition," as it may, and often does, amount to an exclusion of private enterprises from a particular area. For example, the electric light undertaking of a City Council is generally a monopoly within its own area.

452. Another objection of less force which has been stated is: A taxpayer in one Municipality which profitably conducts an enterprise such as electric lighting is at a disadvantage as compared with a taxpayer in another Municipality which from lack of opportunity or other causes is unable to realize profits in that way.

453. An objection somewhat similar to that just mentioned is that the citizens, say, of a capital city, may be making profits from charges levied upon persons who are not residents of that city, or even of the State. An illustration is the conduct by the Melbourne City Council of stock sale-yards to which cattle and sheep are brought, not only from Victoria, but from New South Wales and other States. In such instances the stock fees at the Council's yards may be paid by owners of the stock, who may be resident outside Victoria altogether. It is urged as unfair that any profits so arising should be applied, as they of course would be, either to some relief from Municipal taxation of the citizens of Melbourne or for some Municipal purpose of which the citizens would primarily receive the benefit. In either case it would generally be difficult or impossible to trace any definite pecuniary benefit to any citizen. Again, any reduction in Municipal rate, whether due to the realization of profit from a Municipal undertaking or to some other cause, is reflected in the income tax return of a taxpaying citizen. Municipal Rates being allowed as a deduction from assessable income, if the rate is lowered the taxable income will be increased, and consequently a larger income tax will be payable.

454. Two other points in relation to the matter may be mentioned, viz:—First, that the stock-owners who use the municipal yards are receiving valuable services for the fees paid; second, that the Municipality is not in the position of an absolute monopolist in such matters—that is, it could not prevent the construction and use of yards by the stock-owners themselves in some convenient locality outside the City boundary.

455. In Great Britain the Income Tax Law does not exempt from taxation the revenues of Municipal and other bodies. The British Royal Commission on the Income Tax, 1920, gives the following “summary of the way in which local authorities are dealt with for Income Tax purposes” :—

“The trading profits of a corporation are assessed to Income Tax under the ordinary rules. The property which it owns is also chargeable under Schedule “A,”* or if exemption is granted (*e.g.*, in respect of public schools and premises occupied for the administration of justice), that exemption is not one that is peculiar to corporations.”

But behind any question of practice is the basic question whether the profits of public bodies should be taxable or exempt. On this point the British Commission says :—

“The fundamental question whether a Municipal corporation ought to pay Income Tax at all was not pursued by the witnesses, possibly because they recognised that although the burden of the Income Tax paid by a corporation ultimately falls upon the members of the local community, the ratepayers are in many cases liable to Income Tax, and any burden of taxation removed from them as ratepayers must necessarily be thrown upon them, though not necessarily in the same proportions, in their capacity as taxpayers. It may also have been in their minds that it would not be expedient to claim exemption from Income Tax for public bodies which are actually or potentially competitors of private persons or companies carrying on similar trading undertakings.

“But although this primary question was not raised, a number of important changes were advocated, one of which was that in assessing a corporation a distinction should be drawn between those of its activities which may be regarded as undertaken for national purposes and those which are purely local. There is, in our opinion, no sufficient reason for exempting from Income Tax most of the properties which are devoted to local public purposes.”

456. It will be observed that the opinion given by the British Commission refers to “most of the properties devoted to local public purposes.” That Commission was faced with the view that some properties of a local authority may be of an importance other than local—for example, they came to the conclusion—

“that sewers and sewer mains should be exempted from liability to Income Tax assessment, not only because the present administration of the Income Tax Law, following the practice of rating authorities, produces inequitable results as between different localities, but also because the provision of proper sewerage facilities may be regarded as essential to national as well as to local public health.”

* NOTE.—Tax under Schedule “A” is charged in respect of the ownership of landed property in the United Kingdom, and is based upon the annual value.

457. The passage just cited illustrates the difficulty of determining whether the benefits of a particular public utility, administered primarily in the interests of citizens within an area of local jurisdiction, do or do not extend to citizens outside that jurisdiction. The consideration, that so many services provided by public authorities have this wider extension of benefit, in our opinion, strengthens the view hitherto taken in the Commonwealth that the revenues of public bodies should be exempt from taxation.

458. In the case where a public authority carries on an undertaking in which it becomes a competitor with private enterprise, or by monopolistic power excludes private enterprise from a particular area, witnesses expressed the opinion that the profits derived from such undertaking should be subject to income taxation.

459. There is a general agreement that some particular services—for example, water supply, supply of gas, or electric light, &c.—are public utilities, which in principle may properly be handed over to some public authority.

460. Where the line of unfair competition begins, or upon what class of enterprise a communal authority should refrain from entering, are questions which are outside the scope of our Terms of Reference.

461. The prime justification, in our opinion, for the exemption from Income Tax of revenues of Municipal and other public authorities lies in the fact that they may properly be regarded as exercising a delegated power which in a less-developed community would or could be exercised directly by the State.

462. Another point in favour of the retention of the present exemption of revenues of public bodies is that, where profits are made by them in the conduct of some public service, those profits cannot be used other than for some purpose within their power as a public body.

463. **We are of opinion that the present exemption from Income Tax of the incomes of public authorities should be retained.**

464. **Cricket Associations.**—Section 11 (1) (j) exempts from taxation—

“the income of any society or association not carried on for the purposes of the profit or gain to the individual members thereof, established for the purpose of promoting the development of the agricultural, pastoral, horticultural, viticultural, stock-raising, manufacturing or industrial resources of Australia.”

465. The New South Wales Cricket Association, through its representative, gave evidence in support of a claim for exemption of the revenues of the Association from Income Taxation. The reasons advanced were generally that the Association does not exist for the purpose of any individual gain, and that its activities are entirely devoted to the promotion of a manly sport which is beneficial to the community. The taxable revenue of the Association is chiefly derived from gate money collected in respect of Inter-State or International cricket matches.

466. A side issue introduced into the question is that the public pays Entertainments Tax upon entrance money to such cricket matches. This, however, does not appear to us to affect the question. The amount obtained through the Entertainments Tax is paid by individuals, and the Association is merely the channel through which the amount of tax reaches the taxation authorities. Not at any stage does the amount so paid enter into the real revenue of the Association.

467. It is a clear deduction from the wording of the sub-section that no exemption would be granted where a society is carried on for the purpose of gain to individual members. It seems equally clear that even where that condition-precedent exists, only those Associations will be granted exemption whose purposes commend themselves to the Parliament as of sufficient national importance to justify their inclusion in the exempt list.

468. It will be noted that no Associations whose principal object is the encouragement of sport are at present included in the exempt list, and **we are unable to see any sufficient grounds for recommending the inclusion of any such body.**

469. Dividends Derived from Capital Profits.—Section 14 (b) reads—

“ The income of any person shall include—

- (b) dividends, interest, profits, or bonus credited or paid to any depositor, member, shareholder, or debenture-holder of a company which derives income from a source in Australia, or of a company which is a shareholder in a company which derives income from a source in Australia, but not including a reversionary bonus issued on a policy of life assurance :

Provided that, where a company derives income from a source in Australia and from a source outside Australia, a taxpayer shall only be taxable on so much of the dividend as bears to the whole dividend the same proportion that the profits derived by the company from a source in Australia bears to the total profits of the company :

Provided further that, where a company distributes to its members or shareholders any undistributed income accumulated prior to the 1st July, 1914, the sum so received by the member or shareholder shall not be so included as part of his income. For the purposes of this proviso, amounts carried forward by a company in its profit and loss account, appropriation account, revenue and expenses account, or any other account similar to any of the foregoing accounts, shall not be deemed to be accumulated income ; but, where it is proved to the satisfaction of the Commissioner that an amount standing to the credit of a profit and loss account before the 1st July, 1914, has been appropriated by a company for the purpose of crediting a dividend to the shareholders, and the dividend or a part thereof is retained by the company for the purpose of paying for an increase in value or number of shares issued to the shareholders, the shareholders shall not be liable to pay tax on the dividend or part so retained.”

470. Dividends, under the above sub-section, are made part of income, and are taxed even in the cases where the dividend is derived from capital profits, *e.g.*, profits made by the sale of a capital asset, such as a building. The profit so derived is treated as capital profit and hence not taxable in the hands of the company, but, on reaching the shareholder, it is otherwise regarded. The principle that income does not change its character when passing from a company to a member of the company is exemplified in Section 11, which provides that income derived by a company from tax-free War Loan is exempt from tax, not only in the hands of the company, but also in the hands of a shareholder, who receives it in the form of a dividend. The principle is also applied by Section 14 (b) in respect of income derived by a company from a source outside Australia (not taxable under the Act).

471. **We recommend** that dividends derived from capital profits of a company which are exempt from income taxation in the Company's hands be exempt in the shareholders' hands.

472. **Freedom from Taxation of Income accrued prior to 1st July, 1914.**—Second proviso to Section 14 (b).—The evidence disclosed a considerable amount of dissatisfaction among taxpayers with the form and effect of this second proviso. Owing to the lapse of time since 1st July, 1914, the transactions affected by this proviso must be diminishing in number, but they are still sufficiently numerous to excite protest against the effect of the provision. The first sentence in the proviso is obviously aimed at preventing retrospective taxation, but the additional sentence involves such taxation in certain cases.

473. **We recommend** that the proviso be amended to make it clear that any company income which accrued prior to the 1st July, 1914, shall be free from taxation when distributed to shareholders.

474. Beneficial Interests under Wills, &c.—Section 14 (c) reads—

“ The income of any person shall include—

- (c) beneficial interests in income derived under any will, settlement, deed of gift or instrument of trust.”

We are officially informed that an income derived [from any of the sources specified in this sub-section is taxed at personal exertion or property rate, according to its origin. The Victorian Act expressly provides that—

“all income subject to tax earned, derived, or received by or arising or accruing to a trustee in his representative capacity, or received or receivable from a trustee by a taxpayer as a beneficiary, shall be deemed and be taken to be the income the produce of property, and shall be liable to tax accordingly.”

475. A Victorian taxpayer taxed in respect of a beneficial interest under a will, the income being derived from a business managed by the trustees, would be charged by the State authority at the property rate, and by the Commonwealth authority at the personal exertion rate. Apart from Victorian State taxation, the anomaly arises under the Commonwealth Act that, if a beneficiary under a will or other instrument receives income the source of which is a business, the income in the beneficiary's hands is taxed as income from personal exertion if the business is that of an individual or a partnership, and as income the produce of property if the business is that of a company. It cannot be contended that income in the hands of a beneficiary involves personal exertion on the part of the recipient in the sense of the definition (Section 3) of the Commonwealth Act, and, **in our opinion, it should be regarded as property income and taxed accordingly.**

476. **Life Assurance Companies' Taxation.**—Under Section 16 (1) of the Act, life assurance companies are exempted from taxation in respect of premiums paid upon the policies issued by the companies. Other revenues are taxable, allowance being made for expenses of management. The State legislation on this subject varies considerably. The following are the bases of the State taxation:—

New South Wales	..	Income from real property mortgages, less proportion of total expenses in New South Wales obtained by using ratio of taxable income to total income.
Victoria	..	30 per cent. of “premium income” (ordinary department). 15 per cent. of “premium income” (industrial department).
South Australia	..	Portion of the surplus divisible amongst policy-holders which the Actuary certifies to be attributable to South Australia.
Tasmania	..	20 per cent. of “premiums received.”
Queensland	..	25 per cent. of “premiums collected during the year” (ordinary department). 15 per cent. of “premiums collected during the year” (industrial department).
Western Australia	..	“Interest on investments,” less a deduction for expenses.

477. Taxation of life assurance companies on a percentage of the premium income, while simple, cannot be regarded as scientific or as practically satisfactory. The Life Offices' Association for Australasia pointed out that this method—

“ignores the fact that the ratio of surplus to premium depends upon the age of the institution, and assumes [wrongly] for example that an institution ten years old will have the same ratio as one 40 years old.”

The Association further points out that, under this method, if the percentage rates be high, the stability of a young institution may be imperilled, as for the first few years a large proportion of its premiums must be absorbed in expenses. A further disadvantage pointed out is that this method works inequitably between companies having a preponderance of whole-life business (which probably yields the larger surplus) and those having a preponderance of endowment assurance. The Association asked for complete exemption from income taxation of all life assurance revenues. We do not feel justified in indorsing that request.

478. **In our opinion, the method of taxing life assurance companies prescribed by the Commonwealth Act is the method which should be adopted by all Australian authorities.**

479. **Deductions from Assessable Income.**—Apart from the special deductions commonly known as General Exemptions (£156 in the case of a person who is married and £104 in the case of a person who is not married), the allowable deductions from assessable income are enumerated in Section 18 of the Commonwealth Income Tax Assessment Act. During our inquiry, many witnesses made suggestions for amendment of one or more of the sub-sections of which that section is composed. It will be convenient to quote each sub-section separately, and to make such references to evidence and such comments as may seem appropriate.

