

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA.

---

R E P O R T

OF THE

ROYAL COMMISSION ON  
TAXATION,

TOGETHER WITH APPENDICES.

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SECOND REPORT.

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## COMMONWEALTH OF AUSTRALIA.

# SECOND 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 Saint Michael and Saint 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 Report of the 27th October, 1921, to report hereunder upon the following subjects coming within the Terms of Reference :—

- (8) Harmonization of Commonwealth and State Taxation ;
- (9) Taxation at the source ;
- (10) Differentiation ;
- (11) Graduation ;
- (12) Taxation of income of Australian residents derived from sources outside Australia ;
- (13) Taxation of profits arising from sales abroad of exports from Australia ;
- (14) Casual profits ;
- (15) Live stock values.

### SECTION VIII.

#### HARMONIZATION OF COMMONWEALTH AND STATE TAXATION.

191. The Terms of Reference include a direction to the Commission—

“ 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 (*inter alia*)—

- (a) the harmonization of Commonwealth and State taxation ;
- (b) the simplification of the duties of taxpayers in relation to their returns.”

#### PRESENT DISTRIBUTION OF POWERS.

192. The Commonwealth Constitution expressly confers almost unrestricted powers of taxation upon the Commonwealth Parliament, subject to the qualification, viz., that there shall be no discrimination between States or parts of States (Sec. 51 (ii) ). The power of the Commonwealth Parliament to impose Customs and Excise Duties is exclusive, but, in respect of other forms of taxation, the States possess concurrent powers.

## EXISTING DIRECT TAXATION.

193. Prior to the War the only direct tax imposed by the Commonwealth was the Land Tax, under the *Land Tax Assessment Act* 1910. Presumably the magnitude of the financial obligations arising out of the War compelled further entry by the Commonwealth into fields of direct taxation, and the Land Tax was followed by the imposition of Estate Duties in 1914, of the Income Tax in 1915, of the Entertainments Tax in 1916, and of the War-time Profits Tax in 1917 (which did not apply to profits arising subsequent to 30th June, 1919). The present position is that the Commonwealth continues to levy—

1. Land Tax ;
2. Income Tax ;
3. Estate Duties ; and
4. Entertainments Tax ;

while in each State there are also—

1. Land Tax ;\*
2. Income Tax ; and
3. Probate or Succession Duties.

In South Australia and Tasmania there is also a State Entertainments Tax. In Tasmania the tax is collected by the Commonwealth on behalf of the State.

## HARMONIZATION—HOW TO BE ATTAINED.

194. Three sets of circumstances, viz. : (1) the possession and exercise of concurrent powers of direct taxation by Commonwealth and States ; (2) the magnitude of their respective Revenue requirements ; (3) the numerous and marked divergencies, both in principle and practice, in the several Taxation Acts, render the harmonization of Commonwealth and State taxation peculiarly difficult. Close study of the various Taxation Acts of the Commonwealth and States, and the light which has been shed in the course of our inquiry upon the nature and extent of the resultant burdens imposed upon taxpayers, have led us to interpret the term "harmonization of Commonwealth and State taxation" more widely than have the majority of the witnesses who appeared before us.

195. For example, some witnesses considered that harmonization would be attained by—

- (a) the adoption of one form of Income Tax return for both Commonwealth and State purposes ; and
- (b) the appointment of one collecting authority for all direct taxes.†

But, even if these reforms were found to be generally acceptable and practicable, they would only provide a partial remedy for the existing evils arising from duplication and complexity.

196. The question of allocation of spheres of taxation between the Commonwealth and the States was frequently discussed by witnesses, and much difference of opinion as to detail was exhibited. Practical agreement was shown to the extent of accepting as reasonable the allocation of Land Taxation exclusively to State authorities. Divergencies of opinion were expressed in connexion with the Income Tax. Apparently the elasticity and productivity of this tax and the difficulty of balancing the Budgets of the two authorities, if either authority were deprived of the revenue now derived from Income Tax, raised doubts as to whether reform could at present be extended beyond the point of appointing one collecting authority for both Commonwealth and State Income Taxes.

197. At this stage it will be well to review the successive steps which have been taken by Commonwealth and State authorities in the direction of securing uniformity of taxation legislation, the creation of a single collecting authority, and the adoption of one form of Income Tax return.

\* In New South Wales the State directly collects Land Tax only from certain freeholds within the Western Division, the general provisions of the *Land Tax Assessment Act* being suspended in respect of lands situate within Shires or Municipalities in which tax is levied by the local authority upon the unimproved capital value of lands, and at a rate of not less than 1d. in the £1.

† An agreement (referred to later) between the Commonwealth and Western Australian Governments, under which the Commonwealth acts as collecting authority for the State came into operation on 1st July, 1921.

### Previous Efforts to attain Uniformity.

**198. Conference of Premiers, 1916.**—At a Conference of Premiers, held in December, 1916, it was resolved that the Commonwealth Government and the Governments of the several States should direct their leading taxation officers to meet and prepare a uniform scheme for Income Tax, Land Tax and Probate Duty (rates excepted in each case).<sup>\*</sup> Action was taken accordingly.

**199. Conference of Taxation Officers, 1917.**—The Conference of Taxation Officers met on the 13th March, 1917, and following days. The Report of that Conference, after quoting the above resolution, goes on to say—

The instructions to the Taxation Conference are headed by the words "Collection of Income Tax, Land Tax and Probate Duty by one authority," but there is nothing in these instructions to say whether it is intended that the Conference should express an opinion as to which authority should collect.

Collection by one authority necessarily carries with it administration. So far as Income Tax and Land Tax are concerned, the collection by one authority will, if the recommendations of the Conference be given effect to, be a practicable one, but certain constitutional difficulties will require to be overcome, to enable the States to collect for the Commonwealth, or *vice versa*.

The question as to whether the administrative authority shall be Commonwealth or State is considered outside the province of the Conference. The respective Parliaments must decide.

### 200. The Conference framed and submitted an Income Tax Bill—

to take the place of the seven Acts now in operation in Australia. If it is adopted, the form of return of income to be filled in by taxpayers, both for Commonwealth and States purposes, will be in all respects uniform, and the irritating and confusing differences (to the taxpayer) done away with.

The uniform Bill has not yet been adopted by any of the States, and only partially by the Commonwealth.

### 201. With regard to Income Tax Returns, the Conference stated—

As matters now stand, it would be extremely difficult to draw up a return in the particular States that would conform with the requirements of the Acts of the Commonwealth and States, so many and varied are the differences in the several Acts now in operation, but it is considered desirable that what can be done in this direction should be done before next year's forms are issued.

An attempt will, therefore, be made by each State and the representatives of the Commonwealth to make the return forms coincide, as far as possible, with a view to ameliorating, even though it may be only to a small degree, the puzzling and irritating differences to the taxpayer.

**202. Conference of Premiers, 1918.**—At this Conference, which was held in May, 1918, the question of uniformity of Income Tax Laws, Commonwealth and State—after debate—was referred to the Taxation Officers present—the officers to confer with the Hon. E. G. Theodore, the Hon. Sir Richard Butler, and the Hon. James Gardiner. The following report was presented to the Conference before its rising by the Hon. J. C. L. Fitzpatrick (New South Wales):—

Mr. Theodore, who has had this matter in hand, has had to leave the Conference, and has left with me copies of the determination arrived at by the officers who were asked to make investigations and come to conclusions in the matter. The questions put to those officers were these—

(1) Assuming uniformity of Income Tax Assessment between the Commonwealth and the States to be impracticable, *e.g.*, that the following points of difference continue:—

- (a) Taxation of Companies' profits;
- (b) Taxation of Insurance Companies; and
- (c) Taxation of profits on realized assets;

is a uniform return possible?

(2) If so, what steps are necessary to accomplish it?

(3) Prepare draft of uniform schedule.

The replies received were—

(1) Yes—if a "uniform" return means one which contains all the requirements common to both authorities, and at the same time the special requirements peculiar to each.

(2) (a) The "basic" or income year must be the same for the Commonwealth and the States.

(b) The respective States' Acts must be brought into line on the basis of the taxation officials' draft Act.

(3) The drafting of a "uniform" return is a difficult task, and is not practicable within the limited time at our disposal.

<sup>\*</sup> A further resolution with regard to uniform land valuation is referred to under the heading "Valuation" in the Land Tax section of this Report.

The setting out of the differences between the taxation officials' Bill and the Commonwealth Bill should be sufficient at this stage.

The State return and the Commonwealth return will contain the same requirements.

These returns should be issued by the respective Government Printers at the same time, and the date for lodgment should be the same for Commonwealth and State alike.

The colour scheme should be adopted—the States' returns to be one colour; the Commonwealth another.

The State return to have a docket attached reminding the taxpayer he must also fill in a return coloured ( ) for Commonwealth purposes. The Commonwealth return to have a similar docket.

The differences between the Commonwealth Income Tax Assessment Act and the draft Bill proposed by the Taxation Conference are as follows :—

Heading.	Commonwealth Bill [1918].	Conference Bill.
As to assessable income—		
Taxing dividends to shareholders .. .. .	Included	Excluded
Five per cent. of the capital value of taxpayer's residence or holiday house ..	Included	Excluded
Gains and profits on sales of assets .. .. .	Excluded	Included
As to deductions—		
State Income Tax .. .. .	Included	Excluded
War-time Profits Tax .. .. .	Included	Excluded
Five per cent. on calls to companies (other than mining companies) and full calls to mining companies .. .. .	Included	Excluded
Interest on mortgage of property in respect of which 5 per cent. on capital value is returned as income .. .. .	Included	Excluded
Contributions to Repatriation Department .. .. .	Included	Not discussed
Sinking Fund to amortise expenditure on improvements on leased land, when the lessee has not tenant rights in the improvements .. .. .	Included	Not discussed
Deduction on account of dependants .. .. .	Included	Excluded as being dependent upon the general exemption

#### Resolution re Officers' Report.—The Conference resolved—

A. That the Report of the Committee be received, the Committee thanked for preparation, and a copy of the Report be forwarded to the Conference of Treasurers to be convened by the Acting Prime Minister.

B. That a copy of the Report be forwarded to the Acting Prime Minister.

**203. Conference of Treasurers, July, 1918.**—At the Conference of State Treasurers, held on the 17th July, 1918, the question of the collection of taxes by one authority was again mentioned, and it was resolved—

That Mr. Holman (New South Wales) and Mr. Theodore (Queensland) be appointed a Sub-Committee to consider and report upon the proposal to create the one collecting authority for the direct taxes of the Commonwealth and the States.

**204. Conference of Commonwealth and State Ministers, 1919.**—At a Conference of Commonwealth and State Ministers held in January, 1919, the Report of the Sub-Committee mentioned in the preceding paragraph was submitted. The Report showed that the two members constituting the Sub-Committee were in agreement on the following matters :—

(1) The whole business of assessing and collecting Income Tax for the Commonwealth and States should be undertaken by an amalgamated Department.

(2) In States where a Land Tax operates, land taxation should also be placed under the control of the same Department.

(3) The formation of such Department need in no way restrict the right of the Commonwealth or States to rescind or amend their taxation laws.

(4) At the same time, a further approach to uniformity in the Acts must be made, chiefly in connexion with the deductions and allowances made under the Commonwealth and State Income Tax Acts, if any advantage is to be derived from the amalgamation.

(5) The joint administration of two Acts widely divergent upon these points, though practicable, would really amount to nothing more than the housing of the two existing staffs in one office, as each return would probably have to be dealt with by the two sets of officers. Very little, if any, economy would result from this.

205. After enumerating certain differences between the Commonwealth Act and the respective Acts of Queensland and New South Wales, the Report goes on to say—

(8) Our present opinion is that, if some working approach to uniformity were made upon points—

(a) exemptions; and

(b) deductions;

adequately trained assessors could deal with each taxpayer's return for both State and Commonwealth purposes, in spite of the divergencies on the other heads.

(9) Our proposal, therefore, is to establish a Bureau with such assessors in each capital, and to secure the passage of the necessary legislation by all the Parliaments, to obtain the necessary additional measure of uniformity.

(10) So far we are in agreement; but with regard to the control of such a Bureau, two alternative proposals have been put forward.

206. Mr. Theodore's proposal with regard to the control of the Bureau was that it should consist of two Commonwealth Ministers and three State Ministers; the Bureau to control the staff and to be responsible for appointments, promotions, dismissals, &c. The Chief Commissioner of Taxation to be solely responsible for the administration of the various Acts of the Commonwealth and State Parliaments relating to Income Taxes and Land Taxes. Certain provisions were also suggested to secure the supply to any of the Governments concerned of such statistics as might be required for legislative purposes.

207. Mr. Holman's scheme of control did not include any Ministers as Directors, but suggested a Department jointly controlled (as to the general business in each State) by the present State Commissioner of Taxes and the Deputy Commissioner for the Commonwealth in each State. Where any differences of opinion arose between the two Commissioners acting together in a State, then if these differences related to staff matters they were to be referred for arbitration to the Chairman of the Public Service Board or corresponding officer of the State. Where the differences of opinion arose *re* the interpretation of the Statutes, they were to be referred to a Central Committee, consisting of two State and two Commonwealth representatives, meeting under the presidency of the Commonwealth Treasurer. The State representatives to be the Treasurers and Under-Secretaries of two States (for choice South Australia and New South Wales); the Federal representatives to be the Secretary to the Treasury and the Chief Commissioner of Taxation. One paragraph in Mr. Holman's Report states that, although the control is nominally in the hands of the Central Committee, it will be actually in the hands of the Federal Chief Commissioner. After some discussion on details, the Report was "received."

208. **Offer by the Commonwealth.**—At the same Conference (1919) the then Commonwealth Treasurer, the Right Honorable W. A. Watt, offered, on behalf of the Commonwealth Government, to collect the whole direct taxation of the States at one-third of the present cost to the States.

209. **Offer by the Government of Victoria.**—On behalf of the Government of Victoria, the Treasurer of that State, the Hon. W. M. McPherson, made a counter offer to that of the Commonwealth, in these words—

I am prepared to offer that Victoria will collect your (Commonwealth) taxation, in *Victoria*, at half what it is costing you at the present time.

The Commonwealth Treasurer replied—

I have thought it over, and I rejected it for reasons which I explained to the House of Representatives.

A reference to *Hansard* of 1st May, 1918, p. 4264, shows that the Treasurer, in introducing an amending Income Tax Assessment Bill (in which, he said, had been incorporated as many as possible of the recommendations of the Conference of Taxation Officers, 1917) (see paragraphs 200 and 202 above), went on to say (p. 4264)—

I have shown the principal differences between the Commonwealth proposals and those of the States, and I do not think the difficulties presented are insuperable. Although the Acts may differ, I think we could still provide, if the States are willing, for a uniform return; and the question is—Who shall collect the taxes if the Commonwealth and States come to an agreement? The proposition of the Treasurers of the States is that we should scrap our Taxation Officers and hand the work over to them because they were first in the business. In this connexion I am a half-and-half Federal and States man. I do not mind saying I am "shandygaff" on the question. The bulk of my experience and my work—legislative and administrative—has been in the State, and I do not believe that the change in arena has changed my feeling. But, looking at the question from the stand-point of simplicity, economy, and convenience to the taxpayers, there is no doubt as to what should be done. I can see, for example, that if we agreed to the States collecting the taxes, it would be impossible to destroy the Federal Taxation machinery that we have erected. In my dual experience I have been able to take both spheres into account, not unduly weighted in favour of either; and we are now looking for a track which the people of Australia would most approve. There are many people who, like most Companies, do business all over Australia, or in many of the States. If we decided to allow the States to collect the taxes tomorrow, there would still have to be a Federal Office to collate those people who make, perhaps, £1,000 in New South Wales, £12,000 in South Australia, or £500 in Victoria, and graduate their taxation in the Federal Account. It is impossible for us, if we are in the direct taxation business, to delegate our authority to the States and hope to do so economically. On the other hand, it is possible for the Federal machinery to be mobilized and organized so that the State machinery may disappear.

During the same speech, Mr. Watt also said (p. 4265)—

After a close study of the question, I believe that with our present machinery we could collect the taxation of the States for half of what it costs the States, and I would be prepared, on investigations already made, to guarantee that very substantial saving.

**210. Repetition of Commonwealth Offer.**—At a Conference of Commonwealth and State Ministers held in July, 1920, the Prime Minister of the Commonwealth referred to the offer made by the Commonwealth Treasurer in 1919, and said—

That offer is still open, and so it is idle to deal with the question as to what the States are doing and paying for this work. Here is a firm offer to collect taxation at one-third the existing cost; not one-third the cost in each particular State, because some States may be doing it for more and some for less; but, taking the States by and large, we say we are prepared to do the work for one-third the existing cost.

No immediate response was made by the States, but, before the close of the Conference, it was intimated that the State Treasurers had agreed that there should be one collecting authority and a uniform Schedule.

**211. Board of Inquiry.**—The Conference also decided to appoint a Board to report upon the best means of giving effect to—

- (a) One tax-gathering authority for the Commonwealth, and
- (b) One form of return.

The Board of Inquiry appointed in accordance with that decision consisted of the Hon. James Ashton, M.L.C., of New South Wales (Chairman), Mr. Robert Ewing, Commonwealth Commissioner of Taxation, and Mr. R. M. Weldon, State Commissioner of Taxes for Victoria, as representing all the States except Western Australia. The Report of that Board, dated 23rd February, 1921, shows that, at its first meeting—

The Commonwealth Commissioner of Taxation submitted a proposal involving an amalgamation of the staffs of the Commonwealth and State Taxation Departments by transfer of permanent State Officers to the Commonwealth Service under the Commonwealth Public Service Act, except in the case of the State Commissioner of Taxes. The scheme provided that the latter officer should remain an officer of the State Service, and should have the free administration of the State law without interference from any Commonwealth authority. On the other hand, the Commonwealth Commissioner of Taxation would have the free administration of the Commonwealth laws without interference from any State authority.

The Commissioner of Taxes for the State of Victoria (Mr. R. M. Weldon), as representing all the States except the State of Western Australia, submitted that the control of administration of both Commonwealth and State taxation laws should be vested in a body representing the Commonwealth and State Governments.

**212. Recommendation of Board.**—With regard to item (a) of the Reference to the Board—the best means of giving effect to the principle of one tax-gathering authority for the Commonwealth—the Board by majority (the Chairman and the Commonwealth Commissioner) recommended the adoption by all States of a scheme on the lines of the arrangement entered into between the Commonwealth and Western Australia.

**213. The Commissioner of Taxes for Victoria, in a Minority Report, recommended a scheme for the establishment of one tax-gathering authority for the whole of the Commonwealth, consisting of a Board of Control of—**

five members, two members to be appointed by the States as their representatives, and to be selected from the present State taxation officials; two members to be appointed by the Commonwealth as their representatives, and to be selected from the present Federal taxation officials; the fifth member to be an outsider, with wide business experience, preferably a practising accountant, with a full knowledge of commercial law and practice, to be appointed by the Commonwealth and States jointly, and to be the Chairman of the Board.

**214. Majority Report of the Board.**—The following extracts from the Majority Report indicate the views taken of the principal points at issue :—

1. In considering the subject of one collecting authority for Commonwealth and State Land and Income Taxes, we consider the following points are fundamental :—

- (i) To be acceptable to both State and Commonwealth Governments, any scheme for the collection of taxes by one authority should preserve to the respective Governments, inviolate and without surrender to any body, all their existing rights in regard to administration and control. All other rights, such as legislation as to the character of Taxation Acts and rates of tax, are already preserved fully by Constitutional enactment;
- (ii) The object should be capable of achievement with considerable reduction in the present combined expenditure by Commonwealth and States. . . . .

5. The Western Australian scheme thus clearly preserves the independence of administration of Commonwealth and State Laws, not only by the respective Commissioners, but by the respective Governments through those Commissioners. Each Government is thus free to make any special arrangements it may desire in connexion with the administration of its laws or the collection of its taxes, by consultation with and direction of one person only. There is no possibility of any opposition to these directions by persons representing any other authority, and there is thus no duality of control by Governments of any corporate body having united supervision over both Commonwealth and State taxation laws.

7. On the point of reduction in cost, the Commonwealth Commissioner of Taxation is satisfied from his investigations to date into the facts arising under the Western Australian agreement that the reduction in the present combined expenditure by the Commonwealth and that State will be two-thirds of the present State expenditure.

10. On the other hand, the scheme proposed by the Commissioner of Taxes for the State of Victoria involves the abdication of authority by the Commonwealth and State Governments in favour of a mixed tribunal. If it be contended that the respective Governments should, under the scheme, retain their present powers of control over the administration of their own laws, it follows that both the Commonwealth and all the State Governments might exert their control in such manner as to interfere with smooth administration or harmonious relations both between themselves and between the members of the suggested administrative body.

The scheme would introduce into the administrative control a person without experience in the administration of taxation laws, and would give him, as Chairman of that body, a commanding position in comparison with the positions to be occupied by his trained and expert colleagues.

12. . . . . Under the scheme recommended by the Minority Report, the question of cost remains at large, and, while certain additional expenditure is definitely foreshadowed, a guarantee of saving to the State such as is involved in the Commonwealth undertaking is entirely lacking.

#### 215. On question (b) of the Reference to the Board, *i.e.*, as to one form of return—

. . . . . the Board came to the conclusion that, while the State Taxation machinery laws remain in their present respective forms, and while existing conditions of administration continue, no practical advantage would accrue to taxpayers by the use of a combined form of return.\*

### THE WESTERN AUSTRALIAN AGREEMENT.

216. Between the date of the Premiers' Conference, 1920, above referred to and the issue of the Board's Report, an Agreement was entered into between the Commonwealth and the State of Western Australia, the main lines of which are indicated in paragraph 210. That Agreement is printed as Appendix No. 4 to this Report.

217. **Criticism of Agreement by Representative of States.**—As a member of the Board above referred to, Mr. Weldon, Commissioner of Taxes for Victoria, stated his reasons for dissenting from the recommendation to adopt the Western Australian Agreement as follows :—

The Agreement is unequal in its incidence, inasmuch as it practically places the control of the assessment and collection of the State taxes in the hands of the Commonwealth authorities notwithstanding that the States and the Commonwealth have equal rights and interests in this matter, and notwithstanding the fact that the States have indicated at various times through their Governments that they are not prepared to hand the assessment and collection of State taxes to the Commonwealth.

The sovereign rights of the States appear to be subordinated in the following ways :—

- (1) Where the law of the State is identical with or substantially similar to the law of the Commonwealth, the Commonwealth Commissioner determines the interpretation (Clause 12). This limits the present powers of the State Commissioner in this connexion almost entirely.
- (2) Bills fixing the rate of State taxes for the year are to be submitted by the Government of Western Australia to Parliament before the 30th September in each year (Clause 15). This is a dangerous clause, as it may possibly restrict the Government's discretion as to when it shall bring in the Budget, as it is a constitutional practice that Tax Bills should be introduced after the Budget.
- (3) The Commonwealth Commissioner appears to have the power to decide what are reasonable statistics concerning State taxes that the States may require to be kept (Clause 17).
- (4) Certain State taxpayers are given power to lodge their returns outside State jurisdiction, and on returns in the Commonwealth prescribed form (Clause 18c (1)).
- (5) Prosecutions for offences against State laws are to be conducted by the Commonwealth (Clause 20a).
- (6) When the offence is against both the laws of the Commonwealth and the State, the Commonwealth Commissioner decides under which law the prosecution is to take place (Clause 20b (1)).
- (7) As a general rule, the prosecution shall be instituted under the law which provides the greater penalty. This, in effect, means the Commonwealth Law (Clause 20b (2)).
- (8) The State Commissioner cannot defend an appeal to the Courts until the Commonwealth Law Officers approve (Clause 24). This is a distinct giving up of necessary State rights.

*Position of State Commissioner.*—The Agreement provides for the State Commissioner's independence with regard to his State duties, but since he will be required to carry out Commonwealth duties as a subordinate to the Commonwealth Commissioner, his independence is more imaginary than real. In a very little time the State Commissioner will become, in effect, a Commonwealth officer. The transfer of the State officers to the Commonwealth Public Service will materially interfere with and lessen his real authority over them, for their dominating interests will, necessarily, be more and more with the Commonwealth. They will be Commonwealth officers doing State work, and he (the State Commissioner) will

\* A combined form of return has, however, since been issued for use by all taxpayers in Western Australia who are liable to payment of Income Tax.

be a State Officer in control of them (Clause 6). In the case of any difference in a Commonwealth matter, he is a mere subordinate. With regard to any difference that may arise in a purely State matter, how is he to give effect to his decision if his staff does not agree with him and the Commonwealth Commissioner does not support him? In the event of his position becoming vacant at any time a Commonwealth officer will probably be appointed to succeed him, as there will probably be no trained State officer available to take his place.

*Further State Disadvantages.*—The Agreement may be terminated by six months' notice. This might result in a serious dislocation of a State's finance by making it impossible for the taxes to be got in during the particular financial year as the only taxation officer the particular State will have will be the State Commissioner; the other State officers will have been absorbed by their becoming Commonwealth Public Servants.

The arrangement does not take into consideration the probable growth and expansion of the Commonwealth and the States.

The effect of the Western Australian Agreement will mean that in a short time that State will lose its identity with respect to its management of the direct taxation concerned. It certainly has power to terminate in six months the agreement but should it do so at any time it will find itself without staff or records (which are indispensable to the proper working of a Taxation Office) as the records will be so interwoven with the Commonwealth records that the Commonwealth may point out that it is impossible to separate them into what is State and what is Commonwealth.

**218. Views of Under-Treasurer, Western Australia.**—The Under-Treasurer for the State of Western Australia, who was formerly Commissioner of Taxes in that State, furnished the Commission with a statement of his views upon the Agreement between the Commonwealth and Western Australia. Generally he indorses the criticisms of Mr. Weldon above cited, adding some further objections on points of detail. The general view he takes of the Agreement may be inferred from paragraphs 7 and 11 of his Statement, which are as follows:—

7. The only rights which the State retains under the Agreement are the power, through its Parliament, of prescribing the rates and incidence of taxation, and the power of obtaining such statistics relating to the taxes as it may desire.

11. In short, I regard the Agreement as expressing in legal form, not an amalgamation, but an absorption, a surrender by the State of valuable rights and executive power.

**219.** The Under-Treasurer's Statement is not only critical, but also constructive, in that he suggests a scheme somewhat similar to that recommended by Mr. Weldon. The suggestion is that in each State the assessment and collection of Commonwealth and State direct taxes should be by one authority, control to be exercised by a Board of three Commissioners, one appointed by the Commonwealth, one by the States acting jointly, and the Chairman by the Commonwealth and States acting jointly. While the Board would have general control, it is suggested that the Board should not make or be deemed to make any assessment, or collect or be deemed to collect any taxes, those duties being carried out in each State by two Chief Assessors, viz., one Chief Land Assessor in charge of the Land Branch and one Chief Income Assessor in charge of the Income Branch. The Control Board (the Statement suggests) should also be a Court of Appeal to hear and decide appeals from assessments of a Chief Assessor in any State; taxpayers to have the right on any question of law to carry the matter from the Board to the Supreme Court of the State or to the High Court or the Privy Council.

**220. Views of Queensland State Commissioner.**—The Majority Report of the Board was also the subject of criticism by the Queensland Commissioner of Taxes, a copy of whose memorandum to his Government has been supplied to us. The Queensland Commissioner quotes the fundamental rules laid down by the Majority Report, which may be shortly stated as requiring that any scheme for the collection of Commonwealth and State Land and Income Taxes by one authority should—

1. Preserve existing rights in regard to administration and control;
2. Effect considerable reduction in the present combined expenditure by the Commonwealth and States.

**221.** The Queensland Commissioner, agreeing on this point with the Minority Report, considers that the Majority Report fails to comply with its own rules. He says—

There is no doubt that under this recommendation the State Government would have practically no control over the administration of the Act.

**222.** On the question of cost, the Queensland Commissioner refers to correspondence which he had with the Federal Department, and which, considered in connexion with published figures of cost of collection in the States of New South Wales and Queensland, led him to the conclusion that the Commonwealth offer to collect for all States at one-third of their present cost is much below what would prove to be the actual cost.

**223.** This view may be compared with the offer mentioned above of the Victorian Treasurer to collect in Victoria the Commonwealth's direct taxes at one-half of the present cost to the Commonwealth. Assuming the respective offers of the Commonwealth and the State of Victoria to have been based upon an adequate study of the position, they are very important as indicating the large waste of public money involved in the continuance of the present separate administration of direct taxation.

224. As to the difficulties to the State which might arise owing to the Agreement being terminable on short notice, as also on other grounds, the Queensland Commissioner's views generally support those of the Minority Report.

225. **Views of South Australian Commissioner.**—The State Commissioner of Taxes, South Australia, furnished us with a copy of a memorandum he had submitted to his Government in criticism of the Western Australian Agreement. The views expressed in that memorandum are generally on the same lines as those of the State officers above quoted. The South Australian Commissioner, however, gives special emphasis to the question of cost of collecting. According to his statement, during the year ending 30th June, 1920, the Federal Income Tax collected in South Australia was £639,211, the staff employed numbering 156; while the State Office collected £662,334 with a staff of 40. He adds—

On the face of these figures, it is incomprehensible that the Federal Department can collect the revenue at a cheaper rate than the State.

There may be some special reasons for the apparent difference in this instance; and, in any case, the Commonwealth offer, as expressed by the Prime Minister (see paragraph 210) was based upon the aggregate cost to the States collectively.

226. **Western Australian Agreement—Comments by Commission.**—The Western Australian Agreement represents the first joint action taken by the Commonwealth and the States to reduce the administration cost, and the expense and inconvenience to taxpayers, arising from dual control. The criticisms directed against it include complaints that the Commonwealth has ceded too much in one direction and that the State has ceded too much in another.

227. The Majority Report and the Minority Report, as well as the witnesses from whose evidence we have quoted, all accept as fundamental the principle expressed in the Majority Report (see paragraph 214), viz., that—

to be acceptable to both State and Commonwealth Governments, any scheme for the collection of taxes by one authority should preserve to the respective Governments, inviolate and without surrender to any body, all their existing rights in regard to administration and control.

They do not, however, appear to have paid sufficient regard to what, in our opinion, is the main consideration which should govern reasoning upon the subject, and to which all other considerations must be adjusted. **That consideration is the sovereign right of Australian taxpayers to have the mechanism of taxation so designed and controlled as to impose the minimum of inconvenience and involve the minimum of cost.** Cost to the taxpayers cannot be reckoned only in terms of the amounts which the Commonwealth and State estimates show as the charge upon the consolidated revenue of the respective Governments for the maintenance of their Taxation Departments. That cost is indeed very heavy, amounting to about £750,000 per annum, but over and above this there is the cost to taxpayers for skilled assistance in the preparation of returns, and in complying with Departmental requisitions, which was estimated by one witness to be not less than £1,000,000 per annum. It is not only the larger taxpayers who have to incur such expense, but instances were brought before us showing that in numerous cases country taxpayers, primary producers and others, are forced to incur costs for journeying and for professional assistance in the preparation of returns and checking of assessments, often out of proportion to the amount of tax payable. It is not suggested that by any possible scheme the whole of these special costs to taxpayers can be avoided, but those costs are largely caused by the differences between the different Statutes with which taxpayers must comply; partly by complexities in the Statutes which may be greatly reduced; and, in the case of the Commonwealth particularly, by the fact that the general instructions or Office Orders which guide the administration, and which would also be a valuable guide to taxpayers, have not hitherto been accessible to the public.

228. The recommendations of this Commission will, it is hoped, lead to amendments in the first two respects, and the Commission is informed that these Office Orders will shortly be made readily available to the public. Access to this information should, in our opinion, have a material effect in reducing both the special expense now incurred by taxpayers and also the administrative costs, while it will tend to reduce friction between the taxpayer and the Department.

229. The Western Australian Agreement effects some useful reforms, *e.g.*, it makes possible a saving in the aggregate cost of collection of direct taxation (Commonwealth and State) in that State.\* It tends to produce uniformity of Income Tax Law and of the interpretation of that Law; and it does away with the necessity for reference by taxpayers to more than one office. But by leaving intact all the differences between the Commonwealth and State Income Tax Law, its value is very greatly reduced, and **we do not recommend the adoption of a similar agreement by the Commonwealth and other States.**

#### CONTROL OF DIRECT TAXATION BY THE STATE.

230. We have considered a suggestion that the States should be given exclusive power to impose direct taxation, subject to an obligation to pay to the Commonwealth on a per capita basis such amounts as might be determined from year to year by the Commonwealth Parliament.

231. It is claimed in support of this scheme—

1. That there would be no practical curtailment of the present powers—
  - (a) of the Commonwealth, since the Central Government could still command revenue, and, if the State machinery failed, could itself collect from the individual taxpayer;
  - (b) of the States, since each State would have the right within its own jurisdiction to determine the method and incidence of taxation levied to meet its financial obligations, including those to the Commonwealth.
2. That it would restore the position existing before the Commonwealth entered the field of direct taxation. (In this connexion it has been suggested that the retirement of the Commonwealth from that field would be in harmony with the intention of the framers of the Constitution.)
3. That it would do away with the (alternative) necessity for the enactment by all the Australian Legislatures, and the maintenance unaltered, of uniform Assessment Acts.

232. We are of opinion that the scheme would involve a very important curtailment of the present powers of the Commonwealth. Taking Income Tax as an example, the effect would be that the Commonwealth would have no voice in determining the rates, the mode of collection, or the nature or incidence of the tax. We consider it a sound principle that where any Authority is, by right and not by grace, directly or indirectly receiving revenue raised through taxation imposed upon its citizens, that Authority should, wherever possible, be charged with the responsibility of determining the nature and incidence of the taxation. A departure from that principle in the case of the Authority which has the predominant interest in the proceeds of a tax and the widest power to make it effective is specially to be avoided. (The acceptance by the States of the present per capita grant from the Commonwealth does not, in our opinion, infringe this principle.) The permanent exclusion of the Commonwealth from the whole field of direct taxation would tend to weaken the sense of responsibility of the citizens to the Commonwealth Government, a result which, in view of the paramount responsibilities of that Government and its financial needs arising out of the War, would be particularly undesirable.

233. The hypothesis upon which the scheme is founded is that the exclusive power of imposing all direct taxation shall be vested in the States, subject to an obligation to pay to the Commonwealth on a per capita basis such amounts as might from year to year be required by the Commonwealth Parliament. Apart from the probable legal difficulties arising out of the attempt to make effective a power coupled with an obligation of indefinite extent, the position which would be created if a State made default in respect of the payment to the Commonwealth would be full of menace to harmonious relations between the respective authorities.

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\* With regard to the saving in the aggregate cost of collection effected under the Western Australian Agreement, actual figures are not yet available as the agreement has not been in force for twelve months. The Minister for Works and Railways (the Hon. L. E. Groom) speaking in the House of Representatives on the subject, stated—

“The amalgamation of our Western Australian Branch with the State Taxation Department had led to an increase of £21,598. . . . The expenditure of the Commonwealth Department in Western Australia in 1920–21 was £42,995, and the cost of the State Department in that year was £33,367, the two Departments costing £76,362. This year the amalgamated Departments are estimated to cost £65,986. That Agreement has resulted in saving the people of the Commonwealth and Western Australia a sum of £10,376 19s. 8d.”

Had the expectation of the Federal Commissioner of Taxation that “The reduction in the present combined expenditure will be two-thirds of the present State expenditure” (see paragraph 214) been realized, the aggregate saving due to the amalgamation would have been £22,245. It thus appears that while under the agreement Western Australia benefits to the extent of £22,245 per annum, the taxpayers of Australia generally will, at least in the current financial year, have to make up the difference (£11,869) between £22,245, the sum of which the State is relieved, and £10,376, the real aggregate saving for the year.

234. The majority of witnesses agreed that the levying of Income Tax would be more appropriate to the Commonwealth than to the States, and in this view your Commissioners concur. It has been suggested that there would be equal appropriateness in the allocation to the Commonwealth of any direct tax of which the principle of aggregation is an important feature. But, in the case of Land Tax, the almost universal opinion of witnesses was that it more appropriately belongs to State authorities.

235. With regard to Income Tax, if that were levied only under the authority of State enactments, it is evident that the collection which now takes place as the result of the aggregation under the Federal Law of incomes derived from more than one State would cease. That in itself would reduce the revenue derived from Income Tax, and moreover would prevent the full operation of a principle which in our opinion is just. There is force in the statement by Professor Seligman (in discussing American Income Taxation) that—

A State Income Tax cannot thoroughly succeed because of complications of inter-State taxation and the difficulty of getting at the income derived from inter-State sources. Moreover, as our Federal Income Tax develops, the confusion between State Income Tax and Federal Income Tax levied according to entirely different principles is bound to become greater. (*Annals of the American Academy*, 1915, p. 9.)

236. The ever-growing volume of inter-State business affords another effective argument in favour of the ultimate vesting in the Federal authority of the exclusive power to impose Income Tax under statutory conditions applying uniformly throughout the Commonwealth. State Taxation authorities find great difficulty in dealing with the question of apportionment of Company profits made partly in one State and partly in another. The following extract from a Memorandum supplied by the Victorian Commissioner of Taxes indicates the nature of the difficulty:—

*Companies Trading in and out of Victoria. Inter-State Problems—which do not affect the Commonwealth.*

(1) The Company may make a profit in Victoria and a loss in another State, and distribute in dividends an amount much below the Victorian profit;

(2) It may make a profit in Victoria and a loss in another State, and pay no dividend at all;

(3) It may make a loss in Victoria and a profit in another State, and declare a dividend, no portion of which is earned in Victoria;

(4) It may make large profits in Victoria, and, in dealing with the whole of the Company's operations, only pay a small dividend, and at the same time carry a large amount of the profit to Reserve Fund, contrary to the principles guiding the taxation of individuals.

The Victorian profit has to be ascertained in all these cases for apportionment of dividend purposes.

The dividends shown in the taxpayer's return have then to be divided up on the ratio of the Victorian profit to the total profit. In some cases taxpayers hold shares in 30 different companies; the ratio in each of these companies will vary, and all the ratios will vary every year.

The apportionment (in some cases it must be on an arbitrary basis) is always likely to be a strong point of difference between the taxpayer in receipt of dividends and the Department.

The State authorities also experience continual difficulty in regard to assessment and collection of tax in respect of Company shareholders residing in another State.

These Inter-State difficulties are, of course, not experienced by the Commonwealth administration.

237. So far as the effect of this scheme upon State finance is concerned, it is manifest that the power of the Commonwealth to require large payments year by year would necessarily limit the volume of taxation which the States could impose upon the citizens for State purposes only. The same effect in varying degree follows whenever two authorities are operating in one field by the same mode of taxation.

238. The suggestion that the retirement of the Commonwealth from the sphere of direct taxation would be in harmony with the intentions of those who drafted the Federal scheme appears to us to lack support. For example, Quick and Garran (*Annotated Constitution*, p. 132) say of the Constitution Bill adopted at the Adelaide Convention, 1891, and which in this respect remained unaltered by subsequent discussion, that—

The Federal Parliament was given full powers of raising money, not only by Customs and Excise, but by every other mode of taxation; and the only conditions imposed upon this power were that Federal taxation must be uniform in all the Colonies, and that, on the adoption of a uniform tariff, trade between the Colonies should be free.

But the permanent expression of the intentions of the framers of the Constitution must be sought in the Constitution itself. The Constitution places upon the Commonwealth Government the sole responsibility for defence and for other national services, and, at the same time, as one means of discharging that responsibility, confers upon that Government full powers of direct taxation.

239. Viewing the proposal under comment from a general point of view, it may be said that it would have the effect of increasing State powers at the expense of the Federal, to that extent doing less than justice to the paramount responsibilities which the Commonwealth has been bound to assume in defence of those seriously-threatened national rights, the loss of which would have caused the destruction of every form of Australian citizenship.

## CONCLUSIONS.

240. Any scheme of harmonization or amalgamation which still leaves Commonwealth and State authorities both demanding revenue from the same people by the same mode of taxation can at best be only an imperfect remedy for the existing disabilities. There was practical unanimity of opinion among witnesses that a delimitation of spheres of taxation is desirable. The members of the Commission are of the opinion that only by a delimitation of spheres or allocation of subjects of taxation between the Commonwealth and the States can an ordered and satisfactory system of taxation be brought into being in Australia.

241. Evidence has not been wanting of an insistent and growing desire on the part of taxpayers, and the discussions of Commonwealth and State authorities quoted in paragraphs 198 to 215 disclose a disposition on the part of the several Governments of Australia, to secure co-ordination of the present diverse and complex system of taxation. To the extent to which Commonwealth and States operate in separate and distinct spheres will the harmonization, simplification and economy of administration, which are the common objectives of the Governments and people of Australia, be reached.

242. Clearly any permanent delimitation of spheres of taxation would involve a surrender by one or by both authorities of existing legislative powers within specific areas. The permanent surrender by the Commonwealth of legislative powers in respect of any subject of taxation would involve an amendment of the Constitution. In the case of the States, however, such surrender could be effected without amendment of the Constitution by appropriate action under Section 51, Sub-section XXXVIII. of the Constitution, which provides that the Commonwealth Parliament may legislate upon—

matters referred to the Parliament by the Parliament or Parliaments of any State or States, but so that the Law shall extend only to States by whose Parliament the matter is referred, or which afterwards adopt the Law.