480. **Section 18 (1) (a)** reads—

“ 18. (1) In calculating the taxable income of a taxpayer the total assessable income derived by the taxpayer from all sources in Australia shall be taken as a basis, and from it there shall be deducted—

(a) All losses and outgoings, not being in the nature of losses and outgoings of capital, including commission, discount, travelling expenses, interest, and expenses actually incurred in Australia in gaining or producing the assessable income.”

The wording of sub-section (a) has recently been considered by the High Court in an Appeal case (*Alliance Assurance Co.*, appellant, and Federal Commissioner of Taxation, respondent, 29 C.L.R., 424). The High Court held that—

“ The words ‘ losses and outgoings ’ are not qualified by the words ‘ incurred in Australia in gaining or producing the gross income ’, and that those latter words refer either to the word ‘ expenses ’ only, or at most to the words ‘ commission, discount, travelling expenses, interest and expenses ’.”

Each of the State Acts has provisions similar in general effect to those of the Commonwealth Section 18 (1) (a) above quoted. The Queensland Act specifically includes among losses and outgoings interest paid in respect of money borrowed and used in the production of income which is not exempt from tax and interest actually paid on any mortgage of residence. Tasmania has similar provisions with regard to interest on borrowed money used for purposes of the business, and both those State Statutes provide that where interest charges are payable to persons residing beyond the State, the person paying same will be deemed to be the agent of the person entitled to receive same and liable to pay Income Tax thereon.

481. Witnesses referred to many forms of expense which they contended should be allowed under Losses and Outgoings, or should be allowed to a greater extent than at present. Some of these forms of expense are—

(1) **Legal Expenses.**—The Commonwealth Department of Taxation allows certain legal expenses as deductions. The principle which, it is stated, guides the Department is whether the expense is (in the words of Section 18) “ actually incurred in gaining or producing the assessable income.” We are informed that among the legal expenses allowed are those incurred by way of cost of suing for recovery of trade debts and charges for advice upon interpretation of contracts.

Among the expenses not allowed as deductions are—

- (a) Costs in actions against the Department.
- (b) Costs in prosecuting or defending actions for breach of contract.
- (c) Costs in proceedings before Arbitration Courts or similar tribunals.
- (d) Costs in libel or slander actions.
- (e) Expenses incurred in the preparation of leases, mortgages, transfers, &c.

The disallowance of these items was the subject of much complaint. Many witnesses urged that all legal expenses should be allowed as deductions, and contended also that some at least of the disallowed items are expenses “ incurred in gaining or producing the income.” A further consideration was that, if some of such expenses cannot strictly be considered to be “ incurred in gaining or producing the income,” they are incurred in “ **protecting** ” the income. The Act does not specify protection of income as a ground for deduction of an expense, but the evidence disclosed a widespread opinion among commercial men and others that expenses legitimately incurred for protection of income should be deductible. In some cases it is difficult to draw the line between gaining or producing and protecting income. For example, it was urged upon us that the expenses of actions for breach of contract (whether the taxpayer is the plaintiff or the defendant) should be allowed, on the ground that the protection of income should be regarded as the direct equivalent of the production of income. The same argument may be used with more or less force in relation to other judicial proceedings. (Some expenses of an occasional character, and which are incurred solely for the protection of income, for example, the expenses of transferring starving stock from one district to another, the cost of hiring country, &c., are, and always have been, recognised as legitimately deductible.) Another item of legal expense frequently referred to in evidence was that of proceedings before Arbitration Courts, Wages Boards, &c. At present no deductions on this account are recognised. Representatives of employers stressed the view that these expenses arise out of statutory obligations, and that it would be only reasonable to regard them as incurred in producing income. Items such as the cost of preparation of leases, mortgages, transfers, &c., are in ordinary businesses quite infrequent, but, where they occur, it seems reasonable that they should be treated as business expenses and consequently included among deductions. As shown above, the departmental practice already recognises some expenses incurred in the

protection of income as properly deductible. In our opinion, this recognition should be extended to all cases where the Commissioner is satisfied that legal expenses have been incurred *bona fide* for the protection of income.

Legal expenses are specifically deductible from assessable income under the State Statutes of Victoria (Section 19 (1)) and Queensland (Section 13 (1) (X)). The Queensland provision is limited to legal expenses incurred in collecting debts owing to persons in business or in preparation of leases or in connexion with any award relating to the taxpayer's business or incurred in drawing up agreements for the sale or purchase of goods or service agreements with employees. The only limitation in the Victorian Act is that the legal expenses shall have been incurred in producing income. The Statutes of other States contain no provisions expressly allowing the deduction of legal expenses from assessable income.

(2) **Removal Expenses.**—Among commercial witnesses who referred to this subject, there was unanimity of opinion that expenses incurred in necessary removals from one place of business to another should be regarded as permissible deductions. At present, the practice of the Department is to disallow such claims. Business removals usually occur from one of two causes—either the expiry of the lease or the necessity for obtaining more suitable premises. To these may be added occasional temporary removals due to alterations or reconstruction of premises to which it is intended to return. **It seems to us that these expenses may be regarded as incurred with a view to gaining or producing income, and on that ground are properly allowable as a deduction.**

(3) **Alterations to Buildings, Plant, &c.**—The cost of fitting up of leased premises, alterations to buildings, &c., is, we are informed, not generally regarded by the Department as an allowable deduction, since it is usually in the nature of capital expenditure. Where that is clearly the case, **in our opinion no alteration of the departmental practice can be recommended.**

(4) **Cost of New Machinery, Replacements, &c.**—Requests for the inclusion of this expenditure as an allowable deduction came specially from representatives of farmers. The Department, we are informed, considers all such expenditure to be clearly capital expenditure, upon which no deduction can be permitted. In this case, as in that dealt with in the preceding paragraph, **we do not recommend any alteration of the present practice.**

(5) **Deduction of 5 per cent. Capital Value of Agricultural Holdings.**—The suggestion was made that farmers be allowed to deduct 5 per cent. of the capital value of their holdings. The argument in support of this suggestion was that, where a farmer leases land, he is allowed to show the rent as a deduction; but, where he is the proprietor, no deduction is allowed, though (it is said) he is in effect paying rent equal to the current rate of interest upon the capital value. The Act indeed embodies a provision which is practically the converse of the claim under consideration, as under Section 14 (c) a taxpayer is required to include in his assessable income 5 per cent. of the capital value of land, &c., owned and used or used rent free by himself for the purpose of residence or enjoyment. The case of the farmer using his own land for cultivation is said to lead to an anomaly, as an owner of such land may also lease adjoining lands and be allowed deduction of the rent of that portion of his farm, while receiving no deduction in respect of the proportion owned. However, **we regard expenditure in the purchase of land as capital expenditure, and, for that reason, cannot recommend any deduction of the nature suggested.**

(6) **Cost of Netting and Eradication of Pests.**—The cost of netting is treated as capital expenditure, except in the case of netting used for repairing. With regard to the eradication of pests, the practice is to regard expenditure under this heading as capital expenditure if at the time of purchase the land is encumbered (for example, with prickly pear), with the consequence that no deduction is allowed. Expenses of maintaining the land in the improved condition are allowed. In these cases we consider the departmental practice to be consistent with the general scheme of the Act, and **do not recommend any change.**

(7) **Subscriptions to Trade Associations, Agricultural Shows, &c.**—This is an instance where some part of the claim put forward by witnesses is already recognised by the Department—for example, subscriptions to Trade Protection Associations are allowed, also subscriptions to Trade Journals, but not subscriptions to Trade Associations, except to the extent to which the subscriptions are regarded as defraying the cost of business functions performed by the associations on behalf of their members. Many traders, it was stated, are continually called upon to subscribe to or furnish free material for agricultural and similar shows, and it was urged that this should be regarded as an expense of advertising. It is not at all clear that expenses of this kind are advertising in the ordinary sense, unless as a result of the subscription or donation the business of the firm is in some way prominently brought before the public. Expenses of exhibiting at an Agricultural Show are recognised as a business outgoing. The departmental practice under this heading, in our opinion, is as liberal as can fairly be required.

(8) **Cost of Preparation of Taxation Returns.**—Witnesses stated that in very many instances taxpayers find it necessary to employ accountants or others outside their own staff to prepare Income Tax returns, and it was urged that all such expenses should be regarded as deductible. It was admitted that in many cases the auditor of the business prepares the returns, and, in such cases, the fees for auditing, which are allowable deductions, include the cost of preparation of the returns. **In our opinion the cost of preparation of taxation returns should be allowed.**

(9) **Cost of Issue of and Discount upon Debentures.**—Company representatives urged that the cost to a company of the preparation and issue of debentures, and also discount which sometimes has to be allowed to subscribers of debentures, should be deducted from assessable income. The two claims may be looked at separately. The preparation and cost of issue of debentures is the cost associated with a loan of money. While no income may result in the year of issue, **the expense of the issue appears to be a legitimate business expense, for which, in our opinion, provision might reasonably be made, to enable it to be treated as a deduction from assessable income.** The question of the discount upon debentures is on another footing. Neither this nor the cost of issue are at present treated as allowable deductions, but the discount may, we think, be fairly regarded as an addition to the interest payable for the borrowed money, and as interest paid is a deductible charge, it would seem consistent to allow the discount also. There is, however, this objection, that if the whole of the discount be allowed in the year of issue, it may, by lowering the rate of tax upon the total income, have a disproportionate effect upon the amount of tax payable. **It would, therefore, be reasonable to divide the amount of discount over a period not exceeding the currency of the debentures, and allow as a deduction in each year of the period the annual proportion of the whole amount.** In the case of interminable debentures or debentures having a long period of currency, an arrangement should be made with the Commissioner as to a reasonable period over which the deductions should be distributed.

(10) **Interest on Borrowed Money.**—Where a trader borrows money for the purposes of his business by way of overdraft or otherwise, he is allowed to deduct interest. Representations were made to the Commission that persons whose income is derived from salary or wages are at a disadvantage as compared with traders in this respect, that, if the salaried taxpayer borrows money—say, to meet medical expenses—he is not permitted to treat the interest paid as a deduction from assessable income; whereas the trader, though borrowing for the same purpose—for example, by way of overdraft—may include the interest as interest paid on account of business obligations, and thereby escape tax. The Department allows interest as a deduction to non-traders in cases where there is some taxable return from the investment of the borrowed money. Where the investment is in the nature of a continuing business, the whole of the interest is allowed as a deduction. If in any cases traders act as suggested by witnesses, inequities would arise, but, in our opinion, **no remedy can be suggested which would not be likely to create anomalies at least as serious as those which it would cure.**

(11) **Interest received from Government Loans.**—A representative of a large financial institution urged that interest received from Government loans (in addition to those which by Statute are tax-free) should be allowed as a deduction from assessable income. **We are unable to recommend this concession.**

(12) **Losses of Original Subscribers on Sale of Commonwealth War and Peace Loans.**—It was urged that original subscribers to Commonwealth War and Peace Loans invariably find that a loss is incurred if it becomes necessary to realize their bonds in the open market. The suggestion was made that any losses so incurred should be treated as a deduction from assessable income. **We are unable to recommend this concession.**

(13) **Interest upon Deposits in Banks and Savings generally.**—A correspondent who did not present himself for oral examination suggested that, as a matter of public policy, with a view to encouraging the growth of capital, and thereby providing the means of employment and production, interest derived from deposits in banks or other financial institutions should be freed from Income Taxation. This suggestion is part of a larger question presented to us by professorial witnesses, who took the view that additions to capital constitute the most important form of production, and that, as capital in the community is only built up by what is saved, the policy of taxing authorities should be to treat all savings as non-taxable in the year in which they accrue. A special case of this nature frequently urged by accountants and company representatives is that of the undistributed profits of companies. Witnesses suggested that, if a company distributes say 60 per cent. of its profits of the year and retains the remaining 40 per cent., the profits so retained will almost certainly be used in such a way as to stimulate production and lead in subsequent years to increased taxable income. **We do not feel justified in accepting the wider proposition nor in recommending the specific exclusion from assessable income of interest on deposits or of the undistributed profits of companies.**

482. Crown Leaseholds.—Increased Rental due to Re-appraisal—How deductible.—General Order No. 1011, issued by the Commonwealth Commissioner, states the practice of his Department in respect of this matter in these terms:—

“The rental of a Crown leasehold was re-appraised, the increase dating back to four years previously. The taxpayer sought to deduct from each of the previous years’ income the increased rent payable retrospectively for each year.

“It was decided that the rent could only be deducted in the year of actual payment, since the increase was not in fact incurred *in* the previous year. It was incurred in the income year as an outgoing in that year measured in amount only by a newly-created liability extending to certain previous years.”

483. Opinions placed before us differed as to whether the practice laid down in the Order cited is the correct one, or whether the deduction should be made proportionately from each previous year’s income, as claimed by the taxpayer quoted in that Order. Which method would be more favorable to the taxpayer would depend upon the relative amounts of taxable income in the various years in question. The inclusion of the whole of the amount of the rent retrospectively charged, as a deduction in a year in which income was large and rate of tax consequently high, would considerably reduce the taxpayer’s burden. On the other hand, if the year in which payment was made was a year of loss, or of relatively low income, an opposite effect would be produced. Similarly, if the amount were distributed over the various years (but of course with less effect, the amount in each case being less) the effect on the rate in some cases would be favorable, in others unfavorable, to the taxpayer, but the effect would be less, the amount in each year being less.

484. It will be seen from paragraph 490 that in discussing section 18 (1) (b) of the Act we have taken the view that any sum refunded on account of previous overcharge of tax should be related to the year of original assessment, and we pointed out in that paragraph that in the case where the Commissioner opens an assessment of a previous year for the purpose of making an additional demand, that demand is related back to the year of original assessment.

485. In our opinion that principle is sound, not only with regard to demands and refunds, but also with regard to the case now under discussion.

486. **We recommend** an alteration of the present practice of the Department to provide that, where retrospective increased rent charges upon a Crown leasehold are levied, the taxpayer should be allowed to deduct the increased rent from each of the years to which the increase applies, any necessary adjustments being made accordingly, the same principle to apply where the rent charges are retrospectively decreased.

487. Section 18 (1) (b) reads—

. . . . there shall be deducted—

“All rates and taxes, including State and Federal land taxes and State income tax, actually paid in Australia by the taxpayer during the year in which the income was received, but not including any tax paid under this Act but including the amount of war-time profits tax payable in Australia in respect of any part of the income :

“Provided that when a taxpayer receives a refund of the whole or part of any of the taxes mentioned in this section the amount of such refund shall be brought into account as income in the year in which the refund is received ; ”

488. Some witnesses urged that this sub-section should be amended to include among the deductions the amount of the Commonwealth Income Tax. Consideration of this suggestion shows that its adoption in the Commonwealth Act would lead to an absurd position, and **we have no hesitation in dismissing the suggestion.**

489. Another change suggested was that the amount of Commonwealth Land Tax paid should be allowed as a deduction from the Commonwealth Income Tax, and not, as at present, from the assessable income. **We are unable to support this suggestion.** It will be noted on reference to paragraph 8 that New South Wales is the only State in which the Federal Land Tax is not allowed as a deduction from assessable income. We have elsewhere stressed the advantages which attach to uniformity in the various Income Tax Assessment Acts of the Commonwealth and the States. In the suggested uniform Act for the Commonwealth and State Income Tax Assessment which was prepared by the Conference of Commonwealth and States taxation officers in March, 1917, Federal Land Tax (also State Land Tax) was specifically allowed as a deduction. **We concur in the opinion that the allowance is one which should be made.**

490. It will be observed that under the proviso to this sub-section any sum refunded on account of previous overcharge of tax must be brought into account as income in the year in which the refund is received. This sometimes leads to a result very unfavorable to the taxpayer, inasmuch as the rate of his tax in that year may be considerably greater than that of the year in which the overcharge was made. In a converse case—that is, where the Commissioner re-opens an assessment of a previous year for the purpose of making an additional demand—that demand is related to the year of original assessment. This appears to us the proper principle to apply, and **we recommend that the proviso in question be amended accordingly.**

491. The State Statutes on the subject of this sub-section are as follows:—

New South Wales.—The Income Tax Act allows deduction from assessable income of the rates and taxes (except State Income Tax) imposed by Acts of the State Parliament or by any authority constituted by any such Act.

Victoria.—The Victorian Act includes among deductions all taxes payable under any Act of the Parliament of Victoria except the Income Tax, also the amount of Land Tax paid to the Commonwealth upon land situated within the State.

Queensland.—The Queensland Act allows as deductions all rates and taxes (except Commonwealth and State Income Tax) and also the amount of Commonwealth Land Tax paid in respect of land situated within the State.

South Australia.—All rates and taxes paid in earning income within the State, except State Land and Income Taxes. The State Act includes a provision for deduction of the amount of Income Tax, including War-time Profits Tax imposed by the Commonwealth Acts, so far as they affect income or war-time profits arising in South Australia.

Western Australia.—In Western Australia rates and taxes, including State and Federal Land Tax and Federal Income Tax, are allowed as deductions, but not State Income Tax.

Tasmania.—All rates and taxes (other than Income Tax, State and Federal, and State Land Tax) are allowed as deductions. A taxpayer residing in the State is allowed to deduct the amount of Income Tax paid elsewhere upon income derived from a source outside the State and assessable under the State Act. A deduction is also allowed of any amount paid elsewhere by way of Land Tax in respect of land from which income on account of mortgage is derived.

492. **Section 18 (1) (c)** reads—

“ . . . there shall be deducted—

“ Every premium or sum paid by the taxpayer on the insurance on his own life or that of his wife or children or for a deferred annuity or other like provision for his wife or children or in respect of any fidelity guarantee or bond which such taxpayer is required to provide in the exercise of his business :

“ Provided that in no case shall any deduction be allowed under this paragraph beyond the sum of Fifty pounds in the aggregate or for any premium or sum paid in respect of any such insurance, annuity, or other provision effected outside Australia ; ”

493. There was some criticism of this sub-section in the evidence, on the ground that it gives a preference to a particular form of saving—that is, life insurance—and that this form of saving is not open to everybody, as some persons are rejected by the insurance companies. With regard to the latter point, a witness in one State informed us that the experience of the largest life insurance company operating in that State was that about 6 per cent. of applicants for life insurance are rejected for physical reasons.

494. Another point in relation to the sub-section was that of the amount to be allowed as a deduction, which under the present Act is **£50**. Some witnesses suggested that this amount should be increased, while in one or two cases its decrease or abolition was suggested. The same amount is allowed as a maximum deduction in all the States except South Australia and Tasmania. In those two States no deduction is allowed on account of life insurance premiums.

495. The figures published by the Commonwealth Commissioner of Taxation in his Seventh Annual Report show that of the total deductions made under this sub-section about two-thirds are in respect of taxable incomes not exceeding **£400**.

496. The form of saving with which life insurance was most often contrasted was that of Savings Bank deposits, and some witnesses urged that such deposits should be placed upon the same footing as life insurance premiums. In our opinion, life insurance may be distinguished from other forms of saving in that:—

(a) It provides immediately after payment of the first premium a financial protection for the taxpayer's family, which would probably be attained through other forms of saving only after the lapse of many years during which savings were continually being made.

- (b) It is usually not possible to withdraw the whole of the moneys invested in this way during the currency of the insurance, nor is the process of obtaining the surrender value under a life policy as simple as the withdrawal of deposits from a bank; and, partly upon this ground and partly because of the sentiment associated with life insurance, it is very much more likely that life insurance once entered upon will be continued than that a deposit will be allowed to remain and be continually added to through a long term of years.
- (c) It is not open to the same abuse as would be Savings Bank or other deposits for such deposits might be made immediately before the end of the financial year, for the purpose of claiming a deduction in the Income Tax Return, and then be withdrawn in whole or in part early in the new financial year.

497. The British Commission on the Income Tax (1920) said on this subject :—

“ Sound reasons may, we think, be found for the action of the State in singling out this one form of thrift for preferential treatment. . . . The distinguishing feature of life insurance, which probably accounts for what would otherwise seem to be an unfair preference, is that by no other means can the less wealthy taxpayer, who has no accumulated capital in his earlier years of productive effort, secure a proper provision for his dependants. Viewing the matter in a broad and national way, we consider that this reason is sufficient to justify the State in looking with favorable aspect upon life insurance and in treating income that is saved and applied in this manner with special indulgence.”

For the above reasons **we recommend the retention of the sub-section in its present form.**

498. **Section 18 (1) (d)** reads—

. . . . there shall be deducted—

“ sums expended for repairs to or on that part of any property occupied for the purpose of producing income or from which income is derived or is deemed to have been derived, and for the repair of machinery, implements, utensils, rolling-stock and articles employed by the taxpayer for the purpose of producing income ; ”

499. The evidence with regard to this sub-section does not suggest the necessity for any change, and **we therefore recommend its retention.**

500. **Section 18 (1) (e)** reads—

. . . . there shall be deducted—

“ such sum as the Commissioner thinks just and reasonable as representing the diminished value per centum by wear and tear, during the year in which the income was derived, of any machinery, implements, utensils, rolling-stock and articles used by the taxpayer for the purpose of producing income, such wear and tear not being of a kind that may be made good by repairs :

Provided that where a deduction has been allowed under paragraph (d) of this section the Commissioner shall take into consideration the sum allowed under that paragraph in determining the sum to be allowed under this paragraph :

Provided further that where in any business income is set apart by the taxpayer by way of a fund to cover depreciation under any of the headings mentioned in this paragraph, the amount so set apart for the year in which the income was derived shall, subject to the approval of the Commissioner, be the sum to be deducted for depreciation ; ”

501. All the State Income Tax Acts, except that of South Australia, make provision for depreciation of plant and machinery, and in each case that depreciation is based upon the diminishing value. The Victorian Act allows, subject to the approval of the Commissioner, the amount set apart by the taxpayer for depreciation to be the sum to be deducted on that account. In South Australia the Statute does not provide for depreciation, but for replacement, to the extent of allowing deduction of the cost of any implements, utensils, or articles employed for the purposes of the trade, where supplied “ in substitution of others which have become useless from wear and tear.” Among the States the Queensland Act alone allows depreciation on account of buildings, bores, wells, and dams. The Western Australian and Tasmanian Acts expressly provide that in no case shall any depreciation allowance be made for buildings.

502. On the question of allowances for depreciation, a considerable volume of evidence was tendered. Very much of this evidence, however, turned upon the question of the rates allowed, which were generally characterized as insufficient. The sufficiency or otherwise of rates of depreciation is a matter with which we do not feel called upon to deal. The Commonwealth Commissioner has issued a comprehensive list of rates of depreciation, and similar but less extensive lists are available in some of the States. While refraining from any attempt to revise the Commonwealth list, **we are of opinion that taxpayers should have the right to go to the Board of Appeal in all cases where they are dissatisfied with the rates fixed by the Commissioner.**

503. Apart from the question of rates, the chief question discussed in the evidence is that of the basis upon which depreciation should be allowed. The Commonwealth "Order" upon the subject prescribes the diminishing value as the basis, and provides further that, subject to the approval of the Commissioner, the allowance made in the books of the taxpayer may be accepted as the sum to be deducted for depreciation. A theoretical objection not without weight urged against the basis of diminishing-value is that machinery, for example, loses value at an increasing rate as it approaches exhaustion, and, further, that the diminishing-value basis provides allowances which are greatest when the need is least, and least when the need is greatest. There is, however, evidence to show that the diminishing-value basis is the one adopted by the great majority of taxpayers for the purposes of their own accounts. The basis of cost value, with regular yearly percentage reductions on account of depreciation, had its advocates. This basis has the great advantage of simplicity, but that may be said to be its only advantage. From the administrative point of view, the cost basis is frequently inapplicable, owing to the absence of reliable records in the hands of the taxpayer.

504. The British Commission on the Income Tax (1920), while recommending the adoption of the diminishing-value basis, recommended also that a taxpayer be given the option of using the cost-price basis where he is able to satisfy the Department that he has kept the necessary records to enable that basis to be applied. **We do not consider it necessary to include such an option in Australian Acts, and recommend the retention of the diminishing-value basis.**

505. One other prominent feature of the evidence was the suggestion, often repeated, that depreciation should be allowed in respect of buildings and fences. In one State—Queensland—such an allowance is made at the rate of 1 per cent. upon the diminishing value, which means that the life of a building is regarded as almost indefinite. Elements in the consideration of the question of allowing depreciation in respect of buildings are that, while the structure as such may suffer some deterioration from age, its efficiency as an income-producing asset for the purposes of a particular business may for a long period suffer no diminution, and its capital value may increase. In Great Britain depreciation is allowed with regard to buildings used for the purpose of housing machinery in motion. The ground for the allowance in that case is that the buildings are exposed to the additional wear and tear caused by vibration. The British Commission, 1920, was urged to extend the allowance to all buildings, including private residences. They, however, thought proper to take into consideration the increase in the capital value of the buildings which frequently arises from the "development or growing prosperity of certain districts," and opposed the extension of the allowance to classes of buildings other than those already provided for. In considering wasting assets, however, the British Commission recommended that some allowance should be made for structures (excluding dwelling houses and cottages) whose estimated life falls short of 35 years, and "whose utility is co-terminous with the duration of the commercial undertaking to which they belong."

506. As shown under the previous sub-section (d), the Commonwealth Act, following in this respect the Acts of the States, makes allowance for repairs. In our opinion, this provision is all that is reasonably necessary in respect of both **buildings and fences**, and **we therefore do not recommend the specific inclusion of those items as the subject of depreciation allowance.** In the case of **dams, wells, and underground tanks**, we are of opinion that the position is fairly met by the allowance of the cost of labour employed in their maintenance.