243. In response to a question addressed by us on the subject, the Commonwealth Solicitor-General, Sir Robert Garran, expressed the opinion that the question whether a State power so "referred" to the Commonwealth could afterwards be taken away is one of some doubt. He inclined to the view that the conferring State could not revoke its grant of power by subsequent legislation—at all events when the power has been acted on by the Commonwealth under the grant.

244. Apart from the necessary Constitutional action already indicated, the delimitation of taxation spheres presents certain revenue difficulties which, though considerable, are not insuperable. The revenue question is rendered somewhat complex by reason of the varying amounts per head of the population collected through the same class of tax in different States. For example, in Victoria the Income Tax for the year 1919-20 equalled 12s. 4d. per capita, whilst in Queensland it amounted to £2 15s. per capita. For the same year, Queensland, with a population of 725,220, raised the sum of £459,188 from Land Tax, while the State revenue from that source in New South Wales, with a population of 2,002,631, was only £2,834. (It will be seen from the foot-note on page 68 that the collection of Land Tax by the State of New South Wales is at present almost entirely suspended in favour of Municipal and Shire Authorities.) The tabulated statements of Commonwealth and State revenue from taxation (see appendix 5) show in a convenient form the nature and approximate extent of the financial adjustments involved in any scheme of delimitation of taxation spheres.

245. In the examination of those figures, three things must be borne in mind—

1. That the amount of tax assessed for any given year will not necessarily correspond with the amount of tax collected in that year.
2. That, on account of the aggregation principle in Commonwealth taxation not being restricted by State boundaries, the yield of any particular tax, levied at the same rates, will be greater in the hands of the Commonwealth than in the hands of the States.
3. That the surrender of any tax by any one authority in favour of another does not necessarily entail any obligation upon the latter to impose that particular form of taxation upon its citizens. The retirement of any one authority from any particular field of taxation certainly frees that area for exploitation by the substituted authority, without increasing the burden of its taxpayers; but it would still be optional on the part of any authority to maintain its tax revenue in any way it sees fit.

246. A careful review of the financial obligations of the Commonwealth and the States and consideration of the existing exceptional circumstances has led us to think that an **immediate and permanent** surrender of any powers of imposing taxation by any of the Governmental authorities may be deemed inopportune, and we are unitedly of opinion that any scheme of taxation based on either a complete or partial allocation of subjects of taxation should preferably be inaugurated by a voluntary agreement between the Commonwealth and States, covering a period of years (say ten) long enough for the disclosure and solution of any unforeseen difficulties.

We have sought, therefore, as preliminary to the adoption of a complete and permanent delimitation of spheres, to evolve a practical scheme capable of almost immediate application, which, while avoiding the inevitable delay involved in amendment of the Federal Constitution, would remove many of the disadvantages of the present conflicting systems.

247. In our consideration of a scheme for the delimitation of taxation spheres, we have borne in mind that it should, if possible, comply with the following conditions, viz. :—

1. It should not have any tendency to weaken the Federal spirit.
2. It should be capable of early application.
3. It should in the first instance be by voluntary agreement between the Commonwealth and the States.
4. It should be reciprocal.
5. It should not involve the financial embarrassment of either the Commonwealth or any State.
6. It should sensibly reduce the double taxation, the duplication of effort and the unnecessarily large expense involved in the existing system.
7. It should allocate to the respective authorities the spheres of taxation which seem most appropriately to belong to them.

248. The provisional scheme we recommend for immediate adoption provides, amongst other things, for the passing, **as soon as possible**, of uniform Machinery Acts in respect of Income Tax by the Commonwealth and the States, each authority also passing its own Rates Acts as at present. **The ideal is one Single Assessment or Machinery Act governing the collection of Income Tax throughout the Commonwealth.** Such an Act could obviously be only a Commonwealth Act, and the recommendation in the earlier portion of this paragraph for the passing of uniform Acts in respect of Income Tax by the Commonwealth and the States must be regarded as intended to apply only to the experimental period covered by the provisional scheme.

#### RECOMMENDATIONS.

249. For the sake of clearness, we repeat that, as the ultimate and permanent solution of the problem, in our opinion—

- (a) An allocation of subjects of direct taxation between the Commonwealth and the States should be made.
- (b) The power to impose Income Tax should be exclusively vested in the Commonwealth.
- (c) The power to impose other existing forms of direct taxation—Land, Probate or Succession, Entertainments—should be exclusively vested in the States, subject only to the overriding powers of the Commonwealth in the case of War.

It is pointed out in this connexion that under Section 96 of the Commonwealth Constitution the Commonwealth Parliament may grant financial assistance to any State on such terms and conditions as Parliament thinks fit.

250. But, while the preceding paragraph represents our opinion as to the permanent solution of the problem, for reasons already given we favour an experimental period during which the allocation of subjects of taxation should be governed by agreement, and therefore—

#### We Recommend as a Provisional Scheme—

1. That the Commonwealth and the States mutually agree as to their respective fields of direct taxation for a period of (say) ten years.
2. That such Agreement provide for exclusive operation by the States during the specified period in the fields of Land, Probate and Entertainments Taxation—any such restriction to cease automatically in the event of War.
3. That during the currency of the Agreement the Commonwealth and the States retain the right to impose Income Tax.

4. That for the purposes of the Agreement, the Commonwealth and the States pass uniform Income Tax Assessment Acts.
5. That during the currency of the Agreement the Commonwealth be the administrative and collecting authority in respect of Income Tax for both the Commonwealth and the States.
6. That the cost of administration be divided between the parties to the Agreement upon a basis to be determined by three expert advisers, such as, for example, the Auditor-General of the Commonwealth, the Auditor-General of New South Wales, and a practising Public Accountant, to whom the matter shall be referred.
7. That as from the date of operation of the Agreement the Commonwealth retain the whole of the revenue derived from Customs and Excise Duties.
8. That, as a means of facilitating the financial adjustments which will become necessary under the scheme, especially in the early years of its operation, the Commonwealth grant such financial assistance as may be deemed to be reasonable to any State or States upon such terms and conditions as may be mutually agreed upon.

[From this Section of the Report Commissioner Jolly expresses dissent. See page 124.]

## SECTION IX.

### TAXATION AT THE SOURCE.

251. In the discussion on the subject of Taxation at the Source, one or two preliminary observations may be appropriate. The Commonwealth Income Tax Assessment Act is primarily based on the principle of a progressive or graduated individual Income Tax. In accordance with this principle, Companies' distributed profits are taxed in the hands of shareholders. Under the scheme of the Act, tax in respect of undistributed profits is paid by Companies. Under the several States Acts, Companies' profits are taxed only in the hands of the Companies prior to and irrespective of their distribution to shareholders. The States' method is generally, though incorrectly, designated "Taxation at the Source," but would be more accurately described as Company Taxation. The term "Taxation at the Source" correctly applies only to the method which tentatively levies tax at the point where income emerges.

252. The volume of evidence tendered in respect of Taxation at the Source may be regarded as proof of a wide-spread interest in the subject, and as affording some indication of the important issues involved in its consideration. The prominence given to the subject at the various Conferences of Premiers, Treasurers, and Taxation Officers, and the fact that it is one of the few remaining barriers to uniform Income Tax legislation in Australia, are doubtless contributory to the public interest manifested.

253. In their discussion of the subject, the majority of witnesses confined their attention to the application or otherwise of the system of payment of tax at the source to Companies' dividends. Some few, however, dealt with the suggestion to extend the system to deduction of tax by employers on all wages paid. The wider application of the system on the lines of the British Income Tax Act was not advocated by witnesses.

254. **The practice in Australia.**—The practice of Taxation at the Source as generally understood in Australia is almost wholly restricted to the taxation of Companies and absentees. The Commonwealth method of taxing Companies is to tax at a flat rate only the undistributed profits and the dividends and interest payable to absentees and to holders of debentures or share stock payable to bearer, subject (in the two latter instances) to certain specified adjustments. In New South Wales, Victoria, and Tasmania, Companies' profits (whether distributed or undistributed) are taxed at flat rates, with no refunds or adjustments, so far as individual shareholders are concerned. The Victorian Act (Section 42) constitutes every Company, Public or Municipal Trust, Body or Corporation, agent for the holders of debentures or bonds for the purpose of deduction of Income Tax payable on the interest thereon, but, we are informed, this provision is not enforced. In Queensland, local Companies are taxed under a graduated scale of rates, a distinction being made between Public Utility and Monopoly Companies. A flat rate applies in the case of foreign companies. In South Australia, Companies are taxed in the same way as individuals at rates applicable to income derived from property without statutory exemption. In Western Australia, Companies are taxed on profits at a flat rate under the Dividend Duties Act. Taxpayers who are recipients of dividends are required to include such dividends in their returns of income, and are assessed on their aggregate income, receiving credit for the dividend duty already paid by the Company.

255. It may therefore be stated in general terms, with sufficient accuracy to indicate the broad distinction between the two methods followed in Australia in respect of the taxation of Companies, that the Commonwealth method is to tax dividends in the hands of shareholders, while the

method adopted by the States is to tax Companies' profits without adjustments to individual shareholders. It may be mentioned in this connexion that the Commonwealth Income Tax Assessment Act provides (see paragraph 277) an incomplete measure of tax adjustment with shareholders in those cases where a Company has paid a dividend in whole or in part out of previously undistributed income upon which tax has already been paid by the Company (Section 16 (2A)).

**256. The practice in New Zealand.**—In New Zealand, Companies' profits are taxed at the source. To meet a hardship experienced by shareholders of small means whose principal or sole source of income is dividends from Companies, and, who through the Company in which they held shares, might be paying Income Tax on the highest scale, the *Finance Act 1917* provides that, in the case of a taxpayer whose income for the year does not exceed £400, a rebate of tax may be made based upon the difference between the individual and the Company rates, so long as the dividend received, together with the rebate made, does not exceed 6 per cent. of the amount paid up on the taxpayer's shares (Section 37).

**257. The practice in Great Britain.**—(See also paragraph 273). The extent to which the system of Taxation at the Source is applied in Great Britain may be gathered from the fact that at the present time taxation is levied at the source and deducted at the time of payment, in the case of—

Dividends payable by Limited Liability Companies.

Debenture and loan interest.

Interest on all British Government "pre-War" securities and on certain securities issued since the War.

Interest on Colonial and Foreign Government securities paid through agents in the United Kingdom.

Annuities and other annual payments.

Mineral rents, royalties, and wayleaves.

Patent royalties.

Interest not paid out of taxed profits (*e.g.*, interest paid out of rates).

Interest and dividends arising out of the United Kingdom and payable by Colonial and Foreign Companies through agents in the United Kingdom.

Coupons for dividends payable abroad which are realized through a banker or coupon dealer in the United Kingdom.

Rents of property let to tenants.

Ground rents, lease rents, head rents, &c.

Mortgage interest.

Deposit interest in certain banks.

Salaries and pensions paid by Government Departments, including Army, Navy, Air Force, and Civil Services, and by Railway Companies.

A brief description of the method of collecting Income Tax under the British System of Taxation at the Source will be found in paragraph 273.

**258. The practice in America.**—The Federal Income Tax Act of 1913 embodied the principle of Taxation at the Source, which, we are told, gave rise to—

"considerable complaint from those charged with the duty of withholding the tax." (See **Introductory Chapter**, which is described as being "almost wholly the work of Professor Robert Murray Haig," to *Montgomery's Income Tax Procedure 1919*, page 19.) And the same authority states (*Income Tax Procedure 1919*, page 21) that in the 1917 Act "The system of Collection at Source was virtually abandoned and a plan of 'Information-at-Source' was substituted, thus removing a prolific source of irritation and embarrassment."

It may be inferred from the remarks quoted that the "irritation and embarrassment" spoken of were largely due to the exacting conditions imposed upon those "charged with the duty of withholding the tax." Montgomery states that—

Under the laws of 1913 and 1916, Collection of Tax at the Source imposed duties and obligations on practically every disburser of interest, salaries and wages, and on many tenants, lessees and fiduciaries. These provisions proved so burdensome that in the 1917 law the entire system was abolished, except as it related to non-resident aliens and interest on bonds containing a so-called tax-free covenant" (Chapter VII.).

**259.** In the presentation of the subject under review, we propose to discuss the issues involved in the following alternatives, viz.:—

- (a) The taxation of Companies' profits without adjustments and the exclusion of dividends from shareholders' returns.
- (b) Taxation at the Source and its wide application to various classes of incomes.
- (c) The taxation of Companies' profits with subsequent adjustment in the individual assessments of shareholders.
- (d) The maintenance of the present Commonwealth method of taxing dividends in the hands of shareholders, with equitable adjustment provisions in respect of dividends paid out of undistributed income upon which a Company has paid tax.

**260. Taxation of Companies' Profits without Adjustments and the Exclusion of Dividends from Shareholders' Returns (a).**—This method is in force in four of the States (see paragraph 254) and its adoption by the Commonwealth has been urged mainly on the grounds of its simplicity and effectiveness and the advantages of Income Tax uniformity in this respect with the States. The Victorian Commissioner of Taxes stated—

From an administrative point of view, with a comparatively low rate of Company tax, and having regard to the simplicity and certainty with which the present method of no repayment operates in this State, I am not in favour of any change to a system of repayment.

The Victorian Commissioner of Taxes, though not in favour of any change to a system of repayment, made the following statement:—

Much has been said to the effect that the Federal method—

- (1) Avoids the apparent injustice of the taxation indirectly of the small shareholder who would otherwise be either exempt altogether or taxable at a rate below the Company rate;
- (2) Enables the principle of Aggregation of Income to be successfully applied;

and the inference is that the "Taxation at the Source" method fails in these two respects. This is not so, and, if desired, the States could establish the Principle of Aggregation to-morrow, applying it to all taxpayers and making adjustments by Rebates (and where necessary by Repayments), or they could confine the aggregation principle to the higher incomes.

**261.** With regard to the possibility of thus modifying the States' method of taxing Companies' profits, we do not consider it desirable that the whole of a Company's profits should be taxed in the Company's hands, even with subsequent tax adjustments with the shareholders, nor do we think it just to confine the aggregation principle to the higher incomes, or equitable to limit subsequent adjustment to taxpaying shareholders.

**262.** The Federal Commissioner of Taxation informed us in a written statement that the taxation of the profits of Companies in the hands of the Companies before distribution of any part of the profits to the shareholders, if the present rate of tax charged on Companies' profits (2s. 8d. in the £1) were maintained, and no adjustment were made with any shareholder would yield additional revenue estimated at **£1,197,036**. This estimate is based on the total profits of Companies for the year ended 30th June, 1920, discounted by 15 per cent., as it was recognised that:—

These figures [those of the year ended 30th June, 1920] represent abnormal profits, and cannot be relied upon as a basis for an accurate calculation of profitable collections of Income Tax in the immediate or near future.

The Commonwealth Commissioner of Taxation further stated—

There are slightly over 200,000 shareholders in Companies who do not at present pay Commonwealth Income Tax, because their total income is less than the amount of the general exemption applicable to their cases.

Under this scheme, however, these persons would suffer either—

- (i) Reduction of their dividends by deduction by the Company of the Company's tax applicable to the dividend (even though the Company may not be officially regarded as paying tax as agent for the shareholders);
- (ii) Reduction in the amount of profits available for distribution by the Company; or
- (iii) Reduction in the amount available to reserves, and therefore reduction in the value of the shareholders' interest in the Company.

The number of shareholders who are taxable at less than 2s. 8d. in the £ is approximately 25,364. These persons would suffer in similar manner, but to less extent than the present non-taxable shareholders. Their rate of tax on other income would be reduced, but their indirect tax on dividends would be increased.

The number of shareholders who are taxable at more than 2s. 8d. in the £ is actually 2,636. These persons would be benefited by reduction in their rate of tax payable on their income other than dividends, and by their indirect tax on dividends being reduced to the Company's flat rate.

The revenue would therefore increase at the expense of approximately 225,364 persons, and would confer a distinct benefit by reduction of tax on 2,636 persons.

**263.** The Commissioner's Statement included the following figures:—

	1	2	3
	—	Figures discounted by 15 per cent. to form basis of estimate referred to in Paragraph 2.	Amount of Tax on discounted figures in Column 2 at present rate of 2s. 8d. in the £1.
	£	£	£
Total profits of Companies for the year ended 30th June, 1920, or the trading period taken in lieu thereof for taxation purposes ..	42,216,256	35,883,818	4,784,508
Amount of undistributed income taxed to Companies .. ..	22,830,640	19,406,044	2,587,472
Amount of dividends taxed to shareholders .. ..	10,612,929	9,020,990	1,202,799
Amount of dividends received by non-taxable shareholders ..	8,772,687	7,456,784	994,237
	<b>£42,216,256</b>	<b>£35,883,818</b>	<b>£4,784,508</b>

264. The Commissioner further stated that, if the method (a) were adopted—

There would be a considerable reduction in working costs to the Department. It is extremely difficult to form an accurate idea of the probable reduction in costs, but it should amount to about £100,000 per annum.

This gain to the Commonwealth would, however, be achieved at the expense of shareholders in Companies who individually would have been non-taxable, or whose rate of tax would be less than the Company's rate.

265. There is no need to traverse the arguments advanced in support of the method under discussion, beyond saying that its comparative simplicity and greater productiveness are purchased at the cost of so great a degree of inequity that we have no hesitation in unanimously deciding that it is a method which cannot be recommended for inclusion in a system of taxation which it is intended should rest upon "a sound and equitable basis."

266. **Taxation at the Source and its Wide Application to Various Classes of Incomes (b).**—The main argument adduced in support of the system of Taxation at the Source is that it affords the only adequate and effective means of protection of the revenue. This contention apparently rests upon three assumptions—first, that evasion of taxation exists or can exist to such an extent as to warrant the employment by the Department of means of prevention other than those afforded by the system of "Information at the Source"; second, that any practicable system of "Information at the Source", however well devised and skilfully administered, would prove ineffective in adequately protecting the revenue; and, third, that the adoption of the system of "Taxation at the Source," with adjustments, would result in a net Revenue gain.

267. The extent to which evasion of taxation prevails in Australia must necessarily be largely a matter of conjecture. Several witnesses, including the Federal Commissioner of Taxation, expressed the opinion that deliberate evasion was largely practised by wage-earners in certain classes of employment, such as, for example, shearers, who, on account of the nature of their employment, are rarely long in one place, and are therefore hard to trace, and wharf labourers, who, it was alleged, frequently resort to the device of using different names. As against the general allegation of deliberate evasion in such cases, which is scarcely possible of positive substantiation, there has to be borne in mind that, in many instances, on account of broken time, strikes, illness, and other causes, the exemption limit may not have been reached.

268. The Federal Commissioner of Taxation, in his Seventh Annual Report, dealing with this question, says—

The only remedy lies in legislation which would provide that the tax at a flat rate should be deducted from wages as they are paid. It would be necessary, however, to provide expensive machinery for adjusting the total amount of tax paid during a year, to the actual amount payable by each person so taxed. The question, therefore, to be decided is whether or not the tax collectable would be sufficient to pay for the additional adjustment machinery.

I incline to the view that it would not pay unless the present minimum rates of Income Tax were considerably increased.

269. The Report also mentions that—

The energetic action of the Department in tracing defaulting taxpayers has been continued with good results to the Revenue.

A special officer was sent into certain districts in one State, with the result that—

In all 631 persons were prosecuted for their neglect of the law, and penalties and costs amounting to £1,713 were recovered. Now that the provisions of the Act are better understood, no further trouble from these districts is anticipated.

270. It is clear from the context of the Report from which the above quotations are made that, in some cases at least, investigation disclosed no fraudulent intent on the part of the taxpayer. The Report also shows that the Department is fully aware that evasion—inadvertent or wilful—exists and that the available resources of the Department are being employed with some measure of success in its frustration.

271. The most glaring instance of evasion of tax that was brought under our notice was one referred to by a State Commissioner of Taxation, in which the taxpayer's return disclosed a tax liability for the year amounting to £25 only. Investigation by the Department disclosed an income for the year of £280,000. The Commissioner stated—

When our examination was over, he paid us £22,500 on that year.

In this case it was the "Information at the Source" which was available to the Commissioner which led to the discovery of the evasion.

272. The British practice of Taxation at the Source is usually quoted as the outstanding example of the financial effectiveness of the method.

273. The following brief description of the general method of collecting Income Tax under the British system is taken from Appendix 2 of the Report of the British Royal Commission on the Income Tax 1920 :—

Whenever it is possible to do so, Income Tax is obtained by deducting it before the income reaches the person to whom it belongs. For instance, a trading company is required to pay to the revenue Income Tax at the standard rate on the whole of the profits made by it, without reference to the ultimate destination of the profits. Such a company on paying dividends to its shareholders is entitled to deduct and retain the amount of Income Tax appropriate to the amount distributed, and the shareholder thus receives his dividends, subject to this deduction of Income Tax. . . . . An individual whose income is *wholly or partly earned* renders a statement in order to claim the reduced rate of tax on his earned income, if his total income does not exceed £2,500. An individual whose income is *wholly unearned* renders a statement in order to claim the reduced rate of tax on his unearned income, if his total income does not exceed £2,000. . . . . When tax is deducted at the source, it is (with certain exceptions) deducted at the standard rate, which rate for the year 1918-19 is 6s. in the £. This rate represents the final liability in certain cases, but where the rate ultimately payable by a resident in this country whose income is taxed wholly or partly by deduction is less than the standard rate, certain adjustments must be made in order to give him the benefits of the relief to which he is entitled. For example, A's income, amounting to £1,800, is derived entirely from dividends taxed at the source at 6s. in the £. The "unearned" rate appropriate to a total income of £1,800 is 5s. 3d. only. A would be repaid 9d. in the £ on the amount of his income, on his making an application for relief, supported by evidence of the amount of tax which has been deducted from his income.

274. The embodiment of the principle of Taxation at the Source in the British Income Tax system dates from 1803. It is stated that the abuses to which the method of levying the tax by means of direct assessments upon the recipients of the income was open led the framers of the Income Tax Act of 1803 to make their approaches to the taxpayer in a less direct, but a more certain, fashion. Since its adoption in Great Britain, the principle has from time to time been more widely applied (see paragraph 257), till at least 70 per cent. of the present yield of the tax is collected at the point at which the income arises. Though Taxation at the Source has been applied in Great Britain for more than a century, it by no means follows that it is the best method for successful collection that can be devised in the modelling of an Income Tax system for Australia. When the revenue effect of Taxation at the Source in Great Britain is estimated, there is no possible comparison by actual experience with a strictly limited application of the system in conjunction with a well-developed system of Information at the Source. We do not for a moment question the strength and sincerity of conviction of the British advocates of the system; but it may be that familiarity with it in some measure accounts for its retention in Great Britain.

275. The rejection by the United States of America of the system of Taxation at the Source, after a short experience of its disadvantages as applied in America (see paragraph 258) seems to justify the doubt we feel as to its applicability to Australia. The following comments in Montgomery's *Income Tax Procedure* 1919 are interesting and informative :—

By providing for a system of Information at the Source in the 1917 law, Congress took the first step in scientific procedure, so far as securing trustworthy information as to the personal incomes of individuals is concerned. Collection at the Source was so technical and annoying that its abandonment was inevitable.

It takes many years to prepare the way for an effective system of reaching the incomes of all individuals who should pay a tax. If the present law calling for information as to the incomes of all individuals who receive annually \$1,000 or more is strictly and impartially enforced, it will be the means of raising many millions of dollars in taxes hitherto untouched. . . . . But the enforcement of Collection at the Source in the case of those in receipt of incomes of, say, \$1,200 to \$2,000 per annum would have been impracticable. It is not unreasonable to call for, and it is not inconvenient to furnish, the information in regard to such payments.

It is important to note that Information at the Source is not confined to business concerns, but to individuals as well, who, in their personal capacity, pay out certain sums aggregating \$1,000 or more to any one person, firm or corporation during an entire year. Each individual must state the amount paid for rent of an apartment or dwelling house, to a chauffeur or servant, if the amount paid is fixed or determinable. (Chap. VI.)

276. There are at least two general objections to the system of Taxation at the Source. First, it involves the collection by the Crown of large amounts of money which in some cases it is not entitled to retain, and which in other cases are in excess of what it is entitled to retain, thus depriving a considerable body of taxpayers of the use of their money for varying periods; and, second, some Revenue gain (it is difficult to estimate how much) will be due to the failure of taxpayers, either through ignorance or neglect, to make and establish their claims for refund or credit. The objections to the system which we have indicated suggest the wisdom of restricting its application to the narrowest possible limits, lest some day public complacency may permit revenue gain to "outweigh every other consideration," even that of an "equitable distribution of the burdens of taxation."

277. **The Taxation of Companies' Profits, with Subsequent Adjustment in the Individual Assessments of Shareholders (c).**—This method would necessitate the repeal of the present Commonwealth law in respect of the taxation of a Company's undistributed income. Tax would be levied at a flat rate on all taxable profits in the hands of a Company before distribution of any part of the profits to the shareholders. The distinction between the method (a) discussed in paragraph 254 and succeeding paragraphs and the suggested method under discussion is that, while under the former Companies' profits would be taxed, and there would be no subsequent tax adjustments by the Department with shareholders, under the latter the procedure presumably would be that

all shareholders sending in Income Tax returns would therein disclose all dividends received from Companies. These dividends would then operate under any graduated scale of tax in determining the rate of tax applicable, and the Department would give the taxpayer credit in his assessment for the amount already paid by the Company or Companies on his account in respect of any dividend disclosed in his return. In the case of shareholders whose total incomes are not large enough to render them liable to pay tax, some provision would need to be made by which they could claim and collect from the Department the tax paid by any Company or Companies on their account. It will be remembered that, according to the statement of the Commonwealth Commissioner of Taxation, there are slightly over 200,000 shareholders in this category. This method would lead to the payment by Companies of dividends, less tax paid or payable by the Companies, at the ruling Company flat rate.

278. The Commonwealth Commissioner of Taxation, in dealing with the suggestion (c) under review, stated that, if the proposal were adopted, the whole of the additional revenue (referred to in paragraph 262) estimated at £1,197,036, would be refunded or rebated to the shareholders, and that therefore no Revenue gain would result, but additional expenditure (in the establishment of a Refund Branch) would have to be incurred by the Department, which he estimated would reach £18,000 per annum.

279. It would appear that the conclusion of the Commonwealth Commissioner of Taxation, that the whole of the additional revenue resulting from the application of this method would be refunded or rebated to the shareholders, presupposes the complete effectiveness of the Departmental Information at the Source in the prevention of evasion of tax by inadvertence or intent, and the adoption of an equally complete Departmental refund system. No estimate was furnished as to the revenue gain which might result from the failure of shareholders to establish claims in respect of refunds.

280. If revenue protection be urged as the main recommendation of the system of Taxation at the Source, as applied to Companies' profits, the question naturally arises as to whether the present rate of 2s. 8d. in the £, which is approximated to the average individual rate of tax applicable to taxpaying shareholders, is fixed high enough. *Complete indemnity against Revenue loss could only be secured by the levy from Companies of tax at the highest current individual rate.*

281. The arguments advanced in favour of the Collection at the Source of tax in respect of the whole of a Company's taxable income, with subsequent adjustments with shareholders, have failed to convince us that it represents any improvement upon the present Commonwealth system, or that it would be instrumental in securing a more equitable distribution of the burdens of taxation, or result in simplifying the duties of taxpayers in relation to returns. Taking into account the additional administrative cost which it involves, and having regard to the facilities for obtaining Information at the Source already used by the Department, and those open to it under the wide powers conferred upon the Commissioner (notably under Sections 55 and 56 of the Commonwealth Income Tax Assessment Act), the probability of the method of taxing Companies' profits (whether distributed or undistributed) with subsequent adjustments to all shareholders realizing any greater net revenue than the method we suggest seems extremely doubtful. Even should there be a net Revenue gain through failure from any cause on the part of shareholders to collect from the Department money due to them under the system, that would be a source of Revenue which should bring small satisfaction to the State, which in all its dealings should set the highest standards to its citizens. It would, in our view, be preferable for the State to suffer some loss of Revenue than, by the retention of money to which it can have no moral claim, to inflict injustice upon any section of its citizens, especially those least able to bear it. After full consideration we are of opinion that the disadvantages attaching to the method of taxing the whole of a Company's profits, even with subsequent adjustments to shareholders, are such as not to warrant us in recommending the adoption of that method.

282. **The maintenance of the present Commonwealth method of taxing dividends in the hands of shareholders with more equitable adjustment provisions in respect of dividends paid out of undistributed income upon which a Company has paid tax (d).—Sub-Section (2A) of Section 16 of the Commonwealth Income Tax Assessment Act provides in effect—**

- (a) That a shareholder whose rate of tax in his individual assessment is lower than the Company rate, and who receives a dividend out of previously undistributed profits upon which the Company has paid tax, is entitled to a rebate of tax in respect of such dividend calculated at his individual rate;
- (b) That a shareholder whose individual rate is higher than that of the Company is chargeable with additional tax based on the difference between his individual rate and that of the Company; and
- (c) That a shareholder whose income is not sufficiently large to render him liable to tax receives no refund of the tax previously paid by the Company.

It is difficult to see any justification for this provision as it applies in the positions arising under (a) and (c), unless it be found in purely revenue considerations. But such considerations should not, in our opinion, be allowed to outweigh those attaching to "the equitable distribution of the burdens of taxation." The clear intention of the Income Tax Assessment Act is to levy tax on the total taxable incomes of all individuals at rates of tax appropriate to those incomes. In pursuance of this intention, dividends received are taken into account in arriving at a taxpayer's total taxable income. It is therefore clearly right that from the total tax assessed thereon there should be deducted such amounts as have already been paid to the Department. This is already done in the case of a taxpayer whose individual rate of tax is higher than that of the Company, but is done only in part in the case of a taxpayer whose individual rate of tax is less than that of the Company. A shareholder who is not a taxpayer receives neither rebate nor refund. This discrimination involves manifest injustice to the two latter classes of shareholders.

283. To remedy this injustice by the rebate or refund to all shareholders of the full amount of tax previously received from Companies in respect of their share of dividends paid out of undistributed income, some loss of revenue must be faced. The extent of that loss cannot be estimated with any degree of accuracy. The Commonwealth Commissioner of Taxation has expressed the opinion that the method (d) under review, if the adjustment provisions were applied only to taxpaying shareholders, while it would cast increased work upon the Department, would not involve any additional expenditure.

284. It may, however, be taken for granted that the work of the Department, as well as the cost, would be increased if refunds were made to non-taxpaying shareholders. The Commissioner also stated:—

Administration of such a scheme would, in my opinion, be impracticable, unless taxpayers were required to include all dividends in their returns, leaving it to the Department to make the adjustment. Even then it would be difficult. The number of cases in which Companies distribute dividends out of past accumulated profits relatively to the total dividends distributed from current profits is small, but numerically they are fairly substantial.

He stated further:—

The point for consideration in this connexion is that the Income Tax is an annual tax payable on the income of a year at the rate applicable to that income by the legal owner of the income. This would appear to mean that the Commonwealth Government should retain tax on Companies' undistributed income at least at the rate paid by the Company on that income.

If this is meant to express the view that, when a Company has paid tax on its undistributed income, the Government on subsequent distribution of that income should be entitled to collect excess tax from individual shareholders whose rate of tax is higher than that of the Company, but should not be required to make any allowances to those shareholders whose income is not taxable or whose rate of tax is less than that of the Company, it is a view which, in our opinion, is neither in harmony with the scheme of the Act nor in consonance with the principles of equity.

285. There can be no question as to the right of the Government under this scheme to retain tax paid by a Company on undistributed profits while they remain undistributed; but, when these profits or any part of them reach the shareholders' hands, then the primary intention of the Act—the taxation of the individual at his appropriate rate—is effected, and can only be equitably effected, by regarding the tax paid by the Company as tentative, because of the possibility of the subsequent distribution to the shareholders of the whole or part of the amount upon which tax has been collected. This view is, in our opinion, both logical and equitable, and justifies the claim for a refund or rebate, either to the Company or the shareholder, of the whole of that payment which the act of distribution by the Company establishes as having been tentative.

286. It was suggested in evidence that the Department, instead of making rebates in individual assessments of taxpaying shareholders and refunding direct to non-taxpaying shareholders, should allow full rebates in the Companies' assessments. It was considered that this would simplify the work and reduce the cost of the Department. Subject to safeguards we think the suggestion worthy of consideration.

287. A somewhat anomalous position arises under the present Act. In the direct levy of tax upon its undistributed profits, a Company is regarded as a legal entity, while in the partial adjustment of tax with taxpaying shareholders, under Section 16 (2A) of the Act when those profits are subsequently distributed, there is some recognition of the Company as having paid the tax in the first instance, not on its own behalf, but, in part at least, on behalf of those shareholders to whom rebate is made. Certain other equally anomalous positions arise through the operation of the provisions of Section 16 (2A) of the Act. For example, it is the usual practice in Australia for Companies to distribute dividends to their shareholders without deduction of any tax previously paid thereon. When, therefore (as is the present practice), the Income Tax Department allows full or partial rebate of tax in the assessments of shareholders whose individual returns include the receipt of a dividend paid out of previously undistributed profits, those shareholders in effect receive an additional dividend equal to the amount of tax so rebated. The

Department, however, does not require these taxpayers to include this additional dividend—or what is in effect an additional dividend—as income in their returns. Furthermore, if, as we contend, this rebate of tax be in effect an additional dividend, it would appear that that additional dividend has reached the hands of these particular shareholders in an indirect way through the Taxation Department, and without the formal sanction by resolution of the Company's shareholders.

288. It will be seen therefore that the present practice involves a three-fold discrimination—

1. Between taxpayers who receive dividends paid out of current profits (whose returns include the whole of these dividends) and taxpayers who receive dividends paid out of accumulated profits, and are allowed a rebate of tax in accordance with the provisions of Section 16 (2A) (whose returns include the dividend, but do not include the rebate, which is virtually an additional dividend).
2. Between those taxpaying shareholders who receive dividends paid out of accumulated profits and whose individual rate of tax is higher than that of the Company, (who receive full rebate of tax) and those whose individual rate of tax is lower than that of the Company (who receive only partial rebate of tax).
3. Between taxpaying shareholders who receive dividends paid out of accumulated profits (who receive either full or partial rebate of tax) and non-taxpaying shareholders (who receive no refund of tax).

289. The position may be more readily appreciated by an example of what occurs under the present practice :—A, B, and C, are three shareholders, each receiving **£100**, being their proportions of a dividend paid by a Company out of accumulated profits, upon which profits the Company has paid tax at the rate of **2s. 8d.** in the £.

Assuming, for the purpose of illustration, that A, B, and C, are the only shareholders of the Company, and that the **£300** distributed represents the whole of the Company's accumulated profits, it is clear that the profits upon which the Company originally paid tax must have been **£346 3s. 0d.** The tax applicable to that amount is **£46 3s. 0d.**, and it is after the payment of that tax that the amount of **£300** is available for subsequent distribution to shareholders.

A has no other income, and is therefore non-taxable. He receives no refund, and the Government retains the tax already paid by the Company on his proportion of the accumulated profits, viz.	..	£15	7	8
B has other income which, together with the amount of his dividend, renders him liable to payment of tax at the rate of <b>1s. 4d.</b> in the £. He receives rebate at the rate of <b>1s. 4d.</b> in the £ (being the difference between his individual rate of tax and that of the Company) equivalent to an additional dividend of <b>£7 13s. 10d.</b> , upon which he pays no tax, and the Government retains	..	£7	13	10
C has other income which, together with the amount of his dividend, renders him liable to payment of tax at the rate of <b>5s. 4d.</b> in the £. He receives full rebate of the tax paid by the Company in respect of his proportion of the total dividend, and of this amount, viz., <b>£13 6s. 8d.</b> , the Government retains	..	Nil		

It will be seen that in the transaction indicated above, by which each of the three shareholders received the same amount from the Company by way of dividend paid out of accumulated profits,

	From the Company.	By way of Rebate.	Total.
A's return is ..	£100 0 0 ..	Nil ..	£100 0 0
B's ..	100 0 0 ..	£7 13 10 ..	107 13 10
C's ..	100 0 0 ..	15 7 8 ..	115 7 8

290. Three methods are open by which the inequities arising out of the present discrimination may be removed :—

1. By the Department rebating or refunding the whole of the tax paid by Companies in respect of dividends paid out of accumulated profits direct to the shareholders, irrespective of whether or not they are taxpayers, and treating tax so repaid or refunded as income in shareholders' Income Tax returns.
2. By the Department rebating or refunding the whole of the tax paid by Companies in respect of dividends paid out of accumulated profits to the Companies after the lapse of a reasonable time from the date of the payment of the dividends.
3. By amending the Act so that Companies shall not be taxed, either permanently or tentatively, in respect of their undistributed profits, and by deeming the whole of the undistributed profits of a Company to have been distributed amongst the shareholders whose individual returns would then include not merely their proportion of any declared dividend, but their proportion of the total profits of a Company, the sum representing which would then be taxable at the rate of tax applicable to each shareholder.

291. We do not favour the latter method, on the grounds :—

1. That it would mean that shareholders would be required to pay tax upon profits which are not received and may never be received by them, except in the remote contingency of the winding up of the Company, or indirectly through a more or less appreciable addition to the market value of their shares.
2. That it would tend to the distribution of too large a proportion of Companies' profits rather than the provision of means of development and financial stability by building up reserves.

292. Whichever of the two former methods may be regarded as the more practicable and simple one, it seems essential to the scheme that all taxpaying shareholders should be required to include all dividends in their Income Tax returns, and that a simple form of return should be prescribed for use by those shareholders whose total income does not reach the taxable amount. Shareholders would be materially assisted if it became the practice for all Companies to set out on all Dividend Warrants the proportion of the dividend which was paid out of past accumulated profits.

293. In dealing with the question of the taxation of Companies' profits, it becomes necessary to refer to the numerous and emphatic protests made by witnesses against the provision of Sub-section (2) of Section 16 of the Income Tax Assessment Act. This sub-section provides that—

Where, in the opinion of the Commissioner, a Company has not in any year distributed to its members or shareholders a reasonable proportion of its taxable income, the taxable income of the company shall be deemed to have been distributed to the members or shareholders in proportion to their interests in the paid-up capital of the company, if the Commissioner is satisfied that the total tax payable on it as distributed income is greater than the tax payable on it by the Company.

We are strongly of opinion that the sub-section is open to two grave objections. The first is in respect of the authority which is conferred upon the Commissioner to determine whether or not a reasonable proportion of a Company's taxable income in any year has been distributed. Having regard to the varied classes of business engaged in, the competition and risks to which they may be subject, and the involved issues in relation to their development and consolidation, we are of opinion that all administrative decisions upon this point should be subject to appeal. The second grave objection is in respect of the limitations imposed upon the Commissioner. For example—Having decided that a reasonable proportion of a Company's taxable income in any year has not been distributed, the Commissioner is not allowed to express an opinion as to what amount would have constituted a reasonable proportion and levy tax upon that amount; but in all such cases the sub-section arbitrarily provides that the whole of the taxable income of the Company for the particular year shall be deemed to have been distributed to its members or shareholders. In our opinion, such a provision is unreasonable and harsh. The remedy we propose for both these objections will be found in our recommendations.

### CONCLUSIONS.

294. For the reasons indicated throughout this section of our Report, we do not approve of the proposal for the adoption by the Commonwealth of the States' method of taxing Companies' profits, nor do we consider that the method of Taxation at the Source should extend beyond the present limits prescribed in the Commonwealth Income Tax Assessment Act. We are of opinion that Information at the Source, extended and efficiently applied, will afford increasing protection to the Revenue, while it is free from the disadvantages which, it has been shown, attach to Taxation at the Source.

### RECOMMENDATIONS.

295. We recommend—

1. That the profits of Companies be taxed in accordance with the existing law, subject to amendment of Section 16 (2A) of the Income Tax Assessment Act, so as to provide for rebate or refund of the whole of the tax paid by a Company on the undistributed income which is subsequently distributed.
2. That Section 16 (2) be amended to provide that, where the Commissioner is of opinion that a company has not in any year distributed a reasonable proportion of its taxable income, he shall have the right to decide the amount which for the purpose of levying tax shall be deemed to have been distributed, and that against such decision the Company shall have the right of appeal to the Appeal Board.
3. That a simple form of return be prescribed for use by non-taxable Company shareholders, in which their dividends shall be disclosed.

[From this section of the Report Commissioners Jolly, Missingham, and Mills express dissent. See page 126.]

## SECTION X.

### DIFFERENTIATION.

296. **Definition of Term.**—The term differentiation is “used to express the discrimination which is made for income tax purposes between incomes that are earned by personal exertion and incomes which are not so earned.”

297. **Demand for Differentiation in the United Kingdom.**—From the introduction of income taxation in 1798, public demand for some degree of differentiation in favour of incomes derived from personal exertion was carried on with remarkable persistence until 1907, when for the first time incomes derived from personal exertion were by Statute made taxable at a lower rate than incomes derived from property. The British Royal Commission (1920) on the Income Tax was satisfied “that some such discrimination is desirable and just.” We concur in that view on the ground that “there is a real difference in taxable ability between the two classes of income in question.”

298. **Terms used to denote the two classes of Income.**—Much discussion has taken place in Great Britain as to the terms which should be used to denote the two classes of income—e.g., “permanent and precarious,” “industrial and spontaneous,” “industrious and lazy,” “personal effort and investment,” “earned and unearned.” The two latter are the terms in use in Great Britain, but the British Commission, in view of objections made to the expression “unearned income,” recommended the term “investment income.” Terms such as “earned and unearned,” “industrious and lazy,” have been considered to convey moral implications, but in our opinion the point of view should be economic—i.e., based primarily upon ability to pay. The terms “income from personal exertion” and “income from property” used in Australian legislation are in our opinion the most appropriate yet suggested.

299. **Degree of Differentiation in the United Kingdom.**—The British Royal Commission (1920), after considering the effect of increase and extension of family allowances (which they recommended) and also of recently increased estate and succession duties, which “tell in favour of earned income as against income derived from invested capital,” recommended some diminution of the existing (Income Tax) Differentiation in the case of smaller incomes. The method they recommended was to diminish personal exertion income by one-tenth, for the purpose of arriving at the amount upon which tax should be levied. Subject to this reduction, the rate was then to be the same as in the case of incomes from property. They further recommended—

- (a) that however large the earned income, not more than £2,000 earned income should rank for differential relief, and
- (b) that the relief should apply, with that limitation, to incomes of all sizes, but for the purposes of Income Tax only, not for Super-tax purposes.

The maximum deduction from any income in respect of differential relief would consequently be £200.

300. **Differentiation under Income Tax Laws of Australian States.**—The following is a brief statement of the differentiation provided under the States Statutes:—

<i>New South Wales</i>	..	The rates on income the produce of property are uniformly one-third greater than those on income from personal exertion. There is also a super-tax operating equally on both classes of income.
<i>Victoria</i>	..	The property rates are double those on incomes from personal exertion.
<i>Queensland</i>	..	The rates on incomes from property taper gradually from double that on the smallest income from personal exertion to identical rates on incomes of £3,000 or over from either source.
<i>South Australia</i>	..	The differentiation in rates varies irregularly, ranging from 50 per cent. on smaller incomes to 22½ per cent. on larger incomes from property over and above the rates chargeable on similar incomes from personal exertion.
<i>Western Australia</i>	..	No distinction is made, each class bearing the same rate.
<i>Tasmania</i>	..	The widest separation is on the lowest incomes, where those from personal exertion carry 3d. and those from property 8d., moving through converging stages till on that portion of the income which exceeds £2,000 both classes bear the same rate.

301. While in Western Australia there is no distinction between the two classes of income in New South Wales and Victoria the differentiation is uniform throughout; in South Australia, Queensland and Tasmania the rates move in converging lines and in the two last-named States they eventually coalesce.

302. **Differentiation under the Income Tax Law of the Commonwealth.**—Differentiation under the Commonwealth Income Tax Law is effected by prescribing two scales of rates, one for incomes derived from property, and another for incomes derived from personal exertion. The scale for personal exertion incomes, which is much the lower, is a straight line up to an income of £7,600. The property scale passes from a straight line graduation, that is, a curve of the first degree, to one of the second degree, and, at a higher point of income, to a curve of the third degree. If the rate on **personal exertion** be represented by 100, the percentage increases of property rate above personal exertion rate will be as shown in Column 4 of the subjoined table. Commencing at practical identity between the rates on incomes from personal exertion and those on incomes from property, the differentiation increases until at £2,250 the rate on property income is about 82 per cent. greater than that from personal exertion. At £3,000 the percentage falls to 81, and thence the two rates gradually converge, *e.g.*, at £8,000 the percentage has fallen to 37, at £30,000 to 6, and at £100,000 to 1·7. If the rate on **property** incomes be represented by 100, the differences between the two scales, expressed as percentage deductions from the property line, give these results:—Commencing at practical identity between the rates on incomes from personal exertion and those on incomes from property, the differentiation increases until at £1,000 it is 36 per cent., and between £2,000 and £3,000 about 45 per cent. Thence the two rates gradually converge, *e.g.*, at £8,000 the percentage has fallen to 27, at £30,000 to 6, and at £100,000 to 1·7. The effect in these cases is shown in Column 5 of the table.

TABLE.

Taxable Income.  Column 1.	Tax on Income from—		If the Rate on Incomes derived from <b>Personal Exertion</b> be represented by 100 in each case, the rate on Incomes derived from Property will be represented by the figures below.  Column 4.	If the Rate on Incomes derived from <b>Property</b> be represented by 100 in each case, the rate on Incomes derived from Personal Exertion will be represented by the figures below.  Column 5.
	Personal exertion.  Column 2.	Property.  Column 3.		
£	£ s. d.	£ s. d.		
100	2 8 0	2 10 6	105	95
300	8 16 0	9 19 0	113	88
600	22 8 0	28 1 0	125	80
1,000	48 0 0	75 0 0	156	64
2,000	149 0 0	269 0 0	180	55
2,250	183 0 0	332 0 0	182	55
3,000	304 0 0	552 0 0	181	55
4,000	512 0 0	904 0 0	176	57
5,000	773 3 0	1,298 0 0	168	60
6,500	1,265 0 0	1,928 0 0	152	66
8,000	1,872 0 0	2,567 0 0	137	73
15,000	4,871 0 0	5,551 0 0	114	88
30,000	11,255 0 0	11,951 0 0	106	94
50,000	19,783 0 0	20,482 0 0	103·5	96·6
100,000	41,108 0 0	41,810 0 0	101·7	98·3

303. In some schemes of income taxation, of which those of New South Wales and Victoria are examples, the differentiation extends with an unvarying percentage of difference in rates throughout all incomes, but it is not uncommon, as in Queensland and Tasmania, to fix a point in income beyond which differentiation no longer directly operates. The indirect operation continues in some cases beyond that point, but with ever-lessening effect. The reasons generally given for limiting the range of differentiation are that beyond a certain point (necessarily chosen arbitrarily) an element of capital earning is considered to be present in the income if derived from business and, what is of more importance, the relative taxable ability of the taxpayer whose income is derived from his own efforts as compared with that of one whose income is derived from property is deemed to increase as income rises, until a point is reached when the necessity for the distinction ceases.

304. **Differentiation effected otherwise than through the Income Tax Laws.**—As already indicated (paragraph 299), taxation of property by means of estate or succession duties is often regarded as effecting a measure of differentiation in favour of incomes derived from personal exertion. As also shown in paragraph 299, the British system nevertheless includes a direct application of the principles of differentiation to income tax. On the Continent of Europe, the practice varies greatly. In Italy the subdivision of incomes for the purpose of differentiation purely in relation to income tax is carried further than in any other country. Income is divided into five classes:—

1. Income from certain investments of a gilt-edged class at a normal rate—  
—say .. .. . 10
2. Income from other capital and all perpetual revenues at a reduction  
of 25 per cent., making the rate—say .. .. . 7·5

3. Income derived from the co-operation of capital and labour, *i.e.*, those produced by industry and commerce, at a reduction of 50 per cent., making the rate—say . . . . . 5
  4. Income derived from labour only by persons in private employment, and income from temporary revenues or life annuities, at a reduction of 55 per cent., making the rate—say . . . . . 4.5
  5. Income derived from salaries, pensions and allowances to persons employed by the State, the Provinces or the Communes, at a reduction of 62½ per cent., making the rate—say . . . . . 3.75
305. In Berne, the income is divided into three classes :—
1. Income from capital, carrying tax at the normal rate—say . . . . . 10
  2. Income from life annuities and pensions, carrying tax at 80 per cent. of the normal—say . . . . . 8
  3. Earned income carrying tax at 60 per cent. of the normal—say . . . . . 6
306. In Spain the Income Tax is linked with an Industry Tax, and in addition to differentiation in the former, running into six classes, there are in these classes five “tariffs,” which provide a further differentiation according to :—
- (a) Character of the business.
  - (b) Its importance.
  - (c) The importance of the locality in which it is conducted.
  - (d) The motive power used in the output ; and
  - (e) The method and nature of the output.

307. In some other Continental countries differentiation, so far as it exists, results from the combined operation of a tax upon the capital value of property and a general but undifferentiated Income Tax. Taxes upon property in various forms have generally preceded in date the imposition of Income Tax, and possibly in some cases the differential effects which attract so much notice when rates are increased and when an Income Tax is added to the national scheme of taxation, were not deliberately designed. The concurrent operation of Property Tax and Income Tax is usual throughout the German States and also in Denmark, Norway and some of the Swiss Cantons.

308. In some other countries, including Saxony, Bavaria, Austria and Hungary, instead of a separate tax on the capital value of property, there is a separate tax on the yield from property. For example, in Bavaria, side by side with the general Income Tax, there are a Land and House Tax, a Business Tax, and a Dividend Tax, which are charged on the annual or estimated yield of the subject property. Another method is the taxation of the capital value of property combined with an Income Tax confined to income not derived from property (income derived from such property being exempt under the latter tax), the rates of the two in such cases being fixed so as to produce a degree of differentiation in favour of the earned income. The most highly developed examples of this method are found in Switzerland and Holland. A further variant is found in the method of loading the assessment under a General Income Tax with a fraction of the value of any property possessed by the taxpayer. Of this, the outstanding example is Sweden. Under the system in force in that country, one-sixtieth of the capital value of any property possessed by the taxpayer is added to his income in order to arrive at the amount upon which income tax is charged.

309. Under Commonwealth legislation, as under that of all the States, taxes are imposed upon unimproved land values and also upon property passing at the death of the owner. To the extent to which these taxes operate, it has been contended that they constitute differentiation against incomes from property apart from that embodied in the Income Tax Statutes.

310. **Differentiation—How should it be measured.**—An argument has been presented with the intention of showing first—the principle upon which differentiation should be measured, and second, that, in view of the differential effect of estate duties, differentiation should disappear from Income Tax Statutes. That argument may be briefly summarized thus :—

- (1) That an equitable measure of differentiation is the percentage of average income which if invested annually at compound interest during the period of active earning (assumed to be 40 years) would enable an annuity to be purchased securing to a married couple during the continuance of both or either of their lives an income equal to the average income of the active period, less the invested percentage. (Figures have been given to show that the necessary percentage is in the neighbourhood of 9 per cent.)
- (2) That annual premiums paid by the recipient of income the produce of property to secure at death an amount equivalent to the estate duty which would then become leviable should be viewed—
  - (a) As an added Income Tax, and consequently
  - (b) As measuring the degree of **Income Tax** differentiation which has been indirectly effected by the Estate Duty Act.

- (3) That, viewed as added Income Tax, the premiums payable by a property-owner to secure at his death an amount equivalent to the estate duty constitute a degree of differentiation exceeding the percentage of saved and invested income required as in No. 1 above, and that consequently no differentiation should be allowed under Income Tax Acts.

311. As to No. 1, it may be said that the argument assumes an ideal prudence and the existence of ideal conditions under which that prudence is to be exercised. In view of the vicissitudes experienced by the great majority of persons dependent upon income from personal exertion, such as uncertain conditions of employment, variable remuneration, ill-health of the breadwinner or his family, &c., it can never be reasonably assumed that a large percentage of taxpayers will be in the position to provide for themselves in the efficient manner contemplated by the theory advanced. With regard to the argument summarized in paragraph 310 (2), that premiums paid to provide for estate duty should be viewed as an added Income Tax, economic opinion may be quoted—for example, Sir J. C. Stamp, writing in the *Edinburgh Review*, October, 1919, says:—

Differentiation between incomes derived from capital and income derived from earnings used to be opposed in England on the ground that the purpose was effected by the death duties. It was argued that, if one man has £1,000 from earnings and another £1,000 from land, and if the latter provided for the source to be kept intact by paying out of his income an annual insurance against the death duty, his effective taxation would be greater. But this reasoning is not entirely sound. The insurance payment cannot be regarded as made to insure that the income is maintained intact during his own life. It is voluntarily paid to insure a similar and undiminished income for some one after the insurer's death.

312. Insurance premiums paid during the life-time of a property-owner for the creation of a fund to be applied in payment of succession duties, thus preserving an estate intact, or for other prudential or charitable purposes cannot, in our opinion, be viewed as in any sense an additional Income Tax, deferred or otherwise, and consequently cannot be regarded as adding to any degree of differentiation which is effected by Income Tax Statutes. If the property-owner, instead of making payments to an insurance company, chose another form of investment as a means of providing for the payment of estate duty at his death, could the payments made on this account be properly regarded as an additional Income Tax and so constituting a differentiation against income from property? We think not.

If we look at the position of the two persons referred to in the argument under review, namely:—

- (1) The income earner who puts by a percentage of his income during the period of active earning with a view to acquiring an annuity to carry him through the years when his earning power may have ceased, and
- (2) The person having a similar income from property,

it will be seen that a marked distinction exists. The income earner must provide about 9 per cent. of his average income for, say, 40 years. At the age of 60 the expectation of life is about fourteen years, and at the age of 65 it is about eleven years, so that in many cases saving continued throughout the whole life period of active effort will result only in the acquisition of an annuity for one or other of these comparatively short periods. When such a person dies, apart from the continuance of the annuity to his wife if she survives him, his whole capital savings will have disappeared, and there will be nothing to hand on to anybody. The property-owner, however, by setting aside, not 9 per cent. of income for 40 years, but (on the basis of current insurance rates, about) 2·1 per cent. on the amount of succession duties for 30 years (or possibly for one year only\*), will be able to pass on to his successor, without any reduction due to estate duty, the same income which he himself has enjoyed.

The person who (by hypothesis) provides the annual insurance payments can never be the actual payor of the estate duty, nor can the annual payments he makes have the effect of maintaining intact the income *he* enjoys, but would, of course, have a contrary effect.

**313. Administrative Saving if Differentiation Abolished.**—It has been suggested that the abolition of Differentiation in Income Tax would “make for saving in the expenses of administration. That may be admitted, but, in our opinion, that action would cause a deep sense of injustice in the minds of a majority of taxpayers.

**314. Retention of Differentiation in Income Tax Law.**—The generally undesigned, remote, uncertain, and little-understood differential effects upon Income Tax produced by the operation of Estate or Probate Duties would, in our opinion, be no sufficient or satisfactory substitute for Differentiation, as expressed directly through an Income Tax Statute. As shown above (paragraph 310), we do not accept the contention that Estate Duties can properly be regarded as effecting a real Differentiation of Income Tax. We may point out that, if our recommendations in the “Harmonization” Section of this Report be adopted by the Commonwealth and the

\* It is assumed that the payments will continue for 30 years, this being taken as the average interval between successions, but the whole amount covered by the policy would be payable if the insurer died immediately after making the first premium payment. Of course, when the death occurs the estate duty becomes payable.

States, the Commonwealth will cease to impose Estate Duty, and consequently will be unable to give effect to the principle of Differentiation except through Income Tax. The allowance in Income Tax to personal exertion incomes, by means of Differentiation, is in most cases the only method by which the depreciation of the human machine can be adequately recognised in taxation, or by which that recognition can be made clearly perceptible to the great body of taxpayers. We are of opinion that the principle of Differentiation is one which should be retained, and that it should be retained by specific inclusion in the Income Tax Law.

**315. Taxation of Property Acquired by the Taxpayer.**—Objections have been raised to the imposition of tax at a higher rate in the case of property acquired by the taxpayer, as contrasted with the case of property inherited. No doubt, such property is frequently acquired by industry and thrift, although there are many cases where the events which lead to its acquisition are of the nature of happy accidents. The argument against taxation of income from such property at differential rates is that it tends to discourage thrift. This, in our opinion, has but little force, and any such effect will generally be outweighed by the sense of security and confidence given by the growing acquirement of a permanent source of income. The argument also loses sight of the fact that the allowance to personal exertion incomes may help in creating and sustaining the impulse to save.

This discussion throughout, while mentioning Commonwealth Estate Duty, applies also to the Succession or Probate Acts in force in the States.

**316. Degree and Scope of Differentiation.**—The Statutes of different Australian Legislatures prescribe degrees of Differentiation, which, represented by a percentage deduction from the higher (property) rates to reach the personal exertion rates, range from zero to about 62 per cent. In considering this question, two points arise for decision :—

1. Whether there shall be any differentiation of incomes for taxation purposes.
2. If differentiation be accepted—

(a) Upon what scale shall it be based ?

(b) Shall it be carried throughout all ranges of income ?

As to 1, we have already indicated our opinion that differentiation should form part of the Income Tax law. As to 2 (a), we have carefully considered a number of different scales of differentiation, and have decided to recommend the scale shown in more detail in paragraph 319. As to 2 (b), we are of opinion that differentiation should cease absolutely at a certain point of income. In the scale we suggest that point is reached at **£4,500**. In some Income Tax laws, what may be termed direct differentiation ceases at a certain point of income, but the effect is carried forward, though with diminishing influence, throughout all incomes. For example, in Tasmania, where direct differentiation is applied to incomes up to **£2,000**, the effect is extended, since the rates common to both classes of income are only applied to that portion of the income which exceeds **£2,000**. In the scheme we recommend, not only does direct differentiation cease at the selected point of income, but for incomes of that amount and over the whole effect of differentiation vanishes, as the undifferentiated rates then apply back to the lower stages of income. In our view, the carrying forward of differential effects throughout all ranges of income is not in harmony with the principles upon which differentiation is based.

**317. Method and Scale of Differentiation recommended.**—In our opinion, Differentiation should be effected, not as at present, by prescribing two scales of rates, one for incomes derived from property, and another for incomes derived from personal exertion, but by :—

- (a) Prescribing one basic scale of rates applicable to all taxable incomes, and
- (b) Making a percentage deduction from income derived from personal exertion for the purpose of arriving at the taxable income to which the scale of rates shall then be applied.

The percentage deduction from income we suggest is 15 per cent. from all incomes up to **£1,500**, the percentage being reduced from that point at the rate of 0·005 per cent. upon each successive £, or one-half per cent. on each successive **£100**, until the vanishing point is reached at **£4,500**. Thus, to take a few examples from the Table below, the method will work out in this way :— Where the (otherwise taxable) income is **£200**, this sum is first reduced by 15 per cent., which brings it to **£170** ; tax at the rate applicable to **£170** is then assessed. At **£1,500** the deduction from income at 15 per cent. is **£225**, so that the taxable income is **£1,275**. At **£2,800** the percentage deduction has dropped to  $8\frac{1}{2}$  per cent., which applied to **£2,800** amounts to **£238**, thus reducing the taxable income to **£2,562**. At **£4,400** the percentage deduction is only one-half per cent., and at **£4,500** it vanishes completely. The result is that the whole of an income of **£4,500** is charged at the same rate, whether it is derived from property or from personal exertion—that is, no part of it receives differential treatment. The same remark applies, of course, to incomes exceeding **£4,500**.

**318. Effective Reduction arising from Differentiation.**—One feature common to all applications of differentiation by percentage deduction from income is that the effective reduction in tax is rather greater than that represented by the figure of differential percentage. This arises from the fact that on any progressive scale of tax a reduction in the amount of taxable income operates in two ways, viz., by reducing the amount upon which tax is leviable, and by rendering it liable to a lesser rate of tax. For example, an income of £300 reduced by 15 per cent. amounts to £255. Using the rates now in force under the Commonwealth Act in respect of income from personal exertion, the effective percentage tax deduction in favour of the taxpayer is not merely 15 per cent., which the scale prescribes, but for the reasons just indicated is over 19 per cent. Somewhat similar effects, but of greater volume, arise from methods which prescribe a percentage deduction of income and carry that deduction through all ranges of income. The effect in that case is that, assuming as in the British Commission's recommendation, that £200 shall be deducted from all incomes above a certain point in order to arrive at the taxable income, a taxpayer will receive a different advantage according to the position he occupies upon the scale of incomes, and the actual benefit in tax in that method is continually growing as incomes rise to the higher levels.

The method we have adopted, it will be noted, withdraws absolutely the differential advantages as soon as the income reaches the selected terminal.

**319.** The following is the table referred to above (paragraph 318).

Table showing effect of Recommended Scale of Differentiation. The rates—column 4—are those of the scale of graduation recommended in the Report—Basic Rate 5d., increasing by 0·005d. for each successive £1 (or ½d. for each successive £100). The figures in column 7 show the tax under the present Commonwealth personal exertion rates in respect of the incomes in column 1.

(1) Income.	(2) Percentage deduction from income on account of Differentiation.	(3) Taxable income when Differentiation applied.	(4) Rate, i.e., rate appropriate to income shown in column 3.	(5) Tax.	(6) Effective percentage reduction of rate due to the deduction from income of the percentage shown in column 2.	(7) Present Federal Tax Personal Exertion.
	%	£	d.	£ s. d.	%	£ s. d.
50	15	42	5·21	0 18 3	16·64	1 2 8
100		85	5·425	1 18 5	16·16	2 8 0
200		170	5·85	4 2 11	17·13	5 6 8
300		255	6·275	6 13 4	17·89	8 15 11
500		425	7·125	12 12 4	19·25	17 6 7
800		680	8·4	23 16 0	20·66	34 2 6
1,000	12½	850	9·25	32 15 3	21·38	47 19 9
1,500		1,275	11·375	60 8 7	22·65	91 19 7
2,000		1,750	13·750	100 5 3	19·79	149 5 11
2,400	10½	2,148	15·740	140 17 6	17·13	204 15 0
2,800	8½	2,562	17·810	190 2 5	14·23	268 14 8
3,200	6½	2,992	19·960	248 16 8	11·13	341 5 0
3,600	4½	3,438	22·190	317 17 5	7·86	422 5 11
4,000	2½	3,900	24·500	398 2 6	4·45	511 17 6
4,400	1½	4,378	26·89	490 10 4	0·91	609 19 8
4,500	0	4,500	27·50	515 12 6	0·00	635 16 11

## RECOMMENDATIONS.

**320. We recommend :—**

1. That the principle of differentiation be retained in Income Tax legislation.
2. That Differentiation be based upon prescribed deductions from certain incomes derived from personal exertion, which incomes so reduced shall then become chargeable in accordance with one specific scale of rates applicable to all incomes.
3. That differentiation in favour of incomes derived from personal exertion be effected :—
  - (a) in respect of incomes from £1 to £1,500, by making a deduction of 15 per cent. from assessable income, in order to arrive at taxable income.
  - (b) in respect of incomes from £1,501 to £4,500, by making deductions from assessable income, in order to arrive at taxable income, of percentages varying (on a reducing scale of 0·005 per cent. for each successive £, or one-half per cent. for each successive £100) from 14·995 per cent. to zero.
4. That from all incomes of £4,500 and upwards no deduction on account of differentiation be made.

[From this section of the Report Commissioner Jolly expresses dissent. See page 134A.]

## SECTION XI. GRADUATION.

321. Graduation as applied to Income Tax is the name given to the principle of levying higher rates of tax upon larger incomes than upon smaller incomes. Differentiation classes incomes according to their nature or origin. Graduation grades and taxes them in accordance with their volume.

322. Any system of income taxation other than one which imposes a flat unvarying rate on all incomes of whatever size embodies a form of graduation, which may consist of the levying of higher rates on larger incomes, or the superimposing of a super tax (itself flat or graduated) on larger incomes or the allowing of exemptions or abatements either continuous or vanishing, on all or any incomes.

323. The term graduation has come to be more strictly applied to that form which expresses itself in rates of tax which increase with the increase of taxable income, and in that specialized sense it is used in this section of our Report.

324. **Practice in Australia.**—Graduation on differing scales is found in the Income Tax Acts of all the States, in respect of both incomes from personal exertion and incomes from property. Confining reference to the rates applied to individual incomes from personal exertion they may be briefly summarized :—

### *Commonwealth.*

The rates of tax on the HIGHEST £ run from 3·00375 pence on the first taxable £, and rise regularly with each £ to 60 pence on the 7,600th £. On each succeeding £ the rate is uniformly 60 pence.

To this have been added super taxes aggregating 70·625 per cent., making the rates on the highest £ range from 5·1251 pence to 102·375 pence.

The AVERAGE rates of tax applicable to each £1 of taxable income run from 3·00375 pence on an income of £1, and rise regularly with each £ to an average rate of 31·5 pence on an income of £7,600. On each succeeding £ of income the rate of tax is uniformly 60 pence. This has the effect of raising the average rate continuously but less rapidly than before.

To this have been added super taxes aggregating 70·625 per cent., making the rates range from 5·1251 pence on an income of £1 to 53·746875 pence on an income of £7,600. On each succeeding £ the rate of tax is uniformly 102·375 pence, which has a similar influence in raising the average.

### *New South Wales.*

The rates run from 9 pence on the first taxable £ by six steps to 24 pence on the 9,700th and each higher £; with the addition thereto of a super tax of 6 pence on each £, thus making the joint tax to range from 15 pence to 30 pence.

### *Victoria.*

The rates run from 3 pence on the first taxable £ by four steps to 7 pence on the 1,500th and each succeeding £.

### *Queensland.*

The rates of tax on the HIGHEST £ run from 6·006 pence on the first taxable £ and rise regularly with each £ to 54 pence on the 4,000th £. On each succeeding £ the rate is uniformly 36 pence.

To this has been added a super tax of 20 per cent. on income exceeding £200, making the rates on the highest £ range from 6·006 pence to 64·8 pence at £4,000. On each succeeding £ the rate is uniformly 43·2 pence.

NOTE.—There is thus a sharp regression in rate of tax at £4,000, on the highest £ of which the rate is 54 pence, while on each succeeding £ the rate is 36 pence. The rate of tax on each £ of income in excess of £4,000 is under the original scale less than the rate on the 4,000th £, by from ·012 pence (on the rate reached in an income of £2,501) to 18 pence (on the rate reached in an income of £4,000), and under the super tax scale is less by from ·0144 pence to 21·6 pence on the same incomes.

The AVERAGE rates of tax applicable to each £ of taxable income run from 6·006 pence on an income of £1, and rise regularly with each £ to an average rate of 30 pence on an income of £4,000. On each succeeding £ the rate of tax is uniformly 36 pence. To this has been added a super tax of 20 per cent. on incomes exceeding £200, making the average rates range from 6·006 pence on an income of £1 to 36 pence on an income of £4,000. On each succeeding £ the rate of tax is uniformly 43·2 pence.

*South Australia.*

The rates run from 5 pence on the first taxable £ by five steps to 22 pence on the 10,000th and each succeeding £; with the addition thereto of a super tax of 25 per cent., making the rates to range from 6·25 pence to 27·5 pence.

*Western Australia.*

The rates of tax on the HIGHEST £ are 2 pence on each of the first 100 £s, and from that point rise regularly with each £ to 94 pence on the 7,766th £. On each succeeding £ the rate is uniformly 48 pence. To this has been added a super tax of 15 per cent. operating from a variable point in the vicinity of £264, thus making the rates on the highest £ range from 2 pence to 108·1 pence at £7,766. On each succeeding £ the rate is uniformly 55·2 pence.

NOTE.—There is thus a sharp regression in rate of tax at £7,766 on the highest £, of which the rate is 94 pence, while on each succeeding £ the rate is 48 pence. The rate of tax on each £ in excess of £7,766 is, under the original scale, less than the rate on the 7,766th £ by from ·008 pence (on the rate reached in an income of £3,934) to 46 pence (on the rate reached in an income of £7,766), and under the super tax scale is less by from ·0092 pence to 52·9 pence on the same incomes.

The AVERAGE rates of tax applicable to each £ of taxable income are 2 pence on all incomes up to £100, and from that point rise regularly with each £ to an average rate of 48 pence on an income of £7,766. On each succeeding £ the rate of tax is uniformly 48 pence. To this has been added a super tax of 15 per cent. operating from a variable point in the vicinity of £264, making the average rates range from 2·3 pence on an income of £1 to 55·2 pence on an income of £7,766. On each succeeding £ the rate of tax is uniformly 55·2 pence.

*Tasmania.*

The rates run from 3 pence on the first taxable £ by nine steps to 15 pence on the 2,001st and each succeeding £; to which is added a super tax of 10 per cent. on all incomes of £200 and over, thus making the rates to range from 3 pence to 16·5 pence.

**325. Practice in New Zealand—**

The rates of tax on the HIGHEST £ are 12 pence on the first £400, and from that point rise regularly with each £ to 124 pence on the 6,000th £, whence they rise by less rapid ascent to 164 pence on the 10,000th £. On each succeeding £ the rate is uniformly 88 pence. To this has been added a super tax of 20 per cent., making the rates on the highest £ range from 14·4 pence to 148·8 pence and upward to 196·8 pence. On each £ exceeding £10,000 the rate is uniformly 105·6 pence.

NOTE.—There is thus a sharp regression in rate of tax at £10,000 on the highest £, of which the rate is 164 pence, while on each succeeding £ the rate is 88 pence. The rate of tax on each £ in excess of £10,000 is under the original scale less than the rate on the 10,000th £ by from ·01 pence (on the rate reached on an income of £4,201) to 76 pence (on the rate reached on an income of £10,000), and under the super tax scale is less by from ·012 pence to 91·2 pence on the same incomes.

The AVERAGE rates of tax applicable to each £ of taxable income are 12 pence on all incomes up to £400, and from that point rise regularly with each £ to an average rate of 68 pence on an income of £6,000, thence by a less rapid rise to an average rate of 88 pence on £10,000. On each succeeding £ the rate is uniformly 88 pence. To this has been added a super tax of 20 per cent., making the average rates applicable to each £ of taxable income up to £400 to be 14·4 pence, from which point it rises to 81·6 pence on an income of £6,000, and thence by less rapid rise to 105·6 pence on an income of £10,000. On each £ exceeding £10,000 the rate is uniformly 105·6 pence.

**326. Practice in Great Britain.**—The rates run from 36 pence on the first taxable £ by four steps to 72 pence on the 2,001st £, reducible in the case of incomes from personal exertion by 9 pence, making the rates range from 27 pence to 63 pence. On each succeeding £ the rate is uniformly 72 pence. To this is added a super tax on so much of the income as exceeds £2,000, rising by nine steps to 72 pence on the 30,001st £. On each succeeding £ the rate is uniformly 72 pence, making the joint rates to range from 36 pence to 144 pence.

Several of these Acts contain minor provisions—such as concessions to returned soldiers or to married men with families receiving less than a certain income, rebates in respect of dividend tax paid on any dividends included in the taxpayer's income, &c.—but as they are of restricted application and for the most part relate to exemptions rather than to graduation, they have been omitted from the above summary.

327. A graph (Appendix No. 7) has been prepared, designed to afford a general comparison of the foregoing scales of rates extending up to a taxable income of £8,000.

328. **Importance of the study of rate on highest £.**—One noticeable feature appears in three of these systems and calls for special comment.

In the regularly graduated scales of Queensland, Western Australia, and New Zealand, the lines of the rates of tax after reaching a certain elevation become flat and are suddenly disjointed and dropped to rates which are very much lower than (approximately half) the height reached by the rates on the £s which immediately precede them. Thus under the scales at present current—

	Original Scale.	Including Super Tax.
<i>In Queensland</i> the 4,000th £ is required to pay a tax of .. .. .	54 pence	64·8
while the 4,001st and succeeding £s are required to pay only .. .. .	36 „	43·2
<i>In Western Australia</i> the 7,766th £ is required to pay a tax of .. .. .	94 „	108·1
while the 7,767th and succeeding £s are required to pay only .. .. .	48 „	55·2
<i>In New Zealand</i> the 10,000th £ is required to pay a tax of .. .. .	164 „	196·8
while the 10,001st and succeeding £s are required to pay only .. .. .	88 „	105·6

thus showing drops which are in each case a reversal of the principle applied throughout the whole range of the graduated scale—for progression in the rates of tax there is substituted (probably unintentionally) regression which is usually regarded as an unjust mode of taxation.

This procedure is not present in the fourth regularly graduated scheme—that of the Commonwealth—where while the rates run from 5·11875 pence on an income of £1 and rise to an average of 53·7469 pence on an income of £7,600, the rate of tax on the 7,601st £ is 102·375 pence, which is the rate carried by the highest individual £ of the ascending scale. This preserves the principle of progression. There is not here the discrimination in favour of higher incomes which is so marked in the first three cases.

329. Attention has been directed to these inconsistent rates for the purpose of emphasizing that in the consideration of a graduated taxing scheme the important subject for study is the rate of tax carried by each individual £ of the income, for, whatever be the amount of the taxable income, each individual £ in one income should carry precisely the same rate of tax as the corresponding £ in every other income; for instance, the tenth £ should always bear identically the same tax in every taxable income however large, and so with every other £. That these progressive rates may be thrown together at any stage and for purposes of easy handling be averaged may assist administration, but though usefully introduced at a later stage in the study of the subject it confuses and obscures the true position and may lead to serious misconception as to the precise operation of the scale.

329A. **Evidence of Witnesses.**—Almost every witness who addressed himself to this subject pleaded for the introduction of a simple method whereby the taxpayer, inexperienced in calculations, could easily ascertain the rate and reckon up his liability without engaging professional assistance. The scales of the present Federal Act running into long decimals, and more particularly the geometrical curves of the property rates, were strongly condemned because of their complexity, which was represented as aggravated by the method in which the tax on composite incomes, consisting partly of income from personal exertion and partly of income from property, is computed.

“It is quite impossible for the average taxpayer in the first place to estimate what his tax is likely to be or to check the assessment as to its accuracy when it eventually comes to hand.”

“I have heard many taxpayers express the view that, even if it meant paying a little more in the way of taxation, they would prefer to do this, as long as they knew that what they were paying was the correct amount.”

These quotations express the views of a large number of witnesses, some of whom also urged that one rate, simple in application, be used for all individual incomes from whatever source derived.

330. The "step" system, as used in New South Wales, Victoria, and South Australia, was advocated by a number of witnesses, chiefly from these States. The system has from long use become familiar, and the tax can be calculated by simple arithmetic, without the use of decimals. Some witnesses, including officials, suggested modified systems which merely convert the smooth ramps of the present Commonwealth Acts into a number of wider or narrower steps whereby one uniform rate may be charged on each section or step of income.

331. The "step system," moving more or less irregularly, does not, however, commend itself to us, a more equitable method being provided in the regularly graduated scale recommended in this section, which is capable of delicate adjustment; and determines a rate easily understood, easily remembered, and easily calculated.

332. Among the schemes submitted to us was one in which the witness suggested a scale akin in principle to, but very different in effect from, that recommended by your Commissioners. He proposed that income from personal exertion and income from property be reduced to one denominator, and then continued:—"Tax to be assessed at a commencing rate on the first £ of 5 1/100d. in £ and to rise by 1/100d. in £ for every additional £ of taxable income up to £10,000 where the rate reaches 8s. 9d. in £. Everything over £10,000 might be assessed at 8s. 9d., or at some other higher figure having regard to the interests of the revenue."

In illustration he furnished a table, reading—

Income.	Rate in Pence.	Income.	Rate in Pence.	Income.	Rate in Pence.
£		£		£	
1 .. ..	5·01	4,000 .. ..	45	10,000 .. ..	105
100 .. ..	6	5,000 .. ..	55	15,000 .. ..	105
500 .. ..	10	6,000 .. ..	65	20,000 .. ..	105
1,000 .. ..	15	7,000 .. ..	75	30,000 .. ..	105
2,000 .. ..	25	8,000 .. ..	85	50,000 .. ..	105
3,000 .. ..	35	9,000 .. ..	95		

Seeing the high altitudes to which the proposal would raise the tax, he wrote:—"The advantages of this basis over the present method are too obvious and numerous to elaborate. The slightly higher graduation may possibly be deemed a detriment, but almost every witness has expressed a willingness to pay a little more if only he could check the calculation, and when it is possible to meet the wish of the public without decreasing revenue, I suggest that every effort should be made to do so."

The highest rate of tax under this scheme reaches not 105, but 205 pence, so that a person having an income of £10,000 would, in respect of the final £, be allowed to retain only 35 pence, and, in respect of every individual £ in the preceding £4,500, would be paying not less than 10s.

333. In the case of taxpayers who derive their incomes in Western Australia, the total taxes payable in any one year on the highest £ of their incomes as under would be:—

Income	£5,000	£6,000	£6,940	£7,000	£7,766	£9,000	£10,000
	Pence.	Pence.	Pence.	Pence.	Pence.	Pence.	Pence.
Proposed Rate	105	125	144	145	160	185	205
Western Australia Rate	70	84	96	98	108	55	55
Total Rate	175	209	240	243	268	240	260

334. **The Adoption of a Single Scale of Rates.**—In the section of the Report dealing with differentiation (par. 320) the Commission has recommended that income from personal exertion and income the produce of property should be reduced to one common denominator, and that all individual incomes should be assessed and taxed at one scale of rates instead of two scales as at present.

335. In selecting which of the two kinds of scales—one a straight line and the other a composite line partly of the first degree, partly of the second, and partly of the third—we have no hesitation in choosing the former for these reasons:—

1. It approaches more nearly to the general contour of the line which expresses the widely accepted theory of the diminishing utility of money or wealth as a whole to its possessor; that is, as his stock of money increases, the marginal utility of the last addition to his stock continuously falls, and, until exceedingly high levels are reached, each additional portion of income is of less utility to him than its predecessor. In its relation to taxability the tax being on a suitable graph represented by the area below the line, such a line viewed from the upper

side would be a hollow curve ascending from its commencement at the rate chargeable on the first £1 of income and not only ascending but also increasing in rapidity of ascent with each unit of increase in income. However closely such a curve may approach to ideal accuracy in the expression of that theory we are unable to recommend its adoption because—(a) it would be as difficult of comprehension by the general taxpayer as are the present property curves under the Commonwealth Act; and (b) the rates determined by the line would not produce the revenue which should be yielded by middle class incomes. We are equally unable to recommend a line which like the scale of the present Federal property rates curves in the opposite direction and causes disproportionately heavy burdens to fall upon lower incomes to the inequitable relief of others.

2. A straight line is the simplest. Its position and direction are the most easily understood. It is not less adaptable than any other form of graduation to the variable requirements of the public revenue and other economic and political considerations which may change from year to year.

336. Being unanimous in the opinion that the rates of tax should follow the course of a curve of the first degree—a straight line—the questions of its position and direction next call for consideration. If on the first graph (in Appendix No. 7) an attempt be made to draw a straight line showing as nearly as possible in respect of each State the mean of the irregular path traversed by the income tax rates of the State, no two of these lines would be found to agree in position and direction, and we have found it impossible to derive from them any definite and indisputable guidance to the discovery of an authoritative and scientifically correct line of graduation. The determination of the points where taxation shall begin and shall cease is the business of the statesman fully informed as to the requirements of the National purse, and the ability of various classes of income recipients to contribute without impairment of the sources of taxation.

337. **Position and Direction of Normal Line of Rates.**—Your Commissioners are of opinion that the personal exertion scale adopted in the Federal Income Tax Act of 1915, and its subsequent adjustments, are reasonably adapted to the economic, industrial, and business conditions obtaining in the Commonwealth, and that its movement represents in the main with fair accuracy the equitable relative taxable capacity of different sections of taxpayers. We are therefore led to recommend for adoption for our standard or normal line of rates one commencing at 5d. (being the point where the present rate commences) and traversing a straight course.

338. In seeking to determine the direction the line should take regard must be had to simplicity, easy comprehension by the average taxpayer, and ready ascertainment by him of the rate applicable to any stated income, as well as the more prominent questions of productiveness and equitable incidence. The smooth progression of the present personal exertion rate is the simplest which could have been used to effect a continuous rise of 57 pence in a series of 7,600 units. It was effected by tracing a straight line which, starting at the point representing 3 pence on the scale of rates rising perpendicularly from zero on the scale of incomes, cuts at 60 pence the line perpendicular to the point on the same scale, representing an income of £7,600. This line being produced backwards cuts the basic (income) scale at a point 400 units to the left or minus side of the zero line. A glance at the second graph (Appendix No. 8) illustrates this. But the system required that, in addition to ascertaining (as this line does) the rate of tax payable on the topmost £ of each income, large or small, there should be quickly ascertained the average rate payable in respect of any income. This line of average rates is found by shifting the pivot from 400 to 800 units to the left of zero and passing this line also through 3 pence on the scale of rates at the zero line—it cuts the 7,600th £ at 31·5 pence, which is the average rate of the tax payable on each £ of an income of £7,600, whose first £ carries a tax of 3·00375 pence and the 7,600th £ 60 pence.

339. Convenient, more easily understood, and equally adaptable lines could have been found in close proximity to these. The lines of progression under the scale operative to-day intersect at 5·11875 pence the scale of rates rising perpendicularly at zero £ and are as follows:—

Pivotal Point.		On Incomes of—	
		£1.	£7,600.
400	Rate of tax on highest £ is .. ..	5·1251 pence	102·375 pence
800	Average rate of tax is .. ..	5·06255 pence	53·7469 pence

We recommend that for these there be substituted lines radiating on pivots respectively 500 and 1,000 units to the left of the zero £ and passing through 5 pence at zero £. Their tracks will be :—

Pivotal Point.		On Incomes of—	
		£1.	£7,600.
500	Rate of tax on highest £ is .. ..	5·01 pence	81 pence
1,000	Average rate of tax is .. ..	5·005 pence	43 pence

These lines are plotted on the graph (Appendix No. 8).

The effect of pivoting at 1,000 on the scale of income “the line passing through 5 pence on the scale of rates” is to introduce a more convenient incline, and greatly simplify calculations. The rate of tax now rises regularly by  $\frac{1}{2}$ d. in each £100. If the rate on £250 is  $6\frac{1}{4}$ d., the rate on £350 is  $6\frac{3}{4}$ d., on £450  $7\frac{1}{4}$ d., and on £600 8d.