507. **Obsolescence.**—One other matter closely related to depreciation may be mentioned under this heading—that is, an allowance for obsolescence. A representative of a State Chamber of Manufactures urged upon us that a special allowance for obsolescence should be made in cases where it is found necessary to discard machinery or equipment. This was urged partly on the ground that the absence of such an allowance tends to deter manufacturers from "scrapping" machinery which, in the interests of the community, as well as of the particular business, should be replaced by newer and more effective equipment. The witness was unable to quote any particular cases in which the retention of obsolete machinery could be directly attributed to the absence of an allowance for obsolescence, but thought that the granting of such an allowance would be a stimulus to users of machinery in the direction of installing at an earlier date than they otherwise would

the newest and most efficient machines. Such an allowance is made under the British Act to the extent of the difference between the value to which the machine has been written down for Income Tax purposes and its "scrap" value. It may be argued, as against the contention of the witness quoted, that, if there is any loss to the owner of the machinery through obsolescence, it is a loss of a capital nature, and, further, that machinery is not likely to be scrapped unless there is good reason to believe that the introduction of improved machinery will result in increased profits. There is also the point that very frequently a change is made not for the purpose of installing an improved type of machine, but because a machine of greater capacity for output is required. In such cases, of course, it is probable that the selling value of the machine discarded would be sufficient to prevent any material loss. **We do not feel justified in recommending a special allowance for obsolescence.**

508. Replacements.—The Commonwealth practice allows the cost of replacements in respect of certain articles, *e.g.*, bedding, linen, crockery, &c., in hotels and boarding houses, and hospitals. The principle applied appears to be that cost of replacement will be allowed in cases where an allowance for depreciation or for repairs would be inapplicable, either on account of the nature of the article or the impossibility of exercising any check. **The practice should, we think, be continued.**

509. Wasting Assets.—In the determination of what constitutes taxable income, the Commonwealth Income Tax Assessment Act, to a limited extent, recognises the principle of the deduction from assessable income of an allowance in respect of the wastage or depreciation of income-producing assets—for example, Section 17 of the Act, which deals with the income derived from mining operations (other than coal mining) provides:—

"(b) the capital expended by the person carrying on the mining operations in necessary plant and development of a mining property from which income has been received (less the distributed and undistributed income derived by that person prior to the financial year in and for which income tax is being levied) shall be divided by the estimated number of years during which payable mining operations may be expected to continue under normal conditions, and the quotient thus obtained shall, in addition to any other deductions allowed by this Act, be deducted from the income ;

"(bb) as an alternative to the deduction allowable by the last preceding paragraph, there shall, at the option of the taxpayer, be deducted so much of the income of the financial year as is expended in that year for development or is appropriated for development (the cost of which is not deductible under section eighteen of this Act) and for new plant :

"Provided that any of the money so appropriated which has not been expended for that purpose at the end of the year in which it was appropriated shall be liable to tax as income of that year :

"Provided further that no deduction under paragraph (e) of sub-section (1.) of section eighteen of this Act shall be allowed on any new plant to which this paragraph applies."

510. Section 18 (e) provides that in calculating the taxable income of a taxpayer there shall be deducted from the total assessable income such sum as the Commissioner thinks just and reasonable as representing the diminished value per centum by wear and tear during the year in which the income is derived of any machinery, implements, utensils, rolling-stock, and articles used by the taxpayer for the purpose of producing income.

511. Section 20 (i) provides that—

"where it is proved to the satisfaction of the Commissioner that any taxpayer (being the lessee under a lease or the assignee or transferee of a lease) has paid any fine, premium or foregift, or consideration in the nature of a fine, premium or foregift for a lease or a renewal of a lease, or an amount for the assignment or transfer of a lease of premises or machinery used for the production of income, the Commissioner may allow as a deduction for the purpose of arriving at the income, the amount obtained by dividing the sum so paid by the number of years of the unexpired period of the lease at the date the amount was so paid."

512. Beyond the instances covered by sections 17, 18 (e), and 20 (i) the Act does not recognise as an allowable deduction from assessable income any provision for the amortisation of the capital value of an asset that wastes in the production of income.

513. The theory underlying the claim for an allowance in respect of the depletion or wastage, by whatever term known, of income-producing assets, is that taxable income does not properly arise till after due provision has been made for the return of the original capital expended or invested. This would necessarily involve an annual charge against the assessable income of such amounts as will in the aggregate equal the original outlay by the time the value of the asset is exhausted.

514. The view has been advanced that as the principle of making an allowance in respect of wasting assets is recognised in the Income Tax Act, the application of that principle should be made general.

515. The British Royal Commission on the Income Tax 1920 realized the difficulty which frequently attends the attempt to translate sound theoretical principles into practice. They stated in the section of their Report dealing with the subject of Wasting Assets :—

“ On a theoretically perfect basis of assessment, it is possible that regard should be had, not only to the wastage of the material asset whence the income emerges, but also to changes in its value occurring during its use.” (Par. 183.)

“ We think that in that practical world which alone can be considered for the purposes of taxation, the income which represents the taxable faculty is not a mathematical abstraction but that net receipt which, in the hands of its possessor, is usually regarded as income, that is to say, as a receipt out of which current expenditure may be met, subject possibly to some general saving, but not (either in theory or practice) subject to any specific appropriation for the replacement of the capital which is used in earning the income, and which over a long period of years may waste in such use.”

516. The British Commission found it impossible to make any general recommendation that from the income produced by any asset allowance should be made for the amortisation of its capital value. They, however, in the further consideration as to what would be a reasonable allowance to make from income arising from a wasting asset, arrived at the conclusion that there should be a time limit to the recognition of wastage. Their recommendation was that no allowance should be made when the life of the wasting asset is estimated to be 35 years or longer (admittedly an arbitrary limit), and that consequently assets with a shorter life should receive an allowance dependent on the time by which their life falls short of 35 years, such allowance to be the sinking fund payment necessary to amortise the capital cost of the asset over its agreed life less the sinking fund payment which would be necessary to amortise the capital cost if the life of the asset were 35 years.

517. Another recommendation made by the British Commission was that no allowance should be granted to incomes arising from wasting assets which consist of the proprietorship of natural resources in Great Britain.

518. The impossibility in many instances of accurately estimating the life of a wasting asset led the British Commission to suggest the necessity for making revised estimates of the life of an asset from time to time.

519. The modification of the abstract principle to which the British Commission were driven in an attempt to devise practical applications are shown in the three preceding paragraphs. We are impressed with the same difficulties, and have therefore sought a solution of the problem of making adequate allowance from taxable income in respect of wasting assets which, while in the main doing substantial justice, will avoid involving both the taxpayer and the Department in complexity and uncertainty.

520. Income-producing assets (other than live stock) may for the present purpose be divided into three classes, viz. :—

- (1) Material assets constructed or manufactured, such as buildings and machinery.
- (2) Material assets consisting of the natural resources of a country, such as land and the mineral deposits it contains or growing timber thereon.
- (3) Immaterial assets, such as an interest in a lease, a franchise over roads, patent rights, &c.

521. With respect to assets included in Class 1, we are of opinion that suitable allowance for depreciation or wastage can be made under Section 18 (1) (e) of the Act. In paragraph 506 of this Report, dealing with that sub-section, we have expressed the opinion :—

- (1) That the provision for allowance for repairs in Sub-section (d) of Section 18 of the Commonwealth Act is all that is reasonably necessary in respect of buildings and fences.

- (2) That, in the case of dams, wells, and underground tanks, the position is fairly met by the allowance of the cost of labour employed in their maintenance.
- (3) That there is no necessity for a specific allowance in respect of the diminution of value arising through obsolescence.

522. With respect to assets included in Class 2, we are of opinion that, if the attempt were made to provide in the Income Tax Act for an allowance in respect of the amortisation of the capital cost in all cases, three factors should present almost insuperable difficulties. These factors are :—

- (1) The great uncertainty which exists in most instances as to the life of the asset. This uncertainty is much greater in the case of assets included in this class than in the case of those included in Class 1.
- (2) The equal uncertainty which attaches to the residual value of the asset.
- (3) The administrative difficulties which lie in the way of a periodical recomputation of the life of the asset.

523. A mining property may be taken as an example of a wasting asset which presents the difficulties indicated. It is often impossible with any degree of certainty to fix its mineral-producing life ; in consequence, any sinking fund provided for the amortisation of its original capital cost would have to be based upon an estimated expectancy of life mutually agreed upon by the Taxation Commissioner and the taxpayer. Experience might prove that the estimate arrived at was wide of the mark. Where such was the case, in order to do justice either to the revenue or to the taxpayer, revised estimates would have to be arrived at from time to time, and adjustments made in respect of tax paid or payable. Again, if at the end of the agreed-upon period of life it should be found that the asset was still of income-producing value, its residual value might be equal to or greater than its original cost, in which case the Taxation Department would be justly entitled to claim consideration for the over-allowance made in respect of wastage. On the other hand, if before the end of the agreed-upon period of life the asset were found to be exhausted, the taxpayer would be entitled to an adjustment by way of refund. In addition to these considerations, we have already alluded to the special provisions made in the Act under Section 17 in respect of the amortisation of the capital expended in necessary plant and in development of a mine.

524. Sir Josiah Stamp, in the Newmarch Lectures for 1919, recognises both the theoretical correctness of the claim for an allowance in respect of wasting assets and the difficulties which surround the application of the principle which underlies that claim. He states :—

“ The taxation of capital may be carried out in various ways. It may occur in an irregular way in the course of taxation of income, where income is so defined as not to exclude every capital element. If no exemptions exist in the income tax for a wasting asset, like a leasehold, we have taxation of capital mixed up with taxation of pure income, and this may generally be justified if the receipts are being **used** as though they were income. The practice as regards such allowances in the income tax is varied, and the evidence before the Royal Commission on the Income Tax has shown that the question is an extremely difficult one.”

525. When dealing with the economic effects of taxation as distinguished from its incidence, Sir Josiah Stamp said :—

“ If you get an anomaly such as is said to attach to the non-allowance of wasting assets, it may be a severe burden at the beginning, but, provided the rate of tax does not greatly alter, the industry may, so to speak, disperse the burden in the course of time, and return nearly the ordinary rates of remuneration upon capital and enterprise. Remedying the anomaly late in the day may possibly be little less than a present to the existing generation.”

526. Consideration of the practical difficulties which surround the attempt to give full effect to the principle of the elimination of every capital element from taxable income (the theoretical correctness of which is not challenged), and the fact that Sections 17, 18, and 20 of the Commonwealth Income Tax Assessment Act allow deductions from assessable income in respect of the wastage of the assets therein specified, have led us to the conclusion that no general extension of the Act in this connexion is necessary or desirable. **We are, however, of the opinion** that, in addition to the recommendation we have made in respect of purchased annuities, provision should be made in the Act for the allowance as a deduction from assessable income of the sinking fund payment necessary to amortise the capital cost of immaterial assets the interests in which subsist for a fixed term.

527. Section 18 (1) (f) reads :—

. . . . there shall be deducted—

“ the sum actually expended by the taxpayer for food, and for rent of quarters, provided for an employee (other than a member of the taxpayer's own family under the age of fifteen years) who is employed exclusively in a business yielding an income to the taxpayer :

Provided that where a taxpayer provides quarters for such employees in any property in respect of which the taxpayer returns as income Five per centum on the capital value of the property, the proportion of such income found by the Commissioner to be applicable to the quarters so provided shall be deducted ;”

It was shown in evidence that many taxpayers are unable to state the actual sum expended by them for food supplied to employees. In such cases the Commissioner allows an amount of 20s. per week. It was contended that this allowance is insufficient. On this question of fact it seems clear that a taxpayer has the right of appeal to the Board of Appeal. **We do not consider any change in the sub-section is required.** The only State Statutes which contain any similar provision are those of Victoria and Queensland. The Victorian Act allows as a deduction the value of food provided for any employee. The Queensland Act has a similar provision, and, like the Commonwealth Act, includes an allowance in respect of quarters provided for any employee.

528. Section 18 (1) (g) reads :—

. . . . there shall be deducted—

“ Payments not exceeding Fifty pounds in the aggregate, made during the year in which the income was derived by a taxpayer who is in receipt of salary, wages, allowances, stipends, or annuity to superannuation, sustentation, widows' or orphans' fund established in Australia or any society duly registered under any Friendly Societies Act of the Commonwealth or a State ;”

We see no reason for limiting the concessional deduction specified in this sub-section to “ a taxpayer who is in receipt of salary, wages, allowances, stipend, or annuity.” **We, therefore, recommend** the amendment of the sub-section so as to make the deduction apply generally.

529. The New South Wales Statute permits a deduction of any payments made under the Civil Service Act of 1884 or the Railway Servants' Superannuation Act of 1910, “ or any similar payment,” without limitation of amount. The Victorian Act contains a provision very similar to that of the Commonwealth. The amount is limited to £50 in any year. The provision in the Queensland Act is almost identical with that of the Commonwealth, including a limitation to £50. In South Australia, Western Australia, and Tasmania there is no provision of the kind.