340. When the rates originally determined were found insufficient for revenue requirements the lines were made to revolve on their pivots through an area representing an increase of 25 per cent. on the previous rates, and a new series of rates, exactly proportionate with the first, was determined to secure the necessary volume of revenue. Later on the lines were again moved to yield an additional 30 per cent. and 5 per cent. The latest movement is sufficiently indicated in the lines on the graph (Appendix No. 8) and they all follow in effect the practice established by law in certain Continental countries where the normal tariff (embodying the whole scale of rates) is fixed once and for all in the Income Tax Law, and is either not varied by the annual Budget Law or is varied only by levying a percentage over or under the tariff rates. In such cases the same percentage is added to (or deducted from) all assessments, so that the ratio of progression established by the original tariff remains unaltered. The tariff—the graduated scale of rates—is thus regarded as a standard basis of progression, and the annual tax is levied at such a percentage over or under the tariff as may be required (*vide* Graduated Income Taxes in Foreign States, House of Commons Cd. Paper 7100).

341. So just as the original normal rates of 1915 Assessment Act when found to yield insufficient revenue were raised by a percentage, the normal rates recommended by your Commissioners can be adjusted in a similar way—and as is shown below, in other ways—to meet the needs and policy of the Legislature.

342. **Simplicity.**—An urgent public demand has arisen for simplicity in the matter of rates, and these new lines respond to that demand, and with other simple features which are explained in pars. 343–345 form an easily comprehended, adaptable, and efficient scheme.

343. Simplicity is claimed for it, in that by the simple rules of elementary arithmetic, a taxpayer can easily ascertain for himself the rate and the tax chargeable upon his income immediately his return has been compiled. Under the line recommended by us the rule for ascertaining the average rate of tax and the total tax payable on any income up to the point where the line of progression in rates is replaced by another rate (under the present Act, £7,600) would be—

- (1) Divide the taxable income by 200: and (2) To the quotient add 5 (that is, the basic rate).

The result will be the *average rate* of tax in pence, thus :—

Taxable income (A) .. .. .	£100	£164	£500	£2,000	£3,500	£7,600
Divide by 200 (B) .. .. .	·5	·82	2·5	10	17·5	38
Adding 5 gives the average rate of tax per pound in pence (C) .. .. .	5·5	5·82	7·5	15	22·5	43
A × C = the tax (D) .. .. .	£2 5 10	£3 19 5	£15 12 6	£125	£328 2 6	£1,361 13 4

344. If collection at the rates of the normal scale be insufficient for the revenue requirements they can be raised by any percentage necessary, as was the case with the scale of the 1915 Act—say, as in that case, 25, per cent. The taxpayer has no difficulty in ascertaining the tax payable by him at the higher rate. He adds :—

	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
25 per cent (E) .. .. .	0 11 5	0 19 10	3 18 1	31 5 0	82 0 7	340 8 4
and finds the tax (F) .. .. .	2 17 4	4 19 3	19 10 7	156 5 0	410 3 1	1,702 1 8

345. The rule for ascertaining the rate of **tax payable on the highest £** of any income (up to **£7,600**, as before, or as far as the scale continues an uninterrupted ascent) is :—

1. Divide the taxable income by 100; and 2. To the quotient add 5.

The result is the **rate of tax payable on the highest £** of the income, thus :—

Taxable income (T) ..	£100 ..	£164 ..	£500 ..	£2,000 ..	£3,500 ..	£7,600
Divide by 100 (U) ..	1 ..	1.64 ..	5 ..	20 ..	35 ..	76
Adding 5—gives the rate of tax in the topmost £ in pence						
(V) ..	6 ..	6.64 ..	10 ..	25 ..	40 ..	81

If the rates be increased by say 25 per cent. he adds—

25 per cent. ..	1.5 ..	1.66 ..	2.5 ..	6.25 ..	10 ..	20.25
and finds the tax on the highest £ to be	7.5 ..	8.30 ..	12.5 ..	31.25 ..	50 ..	101.25

The increase in rate of tax on the highest £ is **1d.** in every **£100** ; thus the rate on the highest £ in—

£100 is	1 + 5 = 6 pence.	£2,750 is	27½ + 5 = 32½ pence.
150 is	1½ + 5 = 6½ „	3,500 is	35 + 5 = 40 „
175 is	1¾ + 5 = 6¾ „	4,800 is	48 + 5 = 53 „
350 is	3½ + 5 = 8½ „	6,250 is	62½ + 5 = 67½ „
1,525 is	15¼ + 5 = 20¼ „	7,600 is	76 + 5 = 81 „

346. **Adaptability.**—The weight and incidence of the scale of rates can be varied by three distinct methods, and, as these may operate jointly or severally, there may be numerous combinations.

1. The tax may be varied by a percentage increase or decrease all along the line.

2. The uniform basic rate (3 pence in the £ in the scale of the original Federal Act, increased since by amendments to the Act to 5.11875 pence, and in our recommended scale 5 pence in the £) which applies without variation to every £ of taxable income may be raised or lowered.

3. The point at which the line of graduation shall cease and another rate be substituted may be pushed upward or drawn downward.

347. 1. The first method has been in operation for several years in connexion with the present Act. In 1916 the original tax was raised in this way by 25 per cent. ; in 1918 it was raised to 62.5 per cent. ; in 1920 it was raised to 70.625 per cent. The lines pivoted at points 400 and 800 units respectively were revolved from 60 and 31½ pence respectively till they eventually reached 102.375 and 53.746875 pence, with proportionate increases in intermediate rates, including the basic rate of tax which at the several successive periods has been 3 pence, 3.75 pence, 4.875 pence, and is now 5.11875 pence in each £. (See footnote).

2. The Second Method.—As the foundation of this scale of rates, there was in the scheme and formula of the original Act a uniform tax of 3 pence on each and every £ of income, irrespective of whether it was small or large. It is expressed by the integer 3 in the formula :—

$$\text{Rate} = 3 + \frac{\text{Income} \times 3}{400}$$

and may be called the basic rate of tax.

348. Without in any way interfering with or destroying the simplicity of the movement of the revolving lines, this basic rate can be separately and independently operated upon to increase or decrease the rate of tax or alter its incidence as between smaller and larger incomes.

349. If, for example, it be decided that 5d. is too high a rate to charge on the first £ of a small income, and that it should be reduced to 4d., the alteration may be effected in two ways : (a) by revolving the normal line down, so that instead of passing through 5, it shall pass through 4 at the zero £. This will involve a reduction of the rate of tax **all along the line** by 20 per cent., but (b) the same object as regards the first £ can be effected by reducing the basic rate from 5 pence to 4 pence on the zero £, which will have the effect of reducing the rate of tax **on all incomes** by one penny in the £. The effects may be contrasted thus :—

Income	£1	£100	£1,000	£4,000	£6,000	£7,600
Average rate in pence on scale proposed	5.005	5.5	10	25	35	43
(a) Deducting 20 per cent.	1.001	1.1	2	5	7	8.6
Reduces effective rates to	4.004	4.4	8	20	28	34.4
(b) If 1d. be deducted the effective rates are	4.005	4.5	9	24	34	42

Method (a) lifts all along the line amounts which are not identical on any two rates, but as the amounts increase proportionately with the increases of rate of tax, the ratio of the lifted amount to the rate previously chargeable is identical throughout. The ratio, but not the amount, is uniform.

Method (b) lifts all along the line an identical amount whatever be the rate of tax, but the ratio of the lifted amount to the rate previously chargeable diminishes proportionately with the increase of the rate of tax. The amount, but not the ratio, is uniform.

350. On the other hand, if it be decided to raise the rate on the initial £ to 6 pence, the alteration may be effected by (a) revolving the normal line, so that instead of passing through 5 pence, it shall pass through 6 pence at the zero £. This will involve an increase of 20 per cent. in the tax **all along the line**. But (b) the same object as regards the first £ can be effected by increasing the basic rate from 5 pence to 6 pence, which will have the effect of increasing the rate of tax **on all incomes** by one penny in the £. The effects are contrasted thus:—

Income	£1	£100	£1,000	£4,000	£6,000	£7,600
Average rate in pence on scale proposed	5.005	5.5	10	25	35	43
(a) add 20 per cent.	1.001	1.1	2	5	7	8.8
Raises the effective rates to	6.006	6.6	12	30	42	51.6
(b) if 1d. be added the effective rates are	6.003	6.5	11	26	36	44

These illustrations show that the altering of the uniform basic rate may have the effect of relieving the lower or relieving the higher incomes at a rate disproportionate with the influence of the change at the other end, and thus modify or accentuate the degree of graduation throughout

**Note.**—The corresponding basic rates of tax of the Acts whose rates are epitomized in paragraph 324 of this Report are:—

	Original.	With Super Tax.		Original.	With Super Tax.
Commonwealth	3 pence	5.11875 pence	Western Australia	2 pence	2.3 pence
New South Wales	9 "	15 "	Tasmania	3 "	3.3 "
Victoria	3 "	3 "	New Zealand	12 "	14.4 "
Queensland	6 "	7.2 "	Great Britain (generally)	36 "	36 "
South Australia	5 "	6.5 "			

the whole field of taxation. In extreme cases smaller incomes might by this method be driven out of the field of taxation altogether, or the rates upon them might be multiplied, while the influence on the larger incomes, though identical in weight, would be relatively light in effect.

351. The Third Method.—It is generally admitted that under a graduated scale the rate of tax on larger incomes should not be so heavy as to imperil the incentive to continued effort, and it becomes a practical question to decide at what point in the ascending scale the rising rates should be superseded by a scale of slower ascent or by a flat rate. Under the scale of rates on incomes from personal exertion at present in force under the Commonwealth Act the point chosen is when the income reaches £7,600. But circumstances may arise which might compel a lowering or necessitate a raising of the point, and in this movement is found the third method of adjustment, namely, the extending, shortening, or deflecting of the normal line, and its supersession at that point by another rate or line of rates. These three methods may be used singly or in any combination, and afford without any change in the normal or standard scale a very flexible system, by which expression can be given to very varied conditions and requirements. They may be combined thus:—

(1) Percentage increased	{	basic rate raised	{	line extended	When for any year the length of the line has been determined, it may for higher incomes be continued by a line of rates which may be itself more or less sharply progressive, regressive, or flat
				line unchanged	
				line shortened	
{	basic rate unchanged	{	line extended		
			line unchanged		
			line shortened		
{	basic rate lowered	{	line extended		
			line unchanged		
			line shortened		
making together 9 combinations.					
(2) Percentage unchanged and 9 corresponding combinations.					
(3) Percentage reduced and 9					”

making in all 27 combinations

352. **Suitability of Recommended Method.**—The flexibility of the system makes it unnecessary, as the exigencies of arithmetic make it impossible, to devise a simple scale of rates which will without modification exactly suffice to bring in the revenue required at the present time, and the

lines of graduation recommended by your Commissioners are not submitted as an unalterable standard adequate without modification for present needs, but as constituting an easily comprehended, readily adaptable and efficient scheme capable of being adjusted as above indicated with any degree of accuracy desired to the requirements of the revenue, and the economic, industrial, and business conditions of the country from time to time. The following is a:—

**353. Comparison of the rates (plus 25 per cent.) proposed by your Commissioners with the rates current under the present Commonwealth personal exertion scale:—**

A. The rates of tax chargeable on the highest £ of some representative incomes from personal exertion up to £10,000 as per the scale of—

- (1) The original Federal Act of 1915;
- (2) The Federal Act at present in force; and
- (3) The rates recommended by this Commission, increased by 25 per cent., and

B. The average rates of tax chargeable on the same incomes as per the scale of—

- (4) The original Federal Act of 1915;
- (5) The Federal Act at present in force; and
- (6) The rates recommended by this Commission, increased by 25 per cent.

The rates in Columns 1 and 2 are shown as rising till an income of £7,600 is reached when they become flat at 60 pence and 102·375 pence respectively. The impulse of earlier increases continues, however, to express itself in the average rates on still higher incomes, as shown in Columns 4 and 5. For purposes of this comparative table, the rates in Column 3 are treated as rising till an income of £10,000 is reached. This does not imply any opinion on the part of your Commissioners that the commencement of the flattened rates should be at that or at any other figure.

Rates on Highest £.			Income. £	Average Rate on each £.		
Top Rates of the Original Scale.	Top Rates of the 1920-21 Scale.	Top Rates of Recommended Scale plus 25 per cent.		Average Rates of Original Scale.	Average Rates of 1920-21 Scale.	Average Rates of Recommended Scale, plus 25 per cent.
(1.)	(2.)	(3.)		(4.)	(5.)	(6.)
Pence.	Pence.	Pence.		Pence.	Pence.	Pence.
3·75 .. ..	6·3984	7·5	100	3·375	5·7586	6·875
4·5 .. ..	7·67805	8·75	200	3·75	6·3984	7·5
5·25 .. ..	8·95785	10	300	4·125	7·0383	8·125
6 .. ..	10·23745	11·25	400	4·5	7·6781	8·75
6·75 .. ..	9·51725	12·5	500	4·875	8·3180	9·375
7·6250 .. ..	14·71645	15·625	750	5·8125	9·9176	10·9375
10·5 .. ..	17·91565	18·75	1,000	6·75	11·5172	12·5
14·25 .. ..	24·31405	25	1,500	8·625	14·7164	15·625
18 .. ..	30·71245	31·25	2,000	10·5	17·9156	18·75
21·75 .. ..	37·11805	37·5	2,500	12·375	21·1148	21·875
25·5 .. ..	43·50945	43·75	3,000	14·25	24·3141	25
33 .. ..	56·31625	56·5	4,000	18	30·7125	31·25
40·5 .. ..	69·10305	68·75	5,000	21·75	37·1109	37·5
47·25 .. ..	80·62025	80	5,900	25·125	42·8695	43·125
48 .. ..	81·90005	81·25	6,000	25·5	43·5094	43·75
55·5 .. ..	94·69685	93·75	7,000	29·25	49·9078	50
59·25 .. ..	101·09525	100	7,500	31·125	53·107	52·125
60 .. ..	102·375	101·25	7,600	31·5	53·7469	53·75
60 .. ..	102·375	106·5	8,000	32·925	56·178	56·5
60 .. ..	102·375	118·75	9,000	35·933	61·311	62·5
60 .. ..	102·375	120	9,100	36·210	61·783	63·125
60 .. ..	102·375	125	9,500	37·2	63·472	65·625
60 .. ..	102·375	131·5	10,000	38·34	65·417	68·75

It will be seen that there is close agreement between Columns 2 and 3, and Columns 5 and 6.

**354. Easy Comprehension.**—Some space has been devoted to explaining the simplicity and adaptability of the method recommended by your Commissioners. We add a few illustrations, showing it can be easily understood and applied by a taxpayer of limited skill in figuring. Having

ascertained when his return is prepared the amount of his income he, if the method recommended by us be without modification in operation, will (1) divide the income by 200 ; (2) add five to the quotient ; (3) multiply the income by the sum, which gives the actual tax payable thus :—

Income .. .. (A)	£150	£225	£375	£412	£515	£670
Divide by 200 .. .. (B)	·75	1·125	1·875	2·06	2·575	3·35
Add 5, gives Rate .. (C)	5·75	6·125	6·875	7·06	7·575	8·35

Tax = (A) × (C) = (D) .. £3 11s. 10d. £5 14s. 10d. £10 14s. 10d. £12 2s. 4d. £16 5s. 1d. £23 6s. 2d.

355. If unskilled in the use of decimals, he may, by using the common fractions of a penny, get results sufficiently accurate for his purpose. To repeat the above examples :—

Income .. .. (A)	£150	£225	£375	£412	£515	£670
Divide by 200 .. .. (B)	$\frac{3}{4}$	$1\frac{1}{8}$	$1\frac{7}{8}$	$2\frac{1}{16}$	$2\frac{1}{2}$	$3\frac{3}{8}$
Add 5, gives Rate .. (C)	$5\frac{3}{4}$	$6\frac{1}{8}$	$6\frac{7}{8}$	$7\frac{1}{16}$	$7\frac{1}{2}$	$8\frac{3}{8}$

Tax = (A) × (C) = (D) .. £3 11s. 10d. £5 14s. 10d. £10 14s. 10d. £12 3s. 5d. £16 1s. 10d. £23 7s. 7d.

356. If he be desirous of ascertaining the tax payable on the highest £ of his income the operation is simple. It is done by cutting off the last two figures, and adding 5 to the result, and multiplying as before, thus :—

Income .. .. (E)	£150	£225	£375	£412	£515	£670
Divide by 100 .. .. (F)	1·5	2·25	3·75	4·12	5·15	6·70
Add 5, gives Rate, in pence .. (G)	6·5	7·25	8·75	9·12	10·15	11·7

Income .. .. (E)	£2,560	£3,128	£4,376	£5,186	£6,923	£7,600
Divide by 100 .. .. (F)	25·6	31·28	43·76	51·86	69·23	76
Add 5, gives Rate, in pence .. (G)	30·6	36·28	48·76	56·86	74·23	81

356A. The illustrations in this section of the Report all relate to incomes, to which the method of averaging as recommended in paragraph 61 of our Report does **not** apply.

For incomes to which the method of averaging is applied, a similar rule obtains, namely, ascertain the average income which determines the taxable capacity and ascertain the rate of tax thereon as above. Multiply this rate by the income of the taxable year and the product is the tax payable.

### 357. We recommend—

1. That all incomes, whatever be their nature, having been by suitable differentiation expressed in one common denominator, there be one scale of rates applicable to all taxable incomes.
2. That a standard or normal scale of rates be adopted and be maintained for as long a time as possible unaltered, but subject to adjustment yearly by the methods indicated in this section of our Report ; and
3. That such scale commences from a basic rate of 5 pence, and that from 5·005 pence on the first £ the average rate of tax on all incomes increase with every increase of income regularly by  $\frac{5}{1000}$ d. for each £ ; that is, increase regularly at a rate equivalent to  $\frac{1}{2}$ d. in every £100 up to such amount as may be determined from time to time.

[From this section of the Report Commissioners Missingham and Mills, and Commissioner Duffy express dissent. See pages 135 and 137.]

## SECTION XII.

## TAXATION OF INCOME OF AUSTRALIAN RESIDENTS DERIVED OUTSIDE AUSTRALIA.

**358. Official Evidence.**—The Federal Commissioner of Taxation, in the course of his evidence on the subject of Double Income Tax, expressed the opinion that :—

With the disappearance of the Double Income Tax there is no reason why Australia should limit its tax to incomes arising from sources in Australia.

(See also paragraphs 169 and 170 of this Commission's First Report). The Commissioner considered that, upon the elimination of Double Taxation in respect of incomes taxed both in the United Kingdom and the Commonwealth, Australian residents should be taxed on their total incomes wherever derived on the basis of their ability to pay. He said :—

It would mean that, instead of the Commonwealth losing Income Tax on large revenue derived by Australians—using the term in a general sense—from such countries as Japan, China, America and South America, we should get the tax on it. There is no reason, to my mind, why that revenue should not contribute towards the cost of government in Australia.

The Victorian Commissioner of Taxes stated :—

If the income is not earned in or derived from Victoria, it is not taxed, and I think the Victorian practice is correct in this respect. . . . My opinion is that Australia should not depart from its present Income Tax principle.

**359. Non-Official Evidence.**—Very few witnesses dealt with the general subject of the taxation of incomes of Australian residents derived abroad. In the majority of instances the references in evidence to the subject arose out of the discussion of the issues involved in the taxation of profits arising from sales abroad of exports from Australia. In one or two instances the scope of the Commonwealth Income Tax Assessment Act in its non-exclusion of all income derived outside Australia was defended by argument, but more frequently that feature of the Act seemed to be accepted by witnesses as a matter of course, or as not calling for special comment or defence. In one State a representative witness, in his evidence in chief on the subject of Double Taxation, said :—

The country of source of income should be the country to impose and collect the tax ; but there are so many national and international considerations to be taken into account that the question is considered one of politics rather than of taxation.

**360.** A representative witness in another State said :—

I consider that any taxation in Australia of incomes derived abroad would be unjust, whether such incomes or part thereof are ultimately received in Australia or not. Income Tax legislation should be based upon the principle that each member of the community should be taxed by reference to :—

- (a) The protection to property, education and other public advantages afforded to him by the Government of the country in which his income is derived ; and
- (b) The amount of his tax to be proportionate to the means and ability to pay derived by him from the country towards whose revenue he is required to contribute.

Taking these principles as the basis of Income Tax assessment it is obvious that any tax imposed here upon income earned abroad is not in the nature of a real Income Tax, inasmuch as this country affords no Police, Naval or Military protection to the property abroad from which the income is derived, and no advantages to the taxpayer, such as education, municipal and other utilities to assist him in the earning of the income. My clients also consider that such taxation would be detrimental to the country's welfare from the point of view of its deterrent effect upon income coming here for investment.

**361.** A third witness expressed the opinion that :—

It would be a fatal mistake to depart from the principle that Income Tax should be computed upon incomes earned in or derived from Australia. . . . Our attitude is just . . . . I think that, as far as Great Britain is concerned, it has a reason for taxing income derived from outside the United Kingdom which we have not for profits earned outside the Commonwealth. There is no doubt that what was called invisible imports, i.e., revenue derived from investments abroad, all over the world of British capital were—and I suppose still are—very large sources of wealth to Great Britain and income to the residents of Great Britain, and a very great deal of the British Naval and Military expenditure was incurred to protect these capital investments abroad.

In answer to the question :—

Supposing an Australian resident invests his money in a foreign country where there is no Income Tax, and the profits are brought to Australia, and these persons enjoy the protection of this community, do you say they should be relieved of Income Tax altogether ?

the witness replied :—

Those are comparatively rare exceptions. . . . Theoretically it does seem that they should be taxed to some extent, but I do not think you should make it a heavy tax, or you may drive them there altogether.

In answer to the question :—

Do you think it would be a reasonable thing to tax the income derived abroad, but allow a rebate of any tax paid to the foreign country in which the income is derived ?

the witness replied :—

Yes, that is a novel suggestion to me, but I think it is a very fair one in that case.

**362. Right of a State to tax Income arising outside its Borders.**—The sub-Committee appointed in 1919 by the British Royal Commission on the Income Tax to confer with representatives of the Dominions on the subject of Double Income Tax within the Empire, in the course of its Report, stated :—

We discussed and admitted as general principles of taxation governing any conclusions at which we might arrive :—

- (a) That a condition of effective taxation occurs when either—(1) a source of income arises in any State or (2) the owner of an income resides in any State ;
- (b) That every State has an unrestricted right to adopt its own methods of taxation within the sphere of its jurisdiction.

The contention, without qualification, that a primary right to tax income is possessed by the country whence the income is derived—to the exclusion of the right to tax it in the country of residence, violates the principle that each country has complete freedom to choose its own measure of liability in imposing taxation, and is difficult to justify on theoretical principles. If this contention were admitted, the United Kingdom would be called upon to surrender a right which it has exercised ever since the imposition of its Income Tax, a right which is common to the systems of many foreign countries and some Dominions, and is based on an admitted canon of taxation, that of ability to pay.

**363. Indorsement of British Practice.**—The Report of the British Royal Commission (while recommending specific reliefs in respect of Double Income Tax within the Empire, and suggesting minor amendments of the law as it relates to the taxation of incomes arising abroad, other than from trade) recommended that :—

There should be no change in the present law, which renders British resident persons or Companies liable to be assessed on the whole of their trading profits, irrespective of what proportion of their profits arises abroad.

**364. Practice in British Dominions.**—There appears in Appendix No. 6 to this Report a statement which indicates in abbreviated form the scope in respect of the sphere of taxation of the various Income Tax Acts in force throughout the British Dominions. The summary discloses considerable variation in practice. The absence in the instances cited of a ruling principle in the determination of the sphere of taxation is conspicuous, but is not remarkable. There must be of necessity many and varied considerations to be taken into account in framing an Income Tax measure. What is deemed appropriate in one country may prove to be wholly inappropriate in another. Income Taxation may in some instances have been introduced as a temporary financial expedient, in the belief that it would be subsequently abandoned or substantially modified upon the passing away of the urgency of the moment. In such cases the supposed temporary character of the tax may account for the presence of some features which later on call for amendment. Revenue necessity and other considerations create practical difficulties in the enactment of theoretically sound taxation measures.

**365. Test of Proposed Taxation.**—Sir Josiah Stamp seems to recognise this when he says :—

The State as a tax-gatherer has to ask and answer the following questions :—

1. Is the proposed tax economical, or will it cost an unwarrantable amount to get it in ?
2. Is it within the powers of the administration for assessment and collection, or is it too full of difficulties to be workable ? Allied thereto is the question :
3. Will it be specially open to evasion and provoke dishonesty ?
4. Will the imposition of the tax tend to dry up the source of the tax, and so prove abortive for the revenue ?
5. Does it raise political difficulties at home and provoke unrest ?
6. Does it raise international difficulties or provoke conflict with other taxing jurisdictions ?

**366. Bases of the Right to Tax.**—In his evidence before the British Royal Commission, Sir Josiah Stamp said :—

The tax that a man is called upon to pay to the State may be said to be divisible into two parts, that which is due for the specific protection and maintenance of particular sources of income, and that which is due for the privileges which the citizen himself enjoys in his person and residence.

His evidence did not question the justice of the British practice of taxing the resident in respect of his income derived from abroad.

**367. Professor Seligman** in his “ Essays in Taxation ” expresses the view that the force of the oldest principle employed in taxation—that of citizenship and political allegiance—has been in modern times considerably weakened. He goes on to say :—

We see then that each of the last three principles—temporary residence, domicile and location of property—has a certain, but not a complete justification. There is, however, one final principle, toward which all modern Governments are tending, which reconciles the three preceding tests. This is the principle of *economic interest or economic allegiance*, as against the antiquated doctrine of political allegiance. Every man may be taxed by competing authorities according to his economic interests under each authority. The ideal solution is that the individual's whole faculty should be taxed ; but that it should be taxed only once, and that it should be divided among the tax districts according to his relative interests in each.

368. Towards the conclusion of a masterly review of the problems of Double Taxation, the Professor admits :—

It is evident that the question where a tax ought to be imposed involves a rather simple theoretical problem and many very difficult practical problems. It is the same with almost every question of taxation. As a matter of principle, it is easy to decide that a man should be taxed according to his faculty; as a matter of practice, it is not so easy to apply the principle of faculty in the actual tax system.

**369. Necessary Considerations.**—The taxation or otherwise of the incomes of Australian residents derived outside Australia is a question which is not only of academic interest, but of practical importance. Viewing the proposal on its practical side, it has to be recognised that the productiveness of such an extension of the Act would probably be considerable, and that it is a form of taxation in force in many countries. It may also be recalled that it was advocated by the Federal Commissioner of Taxation solely on revenue grounds.

370. Preliminary to the more general discussion of the subject, it seems appropriate to refer to two matters. In the first place, there was an absence of any general demand on the part of witnesses who appeared before us for an extension of the scope of the present Commonwealth Act to embrace incomes derived from abroad of Australian residents. The weight of evidence or opinion is manifestly in favour of the present restriction to incomes derived from sources in Australia. In the second place, we are not in a position to judge whether any decrease of revenue from taxation which may result from the adoption of our recommendations, and from other causes, can be balanced by a corresponding reduction in the public expenditure. Hence we are unable, in the absence of the necessary data, to adequately weigh any claim in justification of the suggested impost that may be advanced on the score of revenue necessity.

**371. Arguments for the Proposal.**—(1) It is urged that the generally accepted principle of taxation, that of contribution in proportion to ability, in the application of which income is regarded as the index of ability, does not admit of the exclusion from the sphere of taxation of incomes derived from abroad.

(2) A further argument in favour of the proposal is based on the view that—

“a tax is a compulsory contribution of the wealth of a person or body of persons for the service of the public powers,”

and upon the contention that the State imposing tax upon incomes from abroad extends some measure of effective protection to the sources whence those incomes are derived. It is represented that the Commonwealth in effect protects the interests and property of its citizens in other countries, even though admittedly whatever powers of protection it possesses and exercises are possessed and exercised in virtue of its status as an integral part of the British Empire.

(3) A third reason which is advanced in justification of the suggested extension of the scope of the Act is that the present exclusion from the taxable area of income derived from sources outside Australia tends to encourage the investment abroad of capital which might otherwise be employed in Australia with great advantage to the country. It is represented that there is at present strong inducement to transfer capital from Australia for the purpose of profitable investment to countries which either do not impose Income Tax or whose rates of Income Tax are lower than those current in Australia.

**372. Arguments against the Proposal.**—(1) The view is advanced by the advocates of the present system that the ability of the subjects of every State

“to contribute towards the support of the Government”

has both logically and equitably sole relationship to—

“the revenue which they respectively enjoy under the protection of the State.”

The phrase in Adam Smith's first canon of taxation—

“in proportion to the revenue which they respectively enjoy under the protection of the State”

is accepted as being sound in principle only when interpreted to mean that no legitimate right of taxation exists in respect of income arising outside or beyond the boundaries of the country of the origin of the income.

(2) It is further argued that, when income from abroad is received in the country of residence, any economic allegiance that may be said to arise from this circumstance implies no greater tax obligation upon the resident than that which is amply discharged by the payment of the indirect taxation involved in the expenditure of the income.

(3) Objection is raised to the suggested alteration of the Act on the ground that it would tend to check the flow of capital into Australia. Many important enterprises, it is urged, have been largely dependent for their development and success upon the amount of British or

other outside capital invested in them. If, in respect of the export trade of these undertakings the profits earned outside Australia are in the future to be subject to taxation, they will necessarily, be aggregated with the profits earned within Australia in determining taxable income. It is stated that the increase in tax (which in many cases may be considerable) will have the effect of decreasing the margin of security and probable profit of such investments, and so render them less attractive.

(4) It is further argued that, if the Commonwealth Act be amended, as suggested, there is no reason why the States should not similarly extend the scope of their respective Taxation Acts. Such extension of the States Acts would, it is contended, involve additional complexity in taxation, and add to the difficulties of taxpayers.

### CONCLUSIONS.

373. We do not regard the taxation of incomes of Australian residents derived outside Australia as inherently inequitable, but it cannot be said to have the complete theoretical justification possessed by the existing scheme. Ministerial statements on the subject in the British Parliament indicate a concurrence with that view, and suggest that abandonment of taxation of incomes derived from abroad would be favorably considered if revenue needs permitted. We do not consider the reciprocal arrangement entered into with the British Government in respect of Double Income Taxation—which the Federal Commissioner of Taxation estimated would involve an annual loss of revenue to the Commonwealth amounting to some £45,000—affords in itself a justification for the proposed extension of the scope of the Commonwealth Income Tax Assessment Act. We consider that, while the imposition of the suggested tax might indirectly mean some small measure of relief to those taxpayers who would not be subject to its operation, it would mean in many cases an additional burden to those already subject to heavy taxation at the hands of both Commonwealth and States.

374. We are impressed with the suggestion that great difficulty would arise if, the Commonwealth having amended the scheme of its Act to embrace all incomes derived outside Australia, the several States should extend the scope of their Acts and tax the incomes wherever derived. We consider that, apart from the question of revenue production, the practical disadvantages attaching to the proposed amendment of the Act on the whole outweigh the advantages. The only justification for the suggested extension of the Act, in our opinion, would be revenue necessity.

### RECOMMENDATION.

375. (1) Our principal recommendation must be in a conditional form. If the financial requirements prove to be such that the raising of additional revenue through taxation is unavoidable, then, in preference to a general increase of Income Tax rates materially above their present level, or to the introduction of new forms of taxation, we recommend resort to the taxation of incomes derived abroad.

(2) In the event of Income Tax being extended to incomes of Australian residents wherever derived, we recommend:—

- (a) That the amount of any tax paid in respect of the same income in the country where the income arises should be allowed as a deduction from the Australian tax.
- (b) That reciprocal arrangements for the purpose of avoiding Double Taxation as far as possible be entered into with other countries.
- (c) That within the Empire the terms of any reciprocal arrangement should be those of the arrangement between Great Britain and Australia, which received legislative sanction in the Income Tax Assessment Act No. 31 of 1921.

### NOTE.

Should the scope of the Income Tax Assessment Act be extended to include the taxation of incomes wherever derived, the Recommendations under the Section of the Report dealing with the Taxation of Profits arising from Sales Abroad of Exports from Australia will become unnecessary.

[From this section of the Report Commissioner Jolly expresses dissent. See page 138.]

## SECTION XIII.

## TAXATION OF PROFITS ARISING FROM SALES ABROAD OF EXPORTS FROM AUSTRALIA.

376. **The Existing Law.**—Section 10 of the Commonwealth Income Tax Assessment Act provides for the levying of tax upon “the taxable income derived directly or indirectly by every taxpayer from sources within Australia,” and in section 3 “income from personal exertion” is defined as meaning “income derived from sources in Australia consisting of . . . the proceeds of any business carried on by the taxpayer either alone or as a partner with any other person.” Under the Commonwealth system, which imposes Income Tax only upon incomes derived from sources in Australia, it is necessary to resort to some statutory or administrative expedient in order to ascertain the portion of any income derived partly within and partly without Australia which is attributable to a source within Australia, and therefore taxable under the present law.

377. **Original F.O.B. Provision.**—The Commonwealth Act, as originally enacted in 1915, made specific provision with regard to taxation of the income from goods sold after export from Australia, the section reading as follows :—

(23.) When the carrying on of any business involves the exportation of live stock, produce, or other commodities or substances from Australia for sale beyond Australia, before any sale or contract of sale of them at a definite price has been made, the value of such live stock, produce, or other commodities or substances at the time of their export, based upon the ruling Australian market value for home consumption of similar goods of similar quality shall be the value for the purpose of ascertaining the total income of such business from the sale of such goods for the purposes of section fourteen of this Act.

The method prescribed by this section may, as to its essential principle, be described as the “free-on-board” (f.o.b.) method, though, as will be seen from the succeeding paragraphs, the rigid wording of the section hampered its application.

378. The Commissioner of Taxation stated in evidence that the wording of the Section led to difficulties in connexion with the export of goods for which no ruling Australian market value for home consumption existed, as no similar goods of similar quality were being sold for use in Australia. One instance was of railway sleepers of a size not used in Australia, which had been prepared for use in India. There was also a difficulty with regard to frozen meat, the contention of the exporters being that there was no market in Australia for the particular quality of meat exported. A number of other cases somewhat similar to those cited are said to have occurred, and in 1918 the section was repealed.

379. To meet a difficulty which arose in New South Wales under the New South Wales *Land and Income Tax Act* 1895 in connexion with exports, a Regulation was gazetted in 1899, under authority of a Declaratory Act passed in the previous year, which introduced the f.o.b. method. The Regulation embodies three rules, the second of which provides that—

where the product, commodity or substance has at the time of export a market value at the port of export, that market value shall be deemed to be the value of such product, commodity or substance when exported.

The third rule provides that, where the exported goods have at the time of export no market value at the port of export, the value shall be deemed to be the sale price, less all expenses incurred both inside and outside of New South Wales.

These rules and the section upon which they were based are not now in force. The present practice of the Department is not governed by any prescribed regulation.

380. **Repeal of Section 23, F.O.B. Provision.**—The Commonwealth Treasurer, in his second-reading speech on the Bill for amendment of the Income Tax Assessment Act, including the repeal of section 23, informed the House that the section had proved cumbersome in operation and detrimental to the Revenue. The Treasurer added—

The provisions of the Common Law, as laid down by the Privy Council, will guide the Department in future.

381. While the Amending Bill was before Parliament, the Commissioner of Taxation was waited on by representatives of the Melbourne Chamber of Commerce, who desired to ascertain the Departmental view of the scope of the proposed amendments, including the repeal of section 23. The report of the interview in the *Monthly Journal* of the Chamber contains the following :—

Mr. Ewing . . . informed the Chambers' representatives that the proposed amendments did not extend the scope of the existing Income Taxation Law, as the Department interpreted it, although some of them were intended to validate certain Departmental actions. In answer to questions, he made it clear that profits earned outside Australia and not now taxable would not be affected by the amendments.

382. The Act repealing section 23 contained no substitutionary provision, and determination of the method to be followed was therefore left to the Commissioner, who, however, as to general principles, was guided by decisions of the Privy Council and of the High Court of Australia.

**383. Rules Issued in Substitution of F.O.B. Provision.**—The first rule on the subject issued by the Commissioner was designed to apportion profit arising from the sale of goods abroad, so as to ascertain the portion attributable to Australia, and consequently taxable on the basis now in force as to **imports**. This rule was, however, very soon superseded by the following rules, which are still in force. These rules were issued by the Commissioner in March, 1919, in form of a circular, reading thus :—

In view of the special cases which have arisen, and after consultation with the Crown Law Authorities, I have been obliged to make important alterations in the rules determining the liability to **Income Tax** or **War-time Profits Tax** of profits arising from the sales made by Australian businesses outside Australia. Prior to the alterations, the rule for determining whether any of such profits arose directly or indirectly from a source within Australia required that two out of the following three events had happened in Australia—

- (a) the place where the contract of sale was made ;
- (b) the place where delivery of the goods was given ;
- (c) the place where payment for the goods was made.

For the reasons mentioned, it has become necessary to repeal that rule and to substitute the following rules :—

- (1) Where goods are sold (otherwise than by an agent outside Australia) before export from Australia the whole profit arising from the sale is taxable in Australia.
- (2) Where goods are sold outside Australia after export from Australia (a) under conditions which necessitate acceptance by the seller in Australia of an offer by the purchaser outside Australia (*i.e.*, when the purchaser communicates direct with the seller or the seller's outside agent sends along the offer for acceptance or rejection), the whole of the profits, if any, resulting from the sale should be taxed in Australia ; (b) under conditions in which a contract for the sale has been made outside Australia by an agent for the Australian seller, if the agent has found a buyer and arranged prices and terms with him, the profit is to be treated as having arisen partly inside and partly outside Australia.

In the case of (b), the profit is to be apportioned so as to ascertain the part attributable to Australian sources. For this purpose, the total cost of getting the goods to the purchaser is to be ascertained. From this amount sea freight, marine insurance, and exchange are to be eliminated. The residue is to be divided into two parts, representing (1) the cost price at which the goods were (or would be if a c.i.f. and e. case) shipped f.o.b. in Australia ; and (2) the costs incurred by the selling agent or the Branch house in selling the goods. The profit will be apportioned between (1) and (2), and that part applicable to (1) will be treated as profit arising from a source in Australia.

When the agent outside Australia merely completes a contract of sale with a purchaser who has been referred to him by the Australian business, with instructions to complete the contract, any resulting profit is to be taxed as profit arising in Australia. When an agent outside Australia makes a sale of his Australian principal's goods before the goods are exported from Australia, the profit, if any, should be treated as having arisen partly inside and partly outside Australia, and should be apportioned in the manner already set out. In those cases where the whole of the profit is taxable as income derived from a source in Australia, deduction is allowable in respect of the expenses, if any, outside Australia.

**384. The Kirk Case.**—The Privy Council case above referred to (par. 380) was that of the Commissioners of Taxation (N.S.W.) *v.* Kirk (1900 A.C., p. 588), which was an appeal from a decision of the Supreme Court of New South Wales. The head note to the report of the case reads—

Where income was in part derived from the extraction of ore from the soil of New South Wales Colony, and from the conversion in the latter Colony of the crude ore into a merchantable product—

*Held*, that this income was assessable under the New South Wales Land and Income Tax Assessment Act of 1895, s. 15, sub-secs (3), (4), notwithstanding that the finished products were sold exclusively outside the Colony. *In re Tindal* (1897), 18 N.S.W. L.R. 378, overruled.

Lord Davey, by whom the Judgment of the Judicial Committee was delivered, said—

It appears to their Lordships that there are four processes in the earning or production of this income—

- (1) the extraction of the ore from the soil ;
- (2) the conversion of the crude ore into a merchantable product, which is a manufacturing process ;
- (3) the sale of the merchantable product ;
- (4) the receipt of the moneys arising from the sale.

All these processes are necessary stages which terminate in money, and the income is the money resulting less the expense attendant on all the stages . . . . . The fallacy of the Judgment of the Supreme Court in this and in *Tindal's Case* is in leaving out of sight the initial stages, and fastening their attention exclusively on the final stage in the production of the income.

In *Meeks' Case*, cited in the next paragraph, Mr. Justice Isaacs, in the course of some remarks not essential to the Judgment, but "added at the parties' desire," said—

Kirk's Case would not have been any warrant for saying that, without apportionment in some way, the whole of the £63,000 (the sum at issue) was taxable as derived from a source in New South Wales.

385. **The Meeks' Case.**—In a later case, the Commissioner of Taxation (N.S.W.) *v.* Meeks (Public Officer of The Sulphide Corporation Ltd.), 19 C.L.R., 58 (1915), which was an appeal to the High Court of Australia from a decision of the Supreme Court of New South Wales, the head note is as follows :—

A company incorporated in England, and having its registered office in London, conducted its Australian business at Melbourne, in Victoria, and its practical operations of mining and treating and smelting ore at Broken Hill and Cockle Creek, in New South Wales. By a contract made in London, the company agreed to sell to purchasers a large quantity of concentrates produced from Broken Hill slimes, delivery of which was to be made at Broken Hill in instalments extending over a period of years. Pursuant to the contract, the purchasers paid a sum of £63,000 in advance, but before any concentrates were delivered they made default in further payments which had become due. An agreement was then made in London by which the original contract was cancelled as from the date of the cancelling agreement, and the company were to be entitled to retain for their use all moneys which had been paid under the contract. No concentrates or slimes were ever appropriated, set apart, or treated by the company for the purchasers. Of the £63,000, the balance held by the company, after deduction of commission and brokerage, was £61,425.

*Held*, that for the purposes of the *Income Tax (Management) Act* 1912 (N.S.W.) and the *Income Tax Management (Amendment) Act* 1914 (N.S.W.), the £61,425 should be treated as profits from the business of mining and treating and smelting ore which was carried on by the company mainly, if not altogether, in New South Wales, and therefore that it should be brought into account in ascertaining the income of the company taxable under those Acts, subject, however, to the right of the company to show that portion of it was not attributable to the business which was carried on in New South Wales. Decision of the Supreme Court of New South Wales, *in re* Meeks, 15 S.R. (N.S.W.) 107, reversed (pp. 568-9).

386. In Kirk's Case no method of apportionment was suggested. In Meeks' Case, Mr. Justice Isaacs said (at p. 589), in the course of remarks referred to in paragraph 384 above, that one of two methods must be employed, *i.e.*, either a provision in the N.S.W. Act,\* under which, where a taxpayer carries on business both in and outside of the State, the taxable income is a sum bearing the same proportion to the total profits of the business as the assets in the State bear to the total assets, or, if that provision is not applicable, **the actual income must be found by some practical distribution and means of ascertainment.**

387. **The Kauri Co.'s Case.**—Another case may be referred to—that of the Commissioner of Taxes *v.* The Kauri Timber Co. Ltd., a New Zealand case decided in 1904 by the New Zealand Court of Appeal (N.Z. L.R. XXIV., p. 18). In that case the defendant Company had its registered and head office in Melbourne. It carried on business in Victoria, New South Wales, New Zealand, and elsewhere. Its principal business in New Zealand was the export to Sydney of timbers cut from its kauri forests, which were afterwards manufactured into various articles, and then sold in the manufactured condition. In that case it was—

*Held*, that the company was not liable to Income Tax in New Zealand upon the whole of the profits made by it upon timber exported by it from New Zealand and sold elsewhere (whether or not after further cutting or manufacture outside of New Zealand), but was liable only upon that part of the profit which was derived by it from the business carried on by it in New Zealand; and that this profit must be ascertained (in the case of timber exported from New Zealand) by estimating the value of the timber at the time of its being exported, and deducting therefrom the market value thereof, when in its natural or unmanufactured state (under the proviso to sub-section (7) of section 59), and such cost of felling, transporting and converting, the same into the state or condition in which it was at the time of its export was allowable by law.

It will be seen that in this case the Court adopted as the "means of ascertainment" of the profit upon which taxation should be based the f.o.b. value of the timber at time of export, less allowable deductions.

388. **Opinions of Witnesses.**—The evidence tendered to the Commission disclosed differences of opinion among witnesses as to the desirability of maintaining the present Federal method of apportionment; of reverting to some modification of the (f.o.b.) practice under the original section 23; or of adopting some other basis.

389. Of the State Commissioners of Taxation, three expressed no opinion upon the matter; the Queensland Commissioner considered that the assessable income should be the sale price, less all expenses in connexion with the sale, including Income Tax paid in the country of sale. Except as to allowance of Income Tax paid in the country of sale, the Queensland Commissioner's opinion is in line with the existing Queensland Act. The South Australian Commissioner suggested

\* Section 19 (2), which reads as follows :—"In the case of any other taxpayer carrying on business both in and outside of the State, his taxable income shall be deemed to be a sum which shall bear the same proportion to the net profits of such business as the assets of the business in the State bear to the total assets of the business, or, in the discretion of the Commissioner, as the total amount of sales in connexion with the business affected in the State bears to the total amount of such sales affected both in and outside the State."

that the market value at the time of export, if the goods are consigned to a Branch house, or the sale price realized abroad, if there is no Branch house, should be the basis; while the Victorian Commissioner favoured the Federal method. He said—

As far as ex-Australian transactions are concerned for Victoria, the Federal method would work quite well. It is the way I have been working . . . . . The method of apportionment is elastic enough to meet all cases . . . . . As an arbitrary method I should say that is as fair as you can get it.

The witness also said—

The f.o.b. price is more particularly a State matter. . . . . The f.o.b. generally is good enough for Inter-State cases . . . . .

390. Some representative commercial witnesses favoured taxation in respect of export transactions being based upon prices realized abroad, less all necessary expenses (including, as one or two witnesses suggested, Income Tax (if any) paid abroad). This proposal, which, as shown in the preceding paragraph, had some official support, involves the principle of taxing incomes whatever the source, a principle which is not embodied in the Commonwealth Act.

391. **Advocacy of the F.O.B. Method.**—A number of other commercial witnesses favoured the adoption of f.o.b. values as the basis of taxation. Among others, the Sydney Chamber of Commerce made this suggestion, giving as reasons—

- (a) It enables finality to be reached at once (*i.e.*, as to the amount of tax (if any) which will become payable upon the transaction).
- (b) Over a series of years there would be no great benefit one way or the other, either for the taxpayer or the Crown.

This suggestion, it will be seen, is a reversion to the method embodied in the original section 23, which section was found to entail considerable difficulty. That difficulty, however, appears to have been largely, if not wholly, due to the inclusion of words confining the meaning of f.o.b. value to **the ruling Australian market value for home consumption of similar goods of similar quality**.

392. That particular goods are produced or manufactured to meet the peculiar requirements of certain overseas markets, or that, for any other reason, any goods have at the time of their export no market value **for home consumption**, would in most cases not prevent their value being ascertained, if not for purposes of home consumption, then for purposes of overseas trade. As to primary products and many secondary products, witnesses pointed out that, in these days of frequent transmissions by cable of market reports, giving prices of the staple articles of commerce in the principal markets of the world—information as to transit and other expenses being also easily accessible—there is little or no difficulty in ascertaining at any time and place the value of most exportable commodities.

393. **Finality.**—The first reason advanced by the Sydney Chamber of Commerce in support of the f.o.b. method, namely, that finality as to the amount of taxation on export transactions would be much earlier reached if, in the case of goods exported for sale abroad, the law allowed the f.o.b. value to be taken as if the exporter had actually sold the goods in Australia at a price equivalent to that value, is an argument which was also stressed by other witnesses. Under the present rule (it was said) one has to wait until reports of final realization in the overseas markets have been received before any progress can be made with the allocation into Australian and ex-Australian of the resulting profit or loss; whereas if the question of taxation were determined by the f.o.b. value at place and time of shipment, the whole transaction could be closed many months earlier, and frequently in the year in which the goods are exported, instead of outstanding for twelve months or sometimes longer, as at present.

394. **Fairness over a Series of Years.**—The second reason put forward by the Sydney Chamber of Commerce in favour of the f.o.b. method, *viz.*, that over a series of years there would be no great benefit one way or the other, either for the taxpayer or the Crown—that is, that on the whole it would operate fairly all round—is one which may be looked at from two points of view.

395. **F.O.B. Method—Disadvantages and Advantages.**—*From the point of view of the taxpayer*, the method has the disadvantages—

- (a) That where goods are exported for sale abroad and the transaction results in a loss, the taxpayer may be taxable on the f.o.b. basis, and will not be entitled to claim any refund or allowance in respect of that loss.
- (b) That the tax may become payable before the proceeds of the transaction have been received.

But, in the opinion of the commercial community, as expressed by witnesses, these disadvantages are outweighed by the advantages of simplicity, certainty, and early finality which the method affords. The present method of the Department is based upon the ascertainment of the cost of the goods exported, but cost in many cases is neither known nor ascertainable. The latest statistics available contained in the recently issued official *Year Book* No. 14, show the total Commonwealth exports for the year ended 30th June, 1920, to be in round figures £150,000,000, of which about £130,000,000 represents the value of the primary products, for the most part not manufactured, of which, if the producer be also the exporter, it would be difficult, if indeed possible, for him or the Department to state the cost with any close approach to accuracy. It is doubtless true that, of the total exports of primary products, large quantities—how large cannot be accurately determined—have already passed out of the hands of the primary producer, and that the exporter is in a position to state accurately the cost of the goods to himself. The general conclusion arrived at, for the reasons indicated, is that the f.o.b. value can, in the great majority of instances, be fixed with greater readiness and certainty than the cost price.

396. *From the point of view of the Revenue*, an opinion adverse to the method was expressed by the Federal Commissioner of Taxation. This opinion, however, appears to have been largely based upon experience under the original and since repealed section 23. We have pointed out above that, in our opinion, the difficulties which arose under that section were in great part due to the inclusion of conditions of a restrictive and not of an essential character. Further, much of the revenue loss which occurred in the working of the section was probably attributable chiefly to the fact that the section was necessarily held to apply to all cases, whereas there are certain groups of cases to which it is not properly applicable. The method also involves the position that, if a profit is made on sale after export, the Revenue receives no benefit in respect of such profit.

**In our view, the positive advantages the method is capable of providing justify its incorporation in our Taxation System.**

397. The cost (present Federal) method is said to possess the following advantages and disadvantages:—

Advantages—

- (a) It deals with the transaction when completed and on the basis of actual profit or loss.
- (b) It allows a deduction for losses (if any) ascertainable from the ultimate sale.
- (c) It is said to work smoothly and without complaint.

Disadvantages—

- (a) *From the point of view of the taxpayer*, that great delay often occurs before the amount of tax upon a transaction or series of transactions can be ascertained. For example, delay between the date of export and the date of sale may bring the result into a later tax year.
- (b) *From the point of view of the Administration*, that the Department is too dependent upon the exporter in respect of the principal factor (cost) used in the calculation by which the amount of taxable profit or deductible loss is determined.

398. **Equality of Opportunity.**—It is pointed out that the present rule may have the effect of handicapping the Australian resident. Many overseas traders visit or are represented here by agents who purchase and export our products for manufacture or for sale in overseas markets. On any profits which these traders earn after the product leaves Australia they are not liable to payment of any Income Tax to the Commonwealth. But, under the prescribed Regulation at present in operation, if the exporter be one of ourselves, he would be liable to pay tax on such proportion of the added profit gained by export as would under the Departmental method be attributable to sources within Australia.

398A. **Inequitable Operation.**—If, because of better management, more favorable conditions or other advantages, A is able to produce or acquire a commodity at less cost than B, and if they both export at the same time, and on sale-overseas realize the same price for their commodities, the

allocation of profit as between Australia and ex-Australia by the cost method shows a larger proportion of profit attributable to Australia on *B*'s consignment than on *A*'s consignment. This is contrary to the true position, for, as both parcels realized the same price, *A*, having acquired at less cost than *B*, has clearly made a larger profit.

399. **Methods suggested for Adoption.**—The f.o.b. method and the present Federal method (the chief factor in which is cost) must be regarded as expedients for effectuating that apportionment of the profits resulting from export transactions which is declared to be necessary, both by administrative experience and by judgments of the highest tribunals. Each method has its merits, its imperfections, and its limitations; each is inapplicable to certain cases or groups of cases. In our opinion, the best results will be obtained by using both methods. The f.o.b. method will, we believe, yield fair results both to the taxpayer and to the revenue in perhaps the great majority of cases. That method should therefore be regarded as primary, and to be applied wherever reasonably practicable, the existing Cost method, modified as suggested in the following paragraph, to be applied to the cases in which the data for satisfactory application of the f.o.b. method are unobtainable.

400. The existing Federal (Cost) method excludes sea freight, marine insurance, and exchange from the calculation by which the profit is apportioned "so as to ascertain the part attributable to Australian sources." The Federal Commissioner of Taxation stated that those items were excluded on the ground that they are equally attributable to the Australian and the ex-Australian part of the transaction. In our opinion, they should be included in the ex-Australian costs.

401. **Inclusion of Adopted Methods in Statute.**—Several witnesses suggested that whatever method is finally decided upon should be embodied in the Statute. This suggestion was invariably made on the ground that a method once adopted should not be subject to frequent change. The contrary view is that, in matters of administrative detail, experience in working and changes of mercantile practice frequently reveal the necessity for a notification of method, and for that reason it has become the practice for the Legislature, as far as possible, to confine itself to matters of principle, leaving matters of detail to be dealt with by regulation, which can, when necessary, be altered without delay and without further reference to Parliament. In this instance we are satisfied that the interests involved are such as to justify prescription by Statute of the methods to be adopted.

## RECOMMENDATIONS.

### 402. We recommend—

- (a) That the Commonwealth Income Tax Assessment Act be amended to provide that in the case of goods exported before sale the value of such goods for the purposes of the Act shall be their market value at the time and place of export.
- (b) That in all cases where, in the opinion of the Commissioner, the method recommended in the preceding paragraph (a) is not clearly applicable, the basis of taxation shall be the series of Rules commonly referred to as the Cost method now in operation, but modified to the extent of including in ex-Australian costs the items of sea freight, marine insurance, and exchange, in addition to the ex-Australian charges now allowed.
- (c) That, where a difference of opinion arises between a taxpayer and the Commissioner under either of the methods above recommended, or as to which of the two methods respectively recommended in paragraphs (a) and (b) shall be applied to the case, either party shall have the right of reference to the Board of Appeal.
- (d) That the two methods above recommended be prescribed by Statute.

In our opinion, the methods above recommended should be applied in the operation of State Income Tax Acts in respect of overseas exports or of transfers from one State to another.

NOTE.—Attention is invited to the note at end of the Section of the Report dealing with Taxation of Income of Australian residents derived outside Australia.

[From the recommendations of this Section of the Report Commissioners' Missingham Mills, and Duffy express dissent. See page 139.]

## SECTION XIV.

### CASUAL PROFITS.

403. The term "Casual Profits," which it would be difficult to define by way of an exhaustive catalogue of such profits, is, however, well understood as referring to profits of an infrequent or non-recurring nature, not arising from the ordinary business of the person concerned.

404. Casual profits may be divided into two classes :—

- (1) Those which arise from occasional transactions entered into with the primary purpose of realizing profit, such as speculation, betting, occasional company promotion gains, occasional cash sales, &c.
- (2) Those which arise from occasional transactions not entered into with the primary purpose of realizing profit, such as investment of capital in an income-producing security or purchase of property of any kind for the purpose of personal use or enjoyment.

405. **Commonwealth Law and Practice.**—Under the Commonwealth Income Tax Assessment Act there is no specific provision dealing with the taxation of casual profits. The evidence of the Commonwealth Commissioner shows that the chief provision affecting the matter is the definition of "income." The definition of "income from personal exertion" in the Act includes "the proceeds of any business." The Commissioner states that, while there are many instances of transactions the results of which are difficult to classify as taxable or non-taxable, the broad test is whether the transaction comes under the term "business" or not. The general effect of the Act, as administered, is to leave untaxed what are ordinarily understood as casual profits. Certain statutory exceptions to this practice are contained in section 14 (d) of the Act, which makes taxable, subject to specified deductions—

"Money derived by way of royalty or bonuses, and premiums, fines or foregifts, or consideration in the nature of premiums, fines or foregifts demanded and given in connexion with leasehold estates, and the amount of any payment received by a lessee upon the assignment or transfer of a lease to another person."

In our opinion the retention of the sub-section is undesirable. A partial repeal of the sub-section was effected by the Amending Act passed in December, 1921, which withdrew from its operation profits from the sale of a Mining Lease, where the vendor is a "*bonâ fide* prospector," or, subject to certain conditions, a purchaser from a *bonâ fide* prospector. The complete repeal of the sub-section would leave other transactions of the kind to which the sub-section refers to be dealt with in accordance with the general provisions of the Act which determine whether any particular gain is or is not assessable income.

406. **States Law and Practice.**—In Victoria, Western Australia, and Tasmania, the law and practice with regard to casual profits are similar to the law and practice of the Commonwealth, the usual test as to whether a profit is taxable or not being whether or not it arises in the ordinary course of business. In New South Wales the Income Tax Act provides for the inclusion in taxable income of any gains or profits arising during the year of income from the sale of any estate or interest in land, provided the taxpayer's ownership or interest arose during that year or within the four years next prior thereto. The provision also extends to profits from the sale of shares bought by the taxpayer during the current year or in the two years immediately preceding, and further to any profits from the sale of any other personal property to the value of £50 or upwards bought during the current year. A deduction of losses on such transactions is allowed if incurred during the year of income on the sale by the taxpayer of any estates or interests similar to those from which profit is shown in his return. In Queensland casual profits are taxed, the Act including as taxable profits from the sale of certain minor interests in land, and "all net gains or profits arising from the sale of any personal property whatsoever—whether or not arising or accruing from any business carried on by the taxpayer." The evidence of the Queensland State Commissioner of Taxes shows that losses incurred in casual transactions are allowed as deductions from profits arising in the same year from the same class of transaction, but not otherwise. In South Australia income derived from personal exertion is defined as including "every kind of profit and every kind of gain, whether arising in the course of business or otherwise howsoever, except gifts, legacies and bequests." The South Australian State Commissioner stated in evidence that all casual profits coming within the definition are taxed without exception. In a South Australian case quoted in evidence, the Supreme Court of that State held that the test of a transaction for Income Tax purposes is whether or not it was entered upon with the intention of making an investment as distinct from the intention of making a

profit by re-sale. This interpretation, it will be seen, limits the generality of the definition above quoted. The evidence of the State Commissioner indicates that the practice of the Department is limited to the taxation of profits from transactions arising in the ordinary course of business and not from casual transactions.

**407. Opinions of Witnesses.**—Some witnesses favoured the taxation of gains of every kind, but the greater volume of evidence was unfavourable to that proposal, largely because of the objections enumerated in paragraph 410 below.

**408.** The Commonwealth Commissioner of Taxation in his evidence suggested that, if the amendment or repeal of section 14 (*d*) were considered, it would be proper to consider also the repeal of the proviso to section 20 (*i*). Section 20 (*i*) expressly provides that a deduction from assessable income shall not be made in respect of :—

“any wastage or depreciation of lease or in respect of any loss occasioned by the expiration of any lease”;

but a proviso to that sub-section authorizes the Commissioner, in cases where a taxpayer has made any payment in the nature of a fine or premium for a lease or renewal of a lease, or for the assignment or transfer of a lease, to allow as a deduction the annual proportion of such payment in each year of the unexpired term of the lease. The Commissioner suggested that :—

“If [by repeal of section 14 (*d*)] the person who receives such a payment is to be exempt from Income Tax upon it, then it would appear to be reasonable to deprive the payor of the right to amortize it out of his profits.”

The deduction allowed by the proviso to section 20 (*i*) appears to be correctly based upon the view that a payment in the nature of a fine or premium for a lease is in effect a payment of rent in advance, and as rent, should be allowed as a deduction, either in one sum, or, as the sub-section enacts, in annual proportions spread over the term. In our opinion, this view justifies the retention of the proviso. But if a lease premium is treated as commuted rent, so far as the payor is concerned, it is in our opinion both logical and reasonable to regard it as rent (and therefore assessable income) in the hands of the payee. It might be harsh to tax the payee on the whole sum as income in the year of receipt, but it would be reasonable for taxation purposes to distribute the payment over the term of the lease, just as it is distributed for purposes of allowance to the payor.

**409. British Commission View.**—The matter was considered by the British Royal Commission on the Income Tax, 1920, and in their Report, while the equity of taxing casual profits was recognised, the difficulties of administration were considered too great to justify a recommendation for the inclusion of every kind of gain within the ambit of Income Taxation. An official witness before that Commission, representing the Board of Inland Revenue, stated :—

“The Board are in substantial agreement with the view that has obtained in the past, that any amount of tax that would be derived from an attempt to pursue transactions of every kind, where an intention to derive a profit on sale could be presumed to have existed, would be negligible compared with the trouble and irritation that it would involve. They have also especially in mind that private minor transactions of this kind are to so great an extent hidden from view that, even if an attempt to follow them did in fact result in any additional revenue, it would be to a very great extent a voluntary contribution by the most conscientious taxpayers, and would be likely, on that ground, to give rise to serious dissatisfaction.”

The British Commission recommended that :—

“Any profit made on a transaction recognisable as a business transaction that is, a transaction in which the subject matter was acquired with a view to profit seeking—should be brought within the scope of the Income Tax.”

This recommendation goes a little farther than the present Commonwealth practice.

**410.** The leading and, in our view, decisive objections to an attempt to collect Income Tax upon every kind of casual profit and gain are :—

- (1) The extreme difficulty of tracing transactions and preventing evasions. As shown above, in the quotation from evidence before the British Commission, the view there taken, which also was the opinion of a number of witnesses appearing before us, is that any revenue derived would be to a great extent a voluntary contribution from conscientious taxpayers.

- (2) The necessity for allowing losses on casual transactions as a deduction from assessable income. There would be a strong incentive to record and claim deduction on account of casual losses, but no corresponding inducement to record casual profits, and the net revenue gain would probably be small. The British Commission remarks that :—

“In countries where profits of this nature are taxed, allowance, if any, for losses is generally granted only against profits of the same character.”

That Commission considered that losses from speculations and investments should not be set off against ordinary trading profits. One of the members of the British Commission, dissenting from the Report on this point, contended that, if casual profits are taxed as part of the regular income, losses on casual transactions should be set off against the total income. It seems clear that to confine the set-off of losses upon casual transactions against profits of the same character would be illogical, except in conjunction with a provision that casual profits should be taxed as if constituting a separate income—that is, not aggregated with income from other sources.

- (3) The heavy cost of administration which the alteration would involve compared with the relatively small net revenue gain.

### RECOMMENDATIONS.

#### 411. We recommend :—

- (1) That the *Commonwealth Income Tax Assessment Act* 1915–18 be amended by the repeal of section 14 (d). (It may be necessary to consider whether any further statutory action will be required to preserve the immunity from taxation of the proceeds of sale of a Mining Lease, which is presumably effected by section 6 of the Amending Act of 1921.)
- (2) That the proviso to Section 20 (i) be retained, and that any payment of the kind enumerated in that proviso be regarded as rent and therefore as assessable income in the hands of the recipient.
- (3) That the Commissioner be empowered to allow the tax chargeable in respect of any such payment to be distributed over the unexpired period of the lease in the manner prescribed for the distribution of the deduction allowed to the payor.
- (4) That no alteration of the Act be made with the object of imposing tax upon Casual Profits.

[From this Section of the Report Commissioner Duffy expresses dissent. See page 143.]

## SECTION XV.

### LIVE STOCK VALUES.

412. **Commonwealth Method.**—In the original (1915) Commonwealth Income Tax Assessment Act, Section 14 (a) provided that :—

The income of any person shall include—

profits derived from any trade or business and converted into stock-in-trade or added to the capital of or in any way invested in the trade or business :

Provided that for the purpose of computing such profits the value of all live stock, produce, goods and merchandise (not being plant used in the production of income) not disposed of at the beginning and end of the year in which the income was derived shall be taken into account.

The amending (1918) Act did not amend this Section, but there was added to Section 3 a definition of value in relation to live stock in the words :—

“Value” in relation to live stock means *the value as prescribed*.

413. Under the authority given in Section 65 of the Act, a regulation was framed prescribing the method of valuing live stock on hand at the end of the accounting period for the purpose of the Commonwealth Income Tax Assessment Act. The regulation provided for live stock to be taken into account at specified standard values on the lines of the present schedule for natural increase. Subsequently this regulation was withdrawn and substituted by the following, which is now in force :—

46. (1) For the purpose of paragraph (a) of Section 14 of the Act, the value of live stock on hand at the beginning and end of the year in which the income was derived shall be calculated on the basis of the cost price of the stock.

(2) The cost price of natural increase and the cost price of other stock for which the cost price cannot be stated by the taxpayer shall be deemed to be the fair average values as set forth in Table III\* in the Schedule.

(3) Where live stock is purchased during the year and is kept separate and apart from any other stock owned by the taxpayer, it shall be valued at purchase price at the beginning and end of each trading year during which it is retained.

(4) Where live stock which has been purchased is merged into and becomes part of the general flock or herd of live stock owned by the taxpayer, the stock remaining on hand at the end of the trading year in which the purchases were made shall be valued at the average cost per head ascertained by taking the stock on hand at the beginning of the year at the actual cost, if obtainable, or, if not obtainable, at the average cost per head arrived at under the War-time Profits Tax Regulations at the beginning of the accounting period upon the income of which income tax for 1917-18 is payable, and in each succeeding year at the average cost arrived at under this sub-regulation for the last preceding year, together with the natural increase at the fair average value as set forth in Table III. of the Schedule and the stock purchased during the year at the purchase price of that stock.

(5) All live stock which have died or have been killed for food during the trading year shall be valued at the average cost for the stock on hand at the end of the trading year arrived at under sub-regulation (4) of this regulation.

**414. States' Methods.**—The following is a summary of the methods of fixing live stock values at present in force in the several States:—

#### NEW SOUTH WALES.

(1) No method is prescribed by regulation. The State Commissioner explained in evidence that he allows a wide latitude to taxpayers. The general practice of the Department is to allow the stock-owner to fix his own values, such values once fixed to remain constant, though this practice is not invariable.

#### VICTORIA.

(2), A statement furnished by the Victorian Commissioner of Taxes shows that:—

There are no regulations in force dealing with the valuation of live stock, the value fixed depends on the circumstances of the particular cases.

When the Act came into operation in 1895 taxpayers were allowed to bring in their stock at the ruling market rate at that date, and in a number of cases that method has been maintained ever since with regard to natural increase. In the particular year, stock purchased was brought in at cost, and the stock on hand at the end of the year was averaged to arrive at the value.

In 1906 taxpayers were allowed the option of making their returns on the cash basis—actual receipts and actual expenditure—or continuing on the trading basis, and a large number adopted the cash basis.

The attitude of the Department is that where a taxpayer has adopted either of the above methods he must adhere to it. All new cases have, for some years, been required to adopt the trading basis, and the market value for stock valuation purposes is generally the basis accepted. In some few instances where there have been practically no sales or purchases, the properties being wool-growing propositions, the original values have been maintained right through.

#### QUEENSLAND.

(3) The practice of the Department is that herd values (*i.e.*, the values at which the owner originally returned the stock) are adopted for the reared stock. Young stock are brought into account the first year at one quarter values, but the second year are brought in at average values. This is a statutory obligation. In 1907, provision was made in the Act for those persons who did not wish to bring their live stock into account, to omit them. The Queensland Commissioner stated that numbers of taxpayers availed themselves of this provision, but are gradually reverting to the old method.

#### SOUTH AUSTRALIA.

(4) The method in force in South Australia is, as stated by the Commissioner of Taxes, that—

Reduction is allowed for all purchased stock at cost price, the sale moneys of all stock sold, whether purchased stock or natural increase, are required to be accounted for. Purchased stock, if unsold at the end of the year, are required to be accounted for at cost price. Natural increases when on hand are required to be accounted for at their value on the land where they are.

#### WESTERN AUSTRALIA.

(5) A schedule of rates representing the average cost value of cattle and sheep in various districts was agreed to at the inception of Income Taxation in Western Australia in 1906 by the pastoralists of that State, after several conferences with the then Commissioner of Taxation, and

\* This table is set out in paragraph 426 (page 121.)

has since remained in force without alteration. The approved "flock" returns apply to all classes of stock, including stud stock and natural increase. The full cost of purchased stock is allowed as an outgoing in the year of purchase. The schedule rates are as follows:—

						Cattle.		Per Head.	Sheep.	
						s.	d.		s.	d.
Kimberley Division	..	..	..	..	..	20	0	..	4	0
North-west Division	..	..	..	..	..	30	0	..	5	0
Western Division	..	..	..	..	..	40	0	..	6	0
South-west Division (E. portion of)	..	..	..	..	..	60	0	..	8	0
" " (S. portion of)	..	..	..	..	..	80	0	..	10	0
Eastern Division	..	..	..	..	..	40	0	..	6	0
Eucla Division	..	..	..	..	..	40	0	..	6	0

#### TASMANIA.

##### (6) The Act provides that—

additions to stock resulting from natural increase shall be reckoned in their first year at such values as the Commissioner may consider fair and equitable, reserving to the taxpayer the right of objection to such values should he be dissatisfied.

There are no prescribed regulations bearing on the matter. The system adopted by the Department is that:—

the total value of the sheep or cattle (as the case may be) on hand at end of the previous year is added to the sum paid for purchases during the year, and the average per head is applied at the rate for calculating the value of the stock (under either head) on hand at the end of the year. Any lambs included in the number of sheep given are taken in at ten shillings per head, or less than ten shillings if the average value of the sheep should be less than that sum, and calves are taken in under the same conditions at thirty shillings per head.

#### CRITICISM OF COMMONWEALTH REGULATION.

415. The Commonwealth Taxation Department issued for the guidance of taxpayers directions explaining its practice under the regulation quoted in paragraph 252 from which the following is an extract:—

Sheep purchased in lamb or in wool should be shown at full purchase price at the end of the year, if then held, even though the wool has been cut or the lamb dropped.

How the regulation, as thus explained, may operate will be seen in the following illustrative example:—

A grazier in Victoria purchases in March (say) 1,000 four-year old ewes in nearly full fleece, heavy in lamb, for, say, 42s. Then assuming a drop of 80 per cent., if the lambs be marked and the ewes shorn in June, he will have to show as **Income** for that year:—

800 lambs, at 12s. 6d.	..	..	..	..	..	£500
Wool from 1,000 ewes, say	..	..	..	..	..	600
1,000 shorn ewes on hand, which must, according to the rule, be taken in at the same price as the full-fleeced pregnant ewes, viz., 42s. . .	..	..	..	..	..	2,100
Total income	..	..	..	..	..	£3,200

#### *Expenditure.*

1,000 ewes in lamb, nearly full fleece, at 42s.	..	..	..	..	£2,100
Cost of shearing..	..	..	..	..	150
					£2,250
Taxable income	..	..	..	..	£950

By this method, the grazier is assumed to have made a profit of £950, and is subjected to taxation upon it, when it is evident that the amount shown as profit (£950) is obtained only by making the erroneous assumption that a ewe which has dropped her lamb and been shorn of her fleece is as valuable as a ewe which carries both.

416. Objection to the "average value" method as set out in Commonwealth Regulation 46 (4) as to stock on hand at the end of the accounting period was almost unanimously voiced by witnesses representing primary producers. They contended that this method is unjust and

complicated. Witnesses stated that owing to the operation of the average cost method, the purchase of high-class rams adds to the average taxable value of the whole flock, though it is not an uncommon experience for a proportion of the rams, shortly after purchase, to prove no more valuable than flock sheep. In such cases the Department makes no allowance for this reduction in value. It was also contended that the same position arises in varying degree with any stock purchased which afterwards depreciate in value. Especially is this effect felt at a time like the present when stock values are low, though recent purchases were made at high prices. If a purchaser buys a line of stock at a price per head higher or lower than the average price of his own stock, and sells them during the same year, unless he can prove that they have been paddocked apart from the rest of his stock, he is not allowed to show this transaction separately in his return, but must supply the price of the recently acquired stock in arriving at the average cost value of the stock on hand and thus, perhaps, show a profit where an actual loss had taken place or *vice versa*.

417. The complaint that the present Commonwealth method is complicated and difficult for the average producer to understand is well founded. While taxpayers operating on a large scale are in a position to engage expert assistance to deal with the necessary calculations, the position is very difficult for many small producers who have to depend upon their own resources to arrive at the correct figures.

418. **Alternative Methods Suggested.**—Witnesses were by no means unanimous as to the remedy to be applied to overcome the present difficulties as to valuation of live stock. The three most important suggestions submitted may be summarized as follows:—

1. The taxpayer to make up his return on a cash receipts and disbursements basis ignoring stock on hand altogether.
2. The taxpayer to fix a standard value for each class of his own live stock, such value to remain constant.
3. The taxpayer to take live stock on hand into account at market value at the 30th June each year.

419. The cash receipts and disbursements basis (method 1), while it possesses the element of simplicity, does not reflect the true trading results of the taxpayer, for a taxpayer may devote the whole of his profits over a period to the purchase of stock, and would thus show no taxable surplus. On the other hand, a taxpayer may be compelled to realize practically the whole of his stock, and under this method would then show a taxable surplus, although in fact the year's operations may have resulted in a heavy loss.

420. The Queensland Act of 1907 gave the taxpayer the option of making his returns on this basis. The Queensland Commissioner stated in evidence:—

The experience of people who took advantage of the 1907 Act and did not return stock has been quite against the taxpayers. It means that some day they have to pay enormous taxation. They have to pay on the accumulated profits of years, without deductions.

421. The South African Income Tax Act of 1914 gave the taxpayer the choice of adopting for the purpose of income tax returns either the ordinary accounting method or the cash receipts and disbursements method, with the proviso that the decision of the taxpayer in this regard should be irrevocable. A Committee of Inquiry on Taxation of Incomes derived from farming operations, appointed under Government notice in 1917, recommended:—

That the method allowed, under Section 9 of Act No. 41 of 1917, to persons carrying on farming operations, of framing their returns on a receipt and expenditure basis, should be abolished, and that all persons carrying on farming operations should be required to frame their returns on the same basis as other taxpayers.

422. The second method proposed, that of allowing the taxpayer to fix a flat rate for his stock, such rate to remain unchanged, was strongly advocated by many representatives of pastoralists. It was stated that this method is generally adopted by pastoralists in carrying on their own business, and would work out equitably over a number of years. The method would certainly be simple, but would rarely, if ever, reflect the true result of each year's operations. If live stock were purchased at a price in excess of the standard used by the grazier, and, not being then sold, were required at the end of the year to be taken into account at the standard figure the operation would result in an apparent loss. Sale of the stock in a subsequent year at the actual figure at which it was originally purchased would in the year of sale show a profit (as compared with the standard at which it was taken into account), the method thus resulting in incorrect statements and in possible loss to either revenue or taxpayer, for in fact there may have been no loss on the transaction in the first year, nor any profit in the year of realization. This method also ignores the changes which are constantly taking place in the intrinsic value of stock and the fluctuations of the market which, owing to change of season and other factors, are probably more variable than those of any merchantable property.

423. The third method, that of taking live stock on hand into account at market value, was also strongly recommended, it being contended that, as a merchant or trader is allowed to take his stock on hand into account at cost or market value, whichever is the less, the same option should be allowed the stock-owner. This appears to be a reasonable view, for it is difficult to understand why a merchant who pays 30s. per ton for goods should have (as he now has) the option of returning such stock on hand at 20s., should the market decline to that figure; while a sheep farmer who pays 30s. per head for sheep and at the end of the year finds the market value has declined to 20s. per head has not the same option. As, however, all witnesses agreed that stock-owners are unable to ascertain the cost of stock bred by them, it would be practically impossible to exercise the option of using cost or market value in respect of natural increase. In the case of purchased stock, the option would be exercisable where stock-owners are prepared to keep accounts with sufficient accuracy to satisfy the Department.

424. Several witnesses, including Commonwealth and State officials, contended that it would be impracticable to determine market values, especially in the case of stock on what are known as "out-back" stations. There may be some difficulties in the case of properties far away from market centres or properties from which in seasons of drought or flood stock could not be travelled, but even in those cases a sufficiently close estimate of value could probably be made. In the case of stock within reasonable distance of market centres, no difficulty should be experienced. Should there be any dispute between the Department and the taxpayer, a ready means of check would be afforded by the stock market reports, which are regularly available from all centres.

425. **Taking Natural Increase into account.**—Differing opinions were expressed by witnesses as to whether or not natural increase in a herd or flock should be taken into account before sale. Some witnesses strongly urged that natural increase should not be included in the income tax return, on the ground that such increase does not represent income to the taxpayer until disposed of; whilst others admitted the justice of taking it into account, but objected to the standard values fixed by the Department as being too high. Others again favoured the Queensland method of taking young stock into account in the first year at one quarter value of grown stock and in subsequent years at full value.

426. The present Commonwealth regulation requires the inclusion of natural increase in the stock on hand at standard values varying in different States, and in Western Australia varying according to divisions of that State, as shown in the following table:—

TABLE III.  
Fair Average Value of Live Stock (other than Stud Stock).

—						Sheep.	Cattle.	Horses.	Pigs.
						£ s. d.	£ s. d.	£ s. d.	£ s. d.
New South Wales	..	..	..	..	..	0 10 0	6 0 0	6 0 0	1 0 0
Victoria	..	..	..	..	..	0 12 6	6 0 0	15 0 0	2 10 0
Queensland	..	..	..	..	..	0 9 0	3 0 0	4 0 0	0 15 0
South Australia	..	..	..	..	..	0 10 0	5 0 0	7 0 0	2 0 0
Tasmania	..	..	..	..	..	0 10 0	3 0 0	15 0 0	0 15 0
Northern Territory	..	..	..	..	..	0 12 6	2 0 0	5 0 0	..
Western Australia	..	..	..	..	..	0 5 0	1 15 0	East Kimberley	
"	"	..	..	..	..	0 5 0	2 5 0	West Kimberley	
"	"	..	..	..	..	0 7 0	2 10 0	N.W. Division, E. of Tropic of Capricorn	
"	"	..	..	..	..	0 9 0	3 10 0	N.W. Division, S. of Tropic of Capricorn	
"	"	..	..	..	..	0 12 0	4 10 0	S.W. Division	
"	"	..	..	..	..	0 7 0	2 10 0	Eucla and Central Division	
"	"	..	..	..	..	0 5 0	1 15 0	Eastern Division	

427. This variation of values according to geographical boundaries called forth sharp criticism, as will be seen from the following extract from evidence:—

The ridiculous aspect that is lent to this matter can best be shown by drawing attention to the fact that the arbitrary value is only determined according to the fixing of an imaginary geographical line that separates the various States. Take, for example, the boundaries of Queensland, New South Wales and South Australia. It all depends on which side of this line, where the three States touch one another, a calf is born, as to whether it immediately becomes worth three pounds, five pounds, or six pounds.

An example was given in which a Company operating on the northern boundary of New South Wales showed a profit in the Company's books of £42 16s. 7d. for the year ended 30th June, 1919, and paid New South Wales income tax £3 13s. 9d., but paid Commonwealth income tax

£601 17s. 6d. This was due to the Commonwealth regulation taxing the value of the calves at £6 per head, whereas the firm had valued them at £3 per head. Had the calves been dropped on the other side of the firm's northern fence, the amount of £3 per head would have been accepted by the Federal Department as the correct valuation, and the taxable profit would have been only £42 16s. 7d. Several instances were submitted indicating that it was only by the inclusion of the value of natural increase that a taxable surplus was shown, though such increase was subsequently lost through drought. There is no doubt that the present regulation may create fictitious "taxable" incomes and in years of declining value for live stock would certainly do so.

428. The validity of the Departmental regulation fixing varying average or standard values for live stock has recently been challenged in an action instituted by a Tasmanian taxpayer before the Supreme Court of that State, apparently on the ground that the regulation infringes Section 51 (ii) of the Commonwealth Constitution. The question has been referred on a case stated by the presiding Judge to the High Court.

429. **Natural increase should, in our opinion, be brought into account in the year of marking. This is the practice of the industry, and is accepted by the Department. For taxation purposes, natural increase should be stated in terms of the market value per head of such increase on the property at the close of the accounting period.** This would give a correct view of the taxpayer's position, for it cannot be said he has made more profit on the young stock than he could realize for them at that time. If they are subsequently sold at an advance on the figure set down, the additional profit will be brought to account in the year in which it is actually made. If lambs were worth 5s. per head at 30th June, 1921, and subsequently sold at 8s. per head, the profit (*i.e.*, the difference between 5s. and 8s.) is earned in the year of sale and not prior to 30th June, 1921. Similarly, if the sale resulted in a loss, that loss would properly attach to the year of sale. But at the 30th June, 1921, the position of the taxpayer was that he could have realized the 5s. per head, therefore the profit contained in the 5s. per head properly attaches to that year.

#### CONCLUSION.

430. After earnest consideration of the methods of valuing live stock now in operation in Australia and elsewhere, and of the suggestions of witnesses, we are of opinion that the "cost or market value" method is the soundest in theory, most closely accords with general convenient practice, and in operation will give the fairest results. The adoption of this view would necessitate some special provision for the transition from the present Departmental method.

431. Some variation of the manner in which gains made on the eventual realization of stock when a stock-owner ceases business are dealt with for taxation purposes would also become necessary. The existing method was found to require some corrective. The Department, therefore, decided that—

Tax is only charged on that part of the profit which represents the profit derived from the sale of stock which would have been sold if the business had been continued instead of being sold.

This decision was based on the ground that:—

if the whole of the live stock of an ordinary pastoral business . . . . . is sold off at prices greater than the (prescribed) cost or book values, the whole of the resulting profit is not liable to income tax, since part of it at least represents the profit on the sale of a fixed asset.

Clearly, the eventual "gain" on realization in such a case is not wholly due to an appreciation in values, but partly at least to the fact that the arbitrary values prescribed by regulation turn out to be less than the sum realized by the sale.

432. If, however, the method of taking in stock on hand at the end of the accounting period at cost or market value be reverted to, there will no longer be necessity for any such corrective, as the whole of the gain from a realization sale of the stock would then be treated in the same way as profit on a realization sale of ordinary merchandise—that is, it would be regarded as taxable income, and not as an accretion of capital. The stock-owner, under the existing practice, is exempt from tax in respect of any surplus resulting from final realization as between the prescribed figures and the sale price, and, seeing that re-introduction of the cost or market value method will exclude him from this exemption, it is necessary that some adjustment be made to avoid possible injustice. That can be done by providing that, at the moment in which the change of method occurs, the stock-owner should close his accounts for taxation purposes on prescribed values, and should simultaneously notify the market values at that date to the Department, by memorandum, but not by incorporation in those accounts; the operations of the following year would then be opened with the market values so submitted. It should also be provided that, if the total value with which the year is closed exceeds the total market value with which the first year under the new system is opened, the excess shall in the assessment for such year be treated as a deduction from the taxable income of that year, and any part of the excess not fully absorbed in that year shall in the assessment for the following year or years be treated as a deduction from the taxable income of such year or years.

till it is fully absorbed. If the business is sold off before the excess has been fully absorbed, the unabsorbed balance shall be deducted in the same way from any profit resulting from the final sale.