530. Section 18 (1) (h) reads—

. . . . there shall be deducted—

“ (i) payments made or gifts purchased and forthwith presented during the continuance of the present war to any patriotic fund established in any part of the King's Dominions or in any country in alliance with Great Britain for any purpose connected with the present war, if the making of the payments or the purchase and presentation of the gifts is verified to the satisfaction of the Commissioner ;

“ (ii) contributions made to the Department of Repatriation or to any public authority for the purpose of being handed over to the Department of Repatriation :

“ Provided the value of the contribution, if in kind, shall be verified to the satisfaction of the Commissioner ; and

“ (iii) gifts exceeding Five pounds each to public charitable institutions in Australia if the gifts are verified to the satisfaction of the Commissioner ;”

531. The war having ended, the operation of sub-clause (i) of this sub-section is exhausted. The evidence in relation to this sub-section was all in respect of sub-clause (iii)—gifts to public charitable institutions. The views of witnesses upon this provision varied greatly. Some advocated the abolition of the clause and some its amendment to include all charitable gifts whether above or below £5. A strong objection to a provision of this character is that it affords a concession to the taxpayer, varying in value according to his position upon the scale of graduated rates, but whatever that position may be, the effect of the sub-section is to make the general body of taxpayers contributors of a proportion of the individual's charitable gift. Assuming that an individual makes a gift of £50, then, if his rate of Income Tax is

1s. in the £1, the general body of taxpayers may be said to contribute £2 10s. of the £50. If, however, the donor has an income taxable at 8s. in the £1, then the general body of taxpayers may be said to contribute £20 of the amount of the gift. These extreme differences in effect of the provision as between one taxpayer and another, and the doubt we entertain that the concession has had any appreciable effect in stimulating private benevolence, lead us to the conclusion that it is not in the general interest of the public that this provision be retained. We therefore suggest its omission from the Act.

532. The State Acts of New South Wales, South Australia, Western Australia, and Tasmania contain no provisions similar to that of the above sub-section. The Victorian Act allows a deduction of any sum over £20 contributed to certain public institutions within Victoria. The Queensland Act permits a deduction of—

(a) any cash donation not less than £2 to any approved Queensland patriotic fund and

(b) money contributions to any approved charitable institution.

533. Section 18 (1) (i) reads—

. . . there shall be deducted—

“five per centum of the total amount paid in the year in which the income is derived in respect of calls on the shares of a company carrying on operations in Australia :

“Provided that the total amount of calls paid in the year in which the income is derived shall be deducted in the case of calls on shares in a mining company or syndicate carrying on mining operations in Australia ;”

534. The provision in this sub-section which allows as a deduction from assessable income the total amount of calls paid on shares in a mining company or syndicate was evidently inserted as a means of affording through the Income Tax Act some direct encouragement to the mining industry. We do not interpret our terms of reference as directing us to inquire into the present position of that industry nor into the necessity for the continuance of such encouragement through the Income Tax Act, and therefore make no recommendation with regard to this provision.

535. The provision allowing a deduction of 5 per cent. of the total amount paid in any tax-year in respect of calls upon company shares generally is one the purpose of which is not so easily seen. Nor have we been able to gather any clear reasons for its inclusion from a perusal of the speeches made in Parliament when the provision was passed. Technically there is a distinction (though no essential difference from the point of view of the payor) between amounts paid as application and allotment moneys and amounts paid as calls. There was evidence that in some cases companies are now applying the term “Calls” to application and allotment moneys with a view to the shareholder obtaining the larger deduction. It does not appear that there is any necessity to stimulate company formation by a concessional deduction from Income Tax of this nature, and we suggest that this provision might well receive careful consideration, with a view to its omission from the Act.

536. The only State in which the Income Tax Statute contains any provision similar to that of the above sub-section is Victoria. The Victorian Act allows mining calls as a deduction if the mine is situated in Victoria. With regard to companies other than mining, there is a provision in the Victorian Act permitting the deduction of calls paid upon shares in certain reconstructed companies, which, in the opinion of the State Commissioner, are of no market value. This provision, which dates back to 1893, is a relic of the “boom” period, and applies only to certain companies specified in an Act called the *Reconstructed Companies Act* 1893. Operation of the provision is probably exhausted, or nearly so. The Victorian Act contains a further provision, allowing as a deduction any calls or contributions made by a taxpayer upon shares of a company which is in liquidation.

537. Section 18 (1) (j) (amounts paid to a fund to provide benefits, pensions, or retiring allowances to employees).—No change is recommended in this sub-section.

538. Section 18 (1) (k) (allowance for children).—Recommendation on this subject was made in the Commission's First Report, and the Income Tax Act has been amended in accordance with that recommendation.

539. Section 18 (1) (l) (commission for collecting income).—No change is recommended.

540. Section 18 (1) (m) (interest on mortgage of site of taxpayer's residence).—No change is recommended.

541. **Section 18 (1) (n)** reads—

. . . . there shall be deducted—

“the annual sum necessary to recoup the expenditure on improvements made under covenant with the lessor on land by a lessee who has no tenant rights in the improvements. The deduction under this paragraph shall be ascertained by dividing the amount expended on the improvements by the lessee by the number of years in the unexpired period of the lease at the date the improvements were effected.”

542. Several witnesses suggested that this sub-section should be amended to allow of the deduction of sums expended by a lessee on improvements made **not under covenant**. The position of such expenditure is, in our opinion, quite different from that upon improvements made under covenant. It seems reasonable to treat this expenditure as capital expenditure and to assume that it would be incurred by the lessee only if he saw his way to recoup himself before the expiry of his lease. It would be inadvisable, if the deduction of such expenditure were contemplated, to allow the whole of it to be deducted from one year's income, and there might be difficulties in administration if the deduction were made in annual proportions, especially if a change of ownership occurred during the currency of the lease. To allow a deduction to a lessee in respect of the cost of an improvement, which can be of value to him only during currency of the lease, while no burden is for taxation purposes cast upon the lessor to whom the residual value of the improvement enures as a benefit on expiry of the lease, also provides opportunity for collusion injurious to the revenue. **We do not feel justified in recommending the amendment of the sub-section, as suggested by witnesses.**

543. **Deduction of Losses where more than one Business is carried on.**—Section 21 reads—

- “(1) Where a taxpayer either alone or with other persons carries on or is interested as a partner in more than one business, the income (if any) from which would be taxable, and makes a profit in one or more of such businesses, and a loss in another or others, the taxpayer shall be entitled to deduct the sum of the losses from the sum of the profits.
- (2) Where a taxpayer, having an income derived from property, carries on one or more businesses, either alone or otherwise, and makes a net loss thereon, the loss shall be deducted from his income derived from property in calculating his taxable income.
- (3) Notwithstanding anything contained in Section 13 of this Act, sub-section (2) of this Section shall apply to any taxpayer who is on active service.”

544. We are of opinion that this Section should be amended so as to make it clear that a loss made on any one or more businesses carried on by a taxpayer either alone or otherwise shall be deducted from any other income he may have, and that, when that income consists partly of income from personal exertion and partly of income from property, the deduction shall be made in the first place from the income from personal exertion, and, when the amount to be deducted exceeds that income, the excess shall be deducted from the income from property. **We recommend amendment of the Section to make that clear beyond doubt.**

545. **Interest on Tax Overpaid.**—The lodgment of an objection to an assessment or the fact that an appeal against the assessment is pending does not relieve the taxpayer from payment of tax upon the due date. There are many cases where a taxpayer lodges an objection against the assessment, but for various reasons, though the matter does not lead to an appeal to the Courts, no final decision is reached for some time. In this and all other cases where tax is paid, and it is afterwards found that an over-assessment has been made, it was suggested by a number of witnesses that the Department should allow interest from the date of payment until the date of refund. The fact that the Act provides a “penal tax” of 10 per cent. of the tax unpaid for failure to pay within the prescribed time was adduced as an argument in favour of the claim. It is to be remembered, however, in this connexion, that Section 43, which imposes this penalty for failure to pay tax “before the expiration of the time specified in Section 41 or such further time as may be allowed by the Commissioner under Section 42”, also gives the Commissioner discretionary power in any particular case to remit the whole or any part of the additional tax imposed by way of penalty, a discretion which, the Commissioner states, is freely exercised. Obviously a partial remedy for the grievance complained of would be found in the prompter issue of decisions by the Department. As a matter of the apparent equity of the case, it is difficult to reject the claim for interest on tax overpaid. A recommendation on the subject will be found in paragraph 546 of this Report, dealing with Section 33 of the Act.

545(a). **Amended Assessments—Time Limit for Issue.**—Section 33 reads—

“(1) The Commissioner may at any time make all such alterations in or additions to any assessment as he thinks necessary in order to insure its completeness and accuracy, notwithstanding that Income Tax may have been paid in respect of income included in the assessment :

Provided that every alteration or addition which has the effect of imposing any fresh liability, or increasing any existing liability, shall be notified to the taxpayer affected, and, unless made with his consent, shall be subject to objection.

(2) When any alteration in an assessment has the effect of reducing the taxpayer's liability, the Commissioner may refund the taxpayer any tax overpaid :

Provided that, where the alteration in the assessment is due to an application by the taxpayer, no refund shall be given, if the application has not been made within three years after the payment of the tax.”

546. Many witnesses complained of the absence of any limitation of time upon the Department in issuing amended assessments under this Section, and urged that the Department should be limited to the same extent as the taxpayer is limited by the Section in respect of the time within which applications for refunds must be made. Two positions may arise in relation to the issue of amended assessments some time after the issue of the original assessment. Firstly, where the issue of the amended assessment is due to the failure of the taxpayer to place the Department in possession of all the material facts upon which to base a complete assessment. In this case **we do not recommend** any limitation of time upon the Departmental action. Secondly, where the Department has from the beginning been placed in possession of all the information necessary for the compilation of a complete and accurate assessment, but has issued an imperfect assessment. **In this case we recommend** that a limit of three years be imposed upon the Department as the period within which an amended assessment may be issued. If such an amended assessment discloses an overcharge by the Department in the original assessment, in our opinion, the taxpayer should receive interest at a prescribed rate. Similarly if, in the circumstances of the first case, an under-payment by the taxpayer has occurred, he should be required to pay interest at the prescribed rate. **We are further of opinion** that the provision limiting the taxpayer's right to refund of tax upon alteration in his assessment due to an application made by him within three years after the payment of the tax should not be held to govern those cases in which such application is based upon a departmental ruling not previously available to the taxpayer. For a recommendation on this subject see paragraph 590 of this Report.

547. **Period for Payment of Tax.**—Section 41 (1) reads :—

“Income Tax shall be due and payable thirty days after the service by post of a Notice of Assessment.”

It was pointed out to us that the period of 30 days specified in this section between the service by post of a Notice of Assessment and the payment of the tax is in many instances inadequate, owing to the irregularity and infrequency of the delivery of mails in distant parts of the Commonwealth, and that taxpayers are frequently liable to penalty for late payment of tax through no fault of their own. In our opinion, such cases should be met by allowing a longer period for payment than 30 days.

548. **We recommend** that the sub-section should be amended to read :—

“Income Tax shall be due and payable on a date to be named on the notice of Assessment, not being less than thirty days after the service by post of such Notice.”

549. **Compliance with Income Tax Law before issue of Passports.**—Section 41 (3) reads :—

“Whenever the Commissioner has reason to believe that any taxpayer establishing or carrying on business in Australia intends to carry on such business for a short time only, he may at any time and from time to time require the taxpayer to give security by way of bond or deposit or otherwise to the satisfaction of the Commissioner for the due return of and payment of income tax on the income derived from the business.”

We had official evidence that the Department has had effective assistance from the Commonwealth Passport Department in tracing persons who were leaving Australia, and a proposal was submitted that the existing law should be amended by requiring the production of a certificate from the Taxation Department that the taxation laws have been complied with, before a passport is issued. While not favouring this suggestion in its entirety, **we are of opinion that it would not be unreasonable to require any person not being a resident of the Commonwealth**, on making application for a passport authorizing his departure from the Commonwealth or on making application for his passport to be *visé* or indorsed for the journey to any place beyond the Commonwealth under the Passports Act, to produce a certificate from the Taxation Department to the effect that no objection is offered by the Department to the issue of the passport or to its

visa or indorsement. Such a practice would not necessitate in every case the payment of the tax before the issue of such certificate, but, where a taxable income is disclosed, would permit of the Department satisfying itself by acceptance of security or otherwise that the tax liability will be duly discharged.

550. Payment of Tax in Instalments.—Section 42 reads :—

“ The Commissioner may in such cases as he thinks fit—

- (a) extend the time for payment, as he considers the circumstances warrant, or
- (b) permit the payment of tax to be made by instalments within such time as he considers the circumstances warrant.”