433. Unless the context requires another meaning, the term "live stock" in this section of the Report is used as meaning live stock generally, including sheep, cattle, horses, mules, camels, donkeys, goats, pigs, ostriches, and all other live stock usually depastured by a grazier or farmer, whether his business be that of a breeder or a dealer in such live stock.

434. Horses, mules, working bullocks broken to the yoke, camels, and other draught animals and beasts of burden used by primary producers, merchants, manufacturers, and others as part of the working plant of their business (and not kept principally for purposes of breeding or of making a direct profit on the purchase and sale thereof) should not be regarded as necessarily included in the term "live stock" as used in this section. Such beasts of burden, if regarded as working plant, should be so treated for purposes of taxation, and all moneys expended thereon dealt with in the same manner as moneys expended on other manufacturing or trading plant, and subject to depreciation at such rates and in such manner as may be prescribed.

435. Dairy stock may be regarded as more closely related to working plant used for the production of milk, cream, butter, cheese, &c., than live stock in the more general sense. In our opinion, the owner of live stock used as beasts of burden and of dairy cattle should therefore have the option (to be exercised in the first taxation return lodged by him after the inception of this system, or after the commencement of a new business) of declaring whether his working and dairy stock shall for purposes of taxation be treated as live stock in the more general sense or as working plant. The declaration should be regarded as final, and the taxpayer's returns should be dealt with accordingly by the taxation authorities.

#### RECOMMENDATIONS.

436. We recommend :—

1. That the provisions of the Income Tax Assessment Act, authorizing the issue of regulations prescribing values of live stock, be repealed.
2. That in future (except as set out in the succeeding recommendation) stock-owners be allowed (and required) to show the values of their live stock, including natural increase on hand at the end of an accounting period, at cost or at market value, whichever is the less.
3. That, as an exception to the general rule set down in the preceding recommendation, beasts of burden and dairy cattle shall, if declared by the owner as working plant, be so treated for the purposes of taxation.
4. That in order to effect smooth and equitable transition from the present to the recommended method, the procedure outlined in paragraph 432 be adopted.

In concluding this, our Second 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.

S. E. JELLEY,

Secretary.

Melbourne, 13th April, 1922.

## HARMONIZATION OF COMMONWEALTH AND STATE TAXATION.

### RESERVATION.

1. This is one of the most important and one of the most difficult of the problems intrusted to the Commission. Much time and serious thought have been given to it, and with due deference to my colleagues, I much regret that for reasons set out hereunder I am not able to concur in the principal conclusions and recommendations of this section of the Report.

2. **Amalgamation.**—I agree, however, in its condemnation of the scheme of amalgamation which has been entered into between the Commonwealth and Western Australia. The scheme should not, in my opinion, be continued, nor should similar arrangements be entered into with any other State. I agree with the conclusion (par. 240) of the Commission that "any scheme of harmonization or amalgamation which still leaves Commonwealth and State authorities both demanding revenue from the same people by the same mode of taxation can be at best only an imperfect remedy for the existing disabilities," and though any system of amalgamation, even if it do not amount to practical absorption of one authority by the other, mitigates some of the evils existing under divided authority, it perpetuates others which should not be allowed to continue.

3. **Alternative Recommended.**—The ultimate goal sought in the Report is a delimitation of existing legislative powers of both Commonwealth and States by the compulsion of an amendment of the Constitution. The Commonwealth is to surrender (subject to revocation in the case of war) the power to impose certain direct taxes other than income tax, and the States are to surrender irrevocably the power to impose income tax, but both Commonwealth and State retain individually the power to impose direct taxation in any other form.

4. The first thing which strikes a reader is the ineffectiveness of this scheme in establishing and maintaining harmonization of Commonwealth and State taxation. With a line so indefinitely marked and so zig-zag in character, there is nothing in such an arrangement to prevent the Commonwealth or any State from levying a Wealth tax, an Ability tax, a Property tax, a Corporation Tax, a Dividend tax, or some other direct tax, however named, which unless it is confiscatory and tends to exhaust the subject of the tax must be a direct attack upon and be paid directly out of the income of the people—the same income, though indirectly approached, as will be already taxed directly by the Commonwealth. This would not ameliorate but would aggravate existing evils, and some such step the States, if they are to avoid insolvency, might be compelled to take, seeing how seriously their revenue would be depleted and the field limited by their being excluded from imposing an undisguised income tax.

5. The recommendation of the Commission fails to suggest any clearly defined limit beyond which neither Commonwealth nor States respectively may trespass. Such a line suggests itself in Direct as distinct from Indirect Tax, or taxes on Consumption as distinct from taxes on Income, or Customs and Excise as distinct from all other taxes. Permanent or even temporary harmonization will not be accomplished by merely serving out to one side or the other "existing forms of direct taxation" at present in operation without regard to the imposition of direct taxes in other forms or under other names, but by some mutually acceptable agreement under which *without surrender of powers* there are, for purposes of administration only, allocated to the Commonwealth on one hand and to the respective States on the other hand certain clearly defined and well understood spheres upon which so long as certain conditions are fulfilled the other shall refrain from entering as active collector for a stipulated time, or pending certain events.

6. **Resulting Financial Position.**—Apart from the Constitutional questions involved which will be mentioned later, what will be the financial position of the Commonwealth and the States if effect be given to the recommendation (par. 249) of the Commission in which it is proposed that the Commonwealth permanently surrender to the States Land, Estate and Entertainment Taxes and the States surrender to the Commonwealth Income Tax and the Capitation Grant from Customs? It would be rash to forecast that in ten years the revenue from these sources will be the same as to-day or to what extent they will have changed, but it may be reasonably assumed that, if other conditions continue unaltered, whatever the increase be, their relative proportions will be much the same as now. Using, then, the latest figures available (those for 1919–1920), the recommendation of the Commission proposes that the Commonwealth surrender to the several

States certain sources of revenue and in turn receive from the States other sources which, with their yield for the year named, contrast as under :—

Commonwealth surrenders to States.				Showing 1919-1920 Revenues.	States surrender to Commonwealth.			Commonwealth gains and States loss.
A.	B.	C.	D.	E.	F.	G.	H.	I.
Federal Land Tax.	Federal Estate Tax.	Federal Entertainment Tax.	Total.	States.	State Income Tax.	Customs Capital Grant.	Total.	—
£	£	£	£		£	£	£	£
1,875,634	607,031	234,587	2,717,252	New South Wales	2,308,267	2,533,234	4,841,501	2,124,249
676,271	542,036	176,411	1,394,718	Victoria	915,551	1,878,449	2,794,000	1,399,282
322,546	127,912	62,695	513,153	Queensland	2,023,316	912,628	2,935,944	2,422,791
199,350	95,560	39,105	334,015	South Australia	662,384	588,603	1,250,987	916,972
149,693	158,418	34,350	342,461	Western Australia	416,136	564,735	980,871	638,410
75,179	41,157	10,934	127,270	Tasmania	279,476	272,514	551,990	424,720
3,298,673	1,572,114	558,082	5,428,869	All States	6,605,130	6,750,163	13,355,293	7,926,424

Commonwealth surrenders to States £5,428,869

States surrender to the Commonwealth a total of .. .. .

£13,355,293

Being a positive annual gain to the Commonwealth, and a loss to the States, of .. .. .

£7,926,424

Figures in column B are approximate—the others may be accepted as accurate.

7. In the same year the total sum collected by the States from Probate and Succession Duties, Stamp Duties, Land Tax, Income Tax, Licence Fees, Dividend Duty, and all other forms of direct taxation was £14,291,633, so that the recommendations of the Commission appropriating for the Commonwealth £7,926,424 in excess of the total it surrenders leaves to the States only £6,365,209. The deficiency is distributable thus :—

A.	B.	C.	D.	E.	F.
—	State Revenue from Taxation, 1919-1920.	Net Loss by Proposed Surrenders.	Percentage of Loss (C) to Revenue (B).	Remainder after Proposed Surrenders effected.	Percentage of Remainder (E) to Revenue (B).
	£	£	%	£	%
New South Wales .. .. .	4,962,518	2,124,249	42·806	2,838,269	57·194
Victoria .. .. .	3,159,767	1,399,282	44·284	1,760,485	55·716
Queensland .. .. .	3,323,745	2,422,791	72·893	900,954	27·107
South Australia .. .. .	1,391,830	916,972	65·882	474,858	34·118
Western Australia .. .. .	844,197	638,410	75·623	205,787	24·377
Tasmania .. .. .	609,576	424,720	69·675	184,856	30·325
All States .. .. .	14,291,633	7,926,424	55·462	6,365,209	44·538

8. With Income Tax, the most elastic and most productive of the taxes, forbidden them, how are the States to make up such heavy shrinkage of their resources ? The recommendation of the Commission is little help except to emphasize the poverty of the States. This is recognised, for somewhat indistinctly in the closing sentences of paragraph 249, and more clearly in the 8th section of the following paragraph, the report anticipates crippling financial stringency among the States. Foreseeing the inevitable results of the “solution,” the Report refers to section 96 of the Constitution :—

“During a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.”

9. This section was introduced as a temporary and special provision to allow of assistance being extended to any State seriously crippled at the establishment of the Commonwealth by the loss of Customs and Excise Duties, which formed a large part of the Revenue of some of the States, when these sources were handed over to the Federal Government, but it was never intended to establish a permanent alms chest for needy States. Thus Quick and Garran write—“The close connexion which clause 96 has historically with the Braddon Clause makes it seem probable that the Premiers intended that it should survive while the Braddon Clause survived, and no longer. . . . . The medicine in cases of emergency, not the daily food of the Constitution.”

10. The Commission further recommend “That, as a means of facilitating the financial adjustments which will become necessary under the provisional scheme, especially in the early years of its operation, the Commonwealth grant such financial assistance as may be deemed to be reasonable to any State or States upon such terms and conditions as may be mutually agreed upon.”

11. What necessity is there for any financial adjustments under the provisional scheme in the early years of the operation, seeing that during that period the Commonwealth and the States under this proposal continue to possess and exercise the right to impose income tax? Clearly, none whatever. The fears of the Commission are really for the years which follow, when the States would be by its scheme deprived entirely of the right of collecting Income Tax.

12. What respect is shown for the sovereignty or independence of the States which pictures them as empty-handed, hanging upon the Commonwealth to grant "such financial assistance as may be deemed to be necessary?"; and this not as a temporary expedient during the ten probationary years—during which no such expedient can be required—but as a perpetual heritage of enforced poverty? And why are they to look to the Commonwealth for assistance? Is it not because by the scheme which the Commission recommends it is expected that the coffers of the Commonwealth will be again filled to overflowing? It was the expectation, prior to Federation, that the revenue from Customs would be far in excess of Federal Expenditure (and would thus leave in the hands of the Commonwealth a large distributable surplus) which dictated the insertion in the Constitution of the Braddon Clause and its handmaid Clause 96. The alluring attractions of Federation appeared to justify a temporary disturbance of State finances. Is it again seriously contemplated that the Commonwealth treasure chest be filled to repletion by impoverishing the States? That there be established, not as a passing phase of the period of transition, but as a continuing condition, excessive opulence of the one and chronic impecuniosity of the others? Is it the relation which should obtain between Commonwealth and States? Is it a healthy state of things for either? Six independent "Sovereign" States reduced to a habitude of vassalage, dependent for part of their revenue upon eleemosynary assistance given to them "as a matter of grace, and not of right," and in measure as may, in the opinion of the donor, "be deemed to be necessary?" Dives, within, clothed in purple and fine linen, and six mendicants seated at the gate begging for the crumbs which fall from the rich man's table and contending for each morsel! This is the condition of things involved in the recommendations of the Commission, and no advantage, not otherwise obtainable, is in view to warrant the sapping of the financial independence of the States. It implies a derogation of the dignity of the States, and will deprive them of powers which they must possess if they are to carry unrelieved present responsibilities. It menaces the Federal relation which at present subsists between them and the Commonwealth, and is more compatible with, and might well be used to hasten the advent of, unitary Government. It will weaken the principle of Federation which is fundamental in the Constitution, and should, until some other principle is adopted by the people, dominate the relations between the Central and the State Governments.

13. **Necessity for Commonwealth Retaining Unlimited Power with Respect to Taxation.**—While strong objection must therefore be taken to the proposal to restrict the taxing power possessed by the States, still stronger objection must be taken to the proposal of the Report to restrict the taxing power of the Commonwealth at *any* time irrespective of the existence or non-existence of war. A Government which during a great struggle can offer no permanently dependable security invites the attacks of its enemies; the safety of a country at war does not depend mainly on the taxes which the Government can raise during the progress of hostilities, but upon moneys borrowed on security of the future revenues which the Government can continue to command and pledge to obtain the moneys to carry on operations. The unrestricted power to tax and to enforce its collection by in the last resort distraint, if necessary, upon the property of the individual citizen must always remain a power—a sword sheathed, it may be, but ready to be drawn and used when required—in the control of the authorities intrusted with Defence and the supreme interests of the Commonwealth. The pioneers of Federation realized this when against expressed opposition it was proposed that unrestricted power of taxation be bestowed upon the Federal Government, though at that time far more revenue than was apparently necessary for its needs was receivable from Customs and Excise. Sir Samuel Griffith, in introducing the Draft Bill to Constitute the Commonwealth, anticipated the difficulty of disposing of the surplus revenue from Customs, and said—

"I myself believe that some day the difficulty will be found to be so great that the Federal Parliament and the Parliaments of the different States will come together and make provisions for transferring on a fair basis such obligations of the States to the Commonwealth as will absorb all the Federal revenue."

At the same Convention (Adelaide, 1891), Sir William McMillan said:—

"To limit the greatest and necessary power of any State, the power of Taxation which lies at the bottom to a certain extent of all government, would be to at once stultify the whole constitution you bring into existence. Notwithstanding the many fears which may possess those representing certain Colonies, it seems to me we are going into this Federation with the hope that the central power will be animated by a sense of justice to the whole of the Colonies, and it would certainly be a step backward,

and we should at the same time practically stultify the whole of our work if we were to stop short of the sovereign power necessary to the creation of a State. . . . . *It is an absolute necessity that this power should be vested in the Sovereign State irrespective of the consequences.*"

He was supported by Mr. Playford—

"So far as my reading extends, no Commonwealth in the world has existed, or can exist, without possessing unlimited power of taxation. It is so in the case of the United States, in the case of Canada, and also in the cases of Germany and Switzerland."

**14. States must also Retain Unlimited Power in Respect of Direct Taxes.**—Mr. Deakin was not less emphatic with regard to the power of the Commonwealth and the States alike to tax :—

"I can imagine nothing more calamitous than that such an idea—the idea of taking away the power of taxation at present possessed by the several States—should be adopted by any of the communities that compose Australia. Suppose this clause (51 (2)) is passed, the same unlimited power of taxation as is possessed at the present time by the Colonies will be retained by them in every respect except as regards Duties of Customs and Excise. With regard to direct taxation which we are more particularly discussing, the Colonies will possess in future every power which they now possess. . . . . There is nothing in the clause which will give the Federal taxgatherer priority over the State taxgatherer. . . . . One of the foremost of the duties, that, in fact, which created the Convention, was to provide for the common defence of Australia, and it may be necessary to devote not only the last ship, but the last shilling, to that object. It is impossible to cast the duty of defence on the Government of the Commonwealth without giving them unlimited taxing powers."

**15.** Though the Convention did not especially provide for, some of its members appear to have had forebodings of, the conflict in the sphere of taxation which has been experienced in other Federated communities, and which, at a later date, impelled the Prime Minister of Canada, Sir Wilfrid Laurier, out of the fullness of his experience, to warn the framers of the Constitution of the South African Union to "avoid the pitfalls of concurrent jurisdiction."

**16.** These pitfalls could not have been wisely avoided by permanently excluding the Federal Government from any field of taxation, but it was apparently believed and hoped that the Commonwealth would not find it necessary to go outside of Customs for its revenue. This appears to have been generally felt, for it is recorded that one of the reasons for not urging the transfer to the Commonwealth of State Debts, Railways, &c., was the fear that the increased responsibilities thereby created would involve increased Customs duties (as though that were the only field in which the Federal Authorities would operate to secure increased supplies), and so imperil the free-trade leanings of some of the States. So Quick, and Garran, commenting on the proceedings of the Sydney Convention of 1891, write—"To saddle the Commonwealth with the interest on the public debts would practically have meant imposing on the Federal Parliament the duty of raising a large amount *through the Customs*, and would have placed the free-trade party at a disadvantage in Federal politics. It was seen that the amendment touched on dangerous ground, and it was accordingly negatived without division." Practically, Customs duties were regarded as the sufficient source of Commonwealth revenue, and unlimited power to tax was conferred in accordance with the dictates of experience and accepted principles of Statecraft, but in the confident hope that in practice there would be no need for the Commonwealth to exercise the larger power.

**17. Provisional Scheme of the Report.**—The provisional scheme outlined by the Commission, to which passing reference has already been made, is equally unacceptable. During the twilight period of ten years, while the country is preparing for the enactment of the "ultimate and permanent" scheme, there are to be seven uniform machinery Acts in respect of income tax, emanating from seven distinct sovereign and self-determining legislatures. That they are to be at all times uniform implies that seven distinct Parliaments containing thirteen independent Chambers, expressive of the ever-changing phases of public opinion, will have so conquered the confusion of Babel and the strife of tongues that they will all speak simultaneously as one man with one voice and with such compelling force that their tones will reverberate through a decade and be echoed by every succeeding House, without variation, irrespective of whether at any time the dominant party in any State be Conservative or Progressive, Nationalist or Labourite, Federalist or Unificationist, Free-trade or Protectionist. What are the means by which the thirteen Chambers, ever changing and variously constituted, will be simultaneously moved to make identical amendments in the "Uniform Acts" so that uniformity may be maintained and stagnation and discord alike avoided? Is it conceivable that in the domestic and social policy of the States there will be no differences or developments in any State calling for adjustments of the machinery controlling taxation and

fiscal burdens ; or, if there be, that every State will feel impelled to move in the same direction at the same time ? The provisional scheme as propounded could not exist concurrently with freedom of Parliament, progressive legislation, or ministerial responsibility to the citizens of each State.

18. This decade is spoken of in paragraph 248 as "the experimental period covered by the provisional scheme." "Experimental" in what sense ? Not experimental in the sense of testing how the "permanent solution of the problem" is likely to act, for the dominant feature of that epoch is entirely different from that of the interval. For a period of strict delimitation (whatever be the *lines* of the delimitation) a period of voluntary acquiescence in a uniform machinery Act and freedom to each authority to fix its own rates of tax furnishes little or no experimental guidance. That it is advanced as a temporary expedient only may be regarded as proof that its advocates have little confidence in its continued efficiency, a lack of faith which appears justified by its visionary character.

19. **Reasons for Dissent from Recommendations.**—Supported as they are by the opinions of publicists of wide experience, profound respect must be felt for the measured pronouncements, including those already quoted, of statesmen whose sagacity laid the foundations of Australia's nationhood. From proposals which are diametrically contrary thereto and contain elements of national danger, there is no alternative but to express dissent. I am not able to support the conclusions and recommendations of my colleagues for these reasons :—

1. The recommendations involve an unjustifiable and dangerous limitation of the power of the Commonwealth to levy taxation.

Having regard to international relations, there should be no constitutional surrender or withdrawal of the powers possessed by the Commonwealth to levy tax in any sphere at any time. So far only as the Commonwealth may voluntarily or in terms of a terminable agreement decide, it may refrain from exercising them.

2. The recommendations involve a dislocation of State machinery and a serious encroachment upon the powers of the States with paralyzing effects on their activities.

The States must be free to determine their own domestic policy and control the development of their own internal and social structure without diminution of the powers of taxation conducive thereto.

3. To Commonwealth and States alike any permanent surrender or withdrawal of powers of taxation would lessen the value of the security which bond-holders are entitled to expect should be kept intact, and to either an irrevocable delimitation might be seriously embarrassing if not disastrous.

The compellable resources to which creditors look as security for payment should not be weakened, but remain unimpaired and readily available for future requirements.

4. The scheme would necessarily restrict the freedom and self-determination of the States, and is therefore inimical to the Federal spirit as distinct from the principle of unification, which the people deliberately rejected in favour of Federation.

There should be preserved as a perpetual heritage "the indissoluble Federal Commonwealth" by leaving inviolate the domestic self-sufficiency and self-reliance of the States, and of such other States as may in the future be carved out of them, with undiminished power to control their own internal affairs and determine their own domestic policy.

20. **The Sovereign Right of Australian Taxpayers.**—In a general criticism of "the witnesses from whose evidence we have quoted," including leading officers of Commonwealth and State Taxation Departments, the Report, in paragraph 227, reads :—"They do not, however, appear to have paid sufficient regard to what, in our opinion, is the main consideration which should govern reasoning upon the subject and to which all other considerations must be adjusted. That consideration is the sovereign right of Australian taxpayers to have the mechanism of taxation so designed and controlled as to impose the minimum of inconvenience and involve the minimum of cost," a criticism and a principle which will probably receive general indorsement.

21. Conference after conference has been held at intervals without evolving a satisfactory solution of a problem which has become more pressing and irksome, and the reports of these conferences cannot be read without creating a feeling that some of the representatives appear to have been swayed too much by parochial jealousy and regard for security of office, and showed a lack of detachment and of devotion to the pursuit of a great purpose. The way was not found because there was no dogged determination to find and pursue it, even at the cost of personal loss

or inconvenience. Viewing the failure of these efforts, one recalls the forcible exposure by Mill of the evils which show themselves in bureaucracy as in autocracy—"It is no less important in a democratic than in any other Government that all tendency on the part of public authorities to stretch their interference and assume a power of any sort that can readily be dispensed with should be regarded with unremitting jealousy. Perhaps this is even more important in a democratic than in any other form of political society."

That both Commonwealth and State have heavy responsibilities and should have correspondingly extensive powers will not be disputed, and for the existence and continuance of both central and State Governments there are useful and quite distinct spheres. Viscount Bryce, in *The American Commonwealth* (page 33), describes the position in that Federation in words that would be equally applicable to Australia :—

"The administrative, legislative, and judicial functions for which the Federal Constitution provides are those relating to matters which must be deemed common to the whole nation, either because all the parts of the nation are alike interested in them or because it is only by the nation as a whole that they can be satisfactorily undertaken."

and he adds—

"It is as much the duty of the States' Authorities to watch over the rights reserved to them as of the Commonwealth to exercise the powers delegated."

Among the rights reserved to the Australian States is the power of taxation limited only by the exclusion of Customs and Excise. In this respect the Federal compact is comparable with the Constitution of the Dominion of Canada, which (section 91) gives the Federal House of Commons "exclusive authority for the raising of money by any mode or system of taxation," and also provides (section 92) that each Province may "exclusively make laws for direct taxation within the Province in order to the raising of a revenue for provincial purposes."

**22. The Cause of the Trouble.**—The possession of unlimited powers of direct taxation by both Commonwealth and States (minor restrictions expressed or implied in the Constitution are not overlooked) did not create difficulty during the first decade or more of Federation. Clearly the **possession** of power necessary for national defence and domestic development is not itself injurious. So long as the power of the Commonwealth to enter into "the direct taxation business" lay dormant there was no inconvenience and no outcry. Complaint began when, the States being already in the field, the Commonwealth commenced to exercise its powers in the same arena. In searching for a remedy the first concern is to locate the cause of the trouble. The cause in this case is not in the **possession** of powers, but in the **exercise** of powers concurrently by Commonwealth and States, in that two independent and (in regard to direct taxation) sovereign authorities are arbitrarily exercising their powers directly in the same field, at the same time, "demanding revenue from the same people, by the same modes of taxation," and the trouble would be almost as great if the powers were exercised co-operatively instead of independently, as at present. Doubtless the public irritation and loss caused by the simultaneous exercise of their powers by both authorities would be relieved by partially or wholly dispossessing one or other of them of these powers—by, for example, the delimitation recommended by the Commission—as a headache may be cured by decapitation. The cure may be worse than the trouble, and permanent delimitation of spheres as prescribed in the Commission's Report might prove a remedy worse than the existing evil.

**23. Remedy.**—Accepting as axiomatic that Commonwealth and States alike must possess in full potency the powers of direct taxation they now possess, a practical remedy may be sought in such a voluntary suspension of the exercise of these powers by one or both as may restore the comparative contentment of the *status quo ante bellum* to which the harassed taxpayer looks back longingly. If it be practicable, and such matters must be tested by reference to their practical consequences, there need not be any sense of subordination of one authority to another. It is the prerogative of power to assert itself or to restrain itself, to act or to refrain from acting, and, if less demonstrative, it may be more effective in masterly inactivity than in action. The possession of power does not necessarily imply its exercise, and a test of statesmanship is not in the creating of power so much as in the controlling of a power already created. If there be reason why in the public interest one or both authorities should cease to operate in the field of direct taxation, convention, prejudice, or narrower interests should not be allowed to stand in the way.

**24.** I respectfully submit that the solution of the difficulty created by the operations of independent authorities possessing concurrent jurisdiction will be found not in any delimitation of powers or any irrevocable abdication of rights, but in some method of passive or active alliance. Can a scheme be devised which, while maintaining inviolate the powers of taxation possessed by both Commonwealth and States, and without invading any necessary constitutional power, will secure the revenue required by both, with efficiency, simplicity, economy and convenience to the taxpayers?

25. **Methods Tried or Suggested** include the following :—

- (1) A scheme in which the perfect independence and sovereignty of both Commonwealth and State were exhibited is that under which each authority in accordance with its own laws and methods and without regard to the actions of the other collects tax in such form as it determines. Under this scheme the taxpayer has been ground as between the upper and the nether millstones, and because of this, combined with its costly administration, its perplexity, its irritating duplication, and purposeless expense it is after several years' trial generally condemned.
- (2) A second method is being tried in Western Australia of appointing one authority the collector for the other, under laws which may differ in many respects from one another and on differing scales of tax. Details of the method are fully set out in the Commission's Report. It involves some interference with the sovereignty and independence of the State, though the Commonwealth and State laws and rates continue as elsewhere to operate side by side; it also involves a minimum of advantage for the taxpayer, who has still to acquaint himself with two distinct machinery Acts and the legal interpretations of both, and two distinct scales of rates, has still to prepare two sets of returns (albeit they be written on the same sheet of paper), has to check two assessments, nothing simplified by their being printed on one sheet of paper, has to decide whether he shall accept or dispute either or both and eventually has to pay both simultaneously, instead of at separate dates one conveniently distant from the other. After full inquiry and studying the opinions of experienced administrators, your Commissioners strongly disapprove this method and unanimously recommend against its continuance or extension.
- (3) A method has been proposed by the Commissioner of Taxes in the State of Victoria and is fully explained and criticised in the Report of the Board of Inquiry issued on 23rd February, 1921. It proposes the appointment of a Board of Control of five members, two being taxation officers of the Commonwealth, two taxation officers selected from the States, and a Chairman who would "represent the general taxpayer." This Board was to take over control of both Commonwealth and State taxation staffs, by whom the several taxing Acts of the Commonwealth and the States would be administered, by reserving to both the right to amend their Acts and vary their rates from time to time. In addition to minor objections which are voiced in the Majority Report of the Board of Inquiry, this scheme "leaves Commonwealth and State authorities both demanding revenue from the same people by the same mode of taxation which can at best be only an imperfect remedy for the existing disabilities."
- (4) A fourth method partakes of the nature of a partnership agreement: the provisional scheme recommended in the Report, and which is in my opinion unworkable and visionary.

26. In each of these there is an element which foredooms it to failure as a satisfactory solution: it attempts to establish simplicity while maintaining duplicity. The inherent fault in all these schemes is absent from the "ultimate and permanent solution" recommended by the Commission in which is recognised and clearly expressed the necessity for simplicity—for delimitation of spheres, reserving each to one authority only—a scheme which, however, offends seriously in another respect in that it involves a dangerous dispossession of powers as well as a constitutional delimitation of spheres of control, a dispossession and a delimitation which are neither prudent nor necessary.

27. **Other Preferable Propositions.**—There are at least three methods by which with promise of varying degrees of success the problem submitted to us can be solved and simplicity, economy and convenience in administration be reached without involving a permanent delimitation of spheres or the dispossessing of any authority of the powers of taxation now possessed. The Commonwealth and the States each acting as independent self-determining authorities can, not by abdication, but in the full panoply of the powers they possess, enter into agreements for a term subject to stipulated conditions, and to summary termination in certain events, whereby—

- (1) The Commonwealth may exercise the power of taxation in respect of certain direct taxes, and, while it does so, the States may exercise the power of taxation in respect of all other forms of direct taxation, but shall refrain from operating in the field reserved under the agreement to the Commonwealth; or
- (2) The States may refrain from exercising their powers of taxation and entrust the whole of the collecting of taxes to the Commonwealth, the latter to pay over to the States such sums computed on a uniform basis as the States may from time to time require; or

- (3) The Commonwealth may refrain from exercising its powers of direct taxation in any or all of the States so long as the latter pay over to the Commonwealth such sums computed on a uniform basis as the Commonwealth may from time to time require ; or
- (4) Theoretically there is a fourth—that direct tax be not collected by any authority. It need not detain us.

28. One of these resembles in a measure the “ultimate and permanent solution” recommended in the Report, but with all three there is the important difference that none of them will permanently deprive either of the authorities of the powers of taxation now possessed : they each provide for voluntary passivity, partial or total, which may if occasion require be terminated. The unrestricted “power to make laws with respect to taxation” remains in full efficiency : Parliament may for sound reasons refrain for the time being from exercising them, but can do so immediately occasion justifies.

29. The recommendation of the Report that the power to impose income tax be exclusively vested in the Commonwealth involves a radical renunciation by the States which, when once availed of by the Commonwealth, could only, it is thought, be reversed by an alteration of the Constitution ; grave doubt has been expressed whether the Commonwealth can renounce any rights, original or transferred, it may possess to collect land or any other direct tax, and, if effect is to be given to such an intention, an alteration may be necessary in the Constitution. The National Charter should be tampered with as seldom as possible, and only when the object desired is of paramount importance and of permanent value, and when no arrangement can be satisfactorily made consonant with the Constitution as it stands.

30. The recommendation if carried into effect cannot but inscribe in the Constitution a restriction, which, unsound now, may be pernicious in future years when financial requirements may have substantially changed.

31. Attention has already been directed to reasons why the States should retain undiminished their present powers of taxation. To quote Burke—“The revenue of the State is the State. In effect all depends upon it whether for support or for reformation.” To the States especially the collection of direct taxes is vital, for they are expressly excluded from imposing Custom and Excise duties.

32. Assuming then that the true solution must respect existing powers and can be found not in deprivation of function but in deferring the exercise of the function by one or both authorities, let us examine briefly the three possible practicable methods already named.

**The First.**—The Commonwealth to exercise exclusively the right of taxation in respect of certain direct taxes, say, income tax, the States collecting others, say, land, estate, and entertainment taxes. There will follow :—

**Simplicity :** Only one authority will operate in each area in respect of each class of tax.

**Convenience :** Only one set of Acts would have to be studied and followed and only one set of tax returns compiled and lodged.

**Economy :** There will be a saving both in the cost of administration and in the cost to taxpayers compared with the present duplication inseparable from the two authorities operating in each sphere in respect of similar taxes.

But as compared with the cost if **all** direct taxes were collected by one authority (and subsequently allocated between Commonwealth and States as may be arranged) there is in this method considerable preventable waste. It implies the maintenance of two distinct taxing staffs in every State, the Commonwealth's and the State's, with inability to transfer officers temporarily to cope with a special rush or permanently from one sphere to another for which they may be better equipped.

**Certainty :** It is now found that the handling of returns under the Estate Duty Act in the same office in which the income tax returns of the deceased were handled has led to the detection of evasion in the returns lodged by the testator and the recovery of the evaded tax. Reference to the land tax records facilitates the checking of estate statements. An apportionment of the direct taxes in the manner proposed in the Report will hamper the treatment on both sides. The entertainment tax is quite separate from the others, but the collection here is simple, and amounts practically to an audit of the accounts of entertainment promoters.

33. Not only so, but the first method implies the unanimous agreement of six separate legislatures as to what taxes shall be dealt with by either party and on what terms, and universal harmony as to the details of an intricate agreement not only at its inception but during its continuance and on renewal. The States must be unanimous in refraining entirely from imposing taxation of the classes entrusted to the Commonwealth: if any of them interferes or attempts to control the collection the method mentioned in para. 25 would really be substituted, and instead of the Commonwealth acting as the sole and only administrative collector it would become one of two collectors or merely the agent of the controlling State, collecting two taxes, one for itself as principal the other as agent for the State.

34. Seeing the States under this method refrain from collecting, say, income tax (as they do not now collect Customs or Excise duties), all State taxing Acts would for the time lie dormant and collections would be made under provisions of the Federal Act alone, which in accordance with the Constitution cannot discriminate between States or parts of States. (This provision of the Constitution is so essential that, notwithstanding American precedent, one cannot entertain any idea of altering it.) Consequently the machinery and rating Acts would have to operate uniformly throughout Australia, and the States, each keenly alive to its own interests, would insist that the payments to them be on a uniform basis similar to the grant now paid them out of Customs duties. To provide for suitable distribution to cover the necessities of all the States the Commonwealth would require to regulate its rates and collections to provide a sum sufficient to meet the requirements of the most needy State, and, since the distribution to all States must be on the same basis, the amounts paid to other States would be in excess of their requirements—conducive to waste and extravagance and causing the extraction from the pockets of the people of more than otherwise would be necessary for maintenance of the public service.

35. Take income tax, the most important and most productive of the direct taxes, as a typical instance, including in it dividend duty which is a species of income tax. The total State collections and rates per head for 1919-1920, the latest year for which records are available, were as under:—

State.	Population.	Total Sums Collected as Income Tax (and Dividend Duties).	Amounts per Head.
		£	£ s. d.
New South Wales .. .. .	2,091,115	2,308,267	1 2 1
Victoria .. .. .	1,528,151	915,551	0 12 0
Queensland .. .. .	752,245	2,023,316	2 13 10
South Australia .. .. .	491,177	662,384	1 7 0
Western Australia .. .. .	330,819	416,136	1 5 2
Tasmania .. .. .	212,847	279,476	1 6 3
All States .. .. .	5,406,354	6,605,130	1 4 5

If to cover the requirements of Queensland the Commonwealth were to collect and distribute to the States at the rate per head ruling in that State the total so collected and distributed would be much in excess of total needs, thus:—

A. State.	B. Present (1919-1920) Collection.	C. Population.	D. Amount which would be Distributed at £2 13s. 10d. per Head.	E. Excess of D over B.
	£		£	£
New South Wales .. .. .	2,308,267	2,091,115	5,624,489	3,316,222
Victoria .. .. .	915,551	1,528,151	4,110,282	3,194,731
Queensland .. .. .	2,023,316	752,245	2,023,316	..
South Australia .. .. .	662,384	491,177	1,321,122	658,738
Western Australia .. .. .	416,136	330,819	889,807	473,671
Tasmania .. .. .	279,476	212,847	572,496	283,020
All States .. .. .	6,605,130	5,406,354	14,541,512	7,936,382

That is, the only operative taxing Act imposing one general scale of rates would, to meet Queensland's needs, have to collect and distribute to the other States nearly £8,000,000 more than is at present being collected by them from this source. A remedy would be to restrict the distribution to, say, the average, 24s. 5d. a head, but this would only compel Queensland, precluded from collecting income tax, to unwillingly levy some other tax to make up the shortage.

36. If the Commonwealth retain for its own purposes all the income tax, the States will be seriously restricted and compelled by the necessity which knows no law to take measures regarded as objectionable in order to secure indispensable revenue, or it will result in the financial strangulation of the States.

37. The method, however practicable financially, would involve interference with the self determination and autonomy of the States, which, because of the insufficient or overabundant distributions, might have to alter other State taxes in a way in which they unfettered would not do. They might be compelled to greatly increase, for example, the land tax—a class levy—though it might not be generally approved of by the citizens of the State, or they might be driven to impose prohibitive licences on certain industries so that same may become a revenue-producing monopoly of the State, as for example the manufacture of sugar in Germany or tobacco and matches in France. This would involve intolerable interference with the freedom of the States in the management of their own domestic affairs.

38. The method would still require the maintenance of State taxing staffs to collect land and other direct taxes, unless the collection of **all** direct taxes were undertaken by the Commonwealth. So long as the Commonwealth and the States maintain separate Departments collecting direct taxes there will be duplication and preventable waste and lessened efficiency; while if carried out under one organization, be it Commonwealth or State, co-ordination and the use of returns under one Act to check those under another tend to increased efficiency and reduced cost.

39. These objections, in addition to others, are inherent in the “ultimate and permanent solution” recommended in the Report.

40. This scheme stands condemned in my judgment because of the injurious influence on the stability and independence of the States, apart from the fact that duplication of direct taxing staffs involves an unnecessary drain upon the public purse and an intolerable burden on the taxpayer. The objection as to cost could be overcome if the collection of all direct taxes were intrusted to one authority, Commonwealth or State, under an arrangement whereby the non-active receives such share as may be arranged.

41. **The Second and Third Methods**, like the first, do not involve delimitation of powers. Each authority retains in all their plenary fulness the powers it now possesses—in the one active and operative, in the other passive, stored up potentially ready to burst into activity if and when occasion arises. The two may be considered together: in essence they are similar. In one the State, in the other the Commonwealth, administers under its own Acts, collects and under agreement pays to the other such sum as may from time to time be arranged.

42. Either method will introduce a larger measure of simplicity and convenience than under the first method, indeed the greatest possible measure, for in each State the taxpayer has now to deal with only one taxing authority administering one set of Acts, and the complexities attendant on duplication vanish.

43. Economy in administration can also be accomplished. Little or no additional expense would be incurred by the Commonwealth if it collected under its own Acts its own and the States' needs, and little or no additional expense would be incurred by the States if they collected under their own Acts their own and their shares of the Commonwealth's needs. The rates (being in effect a combination of Commonwealth and State rates) would be greater than either taken singly, and the Commissioner of Taxation has informed us that the doubling of the rates by any Government would have the effect of halving the percentage cost. In this connexion comparison of the costs of collecting Commonwealth and State direct taxes for the latest year on record is instructive and examination of the table will help to form an estimate of the probable saving in expense under either method.

*Cost of Collecting Commonwealth and State Revenue from Taxation, 1920-1921.*

Government.	Population.	Total Direct Taxation.	Total Cost.	Percentage of Collection.	Per Capita.
		£	£		s. d.
New South Wales .. .. .	2,101,384	7,388,133	52,631	0·71	0 6·01
Victoria .. .. .	1,535,938	3,846,833	63,102	1·64	0 9·86
Queensland .. .. .	768,964	3,682,642	56,084	1·52	1 5·50
South Australia .. .. .	497,525	1,622,076	38,176	2·35	1 6·42
Western Australia .. .. .	333,117	955,359	33,872	3·55	2 0·40
Tasmania .. .. .	211,984	708,603	16,412	2·32	1 6·58
All States .. .. .	5,448,912	18,203,646	260,277	1·43	0 11·46
Commonwealth .. .. .	5,455,423*	20,617,515	513,422	2·49	1 10·59
Commonwealth and States ..	5,455,423	38,821,161	773,699	1·99	2 10·04

\* Population includes Northern Territory, 3,928; Federal Territory, 2,583. For fuller details see Appendix 5.

The total collections of the States and of the Commonwealth are about equal, and if the doubling of the total amount collected by any Government would have the effect of halving the percentage cost these figures indicate that collection of the whole by the present staffs of the States would result in an annual saving of half-a-million pounds, while collection by the Commonwealth solely would effect an annual saving of quarter of a million pounds. The expense to which taxpayers are at present put would also be greatly reduced.

44. While either method will achieve simplicity, convenience, and in greater or less degree economy in expense of administration, there are substantial practical differences between them.

45. **Collection by Commonwealth.**—(1) If the collection of all direct taxes be undertaken by the Commonwealth under its own Acts (the second method), the States will be entirely dependent on the Commonwealth machinery for their requirements, seeing they are already precluded from collecting Customs and Excise duties. The power of the purse is weighted very heavily to one side. If, on the other hand, the Commonwealth collect under the State Acts as agent for the States, as is being tried in Western Australia, the evils of duplicity are revived. These have been exposed both in the Report and in this reservation.

(2) The Commonwealth must collect on conditions and at rates uniform throughout Australia, it cannot adapt itself to local conditions, and it would also have to distribute to the States on a uniform basis irrespective of their individual needs. If any attempt were made to cut down the amount equitably payable to any State, or what would be equivalent to the same thing supplement it in some cases, there would be general discontent; not only would the development of the country be checked, but the jealousy and bitterness engendered would undermine the national life. The Commonwealth must be either the dispenser of patronage—an intolerable position—or must collect and distribute without discrimination. This would involve unjust and unwise treatment of a State not yet developed or sparsely settled, as compared with a State more fully developed and with denser population.

(3) Again, as the above table shows, the cost of collecting direct taxes varies greatly in different States, not because of differences in the efficiency of the methods in use, but because of differences in general conditions; for example, in one State the cost may be low because there is a greater volume of business accounts to be dealt with than in another; in one State the expensive assessments of primary producers will exceed those of another State, with corresponding increase in the percentage cost. If the Commonwealth be the collector and distributor of the direct taxes, certain States would be benefited in this regard to the disadvantage of others.

46. **Collection by States.**—These objections are absent if the States control and collect (the third method). If the collection of all direct taxes be undertaken by the several States, each operating in its own sphere, the burden of the taxes can be adjusted to exactly meet the requirements of that State plus the contribution calculated on a uniform basis to be passed on to the Commonwealth.

47. The State desiring to push on with developmental work can do so financially independent of the activity or inactivity of other States, and the State in which for any reason the collection of tax is more costly than in another will itself reap the reward or bear the expense of its more searching or less efficient methods.

48. Opposition to this method may be expected from unificationists and those who subordinate public weal to personal interest; but appeal can, I think, be made to the larger body of citizens removed from official strife for pre-eminence who are concerned solely in the establishment of an effective, economical, convenient, and adequate system compatible with safeguarding the most vital interests of the Commonwealth, who without impairing the powers and efficiency of the Commonwealth desire to have the "mechanism of taxation so designed and controlled as to impose the minimum of inconvenience and involve the minimum of cost."

49. **Incidence of Taxation.**—There has not been advanced by any witness nor has there been found in any of the evidence and discussions of the many conferences which have been held any convincing reason why the Commonwealth should "remain in the direct taxation business." The halting and doubly conditioned opinion of paragraph 232 of the Report—"We consider it a sound principle that where any authority is, by right and not by grace, directly or indirectly receiving revenue raised through taxation imposed upon its citizens that authority should, wherever possible, be charged with the responsibility of determining the nature and incidence of the taxation"—is not supported by the experience of administrators or the investigations of students, who find ever increasing difficulty in determining the incidence of any tax. The first impact is easily discerned, but by diffusion and shifting the final incidence may either elude detection or fall on persons and in manner very different from those intended. Taxation as a weapon of social

adjustment often proves to be a boomerang. As Professor Hamilton has it—"The payers of taxes are quite distinct from the bearers of taxes." Thus Professor Shield Nicholson concludes a discussion of "the Social Function of Taxation" with an indorsement of the opinions of Professor Bastable (*Principles of Political Economy*, Vol. III., page 284):—

"On the general question the summary of Professor Bastable seems temperate and well founded. 'The results of financial experience are of some value in respect to the use of taxation for other than fiscal purposes. The taxing power has often been employed to encourage industry, to improve taste, to benefit health, or to elevate morals, but in none of these applications has the desired success been obtained. There is, therefore, a presumption against its use in remedying the inequalities of wealth. **Its definite and universally recognised function is the supply of adequate funds for the public services. To mix up with one very important object another different, and perhaps incompatible one, is to run the risk of failing in both.** . . . If the socialistic régime is the goal to be aimed at, there are more direct and more effective modes open than the manipulation of taxation.'"

50. A view with which Professor Seligman is also in agreement (*Essays in Taxation*, page 341).

"We see, therefore, that the chief development of the last quarter of a century, in the practice as well as in the theory of taxation, has been increasing emphasis laid upon the social [as distinct from the individual] point of view. In a great domain of taxation, as we have just learned, the individual point of view has been completely superseded by the social point of view, and the study of the incidence and effects of taxation has emphasized to a continually greater extent the fact that the individual who pays a tax is by no means always the person who bears the tax."

51. The only taxes which were, by exclusion of the States, specially reserved by the Constitution to the Commonwealth have in a marked degree a distinguishing characteristic: they are never expected to rest where they first fall. Customs and Excise duties, whatever be their impact, are shifted, and are expected to be shifted. Potent as are the influences of these duties in the life and the foreign and commercial relations of the people, it is beyond the power of the taxing authority to fix their final incidence. If the Federal Authority be unable to determine the distribution or final burden of the Customs and Excise duties, which are the principal source of its revenues, what essential necessity is there why it should control the final and individual incidence of the other? By what school of economists has the "principle" enunciated in paragraph 232 of the Report, coined for the occasion, been supported? Why was it flagrantly broken (if it ever existed) in the Constitution which, while it secured to the States 75 per cent. of the Customs and Excise duties, deprived them of any decisive voice in "determining the nature and incidence" of the duties? The States "had the predominant interest in the proceeds of the duties," but they were expressly prevented from exercising any direct control.

52. The Board of Inquiry appointed to inquire into and report upon the best means of giving effect to the principle of (a) one tax-gathering authority for the Commonwealth and the States, and (b) one form of return, considered it as fundamental that "any scheme for the collection of taxes by one authority should preserve to the respective Governments inviolate and without surrender all their existing rights in respect to administration and control," by which, as their later deliverances show, was meant **the preservation of these rights in full exercise and active energy.** This involves an encroachment on the powers conferred by the Constitution. It implies that the authorities, both Commonwealth and State, are required to exercise the powers of levying direct tax, whereas both are perfectly free to refrain from imposing any direct taxation, and are equally free to impose direct taxes in such way and through such active agencies as they may each determine. One might, from the terms of its deliverance, conclude that its members conceived the real purpose of the Board to be to devise some means of conserving the interests and maintaining the status of two taxing Departments, instead of the paramount interests of the people of Australia. What the Board deemed fundamental was not the economical and efficient service of the people, nor the framing of a scheme which would give acceptable expression to the provision of the Constitution conferring on the Commonwealth "the power to make laws in respect of taxation," but the continuance of conditions, which, if fundamental, necessarily limit the powers reserved by the Constitution to the respective authorities. But, in fact, continuance of these conditions is not fundamental. The resolution of the Board continues—"All other rights such as legislation as to the character of taxation Acts and rates of tax are already preserved fully by legislative enactment," from which it is clear the Board attempts to superimpose on these "all other rights," and to treat as fundamental, "rights" which are neither essential nor fundamental, and it ignores another right, namely, the right to refrain entirely from exercising the power to make laws in respect of taxation. There is no constitutional compulsion on either Commonwealth

or States—apart from consideration for the welfare and interests of the people and maintenance of the public services to levy any direct taxes, and both would doubtless desist from doing so if sufficient revenue were received from other sources. To this power of abstention the Board failed to give any practical recognition.

53. The unlimited power of taxation conferred on the Federal authorities is not confined to income tax or estate duties or entertainment tax, but extends to **all** taxes; it includes the power of collection, administration, and control of, for instance, local rates all over the Commonwealth, for, as Bastable writes, "all contributions to the various organs of government are taxes. A rate raised by the smallest parish is as much a tax as if it were levied by the Imperial Government." By virtue of the powers conferred upon it by the Constitution, the Commonwealth has as much right to enter upon the control of these as upon the control of income tax or any other tax. Does the Commonwealth take any voice "in determining the rates, the mode of collection, or the nature or incidence" of these rates? Is there any reason why it should? Is there any cogent reason why it should endeavour to control taxation which can be most effectively and discriminatingly controlled by the States themselves?

54. The claim that the levying of income tax would be more appropriate to the Commonwealth than to the States, if advanced as a general rule, must be challenged. The claim may be conceded in part so far as it applies to the businesses of companies or individual owners which are carried on in more than one State, but it cannot be sustained in respect of taxpayers whose operations are confined to one State. In Australia the individual taxpayers under the Federal Income Tax Act whose operations extended to more than one State numbered in 1918-1919 8,212, being less than 2 per cent of the whole (430,542); the operations of fully 98 per cent. were confined to one State. In Continental countries and in Great Britain extensive use is made of local agencies in the assessing and collecting of tax. In Great Britain, where there are larger and more numerous multiple branch companies and business concerns operating all over the kingdom than any known in Australia, the country is divided into 725 separate districts, and 725 distinct bodies, comprising 5,600 local commissioners, are engaged in the income tax administration required "to take the necessary steps for putting the Income Tax Acts into force as regards each parish within their respective districts." This extreme decentralization, because of the intimate local knowledge it provides, is a powerful check on tax evasion.

It has been objected that if Income Tax, Land Tax, or Probate Duties, or indeed any tax in which the subject-matter all over Australia is cumulative, and the rates steeply graduated under Federal Acts, were collected by the individual States under State Acts the aggregation and the graduated rates of the Commonwealth would not apply. Naturally, but the States would still be at liberty, so long as they pay their proper quota to the Commonwealth, to collect from their own citizens such direct taxes under such conditions and at such rates as they individually determine, and there is no valid reason why the self-determination of any State as to the method and manner of its collections should be dictated by any body other than the electors, who through their own representatives in the State Parliament direct the affairs of the State.

55. **Conclusion.**—From an extensive and close study of the subject these facts and principles emerge :—

- (1) The direct taxes at present collected in the several States and those collected by the Commonwealth—income, land, entertainment taxes, probate, succession, estate, and dividend duties—could be handled more efficiently and more economically if all were controlled by one authority collecting under one Act for each object of tax in each area in which they operate.
- (2) That no system which maintains in full operation more than one Act in respect of one object of taxation will quite overcome the expense, irritation, inconvenience, and perplexity of the present duplex system of two authorities operating in the same sphere.
- (3) That either the Commonwealth throughout the whole of Australia or the several States each in its respective sphere should be employed to act as sole collector for a term to be fixed by agreement subject to such payment to the inactive authority as may be arranged and to determination on short notice if adequate reasons for same arise.
- (4) Owing to the diverse conditions obtaining over the extensive area governed by the Federal Parliament and the necessity for adjusting taxation to meet the varying needs of the several States (and the States which may in time be formed or the parts which may be surrendered to the Commonwealth) the Commonwealth, compelled if it exercises the power of taxation at all to exercise it so as not to discriminate between States, or parts of States, is unable to adapt itself to the particular circumstances of all parts of the Commonwealth.

- (5) That the States not being so hampered and having more intimate knowledge of their own special needs are better equipped to administrate and control the collection of direct taxes.
- (6) Its claims being paramount, the Commonwealth should have unfettered right to determine what amount per head of the population (or other basal unit) uniform throughout Australia should be paid over by the States to it during each fiscal period.

56. Whether the method recommended in this reservation can be adopted and fully dealt with by agreements between the Commonwealth and the States or its adoption would require amendment of the Constitution or some other enabling Acts, I cannot discuss. Without elaborating details, **I therefore respectfully recommend—**

- (1) That the Commonwealth and the States mutually agree that the latter each in its own area shall exclusively exercise the power of collecting direct taxes from its taxpayers in such manner and under such Acts as it may determine—
  - (a) the agreement to be terminable on stipulated notice by either party ;
  - (b) during the continuance and for                      months after notice of termination has been given the State shall pay to the Commonwealth in (? monthly or other) instalments such an amount per head of the population of the State as may be required by the Commonwealth, such amount per head to be uniform throughout Australia and notified to the States not later than a definite date in each year ;
  - (c) such monthly amounts to be paid to the Commonwealth out of tax collections before any of such collections for the month are transferred to State spending Departments. Interest on State debts to have priority over all other claims.
- (2) That adequate means be taken to establish the right of the Commonwealth in case of need to intervene, and, if necessary, itself collect the tax if any State fail in its payments.

JOHN JOLLY.

## TAXATION AT THE SOURCE.

### RESERVATION.

We regret we are unable to concur in the principal recommendation expressed in the Report on the above subject.

**1. Definition of Terms.**—In this Reservation the term “Taxation at the Source” will be used in the same sense as in the Report—that is, as meaning a method similar to that in force in Great Britain, which as applied to companies requires payment by a company of tax on the whole of its profits at a flat rate. As to the amount distributed in dividends, the method provides also—

- (a) For refunds to shareholders whose income, including the dividend, is below the exempted amount;
- (b) For rebates to those whose personal rate of tax is less than the Company rate; and
- (c) For additional payment by shareholders whose rate is higher than the Company rate.

The British method is described with more detail in Paragraph 273 of the Report. The term “Company Taxation” is also used as in the Report. (See also Paragraph 4 of this Reservation.)

**2. Origin of Taxation at the Source.**—The British Income Tax Act of 1803 introduced the method of Taxation at the Source, which has remained an important element in the British system up to the present day. In the year 1801–2, before the method of Taxation at the Source was introduced, the British Income Tax at 24d. per £1 produced £5,301,000. In the following year no Income Tax was in force. In 1803–4, when Taxation at the Source came into operation, the tax at 12d. per £1 produced £4,862,000. Before its introduction each penny of tax produced £221,000. After its introduction each penny of tax produced £405,000. Commenting upon this, Professor Seligman, in his work “The Income Tax,” published in 1914, writes:—

“In other words, the alteration in the principle of assessment at one blow doubled the efficiency of the tax. No more signal proof could be afforded of the vital importance of good administrative methods in fiscal administration.”

While there have been some changes in the classes of income to which that method of tax collection has been applied, those changes have been in the direction of addition. The principal classes of income upon which tax is now collected by deduction at the source in Great Britain are enumerated in Paragraph 257 of the Report.

**3. Recent Inquiries into Taxation at the Source.**—In 1905 a Departmental Committee, and in 1906 a Select Committee of the House of Commons, were appointed to inquire into and report upon various phases of the Income Tax, and in each case the Committee considered, among other things, the method of Taxation at the Source, and recommended its continuance. The British Royal Commission on the Income Tax, which reported in 1920, stated that—

“Taxation by deduction at the source is of paramount importance, lying as it does at the very root of our Income Tax system. . . . We are convinced that to abandon Taxation at the Source now would involve an enormous loss of revenue, and would throw upon scrupulous, honest, and careful taxpayers an unfair share of the burden imposed by the taxation necessary for the country’s needs. We are not satisfied that any system of ‘Information at the Source’ would be a practical and efficient substitute for the present system, and it would be a source of trouble and irritation to the community in general.”

**4. Commonwealth Practice.**—The Commonwealth Income Tax Law does not embody the method of Taxation at the Source, as above defined, so far as dividends distributed from the profits of the immediately preceding year are concerned. In all such cases the Company remains untaxed to the extent of the distribution, but the shareholder is required to show the dividends in his Income Tax return, and is charged tax at the rate appropriate to his total taxable income. Under the Commonwealth Law, there is, however, a somewhat anomalous method in force with regard to taxation of dividends derived from profits which in earlier years had been carried to Reserve or similar account in the Balance-sheet of the year in which they were made, but are distributed in subsequent years. The Commonwealth method of dealing with dividends wholly or partly paid from such undistributed profits cannot be described either as “Taxation at the Source” or as

Company Taxation. It is rather a mixture of both. For example, if "undistributed profits" are in a subsequent year paid to shareholders by way of dividend, the position of the shareholder in respect of the tax which had been paid by the Company varies according to the rate of tax applicable to his personal income. Four positions arise :—

- (a) If the shareholder's income, including the dividend in question, is less than the General Exemption—i.e., if he is not a taxpayer in that year—he will receive no refund, although the Company rate (now 2s. 8d.) has been paid by the Company upon the profits of which he has now received a share by way of dividend.
- (b) If the shareholder is a taxpayer, but his personal rate is lower than the Company rate, he will receive a refund or rebate, not of the whole amount paid by the Company, but of a proportion calculated by applying his personal rate of tax to the amount of dividend received—that is, assuming 2s. 8d. was paid by the Company, and the shareholder's rate is 1s., he will receive refund or rebate at the rate of 1s. on the dividend, and the balance of the tax will be retained in the consolidated revenue.
- (c) If the shareholder's personal rate of tax is exactly the same as the rate originally paid by the Company, he will receive refund or rebate of the full amount.
- (d) If the shareholder's rate is higher than the rate originally paid by the Company, he will be called upon to pay tax on the dividend at a rate equivalent to the difference.

It will be seen that, in case "a" above, the Commonwealth method in respect of taxation on dividends derived from "undistributed profits" is one of "Company Taxation." In respect of case "b", it is a mixed method, partaking of the character of Taxation at the Source and of Company Taxation. Cases "c" and "d" may be regarded as instances of Taxation at the Source.

**5. States' Practice.**—The practice of the Australian States is described in paragraphs 254 and 255 of the Report. In all the States the method in force is correctly described as "Company Taxation," since taxpayers are not required to include the dividends received in their Income Tax returns, and, while, except in Western Australia, refunds are not allowed to shareholders whose personal rate of tax is lower than that imposed upon the Company, those shareholders whose personal rate of tax is higher than the Company rate are not called upon to pay the difference. The practice of the States has the advantage of ease, certainty, and economy in collection, but **on the ground of equity not one word can be said in its favour.** It relieves of tax those taxpayers whose personal rates are higher than the Company rate; in effect imposes taxation at a relatively high rate on a large body of shareholders who would otherwise not be taxable, and adds to the taxation of another large body of shareholders who, though taxpayers, are liable only to a lower rate of tax than the Company rate.

**6. Opinions of Witnesses—Unofficial Witnesses.**—Among professional and commercial witnesses, the advisability or otherwise of incorporating in the Commonwealth system of Income Taxation the method of Company Taxation practised under State Acts, or of Taxation at the Source, as in force in Great Britain, was thoroughly discussed. A strong preference was expressed by some witnesses for the State method, which deals with the Company only, and those witnesses commended that method on the grounds of its simplicity and economy, which they considered sufficient to outweigh the obvious inequity of the system with regard to shareholders whose total income is below the general exemption, or whose rate is below the Company rate. Those witnesses were all familiar with one or other of the State Statutes, and their opinion as to the method which should be adopted was perhaps influenced by the fact that in the States the Company rate is low as compared with that of the Commonwealth. A number of the witnesses who urged this view were acquainted with the British system also, and, while considering certainty of yield of the tax to be the paramount consideration, they were unwilling on the ground of expense to urge the adoption of a method involving refunds, as allowed in Britain. Many other witnesses, however, were so seriously impressed with the injustice done by a method which allows no refunds or rebates to shareholders having small incomes that they were led to recommend reliance upon the Commonwealth practice with regard to dividends based upon current profits, or upon the method of Taxation at the Source, which makes the Company merely the agent to pay tax in the first instance, leaving the shareholder to claim any refund or rebate to which he may be entitled.

7. **Official Witnesses—The Commonwealth Commissioner.**—With regard to the anomalies above pointed out (paragraph 4) in respect of the Commonwealth taxation of dividends derived wholly or in part from undistributed profits, the Commonwealth Commissioner of Taxation was of opinion that the Act should be amended, in order to deal equitably with those shareholders who are not taxable or whose rate is below the Company rate. With regard to the wider question of substituting the method of Taxation at the Source for that of taxing the individual direct in respect of all Company dividends, the Commissioner was opposed to such a change on the grounds that it would involve additional expense, estimated at about £18,000 per annum (being the cost of an additional staff to deal with refunds), and that there would be no net gain to the revenue. This opinion means that in the Commissioner's view the method of "Information at the Source" now in operation is so complete as to afford a protection to the revenue equal to that attainable by Taxation at the Source. In this respect his view is in opposition to that expressed with the strongest emphasis by the British Royal Commission of 1920 (*see* paragraph 3). One of the British Commissioners of Inland Revenue, in evidence before the British Royal Commission, stated :—

"Taxation at the Source is the primary safeguard against evasion of duty, because it deprives the taxpayer of opportunity to escape, either by carelessness or by ignorance or by fraud, from payment of his due share of Income Tax. It is obvious that at any time and in any circumstances abandonment of the system would result in a heavy loss, and that at the present day, when the exceedingly high rates of duty afford an unparalleled temptation to the taxpayer to give himself the benefit of the doubt and even wilfully to evade the tax, abandonment of the system would be disastrous.

In my judgment, the abandonment of the system would result in a dead loss to the Exchequer of upwards of £50,000,000 a year."

In Great Britain, the proportion of tax obtained by Taxation at the Source is stated by the British Commission to be about 70 per cent. The loss estimated by the Board of Inland Revenue, if the system of Taxation at the Source were abandoned (£50,000,000), may be set down as approximately 20 per cent. of the whole Revenue. If anything approaching the same percentage of loss is incurred in Australia by non-adoption of the British system (and this seems quite probable), the argument in opposition based upon the expense of a Refund Staff becomes untenable.

8. With regard to Information at the Source, it is fair to say that the position of the Commonwealth Commissioner is much stronger than was that of the Board of Inland Revenue at the time of the British Commission's Report. The British authorities had not the same statutory powers of investigation of books and documents as are possessed by the Commonwealth Commissioner. The British Commission remarked, indeed, that the powers of investigation possessed by the Board of Inland Revenue—

"are extremely limited, and there can be no doubt at all that knowledge of this limitation is taken advantage of by the unscrupulous."

That Commission made a number of recommendations with a view to conferring upon the Board complete powers of investigation. Their recommendations, indeed, went beyond the powers conferred by the Commonwealth Act, but, **after allowing for this large extension of investigating power**, that Commission was "not satisfied that any system of Information at the Source would be a practical and efficient substitute for" Taxation at the Source. The inadequate powers of investigation possessed by the Board of Inland Revenue were in practice materially increased—

- (a) By free use of the power to make default assessments, which placed the taxpayer in the position that, if he challenged those assessments, he could be called upon to produce books and documents; and
- (b) By extensive use of the check upon tax evasion which local knowledge provides. Extraordinary opportunities for application of this check arise from the extreme decentralization of the British administration and the very large use of local officers and of local Commissioners (of whom there are 5,600, having jurisdiction in 725 separate districts).

9. **State Commissioners.**—The State Commissioners, all of whom are familiar with a method of Company Taxation which leaves the shareholder out of account altogether, are naturally impressed with the simplicity and certainty which that method affords. Their opinions were not uniform with regard to the question whether such a method should have the element of equity introduced by a provision for adjustments to shareholders, so that eventually no taxpayer would

be charged upon his dividends at a rate higher than that appropriate to his total personal income. Whilst some favoured the introduction of adjustments to shareholders, one or two were opposed to that change.

10. (1) **Present Commonwealth Mode of dealing with Undistributed Profits.**—It has been shown above (paragraph 3) that, where dividends are wholly or in part derived from “Undistributed Profits,” that is—profits of previous years, which at the time had been withheld from distribution, the Commonwealth Income Tax Act operates inequitably. This inequity affects (A) shareholders whose total income, including dividends, is less than the exemptions to which they are entitled, with the consequence that they are not taxpayers, and (B) shareholders who, though taxpayers, receive only a partial refund or rebate of the amount paid as tax by the Company in respect of “undistributed profits”. The following comparisons, founded upon figures supplied by the Commonwealth Commissioner of Taxation, indicate the extent of the injustice caused by the present system to shareholders in the above groups (a) and (b):—

(a) The total profits of Companies in Australia for the year ended 30th June, 1920* (or the trading period taken in lieu thereof for taxation purposes), was	£42,216,256
(b) The amount of dividends taxed to shareholders was	£10,612,929
(c) The amount of dividends received by non-taxable shareholders (their total income being less than the General Exemption) was	8,772,687
(d) The amount of undistributed income taxed to the Companies was	22,830,640
	<hr/> 42,216,256

That is, fully 54 per cent. of the income was taxed in the hands of the Companies at 2s. 8d. in the £1, the tax amounting to 3,044,085.

If the profits under heading (d) were distributed in the following year, they would fall into groups, corresponding to (b) and (c) above, thus:—

(e) The amount of dividends taxable to taxpaying shareholders	£12,498,555
(f) The amount of dividends payable to non-taxable shareholders	10,331,685
being a total as above	<hr/> £22,830,640

The tax to be paid by the Company would thus be—

In respect of shareholders in group (e)	£1,666,527
In respect of shareholders in group (f)	1,377,558
being a total as above	<hr/> £3,044,085

(2) Shareholders in group (f) who are not directly taxable as individuals (their income in each case, inclusive of dividends, being less than the General Exemption) would thus pay, indirectly through the Company, tax amounting to £1,377,558, and, as such shareholders number about 200,000, they would pay on an average £6 17s. 3d. in tax, for which they would receive no refund or allowance. This figure of tax should probably be slightly reduced, in view of the fact that, if the amount shown under item (d) had been distributed, some of the shareholders in Group (f) would perhaps have been brought into the taxable field as individuals.

(3) With regard to shareholders in Group (e), the result is not quite so obvious. Group (e) must be considered as consisting of two sub-groups, viz. :—

1. Those whose individual rate of tax is less than the Company rate.
2. Those whose individual rate is greater than the Company rate.

(4) The Commissioner has informed us that the taxpaying shareholders whose individual rates are less than the Company rate number about 25,364, and those whose rates are greater than the Company rate number 2,636. No exact figures are available showing the respective proportions of the whole tax paid by each of these groups, but, using as a basis figures of distribution of income given in the Commissioner's Seventh Annual Report, and making the assumption that the average individual rate among those whose rates do not exceed the Company rate, is 1s. in the £1, it

\* The Commissioner states that the year in question disclosed abnormally high profits, and he expressed the opinion that a deduction of 15 per cent. should be made from the figures if comparison with other years is sought.

appears that the 25,364 shareholders covered in that category would pay indirectly through the Company—in excess of the amount credited to them by way of rebate, *i.e.*, used in payment of their individual tax upon the dividend—the sum of about £300,000, or an average of nearly £12 per head.

**11. Should Refunds in respect of Dividends paid from Undistributed Profits be made to the Company or to Individual Taxpayers.**—As to the mode of making the refunds which will be necessary in these cases if justice is to be done, the more obvious course is that of paying the amount due as a refund direct to the taxpayer, or allowing it as a rebate from his assessment. The objection to this, from the point of view of administrative cost, is that a very large number of individuals must be dealt with, and for that reason some witnesses suggested that the necessary refunds should be made direct to the Company. For example, if a dividend, say of £10,000, were paid by a Company entirely from the accumulated profits of earlier years, upon which the Company had paid tax at the present rate of 2s. 8d., the suggestion was that, as the taxpayers become individually liable (if taxable at all) for taxation upon the amounts received, the whole sum originally paid in tax by the Company on the amount of such dividend should be returned to the Company. Obviously, this would provide the Company with a fund from which a further dividend might be paid, or it might be used to augment the next regular dividend. This suggested method certainly possesses the advantages of ease and saving in clerical work, but, from the point of view of shareholders of small income, it does not possess the same element of equity as the method of dealing directly with shareholders. It also detracts from the value of the method of Taxation at the Source, by removing from taxpayers the incentive to bring themselves into contact with the Department, which otherwise would become necessary in order that they should receive their refunds. On the whole, the disadvantages of refunding to the Company, in our opinion, outweigh the advantages of that course.

**12. Refunds and Adjustments Generally.**—The question of refunds in respect of dividends arising from undistributed profits referred to in the preceding paragraph is only one phase of the wider question of refund, which would become a practical question if the system of Taxation at the Source were adopted. The objections of the Commonwealth Commissioner on the score of expense, estimated at £18,000 per annum, have already been mentioned. The necessity for refunds exists in any equitable scheme by which Income Tax is intercepted at the point where it arises, whether applied to the whole or restricted to the undistributed part of the profit of the Company. In our opinion, the benefits accruing from such an interception of tax are so great that the expense with regard to refunds and adjustments may be looked upon as representing a very moderate premium for the advantages secured.

## TAXATION AT THE SOURCE—ADVANTAGES AND DISADVANTAGES

### 13. Advantages—

Taxation at the Source is—

1. **Equitable.**—Any evasion of tax whether due to inadvertence or to design involves an added—and unjust—burden upon those taxpayers who without concealment or omission return the whole of their taxable income. Taxation at the Source in the sphere to which it is applied defeats evasion and prevents inequity by—
  - (a) Creating an incentive to taxpayers whose rate is less than the Company rate to make full disclosure in their return of all income derived in respect of which tax at the source has been collected in order to claim the rebate which may be due to them on account of the tax paid on their behalf; and by
  - (b) Bringing into contact with the taxing authorities persons who should pay tax, but who otherwise might fail to render return.
2. **Convenient.**—The Company taxpayer as agent for all its shareholders makes a single payment in respect of tax on the whole of its taxable income whether such income be distributed in dividends or not, and it then rests with the Department in its ordinary checking of the returns of the shareholders to allow credits in their assessments for such sums as have already been paid on their behalf by the Company.
3. **Certain of Collection.**—The fundamental advantage of a method of Taxation at the Source is the certainty that, in respect of the collection of tax on the Income to which the method is applied, there can be no evasion by a shareholder through fraud or negligence or through his leaving the country after collecting dividends and before paying tax thereon.
4. **Economical.**—Taxation at the Source will not place any greater burden upon Companies than is done by the method of Information at the Source, but will tend to lighten that burden, since it will probably eliminate almost the whole of the work involved in dealing with the special inquiries now made by the Department from Companies in respect of individual assessments.

The work of the Department would also be lightened by removing the necessity for much investigation which has now to be undertaken to check omissions and evasions in shareholders' returns and correspondence consequent thereon.

14. **Disadvantages.**—The administration will collect considerable sums which must ultimately be refunded to shareholders. Apart from expense to the Department in making refunds, there is the more serious element of a temporary inconvenience to those who for a time at least must stand out of money to which they are properly entitled. Such inconvenience is, however, limited to those taxpayers whose total tax proves to be less than the sum paid on their behalf by the Company from which they drew dividends. In the case of small incomes the sums temporarily retained by the Department will also be small, as the amounts increase the inconvenience does not increase but decreases, since the more nearly the taxpayer's individual rate approaches to the Company rate the smaller will be the proportion of tax paid by the Company which will ultimately be claimable as rebate by the taxpayer. It may be considered a partial set-off to the disadvantage under review that a taxpayer in this group is not called upon to make any actual payment; but is receiving, in the first place, the dividend (less tax) from the Company and, in the second place, such refund or rebate from the Department as represents the excess (if any) of the tax paid by the Company over that which is due from the individual.

15. Paragraph 276 of the Report states as a second disadvantage that—

“Some revenue gain (it is difficult to estimate how much) will be due to the failure of taxpayers, either through ignorance or neglect, to make and establish their claims for refund or credit.”

The possibility of such failure through ignorance could easily be prevented by Companies issuing to each shareholder with the dividend warrant or cheque a slip explaining the conditions under which a claim for refund or credit becomes due and the mode of making the claim. Neglect on the part of the taxpayer to apply for any refund to which he knows himself to be entitled can hardly be a cause of complaint against the method, and the Administration might well devise special means for facilitating the payment of such refunds. If, as the argument of the Report assumes, a material amount of Revenue would probably be derived from the neglect of taxpayers to apply for refunds which they know are obtainable on application, how much greater effect upon the Revenue, but in the adverse sense, probably arises under the present system from the neglect of taxpayers or those who should be taxpayers, and who are not now reached through Information at the Source.

16. (1) **Taxation of all Company Profits in the hands of shareholders, whether the Profits are distributed or not.**—We are all agreed that the primary scheme of the Commonwealth Income Tax Assessment Act is to tax individuals at the rate appropriate to their taxable income. The provisions with regard to the taxation of a Company's undistributed profits in the hands of the Company constitute an important and undesirable departure from this main principle. This not only leads to a number of complications which cause confusion, expense and irritation, but also creates opportunities, particularly in respect of Proprietary Companies, for certain forms of abuse. In our opinion, this intrusive element could with great and permanent advantage be removed by full recognition of the principle of individual taxation. This could be effected by treating the whole of the disclosed profits of a Company at the end of each accounting period as if they had been distributed to the shareholders, according to their class, preferred, ordinary, deferred, &c., and as taxable in their hands. This is now the case with regard to the disclosed profits of a Partnership, and there is no logical reason why the same principle should not govern the taxation of Company profits. In the one case as in the other the proportion of profits distributed, as well as the application and use of the proportion not distributed, is determined by the persons who hold the beneficial interest, and with a view to their own gain, immediate or prospective. Under this method the function of a Company as taxpayer would be extended (but only as an intermediary, an agent for the shareholders) to pay tax, at a rate to be fixed, upon the whole of the profits, distributed or undistributed. Each shareholder would be regarded as having received a proportion of the total profits corresponding with his individual interest therein, but would be entitled to rebate or refund, if the rate of tax payable upon his total taxable income, including his share of the Company profits, were less than the rate paid by the Company on his behalf. Similarly, if the operations of a Company in any year result in a loss, such loss would for purposes of taxation be apportioned among the shareholders in the proportion to their interests, having regard to the class of shares held, and be treated correspondingly in the shareholders' individual returns. The advantages of this change may be summarized thus :—

1. That it would produce a more perfect compliance with the main scheme of the Act.
2. That it would effect a great simplification.
3. That it would place shareholders in Companies in respect of the profits or losses of the undertaking on the same footing as members of a partnership, thus introducing uniformity of treatment which is now absent.
4. That it would provide a safeguard for the danger to the Revenue pointed out in paragraphs 139 and 140 of the Commission's First Report. Those paragraphs deal with the case of bonus shares issued in respect of profits of the current year. The danger in question where shares are issued in that way, is that, if bonus shares be treated as capital, neither the Company nor the shareholder would be liable to taxation in respect of those shares.
5. That it would prevent the occurrence of the difficulty indicated in paragraph 293 of the Report.

(2) If under this method a Company furnished each shareholder with a slip showing the total amount of the profits of the year and his share of those profits, also the amount actually distributed, the shareholder would be in possession of all the necessary facts, both with regard to his relations with the Company and his relations with the Taxing authorities.

(3) If the method indicated in this paragraph be not adopted, we do not think the general question of Taxation at the Source treated in this reservation should be regarded as thereby prejudiced.

17. The method suggested in the preceding paragraph is criticised in the Report on the grounds—

1. That it would mean that shareholders would be required to pay tax upon profits which are not received and may never be received by them, except in the remote contingency of the winding up of the Company, or indirectly through a more or less appreciable addition to the market value of their shares.
2. That it would tend to the distribution of too large a proportion of Companies' profits rather than the provision of means of development and financial stability by building up reserves.

As to the first ground, it is correct that shareholders, if treated, as they would be under this method, in the same way as members of a partnership, would still continue the practice of investing some of the profits in machinery, plant, &c., or in some other way connected with the business, with the result that those profits would reach the hands of the shareholders only in the form of future profits. This is a common incident of business, and in our opinion does not affect the validity of the method

we suggest. With regard to the second objection, that the introduction of the proposed method would weaken the prudent management of their affairs by Company Directors, it may be sufficient to say that, not only with regard to Companies, but also with regard to businesses, whether individual or partnerships, there must be a continual weighing of the respective advantages of distribution of the profits earned as against reinvestment in the business. We do not share the view that business men would cease to be guided by prudential considerations.

**18. Extension of Taxation at the Source to Incomes other than Company Dividends.—**

Paragraph of the Report shows the wide range of incomes to which the method of Taxation at the Source is applied in Great Britain. During our inquiry witnesses (perhaps because of their familiarity with the State methods, which deal only with Company dividends) rarely made any suggestions in respect of extension of the method of Collection at the Source to such sources of income as—

Interest, either on Government Securities or Securities of local authorities ;

Interest from deposits with Financial Institutions ;

Interest from Mortgages or other forms of security upon real property ; also

Salaries of officers of Public Departments and of all large organizations, public or private.

19. In principle, the method of Taxation at the Source, in respect of those sources of income is entirely equitable, and in a large majority of cases would be convenient to, and would greatly reduce the actual pressure of the tax upon, the individual, as deductions would be made from periodical payments, and no positive outgoing of a direct kind would be demanded from the taxpayer. The question of raising tax by this method upon Company dividends is, however, the one which is most prominent in the public consideration of the question, and, in our opinion, it is desirable that the method should first be applied to that class of income. It may soon be found possible, as we think it is desirable, to extend it to some at least of the several other sources of income so taxed under the British system.

**20. Conclusions.**—On the broad general question of the substitution of the method of Taxation at the Source for the individualistic system now mainly in force in the Commonwealth, we are satisfied that the system of Taxation at the Source possesses advantages which justify its adoption. We are also of opinion that, as shown above, the total profits of a Company, whether distributed or not, should be deemed to have been received by the shareholders in proportion to their individual holdings, and consequently to be taxable in the hands of the shareholders. Losses should be treated similarly. This proposal would eliminate the Company as ultimate taxpayer in respect of any of its profits, even those which are never distributed, and would substitute the constituent shareholders. For reasons already indicated, we are unable to recommend the system of Company Taxation now in operation in the Australian States, as we consider it inequitable. That system penalizes shareholders whose incomes are small, and provides bonuses for those whose incomes are large. On the question of removing the injustice now done to taxpayers under the Commonwealth Act, where dividends are derived from "undistributed profits," we repeat our opinion that the Act should be amended to insure that no shareholder shall be called upon to pay tax on account of dividends, however derived, at a rate higher than that applicable to his individual income. With respect to the further question as to whether refunds in respect of tax overpaid upon dividends derived from undistributed profits should be made to the Company or to the individual, we favour dealing directly with the individual concerned.

**21. Extent of Concurrence with Recommendations of the Report.**—With regard to Recommendation (1) of the Report, our position is—

- (a) We dissent from that portion of the Recommendation reading "that the profits of Companies be taxed in accordance with the existing law."
- (b) If our own Recommendation "B" be adopted, Section 16 (2A) of the Income Tax Assessment Act will become unnecessary, and consequently the amendment of that sub-section suggested in the second clause of Recommendation 1 would also be unnecessary.
- (c) If our Recommendation "B" be not adopted, we wish to be understood as concurring in the proposed amendment to Section 16 (2A).

We concur in Recommendations 2 and 3 of the Report (but see parenthesis following Recommendation B).

## RECOMMENDATIONS.

We recommend—

- A.—That the method of Taxation at the Source be applied to Companies—*i.e.*, that Income Tax at a uniform rate be collected from Companies in respect of the whole of their net profits, whether distributed to shareholders or otherwise dealt with, and that shareholders, whether taxpayers or not, be entitled to rebate or refund (as the case requires) of the sum paid in Income Tax by the Company proportionate to the interest of such shareholders in the whole of the net taxable profits of the Company.
- B.—That each shareholder in a Company be regarded for taxation purposes as having received a proportion of the total disclosed profits of the Company, whether distributed or otherwise dealt with, corresponding with his individual holding; that he be required to show such proportion of the total profits in his return of income; and that, subject to any allowable deductions, he be taxed upon such proportion of the total profits, as forming part of his taxable income, and that from the tax thus ascertained there be deducted a sum having the same proportion to the tax already paid by the Company as his share of the profits bears to the total profits of the Company. (It will be seen above that we concur in the Recommendations of the Report the intention of which is to insure that no shareholder shall be called upon to pay tax on account of **dividends**, however derived, at a rate higher than that applicable to his individual income. If our Recommendation "B" be adopted, the same principle would of course apply to taxation of the shareholder on account of Company **profits**, whether actually distributed or not. In that case Section 16 (2) of the Act and the amendment of that Sub-section proposed in Recommendation No. 2 of the Report would become unnecessary.)

JOHN JOLLY.

W. T. MISSINGHAM.

S. MILLS.

## DIFFERENTIATION.

## RESERVATION.

1. I am not able to accept the arguments, the conclusions, or the recommendations contained in the Report of the Commission on this subject, and respectfully submit my reasons :—

2. **Definition.**—Unless the context implies another meaning, the term differentiation is used throughout this reservation to express the discrimination which is made (not in the income tax law only but) in any part of the system of taxation as between incomes that are earned by the personal exertion of the taxpayer and incomes that are not so earned.

3. **The Differentiation Recommended.**—The differentiation proposed in the Report is arbitrary, erratic, and inequitable, and would in practice be troublesome and perplexing. Why the rate should be 15 per cent., and not 10 per cent. or 20 per cent. or any other rate, is not disclosed; the rate is quite unsupported by any logical reasons, is purely arbitrary, with equal arbitrariness it erratically disappears, and throughout its career it is inequitable.

4. In the Recommendation (and elsewhere) the word “income” is used ambiguously. It is not clear whether the percentage proposed is to be based on the total income (the impression which paragraph 318 creates) or on the net income after deducting the general exemption and other concessional allowances (the impression which paragraph 319 leaves). The former paragraph indicates, however, that the procedure of the British Act is favoured, which deducts allowances in respect of dependants, insurance premiums, and other concessional allowances from the net income, and confines the percentage deduction to the net assessable balance. The typical wage-earner, married and with three dependants, who reads paragraph 318 “an income of £300 reduced by 15 per cent. amounts to £225” and expects that, under this scheme, £45 would be exempted from tax, will be disappointed to learn that it will exempt in his case £13 only. If the percentage, whatever be the rate, be taken off the net income before concessional allowances are deducted, the scheme still operates inequitably.

5. The closing sentence of paragraph 318 exposes the inequitable operation of such a continuing scheme in that as income increases, the differentiation increases both in absolute and in relative value, but the table in paragraph 319 shows that precisely the same effect is inseparable from the method proposed in the Report until a partial counteractive is introduced. To correct this and infuse some colour of equity a sliding scale is proposed at £1,500 which introduces added complexity into an Act already complex enough, and will, when all is done, be remedial in only a very small percentage of cases. The inequitable influence of the scheme will be felt without any mitigation right up to incomes of £1,500, and seeing incomes under £1,500 number more than 97 per cent. of all the taxable incomes in the Commonwealth, the mischief is widespread, almost universal. The attempt to modify gradually its operation in regard to four-fifths of the remaining 3 per cent. and to exclude it from operating on the remaining  $\frac{1}{5}$  per cent., implies condemnation. In paragraph 316 of the Report it is written :—“In our view the carrying forward of differential effects throughout all ranges of income is not in harmony with the principles upon which differentiation is based.” What then can be said in defence of a scheme which carries forward these differential effects into 99 $\frac{1}{5}$  per cent. of all incomes and leaves only one half per cent. untouched by it?