Various suggestions were made in the course of evidence as to payment of Income Tax in instalments. Some witnesses favoured quarterly, others half-yearly payments. The majority were of opinion that interest at a moderate rate should be charged to cover the added cost of collection. The advocates of the change considered that such a provision, whether made of general application or applicable at the option of the taxpayer, would greatly reduce the number of applications for special extension of time for payment of tax under Section 42. In dealing with the representations made to us on the subject, we have taken into consideration, in addition to the added cost of administration, the fact that few of the assessments under the Income Tax Act are made payable in the first half of the financial year. The change of system, if made general, would mean that at least half the total revenue from Income Tax would not be collected till after the close of the financial year. This would, in the initial year at least, occasion dislocation in the public accounts. It does not appear practicable or desirable to require returns by taxpayers to be sent in earlier than at present, nor to demand payment of the tax in the first half of the financial year. In view of these considerations, and in the absence of any generally expressed demand for alteration in the present method, also for the reason that in our opinion the provisions of Section 42 are adequate to meet individual cases of difficulty or hardship, **we are not prepared to recommend the change suggested by witnesses.**

551. Late Payment of Tax—Penalty.—Section 43 reads—

“ If the Income Tax or additional Income Tax payable on an amended assessment is not paid before the expiration of the time specified in Section 41 of this Act, or such further time as may be allowed by the Commissioner under Section 42 of this Act, additional tax amounting to 10 per cent. of the tax unpaid shall be payable in addition by way of penalty :

“ Provided that the Commissioner may, in any particular case, for reasons which in his discretion he thinks sufficient, remit the additional tax imposed by way of penalty or any part thereof.”

552. A large number of witnesses protested strongly against what they considered the oppressive severity of the above Section with regard to the penalty imposed for any late transmission of Income Tax, and it was very generally suggested that any percentage penalty should be at a rate per annum of the tax unpaid, instead of an absolute 10 per cent. of the whole tax, as at present.

553. We understand that in practice the Commissioner allows a reduction of the prescribed 10 per cent., according to the lapse of time after the due date at which the tax is actually paid. There is, however, no scale of which the public is aware according to which the matter is adjusted.

554. In our opinion, a rate per cent. per annum should be prescribed in lieu of the present absolute 10 per cent., and **we recommend** that the rate be 10 per cent. **per annum.** In making this recommendation, we do not recommend any limitation upon the discretion now given to the Commissioner to remit the penalty or any part thereof.

555. Penalty for Failure or Neglect to furnish an Income Tax Return.—Section 58 of the Commonwealth Income Tax Assessment Act constitutes (*inter alia*) the failure or neglect to duly furnish a return an offence, the penalty for which is fixed at not less than Two pounds nor more than One hundred pounds.

556. Complaints were made to us as to the undue severity involved in many cases by the infliction of the minimum penalty. Amongst representations received by us on the subject was one from the Chairman of the Metropolitan Bench of Stipendiary Magistrates in Sydney, who addressed us in the following terms :—

“ A large number of cases in New South Wales come before the Metropolitan Magistrates in Sydney, in which defendants are charged with neglecting to furnish Income Tax returns. In many of these cases the actual tax for which they are liable is very small, in a number of cases under One pound, and in a number of others under Two pounds. Many of the defendants are working girls, and poor people, quite unaccustomed to filling up Income Tax returns. Persons engaged in clerical or professional work have no idea how hard it is for persons in other walks of life to realize or comply with the requirements of the Income Tax Assessments Acts, or how difficult it is for them to fill in returns.

“ Two pounds, with costs added, is in itself an important matter to people with small incomes, or with large responsibilities, and the infliction of this penalty is in some

cases positively cruel. To deprive magistrates of any discretion in the infliction of a minimum penalty is to deprive them of power to make any allowance for accident, incapacity, illness, or poverty in respect to offenders, all of which reasons are frequently justly offered as an excuse for neglect to comply with the law.

"I think the record of penalties in the Metropolitan District of Sydney indicates that the Metropolitan Magistrates inflict most substantial fines on persons who are careless or wilful in neglecting to make returns, more particularly in respect to educated persons whose incomes are substantial, and for this very reason to force the imposition of a fairly large fine in the case of poor and ignorant persons as a minimum penalty is not only wrong in principle, but tends to create a just discontent which, if possible, should be avoided. The State Acts allow Magistrates a discretion in fixing penalties, and the contrast between the State and Federal procedure is not understood by the illiterate public, and adds to the prevailing sense of injustice.

"I strongly recommend that the infliction of penalties should be left to the discretion of the Magistrates. If necessary, jurisdiction in respect to offences of this nature might be confined to Stipendiary, Police, and Special Magistrates, which would insure a procedure based on experience, and would prevent the imposition of nominal fines in more serious offences."

557. **We recommend** that the Act be amended so as to provide that the minimum penalty for the offence of failing or neglecting to furnish a return be either a nominal amount, say 2s. 6d., or be left to the discretion of the Magistrate.

558. **Taxation of Wages at the Source.**—Many witnesses put forward the suggestion that the system of taxation at the source should be extended to wages, deduction being made by the employer from each "pay." The principal reason adduced for the suggestion was that, in the opinion of the witnesses, a large number of wage-earners, particularly those whose habits are nomadic, escape taxation, partly by failure to render returns, and partly by assuming different names in different localities. It was stated that this applies specially to shearers, sugar-cane cutters and, to a less extent, wharf-labourers. Another reason put forward in support of the proposal was the opinion that all persons earning should contribute something towards the cost of the State, and that the most convenient method would be by collecting the tax in small sums out of each payment of wages, and making it compulsory for employers to deduct the tax when making payments, the employee to receive stamps to the value of the amount deducted, such stamps to be accepted as evidence of payments, and to be produced later on for the purpose of claiming any refunds which may be due when the total income for the financial year has been ascertained. Further, it was urged that the deduction from wages is the easiest possible method for the workmen, as the small amounts deducted from time to time would hardly be felt, while a demand for the aggregate tax after the close of a financial year is often embarrassing.

559. A similar method of taxing workers was urged before the British Commission on the Income Tax 1920, but that Commission found that opinion amongst the wage-earners themselves was strongly against the deduction of tax from wages by employers. The Commission felt that, so long as such an opinion exists, the adoption of any such method would be impracticable; but if a change in view occurred, the Commission was of opinion that the method of deduction of tax from wages would be desirable. At present the British Income Tax Act contains special provisions for the assessment of weekly wage-earners and for the collection of tax. The system is shortly stated by the British Commission as follows:—

"The wage-earner completes a simple form of return at the end of the first quarter of the year, on which he claims any abatement or family allowances or expenses to which he may be entitled; and the employer at the end of each quarter makes a return to the Inspector of Taxes of the actual payments made by him to each employee during that quarter. The assessments are made quarterly by the Inspector, subject to a right of appeal to the General Commissioners; and at the end of the year, when the total liability of the year can be correctly ascertained, there is, if necessary, an adjustment of the four quarterly assessments, followed by repayment where due, whether or not the wage-earner makes a formal claim."

560. Among the witnesses heard by us, some were of opinion that a flat rate should be imposed upon wage-earners to be deducted by the employer without any adjustment when the total income of the year has been ascertained.

561. Other witnesses, however, recognized the justice of treating wage-earners in the same way as other taxpayers—that is, making them finally liable for tax at the rate appropriate to their net income for the year. This, of course, would mean that at the end of the year a wage-earner from whose wages tax had been deducted at a flat rate would have to make a return or statement showing his total income from all sources, and forward the stamps or other evidence of the amount of payments deducted by the employer, with a view to establishing a claim to any refund or rebate to which he might be entitled.

562. We have no hesitation in saying that the proposal to tax wages at the source cannot fairly be considered except in conjunction with a system of adjustments which will have the effect of finally imposing tax only to the extent justified by the total taxable income for the year.

563. Not much evidence was received with regard to the attitude of employers towards such a proposal, but generally the impression conveyed was that employers would be unfavorable to the assumption of such a responsibility as the proposal involves.

564. The extent to which tax is lost owing to the absence of any such scheme is a matter upon which no reliable estimate can be given. The Federal Commissioner of Taxation, in his Seventh Annual Report, estimates the annual loss of tax by evasion, including the failure to make returns, at not less than £300,000. Even if this were a fairly accurate estimate, there is no indication of the proportion due to failure on the part of wage-earners to recognise their responsibility towards the Revenue.

565. As to the revenue benefit likely to be derived from introduction of a system of taxing wages at the source, the Federal Commissioner in his Seventh Annual Report points out that expensive machinery for adjustment would have to be set up, and sums up his comment on the proposal in these words :—"I incline to the view that it would not pay unless the present minimum rates of Income Tax were considerably increased."

566. While so much is doubtful as to the extent of evasion practised by wage-earners; while the proposal to compel employers to deduct tax from wages is unfavorably regarded by both employers and employees, and while the net yield is so uncertain, **we do not feel justified in recommending the taxation of wages by the method suggested.**

[For reasons stated in an addendum, see page 175, Commissioner Jolly does not subscribe to this section of the Report. He also dissents, see page .

From the recommendation contained in paragraph 475 of this section of the Report, Commissioner Mills expresses dissent. See page 177.

From the recommendation contained in paragraph 471 of this section of the Report, Commissioner Duffy expresses dissent. See Reservation *re* Casual Profits, page 143 of the Second Report.]

SECTION XVII.

ADMINISTRATION.

567. **Decentralization.**—The administration of Income Tax, both by the Commonwealth and by State authorities, is highly centralized, the business being conducted wholly from offices in the capital cities. So far as the Commonwealth is concerned, many matters, wherever arising, must be referred to Melbourne.

568. This is in marked contrast with the British method, which is decentralized to a very great extent. The early conception of the British Act was indeed a local administration, with hardly anything more than a general supervision, not amounting to positive control, exercised by a central body. The extent to which administration is localized in Great Britain may be realized from the statement of fact that there are 725 divisions, in each of which an unpaid body known as the General Commissioners has considerable powers, partly as an assessing body, but chiefly as an appellate body. There is also a wide distribution of officers directly responsible to the Board of Inland Revenue, who are called Inspectors of Taxes. The districts in which these officers exercise their authority are not always co-terminous with those of the General Commissioners, and, in practice, owing to the continually increasing complexity of Income Tax law, the functions of the General Commissioners have come to be largely exercised by the Inspectors. The extent to which the purely appellate functions of the General Commissioners are passing into the hands of the Inspectors, subject to formal sanction by the Commissioners, is shown by figures quoted in the Report of the British Commission 1920, which shows that of 67,796 assessments which were the subject of adjustment, only 1,263 were actually heard as appeals by the Commissioners, the remaining 66,533 cases having been settled between the taxpayers and the Inspectors of Taxes.

569. The desirability of some decentralization in the Australian administration was urged by a number of witnesses. It was suggested, for example, that officers of the Taxation Department should, at times to be advertised in the local press, visit country towns, where they would be available for consultation for the purpose of rendering assistance to taxpayers. Both the Commonwealth Commissioner and the Commissioners in the various States have expressed themselves as favorable to this proposal. The Commonwealth Commissioner has personally visited some centres and made himself accessible to taxpayers, with, we understand, very satisfactory results. Other officers of the Commonwealth Department visit centres outside the metropolis, but their work has generally been confined to the conduct of investigations. The State Commissioner of Queensland informed us that he has on occasions visited the northern towns

of his State, and has been able in the course of a few days' visit to bring to a conclusion matters which perhaps would have been almost impossible of settlement by correspondence, and in any case could not have been determined in that manner without great delay.

570. It cannot be said that the present administrators, Commonwealth or State, favoured in evidence the establishment of permanent Branch Offices in country centres, but this is a development which perhaps might come later, if more can be done in the way of temporary visits to overcome the difficulties which many taxpayers feel owing to their remoteness from the administrative centre. In respect of the Commonwealth, the Commissioner states that his difficulty with regard to this, and many other matters, has been and still is inadequacy of staff. For the purpose of visiting country centres, it is clear that only well-trained officers of reasonably high status and invested with real authority can be employed if the taxpayer is to be most effectively assisted and the administration protected.

571. In our opinion, it would be very much in the interests of the taxpayers if the Commissioners, both Commonwealth and State, could arrange for periodical and duly advertised visits by responsible officers to country centres for the purpose of assisting taxpayers with information and, as far as possible, of settling disputes.

572. Many witnesses urged that efforts should be made to minimize the difficulties which occur owing to the number of cases which are referred by Federal Deputy Commissioners of Taxation to the Central Administration. It was not merely the fact of such reference which was complained of, but it was stated that long delays frequently occur in obtaining decisions upon the matters so referred. We recognise the necessity for maintaining uniformity of practice in all States, and that this involves reference to the Central Authority on all questions having more than an individual or local significance. Witnesses in many cases expressed the opinion that matters are referred which should be capable of final determination by the Deputy Commissioners. We have no data by which such an opinion can be tested, but, to reduce the difficulties complained of to the lowest limits—

573. **We recommend—**

- (1) That the widest possible powers be delegated by the Commonwealth Commissioner to his Deputies.
- (2) That the Deputy Commissioners be encouraged to avoid reference to the Central Administration except upon questions of principle which have not previously been the subject of a ruling by the Commissioner.
- (3) That every effort be made to reduce the delays which in a number of cases occur in the Central Office in determining questions submitted by Deputy Commissioners.

574. **Staff and Staff Accommodation.**—The Commonwealth Commissioner of Taxation has represented to us that he has found many difficulties in retaining a competent staff, largely owing to the resignations of a number of senior officers who found it to their interest to enter into business as Accountants and Taxation Experts.

575. The Commissioner's view is that his control, from the point of view of classification and rates of salary, should be complete, instead of, as at present, being in the hands of the Public Service Commissioner. In our opinion, the terms of our reference do not justify such an intensive and extensive inquiry as would be necessary before any sound judgment could be reached upon such a question, which obviously may affect not only one Department of the Government but all Departments. We are quite clear that we have no mandate to inquire generally into the control of the Commonwealth Public Service, and we are equally clear that any recommendations which might be made from the point of view of the necessities of a particular Department would necessarily have far-reaching effects and repercussions upon other Departments.

576. Another matter brought before us by the Commonwealth Commissioner was that of the accommodation for his staff. At the Commissioner's request, we inspected the offices occupied by the Deputy Federal Commissioner and his staff, both in Melbourne and Sydney, and could form no other opinion that that in each case the staff was working under extremely bad conditions, due chiefly to overcrowding. In our opinion, such conditions militate against efficiency.

577. It should hardly need emphasizing that officers engaged in responsible and often difficult duties should work under conditions conducive to health and comfort. The conditions, as we saw them in Melbourne and Sydney, fell so far short of a reasonable standard in both respects that the efficiency of the work must be seriously impaired. There was, also in our opinion, an evident lack of suitable accommodation for confidential interviews between taxpayers and officers of the Department.

578. We are aware that the question of office accommodation is receiving attention at the hands of the Government, and it is obviously not a subject upon which any detailed recommendation should be made by us; but we wish to place upon record our opinion that the conditions now existing and affecting an important percentage of the taxation staff of the Commonwealth should be materially improved.

579. **Office Orders.**—A passing reference was made in paragraph 146 (First Report) to the early issue (as announced in the Federal Taxation Commissioner's evidence) of the departmental rulings and interpretations affecting taxpayers as being likely to reduce the volume of disputes between taxpayers and the Department.

580. In the administration of so technical a measure as the Commonwealth Income Tax Assessment Act, questions of interpretation necessarily arise from time to time. The Commissioner's rulings upon matters of doubt and difficulty determine the Department's practice, and are expressed and embodied in what are known as Office Orders. These Orders are circulated amongst the Branch Offices of the Department in the various States for the guidance of the Deputy Commissioners, in order to secure uniformity of practice throughout the Commonwealth. The cancellation of an Office Order or the substitution of a new ruling may be the result of an altered opinion formed on reconsideration by the Commissioner in the light of fuller information, or, as is sometimes the case, may be due to the decision of an appellate court affecting the question at issue. It may be assumed that the Commissioner is in many instances guided in the decisions expressed in these Orders by the advice of the Crown Law Officers.

581. The greatest possible publicity should be given to these Office Orders, and copies should be made promptly accessible to all taxpayers, so that none need be prejudiced through lack of information. In our opinion, it should be the invariable practice of the Department to apply interpretations to all taxpayers affected thereby, so that the Department may be free from even the suspicion that those who are better informed as to the Department's decisions receive more liberal treatment than those who are ignorant of them. Another essential in our opinion is that all decisions of the Commissioner, whether or not due to the judgment or finding of any competent court or Board of Appeal, should be made to apply to all assessments affected thereby in the current year of assessment, even though such application may involve the issue of a number of amended assessments.

582. It is a matter of regret that the voluminous Office Orders relating to the Commonwealth Income Tax Assessment Act, over 1,000 of which are in existence, have not yet been codified and made available to taxpayers.

583. It has been complained before us that, owing to the non-publication of the Office Orders and the consequent ignorance of taxpayers of Departmental decisions, amounts have been paid in excess of those properly payable. It is said that this is true, not only in respect of Office Orders now current, but also in respect of some Orders which, after governing the practice of the Department for a time, have been cancelled.

584. In a few instances publicity has been given to Departmental interpretations and practice—either through the public press or by publication in the Commissioner's Annual Reports to Parliament—sufficiently to establish their value to taxpayers in the preparation of Income Tax returns and in understanding of the law, and to demonstrate the importance of such publicity from the point of view of equitable administration of the Act. If this be true in respect of the relatively few Office Orders to which publicity has been given, it is to be reasonably assumed that similar advantages would attach to the publication and circulation of the large number of decisions yet unpublished. Those decisions are probably unknown outside the Department except to the taxpayers upon whose assessments the decisions were based.

585. Early in the course of our inquiry, we asked the Federal Commissioner of Taxation to produce for our information and guidance the current Office Orders, and the request has been repeated more than once. These Orders were promised as soon as they could be made available, but, with the exception of some 30 Orders of comparatively recent date, we are still without the desired information.

586. We fully appreciate the difficulties which the Commissioner has experienced in endeavouring to present the information to us in the form in which he felt free to do so, and in which he considered it would be most helpful to us—that is with the elision of personal references to individual taxpayers which the Commissioner stated occur in a large number of the Orders as originally issued for Officers' use, and with the omission of all obsolete Orders. The delay in the compilation and issue of the volume of Orders is attributable by the Commissioner to the loss of competent and responsible officers through death and resignation, and the necessity for assigning other duties to those members of the staff who were engaged in the revision and compilation of the Orders. We regret that the Commissioner has not found it possible to make the Orders available, as throughout our inquiry, and particularly in our critical examination and detailed study of the several sections of the Act, our investigation in many instances would have been rendered both easier and more fruitful had we been in possession of precise information as to Departmental practice of the nature and in the form supplied in the Office Orders.

587. The prompt publication of a handbook on the War-time Profits Tax—to whatever criticism it may be open in matters of detail—was a praiseworthy effort on the part of the administration to make that specially complex measure intelligible to the general body of taxpayers.

588. We have also noted with satisfaction the recent publication by the Department of a handbook explanatory of recent amendments of the law which were recommended in our First Report. These amendments include the introduction of the averaging system to be applied to the Income Tax Assessments of primary producers.

589. Both these publications may be regarded as evidence of a desire on the part of the Department to afford information and assistance to taxpayers. But, in our opinion, more needs to be done.

590. **We therefore recommend—**

- (1) That the existing body of Office Orders affecting the general practice of the Department be published at the earliest possible moment, and be offered for sale to the public at a moderate cost.
- (2) That all such Office Orders subsequently issued be made accessible to taxpayers as soon as issued.
- (3) That, with a view to securing wide publicity, the daily press in each capital city be furnished with copies of all such Office Orders as soon as issued.
- (4) That all such Office Orders be purchasable at each Commonwealth Taxation Office at a moderate cost.
- (5) That facilities be provided free of charge at each Commonwealth Taxation Office for the perusal by taxpayers of all such Office Orders as are operative.
- (6) That all such Office Orders be made to apply to all assessments affected thereby relating to the current year of assessment.
- (7) That, when the promised volume of Office Orders is published, a public notification be made that within twelve months from the date of publication (or such further period as the Commissioner may allow) any taxpayer may apply for an alteration of his assessment for any previous year, where the application is based upon an Office Order the contents of which were not available to the taxpayer at the time of the original assessment.
- (8) That, to meet cases where a claim for refund of tax would be apparently sustainable under any Office Order which had been cancelled before the publication of the volume of Orders, for twelve months after the publication of that volume such cancelled Orders shall be available for perusal by taxpayers at the Taxation Office in each capital city, and that during that period taxpayers shall have the same right of application for alteration of their assessment for any previous year arising out of the provisions of any such Order as they would have in respect of published (current) Orders.

SECTION XVIII.

TAXATION OF INTEREST ON STATE GOVERNMENT SECURITIES AND THE INCOME OF STATE ORGANIZATIONS.

591. The Federal Commissioner of Taxation, in his Seventh Annual Report (page 60), makes the following statement under the above heading:—

“The High Court judgment in the case of *The Amalgamated Society of Engineers v. The Adelaide Steam-ship Co. Ltd.* has raised the question of the power of the Commonwealth to levy Income Tax on—

- (a) interest paid by State Governments or State Government instrumentalities upon borrowed money, and
- (b) the income of a State instrumentality, *e.g.*, a State Savings Bank.

Hitherto, Income Tax has not been levied in either case. The judgment is being studied for the purpose of determining whether any change of practice is now necessary.”

592. The Commissioner, in evidence before us, said that, under the judgment of the High Court in the case of *D'Emden v. Pedder*—

“It was held that the States could not tax interest on Commonwealth loans, and the implication was drawn from that that the Commonwealth could not tax interest on State loans. The High Court has made it clear now, I think [*i.e.*, in the *Engineers* case above cited], that the Commonwealth can tax those loans. At any rate, I am so advised that that power exists.”

593. It may be pointed out that the power of the Commonwealth to prohibit the imposition by a State of Income Tax upon interest derived from a Commonwealth security is definitely expressed in Section 52B of the *Commonwealth Inscribed Stock Act 1911-18*, which reads:—

“The interest derived from Stock or Treasury Bonds shall not be liable to Income Tax under any law of the Commonwealth or a State unless the interest is declared to be so liable by the prospectus relating to the loan on which the interest is payable.”

Apparently no reciprocal power on the part of a State exists to prohibit the Commonwealth from imposing Income Tax upon interest derived from State securities.

594. In 1920 the Queensland Parliament enacted a provision by way of amendment of the Income Tax Act, Section 7 (12), under which the interest upon an issue of Commonwealth Bonds which under Section 52B above quoted was intended to be free of State Income Tax was made indirectly taxable by the State. This effect followed from the requirement of the Amending Act that the amount of interest from such Commonwealth securities should be included in assessable income for the purpose of determining the *rate* of State Income Tax, although tax was not levied upon that part of the income consisting of the interest in question. Action was instituted in the High Court by the Commonwealth against the State of Queensland, claiming a declaration that the State provision in question was invalid, so far as it related to income arising from debentures, &c., issued by the Commonwealth Government. The High Court held that the provisions of Section 52B above quoted are within the powers of the Commonwealth Parliament and that the Queensland Amending Act was in contravention of that section, and therefore invalid. (See the *Commonwealth v. State of Queensland*, 29 C.L.R., page 1.)

595. If, then, it be held that interest on State Government securities or on securities issued by a State instrumentality would be taxable under the Commonwealth Income Tax Assessment Act, unless specially exempted, it is important to consider the more obvious effects which would follow the exercise by the Commonwealth of the power to tax such interest.

596. According to the latest available information, State Government debts at 30th June, 1921, amounted to £458,408,900, but, in order to arrive at the amount the interest upon which would constitute the aggregate income which would be brought into the taxable field for the first time if the Commonwealth, possessing the power to tax interest on State securities, decided to exercise that power, there would have to be deducted from this sum, first, an amount of £67,393,886 loaned to the States by the Commonwealth. There would also have to be deducted an amount represented by the face value of the total Government securities held by institutions, such as Friendly Societies, Provident Funds, Religious Bodies, Charitable Institutions, whose incomes are now exempt by Statute from Commonwealth Income Taxation, and State Savings Banks, whose incomes are now exempt by executive direction. In the aggregate the amount to be so deducted must be very considerable, which, however, it is impossible from any available data to estimate without allowing for a considerable margin of error.

597. The amount of State securities held by the various State Savings Banks at 30th June, 1921, aggregated £66,871,719. As a rough estimate, we assume the sum invested in Government securities by other institutions (such as are indicated above), whose incomes are at present exempt from taxation, together with the amount held by persons whose individual incomes are not taxable, to be an amount of £24,143,295, which is equivalent to rather less than $7\frac{1}{2}$ per cent. of the securities, after making the specific deductions referred to. On this basis it may be assumed that approximately £300,000,000 of State securities are held by taxpayers who at present are not called upon to include in their assessable income the interest derived from these securities, the average rate upon which at 30th June, 1921, was $4\frac{1}{8}$ per cent.

598. It is impossible to estimate other than roughly what the revenue effect would be if this interest were brought within the area of Commonwealth Income Taxation. The uncertainty is due chiefly to the absence of this class of income from so many returns.

599. The rates of tax payable if this class of income became taxable would necessarily vary considerably in the case of individual taxpayers other than companies (to whom a flat rate of 2s. 8d. in the £ now applies), but in our opinion the average rate of tax applicable may be assumed to be about 1s. 6d. in the £. At this rate, on the assumptions previously made, **the revenue gain would be £937,500***, as indicated by the following figures :—

Total State Debts at 30th June, 1921	£458,408,900
Deduct amount (a) loaned by the Commonwealth to the States	£67,393,886
(b) held by State Savings Banks.. .. .	66,871,719
	<hr/>
	134,265,605
	<hr/>
	324,143,295
Deduct estimated amount held by institutions (other than Savings Banks) whose incomes are exempt from taxation, and by persons whose individual incomes are not taxable, say	24,143,295
	<hr/>
	£300,000,000

Interest upon £300,000,000, at $4\frac{1}{2}$ per cent., equals £12,500,000.

Income Tax upon £12,500,000, at 1s. 6d. in the £1, equals £937,500.

600. But effects other than those relating to Commonwealth *revenue* would unquestionably arise if interest on State securities were brought within the ambit of Commonwealth income taxation.

601. The immunity from Commonwealth income taxation hitherto enjoyed by holders of State Government securities in respect of the interest thereon has necessarily increased the burden upon taxpayers who do not hold such securities. The change, therefore, would have as one result the lightening of that burden and its transfer in part at least to the owners of State Government securities.

602. From the point of view of a State, an unfavorable effect would ensue, inasmuch as the market value of its current securities, and, in flotation of future loans, the prices tendered or amounts offered, would be affected by the imposition of the taxation. The same effect would no doubt follow upon the introduction of any new income taxation affecting interest upon securities issued at a time when no Income Tax was leviable nor in immediate contemplation. There is also the consideration that in some States loans have been issued with the undertaking that the interest shall be free both of Commonwealth and State taxation. So far as Commonwealth taxation is concerned, this, in our opinion, need not be regarded as a challenge to any Commonwealth power, but as the assumption by those States of an obligation to indemnify the holders of their stock against any Commonwealth tax that might be imposed. It may be (as to this we have no information) that any such assurances to the investing public have been given as the result of arrangements between the Commonwealth and the States.

603. If, further, it be held that the income of State organizations—for example, State Savings Banks—would be taxable under the Commonwealth Income Tax Assessment Act, unless specially exempted, the question necessarily arises as to whether a distinction should be made between interest on State securities, which reaches the hands of individuals or of companies, and the profits of, say, a State Savings Bank, which do not enure to the benefit of any individual. This distinction is apparently recognised in some of the exemptions enumerated in Section 11 of the Commonwealth Income Tax Assessment Act.

CONCLUSIONS.

604. **Interest upon State Securities.**—We are not aware of any sound principle of taxation which would be infringed by the taxation (by the Commonwealth Parliament) of interest upon loans issued by a State or a State instrumentality in the hands of debenture-holders; but the question of the exercise of Commonwealth power of taxation upon such interest is so involved with the relations of the Commonwealth and the States (as the authorities between which the whole legislative power of the people of Australia is distributed) that **we do not feel justified in making a positive recommendation as to whether that power should or should not be exercised.**

605. **Income of State Instrumentalities.**—As to the incomes of State organizations, we may recall that (in para. 450) we have recommended the retention of the existing exemption from taxation of the incomes of municipal corporations and other public authorities. **That recommendation applies with perhaps an added emphasis to the incomes of organizations which are more directly those of the State.**

* NOTE.—This does not include revenue which might result from the taxation of interest upon loans issued by State Savings Banks.

In concluding this, our Third Report,

We have the honour to be,

Your Excellency's most obedient servants,

W. WARREN KERR, Chairman.
JOHN JOLLY.*
J. G. FARLEIGH.
W. T. MISSINGHAM.
JOHN THOMSON.
S. MILLS.
M. B. DUFFY.

*(Signature subject to Addendum appended).

S. E. JELLEY, Secretary.

Melbourne, 21st July, 1922.

ADDENDUM BY COMMISSIONER JOLLY.

I am not able to either indorse or challenge many matters dealt with in Section XVI. of this Report, and my signature is therefore attached subject to the explanation which follows:—

The primary duty of this Commission “to inquire into and report upon the incidence of Commonwealth taxation,” cannot be fully discharged unless the members make exhaustive inquiry into everything relating the “matter, manner, measure, method, and time” of the tax payment. The “incidence” of a tax may be regarded as extending beyond, but it certainly includes, “the fall,” “the impact,” “the percussion” of the tax on the persons from whom it is exacted, and to understand the incidence, there must be studied not only the nature, strength and direction of the bolt shot from the legislative enactment, but also the accelerating, retarding, directing, and other influences, economic and administrative, which deflect its course or affect its final fall upon different classes of taxpayers.

Many of these influences must be searched for outside the taxing Act, and in the Commonwealth system, some may be looked for in the regulations, the interpretations of its provisions and the rulings on principles and practice which are adopted by the administration, most of which are expressed in a series of papers issued privately at regular intervals and known as “Office Orders.” The necessity and value of such rulings and interpretations in the general understanding and clear administration of an Act, which is not only technical itself, but impinges upon many differing interests involving accurate discrimination is evident, and was appreciated by your Commissioners, who at one of their earliest sittings (15th November, 1920) asked for these orders, and were assured by the Federal Commissioner of Taxation “I have no objection to the Commission having these office orders confidentially, but I do not wish them to go any further than the Commission. I want the Commission to know everything, but there are certain things I do not think should go beyond the Commission.” An assurance was given to him at once that they would be accepted and treated as confidential. At a later stage of the same sitting it was disclosed that the Commissioner had in contemplation the issue of a handbook containing in abbreviated form the gist of these rulings and interpretations, or of such of them as had survived and were still operative: “I have had that in mind for about three years, but I have not had an opportunity of putting it into practice. I have made a start on them twice.” (See Melbourne Evidence, page 352.)

Meantime what has been taking place? Disregarding for the moment other Acts which have their own series of orders, the Commissioner informed us that over a thousand “general orders on the interpretation of our [income tax] laws have been issued to **all officers** for their guidance in making assessments—they contain everything that you [the examining Commissioner] have in mind, and in some cases they are rulings that have not been referred to the Crown Law Authorities. (See Evidence.)

As knowledge and experience grow, some of the rulings are from time to time superseded by others, in some of which it is confessed that the method laid down in the earlier ruling has been found to be *ultra vires*, and must therefore cease to operate, being superseded by the altered method of the later order. This later order may contain instructions to the staff that excessive assessments previously made under the erroneous ruling are to be revised and amended **only if a taxpayer makes demand for it**, but that the Department is not to itself initiate any revision or amendment. A taxpayer who receives secret information that an amended order has been issued could demand revision of his assessment and secure the advantage of the new order, but the great majority of taxpayers, kept in ignorance of the new order whose wider circulation has been prohibited, naturally fail to apply for the benefit of a right, of whose existence they have no knowledge and which the Department had previously disallowed. As a consequence “the people perish for lack of knowledge.” Such inequitable star-chamber proceedings arouse revulsion in the mind of any lover of justice, more particularly if the concealment be deliberate. In regard to opinions contained in these office orders the Federal Commissioner of Taxation informed the Commission—“The public does not give us the benefit of their opinion and **I do not think the Department should give the public its opinion.**” As events show, this Commission has also been treated with aloofness.

Several requests for production of these orders or of the promised code evoked some temporizing reason for non-compliance or delay; the first definite refusal by the Commissioner was contained in a letter dated 24th August, 1921, in which he wrote:—

“Referring to your letter of 19th instant, intimating that, after review of my evidence before it, the Royal Commission on Taxation has decided to repeat its request to be supplied with copies of Departmental Orders issued in connexion with Income Tax, I have to repeat my statement in evidence on the subject, namely that these orders are not yet in a form in which they may be published for general information, or be supplied to the Royal Commission.

“Too many of the orders consist of statements which appeared in taxpayers returns, and which were circulated to officers for their guidance in dealing with similar cases. Section 9 of the Income Tax Assessment Act forbids my divulging these facts, except for the purpose of carrying out the Act.

“I am unable to divulge them to the Royal Commission.”

Notwithstanding that the failure to furnish the rulings in any form was increasingly felt to handicap its work, the Commission exercised great forbearance ; but at a sitting attended by the Commissioner, exactly nine months later—on 24th May, 1922—he was asked by its Chairman—

“ I would like to ask you this—Would it be helpful at all to the Commission if the orders were made available to us for reference or inspection ? ”

And replied—

“ No. Apart from the fact that they are misleading, the bulk of the orders contain details of taxpayers’ affairs. That is the difficulty I mentioned to the Commission. It is necessary to reduce the orders to mere statements of a legal position or a position of fact. That was the work I undertook myself ; but so many other things crowded in that they had to be held in abeyance.”

They have been “ in abeyance ” for five years. How much longer are they to remain “ in abeyance.” We are now in the second half of 1922, so that though conception took place five years ago, the process of evolution is still incomplete, and who knows what agony of protracted travail must intervene before its work is perfected ?

Yet these are the very orders which, during that period, have been and are now being “ issued to all officers for their guidance in making assessments,” including every assessor, whether he be a permanent or a temporary officer. So misleading are they that, we are in effect told, they could not be a safe guide for the members of this Commission, who have spent the greater part of two years in the close study of problems of taxation ; but these same “ misleading ” orders are given to the neophytes of the Department as their *vade mecum* to be consulted on all occasions of doubt and followed as an authoritative guide in assessing (some, but not all) taxpayers. Decisions of the British Board of Inland Revenue, by whom the Income Tax Act is administered, are promptly made available for public information, and in the United States of America the “ Ordinances ” containing departmental interpretations, rulings, digests of cases, &c., are published openly at a nominal charge (a yearly subscription of two dollars entitling the subscriber to a copy of every order issued) and may at once reach all interested persons, their dissemination being assisted by reprints in trade journals and the public press of the country. The importance of such frank and open publication has long been recognised. A century and a-half ago Adam Smith wrote :—

“ The tax which each individual is bound to pay ought to be certain and not arbitrary. The form of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person.”

And so generally had the principle been recognised by modern taxing authorities that in recent years Professor Bastable wrote (Public Finance, page 419) :—

“ Of high importance in earlier times, but now requiring less emphasis, owing to its general observance, is the canon that ‘ **taxation should be certain.** ’ When arbitrary power was able to alter imposts at its will, the uncertainty connected with the demands of the tax-collector was a great aggravation of the evil of the heavy burdens imposed. That the citizen in his dealings with public officials should be under the rule of settled law, not of caprice, is not only a financial but an important constitutional maxim.”

Whatever reasons may be advanced by its servants for refusing to circulate departmental rulings and interpretations of the Act for the guidance of the public, what justification is there for the refusal to place the fullest information before this Commission, by whom assurance was at an early stage given, that evidence conveyed in confidence would be treated as confidential, and who also suggested that anything of a strictly personal kind disclosing the affairs of any identifiable taxpayer should be erased from the file of Office Orders before it left the Department.

The difficulty in making the orders available to the Commission is stated to be “ the bulk of the orders contain details of taxpayers’ affairs.” “ The bulk ” cannot mean less than half ; it usually implies more. The writer has been informed that not one in ten—possibly about one in 50—of them contains such confidential details. If so, the issue of 90 per cent. or more of them would not involve infringement of Section 9 or any section of the Act.

In Australia the concealment practised has engendered certain evils, among them the flagrant injustice that taxpayers who have communicative friends in the Department have benefited, while innocent ignorance not so befriended has been buffeted. The injuries are none the less because the injured are also drugged and unconscious of the seriousness of their injuries.

Because the Commission has been excluded from information as to the principles adopted and the rulings followed by the Department, indispensable to the creation of reliable opinion on the many questions of detail which contribute to the understanding and appreciation of the incidence of the tax, I am unable to either commend, condemn, or criticise what is frequently named the “ present practice of the Department ” in reference thereto. My colleagues have felt—though perhaps less acutely than I—and referred in paragraph 586 to the disabilities under which the Commission laboured, in consequence. “ The present practice of the Department,” which should be as well known and open to all as the King’s highway, is in the circumstances a *terra incognita* to all but the few initiated, and I cannot consent to lead or be led blindly through it. I am consequently unable to subscribe to Section XVI. of the Report.

JOHN JOLLY.

RESERVATION.

Paragraph 475 of the Report.

I regret that I am unable to concur in the opinion expressed by the majority of the Commission in the above cited paragraph of the Report. It may be questioned whether that opinion is consistent with the principle of the recommendation of paragraph 471, and, further it departs from the rule of practice observed by the Taxation authorities of the Commonwealth and of all States except Victoria, that income in the hands of a beneficiary is regarded as income from personal exertion or income from property, according to its classification at its origin in the hands of the trustee. For example, the profits of a business carried on by the taxpayer are taxed as income from personal exertion. Hence, if a business is conducted by a trustee, the profits of the business would in the hands of the trustee be classified as income from personal exertion, and, if a share of the profits is payable to a beneficiary, he would be taxed under that classification. As above stated, this is the practice throughout the Commonwealth, except in the State of Victoria. In that State a claim was made by the Commissioner of Taxes upon a beneficiary receiving income derived from a business carried on by trustees, for tax at the rate applicable to income from property. The claim was disputed, and the matter came before the Courts and eventually was carried on appeal to the Privy Council. The Privy Council, confirming the Judgment of the Supreme Court of Victoria, held that income does not change its character for taxation purposes when passing from the hands of trustees to those of beneficiaries. The Victorian Income Tax Act was subsequently amended to render this decision nugatory. **In my opinion it is desirable that income should for taxation purposes retain its character when passing from the hands of a trustee to those of a beneficiary.**

S. MILLS.