6. **Relation to System of Taxation.**—In any Taxing Act regard should be had not only to the effect of other provisions in the Act itself, but also to the operation of all the Acts which with it compose the system of taxation. This principle is recognised and applied in practically every country. If the subject of taxation is already struck by some other Act that fact must be duly weighed and its effect taken into account when considering with what force or whether at all it should again be struck by another Act. As specific instances, the income from land subjected to State land tax was by the New South Wales Act exempted from assessment for income tax, and a similar rule, though of more limited application, operates in Victoria. The brief survey of European taxing systems contained in the Commission's Report indicates that in all continental countries the incidence of an income tax is adjusted to the conditions created by other—land, property, capital, inheritance, industry, &c.—taxes.

7. The operation of estate or probate duties cannot correctly be described as “generally undesigned, remote, uncertain, and little understood” in their differential effects on income tax (par. 314 of Report). Every student of taxation knows them well. Nor could it be otherwise

for the object in view is the establishment of a sound and equitable *system* of taxation, to which end the several parts must co-ordinate. Each must conform to the general canons that govern the tax system, and should be adjusted to the other component parts with which it has to make a harmonious whole. No single tax can be rightly appreciated without reference to the financial system of which it forms a part. I must, therefore, dissociate myself from the decision expressed in the Commission's Report (par. 314)—

“ We do not accept the contention that estate duties can properly be regarded as effecting a real differentiation of income tax.”

Nor do I feel myself isolated in doing so.

**8. Opinions of Recognised Authorities.**—In a lengthy discussion of the justification for, and the operation of, inheritance taxes which is described by Professor Plehn, of the University of California, as “ the best discussion of this interesting field of taxation,” Professor Seligman, in his “ Essays in Taxation,” writes :—

“ When, therefore, we have a system of income taxes, the inheritance tax may be regarded as a supplementary tax to reach the real ability of the individual. Moreover, *it may be regarded as a convenient method of applying the principle of differentiation in taxation of income.* It is now commonly recognised that incomes from property should pay a higher rate than incomes from labour. Instead of making a difference in the rates to reach this end, the proportional income tax may be supplemented by a property tax ; or where this is for any reason undesirable, by the inheritance tax. The latter would then serve the double purpose of reaching not only accidental incomes, but also property incomes, since all inheritances take the shape of property.” . . . . . “ *For in so far as property is at all an adequate test of faculty in taxation, it is simply a mode of estimating the regular revenue or income.*”

9. Lord Milner, giving evidence before a Parliamentary Commission, said :—

“ I regard the death duties as *equivalent to an extra income tax on property.*”

10. Professor Bastable, in his work on “ Public Finance,” writes :—

“ Assuming that we have a rule of distribution, the burden of succession duties should be so adjusted as, together with other taxes, to secure its observance. From this point of view the chief difficulty with the succession duties is their necessarily irregular levy. Human life is uncertain in its duration, and, as Gladstone once asserted with his wonted impressiveness, ‘ no man can die more than once.’ Taking the average, however, we find that a fairly constant proportion of property passes annually by death, and *we are thus led to regard the death duties as a capitalized income tax levied only on accumulated wealth, and sparing those comparatively temporary parts of income that result from personal exertion.*”

and adds a footnote :—

“ The system of insurance so extensively advertised by British insurance companies to meet the estate duty of 1894 [the year when estate duty was first introduced into the British system] indicates very plainly that this is the essential character of the tax. This view is adversely criticised by Seligman (Essays, 132), on the grounds that (a) if the existing system (*i.e.*, without the inheritance tax) does reach the living taxpayer, there is the injustice of double taxation ; (b) if it does not reach him, there is inequality between persons dying at different ages. To which it may be rejoined that (a) it is because the existing system only partially reaches the taxpayer that the inheritance tax is introduced ; and (b) that there is inequality in the case of persons dying at different ages, but this, like other inequalities, is hardly avoidable without incurring greater evils.”

Summing up a long and incisive discussion of the question, Professor Bastable concludes with the paragraph (“ Public Finance,” page 608)—

“ *On the whole, we may best regard the succession duties as presenting a parallel to the income tax. The latter withdraws annually for the service of the State a portion of the new wealth created in the period : the former operate in the same way, but at uncertain intervals, on the collective wealth of the society.*”

11. The Report in paragraph 311 includes a quotation from an article published in 1919 by Sir Josiah C. Stamp, inserted as expressing his disagreement with the view that death duties should be regarded as an added income tax. Had a more complete extract been inserted it would have been evident that what Sir Josiah is combating is not that death duties should be regarded as an added income tax, but that the particular argument he was discussing was inconclusive because there are a few incomes from property which death duties do not reach. The writer continues, in the same paragraph and immediately following the extract printed in the Report—

“A sufficient reason exists for the differentiation between an income which is earned and one which is being derived *from a life interest in property*. The death duties cannot effect *this* distinction, for they affect neither recipient.”

His argument, not disjointed, but read as a whole, is a declaration of the close connexion between income tax and the death duties—close, but not quite universal, because there are a few incomes from property which death duties do not reach. A defender of the British system of treating both classes of income alike, he writes in the same article—

“In treating them [earned and unearned incomes] as equal in power [to pay income tax] there is a rough correspondence with the facts of life, for the recipients rarely make nice actuarial calculations or introduce differences into their mode of life and scale of expenditure to correspond with the differences in their capital position.”

and he adds—

“If we adopt the fashionable mode of treating the death duty as one which can reasonably be regarded as provided for annually out of income by insurance, then of course it is but an extension of the income tax, and can be made progressive on the same lines of reasoning.”

12. In 1906 a Special Committee of the House of Commons was appointed to report upon “the practicability of graduating and of differentiating for purposes of the income tax”—a small field which the members were able to examine microscopically. In dealing with the bearing which the incidence of the death duties has upon the graduation and differentiation of the income tax they report—

“The death duties have always been regarded as partaking to some extent of the nature of deferred income tax, and it has been contended that the combined operation of the two taxes does in practice effect a very considerable graduation and differentiation. Sir Henry Primrose and Mr. Mallett submitted to us various calculations which will be found in the appendix, the object of which is to show what rates of income tax are represented by death duties, or, in other words, what rate of income tax paid annually during life on the income from the property would be equivalent to the death duties paid on that property.”

And after a synopsis of the principal evidence tendered, the Committee added—

“These conclusions clearly show that if the income tax and the death duties be regarded together as a form of income tax, there is *already a very substantial graduation of taxation on incomes derived from large estates, and differentiation between large incomes derived from personal exertion and those derived from inherited property.*”

13. A separate report drafted by the Chairman of the Committee (Sir Charles Dilke) concluded with this paragraph :—

“A Chancellor of the Exchequer, in considering differentiation, cannot exclude graduation from his view, and *cannot confine his attention, as we have been asked to do, to a single tax.* Your Committee have felt throughout their investigation that while the terms of reference direct them to deal only with the income tax, *our system of taxation must always be treated as a whole, and defects, obvious if the income tax is looked at by itself, lose much of their importance when viewed in connexion with the compensatory effects of other taxes.*”

14. The weighty judgments of these and many other authorities on taxation, and the general consensus of educated thought on the subject, compel me to dissent from the opinion expressed by my colleagues in paragraph 314 that the operation of the estate or probate duties has “a generally undesigned, remote, uncertain, and little understood differential effect upon income tax.” The operation is powerful, intimate, and well understood by students of taxation. That the general public do not fully appreciate the influence of these duties does not justify an ignoring of its existence or release investigators from the responsibility of endeavouring to accurately measure its weight.

15. The divorce between Commonwealth estate duties and income tax referred to in paragraph 314 of the Report need not be taken too seriously; the bonds of wedlock which unite them are strong, and they should remain united till the death of one or the other parts them.

16. The claim (made in the same paragraph) that "the wastage of the human machine can be adequately recognised in taxation by means of differentiation in the income tax" is novel in conception but destitute of proof. Can any degree of differentiation be "adequate recognition of the wastage of the human machine" which affects impartially rich and poor? When and where has "wastage of the human machine" become one of the recognised allowances under an income tax Act which concerns itself with wealth and has been stoically indifferent to health?

17. **Measure of Differentiation.**—That differentiation exists between incomes earned by the mental and physical powers of an individual, and therefore precarious, and incomes not depending for their continuance upon personal exertion and usually therefore more permanent in their nature, evokes general consent, and is unanimously concurred in by your Commissioners. One turns in vain, however, to the Report for any principle or for guidance to determine what is the degree of differentiation between them. The Report may be searched fruitlessly for an answer or for any rationally stated and accepted principle by which to determine the degree which is both adequate and equitable—a rational principle is referred to in the Report but it is not accepted. There is no statement in the Report of "the principles on which differentiation is based," and no reasoned attempt to discover criteria or devise a method by which to measure and determine the degree, uniform or variable, by which the one class of income should be differentiated from the other. A matter of this kind cannot be determined by a random shot or "a splitting of the difference" between those who without assignable reasons advocate a high degree or favour a low degree of differentiation.

18. I respectfully submit that in determining the degree of differentiation to be allowed in an income tax act—

1. Regard must be had to the operation of death duties—under whatever name—Probate, Estate, Legacy, Succession, Inheritance, &c.—they are known, and other taxes on capital;
2. That a reasonably accurate valuation of the differentiation created by these taxes can be and should be made in order that the effect may be studied in its incidence on Incomes; and
3. That seeing the object is to express differentiation in terms of tax, a systematic attempt should be made to appraise in terms of money and tax the difference in value to their recipients of the one as compared with the other class of income.

19. **Estate Duty considered as Deferred Income Tax.**—The reference by Professor Bastable (paragraph 10) to the system of insurance to meet the Estate Duty suggests that one method of estimating the yearly burden of the duty is to assume that the holder insures against the payment at his death. The annual premium paid for this provision will be some approach to the measure of the yearly burden cast by Federal estate duties. Viewed from the stand-point of the State as a tax-gatherer, it is immaterial to the Treasury whether the revenue reaches it in the vesture of Death Duties or arrayed as Income Tax. One is less regular, but both are equally serviceable. There is little difficulty in expressing one in terms of the other. Calculations have accordingly been made, and are tabulated on Schedule No. 1, which follows. The annual income (column B) is throughout assumed to be 5 per cent. of the capital value of the estate (column A). In column C is shown the Income Tax payable on such an income from personal exertion under the current scale of the Federal Act, and in column G the percentage which the tax bears to the income. In column D are shown the rate and the amount of Federal Estate Duty payable on such an estate under the scale at present in force. To provide a sum sufficient for the Estate Duty payable at his death, the holder, who is assumed to have himself succeeded to the Estate when about 30 years of age, may insure his life under a non-participating policy at an annual premium of about £2 2s. 9d. per £100. In column E is shown the annual premium at that rate payable to secure payment at death of the duty named in column D. In column F is shown the total amount payable for both income tax (at personal exertion rate) and premium, together constituting the total annual provision made for duty and tax, and in column H the percentage which the total amount (F) bears to the income (B). In column I the ratio of the total tax (F) to the tax on personal exertion income (C) is shown.

## SCHEDULE NO. 1.

## FEDERAL ESTATE DUTY CONVERTED INTO ITS EQUIVALENT IN DEFERRED INCOME TAX.

(Assuming the Estate to pass undivided to a single inheritor.)

A. Value of Estate just over—	B. Assumed Income at 5 per cent. of Value of Estate.	C. Federal Income Tax on Income at P.E. Rate.	D. Federal Estate Duty.		E. Annual Premium at £2 2s. 9d. per cent. on amount of Duty D.	F. Total of Tax C plus Premium E.	G. Percentage which Income Tax at P.E. Rate C bears to Income B.	H. Percentage which Tax plus Premium F bears to Income B.	I. Multiple which B is to G, that is, if Income Tax C be normal and valued at 100, Value of total Tax F is as follows :—
			Rate in Shillings per £100.	Amount.					
£	£	£ s. d.	s. d.	£	£ s. d.	£ s. d.	%	%	
3,000	150	1 7 6	28 0	42	0 17 11	2 5 5	·9066	1·5125	165
5,000	250	4 14 1	36 0	90	1 18 5	6 12 6	1·881	2·65	141
8,000	400	11 2 8	48 0	192	4 2 0	15 4 8	2·783	3·808	137
10,000	500	16 7 7	56 0	280	5 19 8	22 7 3	3·275	4·4725	137
15,000	750	30 19 10	76 0	570	12 3 8	43 3 6	4·133	5·758	139
20,000	1,000	47 19 9	96 0	960	20 10 4	68 10 1	4·8	6·85	143
30,000	1,500	91 19 7	136 0	2,040	43 12 1	135 11 8	6·2	9·037	147
40,000	2,000	149 5 11	176 0	3,520	75 4 10	224 10 9	7·462	11·205	150
50,000	2,500	219 18 11	216 0	5,400	115 8 6	335 7 5	8·796	13·4166	152
60,000	3,000	303 18 6	256 0	7,680	164 3 2	468 1 8	10·129	15·604	154
80,000	4,000	511 17 6	300 0	12,000	256 10 0	768 7 6	12·796	19·225	150
100,000	5,000	773 2 10	300 0	15,000	320 12 6	1,093 15 4	15·462	21·367	141

20. In this table the rate of the total annual tax on property income—based on the current rates of Estate Duty and of tax (in all cases) on incomes from personal exertion—ranges from 37 to 65 per cent. in excess of the tax alone on incomes from personal exertion.

21. This method of valuation, which assumes the Estate Duty to be a *deferred* payment, under-states, in some cases seriously, the burden of the tax, as will be shown in the later part of this reservation.

22. **Appropriate Degree of Differentiation.**—Do these rates represent a sufficient or an excessive rate of differentiation. There are incomes from investments which are far from being permanent, there are incomes from personal exertion which are less precarious than some derived from investments, and there are business incomes in which the two characters (personal effort and investment) blend in every variety of proportion. Each contains elements which cannot be measured, investments are lost, health and employment are uncertain, remuneration of both labour and capital is variable; but generally the attribute of permanence is considered to attach to the one, and comparative precariousness to the other. A clean line of cleavage between the two is not followed, but probably this constitutes the main, if not the only, distinction, generally observed.

23. From the Commonwealth Bureau of Statistics was received evidence that at 21 years of age the average expectation of the life of males is 43·902 years, and that—

“the Census returns for 1911 (the latest then available) show that the number of those who drop out of income earners before the age of 65 years (for reasons other than death) is comparatively small.”

In the eight years immediately preceding the War (1906-1913) the average percentage of unemployment from all causes was 5·6 per cent., of which approximately 1 per cent. was due to sickness and the balance to lack of work. These figures do not include persons out of work through strikes or lock-outs.

We are not in this inquiry concerned with persons whose incomes do not reach the amount of the general and other exemptions—

Single persons earning not more than . . . . . £104,  
 Married persons without dependants earning not more than £156,  
 Married persons with three dependants . . . . . £234,

are not liable to Federal Income Tax, and any question of differentiation can apply only to persons earning incomes in excess of these exempt sums.

Without adopting the extreme limits of these official figures, it may be accepted that the full earning period of the average worker extends from the twentieth to beyond the sixtieth year—fully forty years—during which he should be able under reasonable conditions—and such conditions are assured for the humblest worker by the industrial laws which operate in every State of the Commonwealth—to save sufficient to enable himself and his wife to enjoy in their later years without physical effort the same standard of living as was enjoyed during the forty years

of active earning. To determine the appropriate degree of differentiation necessary as between funded and industrial incomes there emerges the question—What sum must be set aside from the income of the earning period to provide an old-age pension fund for the worker and his wife? During the years of bachelorhood and while the family is small, the requirements will be less than in later years, and as the children grow up and become self-supporting the necessary outlay will diminish, but, averaging throughout the forty years of industrial efficiency, making allowance for the average idleness through sickness or lack of employment, and assuming money to accumulate at the rate of 5 per cent. per annum, the margin of saving necessary may be ascertained thus :—

24. A unit saved with annual increments of a similar unit will with interest at 5 per cent. per annum, amount in forty years to 120·79977 units. In their sixtieth year there will be a fund of 120·79977 units, with which can be purchased an annuity payable during the lifetime of both or either (that is, until the death of the survivor) of  $\frac{120\cdot79977}{11\cdot852} = 10\cdot1923$  units.

The operations, as they relate to persons whose income brings them within the taxable area, may be illustrated thus :—

A. Average annual income from personal exertion during active years—after making allowance for sickness, lack of employment, &c. . .	£200	£500	£1,000
B. Annual amount (9 per cent.) saved from income to establish annuity fund . . . . .	18	45	90
C. Available for immediate use . . . . .	182	455	910
D. Fund which will in 40 years be established by accumulation of savings (B), with interest at 5 per cent. . . . .	2174·38	5435·99	10871·98
E. Annuity purchaseable therewith payable during life to both (or the survivor of two) persons each aged 60 years . . . . .	£183·5	£485·65	£917·31

Thus the heads of a household of average numbers could during the 40 years of active life from 20 to 60 years of age make, under average conditions, suitable provision for old age, and secure a permanent and assured income for the remainder of their lives, however much their days be prolonged, if they set aside rather less than 9 per cent. of their average net annual income. An income averaging £500 per annum from personal exertion will enable the owner to make during the earning period adequate provision and secure for the whole of his life and that of his wife, if she survive him, a standard of living equal to that of a person receiving a permanent and assured income of £455 from the produce of property.

If it be contended that this involves ideal prudence under ideal conditions, it may be replied that the conditions are **average** conditions, the basis is the **average** net annual income, after allowing for sickness and lack of employment, and that it applies only to persons who have a taxable surplus, which predicates a margin for saving. The ideal prudence in this case is no greater than the ideal self-restraint and prudence of the other, who, it is assumed, neither loses in speculation or by depreciation of values nor spends in indulgence any of his capital fund. But it may be contended that this applies only if the earner reach the retiring age and that if death take place in the earlier years the provision for his dependants being the accumulations of savings to date only would be small.

25. Substantial provision may be made for the widow and children in event of the husband's death before the retiring age if the question be approached in another way: the two following are based upon the table of rates issued by a leading Australian Life Assurance Association :—

- (1) A participating endowment assurance policy payable at 60 years of age or at death if that take place previously, the accumulated amount of which at the retiring age will suffice with reversionary bonuses to purchase annuities in favour of husband and wife yielding during their joint lives the same average income as they were able to spend during the earning years, and in the event of the husband's earlier death a sum which would vary from rather more than half that amount in the first year of cover, and approach the full amount as the retiring age is approached—such endowment assurance policy could be purchased at a premium

equivalent to about 13 per cent. of his average annual income during the earning period. For example, taking the same three cases as before, the protection afforded is briefly—

A. Average annual income from personal exertion during active years—after making allowance for sickness, lack of employment, &c. . . . .	£200	£500	£1,000
F. Annual premium at 13 per cent. of income, saved to purchase an endowment policy as under . . . . .	26	65	130
G. Available for immediate use . . . . .	174	435	870
H. (a) If the assured die in the first year the policy assures immediate payment of . .	1,023	2,558	5,116
(b) The amount payable will by reversionary bonus additions increase yearly during the life of the assured till at the retiring age (60 years) it will be . .	2,013	5,032	10,065
J. There may then with this fund be purchased two annuities in favour of husband and wife respectively, each aged 60 years, and yielding during their joint lives . .	£174	£436	£872

which is almost exactly equal to the average spending capacity (G) during the earning years.

- (2) If the income earning period be taken to end at 65 years of age the benefits are less costly and the annual premium smaller. Instead of 13 per cent. as in the above example a premium equal to less than 10 per cent.—a shade over  $9\frac{1}{2}$  per cent.—of the average income will suffice. The figures are:—

A. Average annual income from personal exertion during active years—after making allowance for sickness, lack of employment, &c. . . . .	£200	£500	£1,000
K. Annual premium at $9\frac{1}{2}$ per cent. of income, saved to purchase an endowment policy as under . . . . .	19	47·5	95
L. Available for immediate use . . . . .	181	452·5	905
M. (a) If the assured die in the first year the policy assures immediate payment of . .	815	2,038	4,076
(b) The amount payable will by reversionary bonus additions increase yearly during the life of the assured till at the retiring age (65 years) it will be . .	1,748	4,370	8,740
N. There may then with this fund be purchased two annuities in favour of husband and wife respectively, each aged 65 years, and yielding during their joint lives . .	£180	£449	£898

NOTE.—The provision in J. and N. is such that the survivor of the two annuitants will receive half the amounts respectively indicated after the failure of the first life.

26. These figures are not submitted as the basis of a scheme of national insurance but as a means of measuring with reasonable approximation the degree of differentiation which in practice may be regarded to exist between earned and unearned incomes. To the young householder on the threshold of life they may look like counsels of perfection but they serve their present purpose if falling short of conclusive proof they indicate with some approach to accuracy the average degree of differentiation. It does not exceed 13 per cent. and is probably nearer 9 per cent. which is indeed almost exactly the degree (10 per cent.) recommended by the British Commission of 1920. Neither your Commissioners nor the members of the British Commission have produced any argument to impugn this or to support any other degree as a more accurate measure.

27. **Examination of Operation of Estate Duties.**—But this makes no allowance for the encroachment on the income from property in consequence of the Estate Duty, as set out in Schedule No. 1, and being part of the general system of taxation it should not be ignored. Inherited property taxed under the Estate Duty has already in all cases paid duty to an amount far in excess of the 9 and 13 per cent., as the figures in Schedule No. 1 establish. Very small estates need not be considered, for the incomes from them standing alone are not taxable. On estates the annual income from which is above the point of general exemption from Income Tax, the total tax paid by the income from property is in excess of that paid by incomes from personal exertion by from 37 to 65 per cent. The degrees of differentiation established by the Estate Duty are already—without any differentiation in the Income Tax Act—considerably over 9 and 13 per cent.

28. **Life Interests.**—There are some cases of incomes from property which have not been submitted to Estate Duty, such as the life interest mentioned by Sir Josiah Stamp and referred to in paragraph 11 of this Reservation, but they are so few in number and small in value that the expense of segregating and specially taxing them would probably not be warranted—but, if it were deemed expedient, they could be dealt with as exceptional cases, just as other sources of income are by necessity treated specially under the present Act.

29. **Taxation of Property Acquired by the Taxpayer.**—A larger and much more important source of income which has not paid Estate Duty is that derived by taxpayers from the investment of their own savings, and, with regard to these, I agree with, and cannot do better than repeat, the views of a former Chairman of the British Board of Inland Revenue :—

“ The effect of a variation of the Income Tax would not be quite the same thing as an increase in the Death Duties. For it would impose a special tax on savings while still in the hands of the person who made the savings, whereas the Death Duties defer any special taxation (other than such as arises under the Stamp Duties) until the savings pass to some one other than the saver. Whether savings should be specially taxed in the hands of the saver hardly falls within the region of a discussion relating solely to practicability. But here, practicability and expedience are so difficult to separate that it may be legitimate to ask why income that results from the double effort of earning and saving should be regarded as deserving of more onerous treatment than income resulting from the single effort of earning. It would surely be very inconsistent if the State, after encouraging savings by means of Post Office and other Savings Banks, were to penalize the income derived from such savings. . . . The principle is the same in whatever class and to whatever amount savings may be made, so long as they result, not from the operation of unequal laws, but from the successful utilization of equal opportunity open to all, and from the exercise of foresight and prudence.”

30. Some other incomes are now derived from properties which, though inherited, have not paid Federal Estate Duty, because when these properties passed into the present holders' hands there was no Estate Duty Act in force. Under the law property and all the rights appertaining to it passed without interference—so far as the Federal Authorities were concerned—to the inheritor, and, the law as it stood having been complied with, he should be established in the same full enjoyment as his predecessor in title. The Income Tax Act should not be used as a means of imposing a retrospective Estate Duty prior to the date when these duties came into force. These properties, subject in all respects to the law as it stood at the time of transmission, should be regarded as in the same category as properties which under the law as subsequently altered have likewise complied with the law as it stands and borne Estate Duty. If in more affluent days the Estate Duties, which now reach 15 per cent., be reduced by, say, a third, and range to 10 per cent., will any privileges or exemptions from Income Tax be allowed to those inheritors whose estates paid toll at the higher rate? To any such proposal reply would be—Duty was collected at the rates current at the time of transmission, and no allowance can be made in respect of a subsequent reduction. The same attitude should be taken towards estates which passed from the dead to the living prior to 21st December, 1914. Since that date all estates exceeding £1,000 in value come under the Federal Estate Duties Act.

31. While, therefore, I am of opinion that the principle of differentiation is one which should be retained in the system of taxation, I am also of opinion that differentiation in favour of income from personal exertion and against income from property should **not** be retained in the Income Tax Act.

32. **Objections.**—An attempt is made in paragraph 310 of the Report to depict the modest income-earner toiling and moiling for 40 years to secure an annuity for fourteen or eleven years. This is over-drawn—the object attainable is an annuity fixed in amount and certain in payment from the sixtieth year throughout the whole period of life, however extended. The comparison is distorted in the same paragraph by assuming that the property-owner dies within a few months of entering into enjoyment and taking out a policy of insurance. “The property-owner, by setting aside 2.1 per cent. for possibly one year only,” &c. If this should happen, all that need be said is that he made an excellent bargain with the Underwriters, and it may also be said with equal confidence that, if this were a common experience, the Underwriters would soon refuse business of this kind. That they continue in the business and make profits from it shows such premature collapse to be extremely unlikely—so unlikely that experienced actuaries are prepared to accept a premium of £2 2s. 9d. as covering the risk of having to pay £100 before another premium falls due. But even this extreme case tells against the imposing of differentiation in the Income Tax Act, for whereas in Schedule No. 1 it is assumed that the Estate Duty is payable once in thirty years, in this case Estate Duty would be payable twice in two years, and the percentage of excess as between Duty plus Income Tax on the income from property and the tax on income from personal exertion is much greater than the figures of the Schedule. If such an experience were frequent, the argument against Differentiation in the Income Tax Act in favour of earned incomes becomes still stronger.

33. **Estate Duty considered as Anticipated Income Tax.**—Against regarding Estate Duty as a deferred Income Tax it is pleaded (paragraph 312) that “the person who provides the annual insurance payments can never be the actual payor of the Estate Duty.” Death relieves him of that worry, but he is not while alive relieved of the desire to leave to his children a capital estate, equal in value to the estate inherited by himself. It is not material, from the revenue point of view, however, who pays the duty, so long as it is paid by some one, but this objection raises the question of incidence. By whom are the death duties paid? and an even stronger case presents itself when, instead of treating the Estate Duty as *deferred* Income Tax (which, as mentioned in paragraph 21 of this reservation, under-states, in many cases seriously, the burden of the tax), it is treated as an *anticipated* or *commuted* Income Tax. In this reservation the weaker case (itself strong enough to show that there is no need for differentiation in an income tax in favour of income from personal exertion) is purposely stated first as paving the way for the stronger arguments which follow, when the Estate Duty is treated—and this is the more correct course—as *commuted* Income Tax.

34. In the Report which he made to the Special Committee of 1906 (referred to in paragraph 12 hereof), Sir Henry Primrose wrote:—

“For the purpose of the calculation of the annual tax on property which would be equivalent to the present occasional taxes on transmission of property at death, it is desirable as a preliminary step to endeavour to determine the incidence of this tax. The Estate Duty has sometimes been regarded as a deferred Income Tax on the holder of property, payable at death, but this description, intelligible enough in the earlier years of the tax, while yet it has failed to touch the majority of existing estates, appears to the Board of Inland Revenue to give but a very imperfect view of the burden of the tax when its operation has been fully developed. The full measure of the tax can only be fully appreciated by looking at its effect on the person who succeeds to property on which Estate Duty has been paid. What the State does is at recurrent intervals to cut a slice out of the capital value of realized property. It is therefore in its essence a tax upon persons who inherit, inasmuch as it diminishes the value of their inheritance by the share which the State takes for itself, as a condition of permitting the transmission of inheritance. The share of the State, like any other share, might be in the form of a capital sum or of an annuity. Under the present law it takes the form of a capital sum, and what we want to ascertain is the annuity which would correspond to the capital sum in each case. If the capital sum were levied once only for all time the burden on the Estate would be represented by a perpetual annuity corresponding to the slice taken out of the estate.”

35. Let us interrupt to illustrate this by means of examples dealing with estates of moderate size, in which the rates prevailing in the Commonwealth are used. A very small estate is not shown, because, while it may be liable to Estate Duty, there may be no Income Tax at all, seeing the income from it may not reach the exemption allowed by that Act. Such a case is therefore unsuitable for comparison. Very large estates are also not shown, because they are exceptional, and attention is therefore focussed on estates of moderate size, the transmission of which is more frequent.

**36. Examples.**—(1) A testator bequeaths to a beneficiary (B) all his property, worth (say) just over **£10,000**, on which the Federal Estate Duty at **£2 10s. 0d.** per cent. amounts to **£280**. Assuming 5 per cent. to be the earning power of money, B's annual income, which would have been **£500**, is because of the duty paid reduced to **£486**. The depletion is equivalent to a perpetual annual tax of **£14**. The tax on an income of **£500** received from personal exertion by a single person is under the present Federal scale .. .. . **£16 7 7**  
 The personal exertion tax on an income of **£486** is .. .. . **£15 11 10**  
 which added to the .. .. . **14 0 0**

makes B's contribution to the revenue equal to an annual tax of .. .. . **£29 11 10**

The effective rate of tax on the one is 7·862 pence and on the other 14·004 pence, that is, 78 per cent. in excess of the tax payable on an income of **£500** from personal exertion.

*Example (2).* The comparison is more striking in the more usual case of an estate left by a testator to a number of beneficiaries. For example, an estate worth just over **£40,000** is left in equal shares of **£10,000** each to children A and B and to other relatives C and D.

On the **£10,000** inherited by A (or B) the Federal Estate Duty at **£5 17s. 4d.** per cent. is **£586 13s. 4d.** Again, assuming 5 per cent. to be the earning power of money, A's annual income, which would have been **£500**, is, because of the duty paid, reduced to **£470 13s. 4d.**, the duty imposing upon A a differentiation equivalent to a perpetual annual tax of **£29 6s. 8d.** Applying the same comparisons as in the preceding example, the tax on **£500** personal exertion income is .. .. . **£16 7 7**  
 The personal exertion tax on an income of **£470** is .. .. . **£14 14 6**  
 which added to the .. .. . **29 6 8**

makes A's contribution to the revenue equal to an annual tax of .. .. . **£44 1 2**

The effective rate of tax on the one is 7·862 pence, and on the other 21·148 pence, that is, 169 per cent. in excess of the tax payable on an income of **£500** from personal exertion.

*Example (3).* On the **£10,000** inherited by C (or D), the difference is more noticeable. The Federal Estate Duty at **£8 16s.** per cent. is **£880**. C's annual income, which at 5 per cent. would have been **£500**, is reduced to **£456**, the Duty imposing upon C a Differentiation equivalent to a perpetual annual tax of **£44**. Applying the same comparison as before, the tax on a personal exertion income of **£500** is .. .. . **£16 7 7**  
 The personal exertion rate on an income of **£456** is .. .. . **£13 19 4**  
 which added to the .. .. . **44 0 0**

makes C's contribution to the revenue equal to an annual tax of .. .. . **£57 19 4**

The effective rate of tax on the one is 7·862 pence, and on the other 27·824 pence, that is, 254 per cent. in excess of the tax payable on an income of **£500** from personal exertion.

*Example (4).* If the estate be larger, the effects are more impressive. If an estate worth, say, **£72,000** be left in equal shares of **£12,000** to each of five children and a brother, the Federal Estate Duty at 10 per cent. is on each child's share **£1,200**. The child's income, which at 5 per cent. would have been **£600**, is reduced to **£540**, the Duty imposing on him a Differentiation equivalent to a perpetual annual tax of **£60**. Applying the same comparisons as before, the personal exertion rate on an income of **£600** is .. .. . **£22 7 11**  
 The personal exertion rate on an income of **£540** is .. .. . **£19 5 10**  
 which added to the .. .. . **60 0 0**

makes his contribution to the revenue equal to an annual tax of .. .. . **£79 5 10**

The effective rate of tax on the one is 8·9578 pence, and on the other 31·716 pence, that is, 256 per cent. in excess of the tax payable on an income of **£600** from personal exertion.

*Example (5).* The Differentiation in the case of the brother is greater. On his inheritance of £12,000 the Duty at 15 per cent. is £1,800. His income, which at 5 per cent. would have been £600, is reduced to £510, the Duty imposing upon him a Differentiation equivalent to a perpetual annual tax of £90. Applying the same comparisons as before, the personal exertion rate of income of £600 is

..	..	..	..	..	..	£22 7 11
The personal exertion rate on £510 is	..	..	..	..	£17 16 3	
which added to the	..	..	..	..	90 0 0	

makes his contribution to the revenue equal to an annual tax of .. .. £107 16 3

The effective rate of tax on the one is 8·9578 pence, and on the other 43·109 pence, that is, 381 per cent. in excess of the tax payable on an income of £600 from personal exertion.

37. These examples may be tabulated :—

Example.	1.	2.	3.	4.	5.
A. Value of estate .. .. .	£10,000	£40,000	£40,000	£72,000	£72,000
B. Inheritor's share .. .. .	£10,000	£10,000	£10,000	£12,000	£12,000
C. Duty paid on share .. .. .	£280	£587	£880	£1,200	£1,800
D. Net share left .. .. .	£9,720	£9,413	£9,120	£10,800	£10,200
E. Income from B .. .. .	£500	£500	£500	£600	£600
F. Tax on E .. .. .	£16 7s. 7d.	£16 7s. 7d.	£16 7s. 7d.	£22 7s. 11d.	£22 7s. 11d.
G. Income from D .. .. .	£486	£470	£456	£540	£510
H. Tax on G .. .. .	£15 11s. 10d.	£14 14s. 6d.	£13 19s. 4d.	£19 5s. 10d.	£17 16s. 3d.
I. Interest on duty (C) .. .. .	£14	£29 6s. 8d.	£44	£60	£90
J. Total (H + I) .. .. .	£29 11s. 10d.	£44 1s. 2d.	£57 19s. 4d.	£79 5s. 10d.	£107 16s. 3d.
K. Effective rate of tax on E in pence ..	7·862	7·862	7·862	8·9578	8·9578
L. Total effective rate per £1 (H + I) in pence .. .. .	14·004	21·148	27·824	31·716	43·109
If F (the tax payable at personal exertion rates on the income of the estate intact) equals 100 .. .. .	100	100	100	100	100
J (the aggregate amount equivalent to estate duty and tax on income of the residue) is equal to .. .. .	178	269	354	356	481

38. **Estate Duty considered as Commuted Income Tax.**—In these examples the amounts paid as Estate Duty have been treated for simplicity's sake as inexhaustible principal, and the annual usufruct only has been taken into account as equivalent to Income Tax. Estate Duties, however, though less regular in their visits than Income Tax, travel in an orbit of their own, and return at uncertain intervals, and it would be more accurate to treat the fund as exhausting itself over the average interval of successions—generally taken as 30 years—that is, to treat the Estate Duty as equivalent to thirty commuted annual payments. Consequently, Sir Henry continues—

“ But the levy is not single. It is recurrent—at intervals of which the average is reckoned at 30 years. Therefore, the inheritor of an estate, unless he is to contemplate the gradual whittling away of the property during succeeding generations, must charge himself with the task of replacing the slice by which it has been diminished on his succession. Thus an inheritor has to suffer not only the loss of income from the slice taken out of his inheritance, but has also, so to speak, to establish a sinking fund which will replace the slice in thirty years.”

39. Dealt with in this way, the results more accurately express the true position, and the Differentiation is more marked. The following Schedule shows the examples which were dealt with as deferred Income Tax in Schedule 1 (paragraph 19), and the foregoing five examples, all treated as commuted Income Tax on the average interval of 30 years. The twelve examples in the first Table assumed that in each case the estate undivided was bequeathed to one beneficiary—in which case the relative duty would be lighter than if an inheritance of the same value were received as part of a larger estate. Such transmissions are comparatively rare, and the more customary division of an estate is among children and other relatives or strangers. Examples showing the operation of Duty in such cases have, therefore, been included, the same cases as before being now used to illustrate four distinct transmissions, viz. :—

Where the whole estate is inherited by one person—

- (a) a wife or a lineal descendant ;
- (b) a person other than a wife or lineal descendant.

Where the whole estate is divided into four shares, of which one or more shares are inherited by—

- (c) a wife or a lineal descendant ;
- (d) a person other than a wife or lineal descendant.

One estate, No. 11, valued at £72,000, is shown as divided into six shares.

TABLE III.—Example showing in column 5 the annual payment for thirty years, which, commuted at 5 per cent., would equal the Federal Estate Duty paid by the inheritor and in column 8 the resulting effect in total annual tax.

No.	1.	2.	3.	4.		5.	6.	7.	8.	9.	10.	11.	12.
	Total Value of Estate. Just over—	Total Value of Estate devolving upon Taxpayer.	Annual Income at 5 per cent. from share of Estate (Intact).	Excise Duty.		Income Tax at P.E. Rate payable by Inheritor of Income from share of Estate (less Duty paid).	Total Annual Payment or equivalent (Column 5 plus 6).	Income Tax at P.E. Rate payable on Income shown in Column 5.	Excess of Column 7 over Column 8.	Effective Rate of Tax in Column 7 per £1 of gross Annual Income shown in Column 3.	Effective Rate of Tax in Column 8 payable on whole Income if derived from Personal Exertion.	If the amounts in Column 8 and the Rates in Column 11 be each equal to 100, the amounts in Column 7 and Rates in Column 10 are equal to—	
				Amount paid by Inheritor on his share of Estate.	Equal to the following sums payable annually for 30 years commuted at 5 per cent.								
	£	£	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	Pence per £1.	Pence per £1.	
1 A—D	3,000	3,000	150 0 0	28 0 0	1 16 6	1 6 1	3 2 7	1 7 6	1 15 1	5	2·2	227	
1 B—R	3,000	3,000	150 0 0	42 0 0	2 14 8	1 5 7	4 0 3	1 7 6	2 12 9	6·42	2·2	292	
1 C—D	3,000	750	37 10 0	7 0 0	0 9 1	Nil	0 9 1	Nil	0 9 1	2·9	Nil	..	
1 D—R	3,000	750	37 10 0	10 10 0	0 13 8	Nil	0 13 8	Nil	0 13 8	4·37	Nil	..	
2 A—D	5,000	5,000	250 0 0	60 0 0	3 7 10	4 11 7	7 19 5	4 14 1	3 5 4	7·652	4·516	169	
2 B—R	5,000	5,000	250 0 0	90 0 0	5 1 8	4 10 4	9 12 0	4 14 1	4 17 11	4·216	4·516	204	
2 C—D	5,000	1,250	62 10 0	15 0 0	0 16 11	Nil	0 16 11	Nil	0 16 11	3·24	Nil	..	
2 D—R	5,000	1,250	62 10 0	22 10 0	1 5 5	Nil	1 5 5	Nil	1 5 5	4·88	Nil	..	
3 A—D	8,000	8,000	400 0 0	128 0 0	8 6 6	10 16 3	19 2 9	11 2 8	8 0 1	11·482	6·68	172	
3 B—R	8,000	8,000	400 0 0	192 0 0	12 9 10	10 13 0	23 2 10	11 2 8	12 0 2	13·885	6·68	207	
3 C—D	8,000	2,000	100 0 0	32 0 0	2 1 8	Nil	2 1 8	Nil	2 1 8	5	Nil	..	
3 D—R	8,000	2,000	100 0 0	48 0 0	3 2 6	Nil	3 2 6	Nil	3 2 6	7·5	Nil	..	
4 A—D	10,000	10,000	500 0 0	186 13 4	12 2 10	15 17 4	28 0 2	16 7 7	11 12 7	15·444	7·862	171	
4 B—R	10,000	10,000	500 0 0	280 0 0	18 4 3	15 11 10	33 16 1	16 7 7	17 8 6	16·226	7·862	206	
4 C—D	10,000	2,500	125 0 0	46 13 4	3 0 8	0 11 11	3 12 7	0 13 3	2 19 4	6·968	1·272	547	
4 D—R	10,000	2,500	125 0 0	70 0 0	4 11 1	0 11 0	5 0 1	0 13 3	4 6 10	9·608	1·272	755	
5 A—D	15,000	15,000	750 0 0	380 0 0	24 14 5	29 16 9	54 11 2	30 19 10	23 11 4	17·458	9·9173	176	
5 B—R	15,000	15,000	750 0 0	570 0 0	37 1 7	29 4 9	66 6 4	30 19 10	35 6 6	21·221	9·9173	214	
5 C—D	15,000	3,750	187 10 0	95 0 0	6 3 7	2 7 5	8 11 0	2 10 2	6 0 8	10·944	3·2106	340	
5 D—R	15,000	3,750	187 10 0	142 10 0	9 5 5	2 5 10	11 11 3	2 10 2	9 1 1	14·8	3·2106	460	
6 A—D	20,000	20,000	1,000 0 0	640 0 0	41 12 8	45 12 6	87 5 2	47 19 9	39 5 5	20·942	11·517	181	
6 B—R	20,000	20,000	1,000 0 0	960 0 0	62 9 0	44 9 4	106 18 4	47 19 9	58 18 7	25·66	11·517	222	
6 C—D	20,000	5,000	250 0 0	160 0 0	10 8 2	4 7 4	14 15 6	4 14 1	10 1 5	14·184	4·516	314	
6 D—R	20,000	5,000	250 0 0	240 0 0	15 12 3	4 4 10	19 17 1	4 14 1	15 3 0	18·94	4·516	419	
7 A—D	30,000	30,000	1,500 0 0	1,360 0 0	88 9 4	85 4 3	173 13 7	91 19 7	81 14 0	27·788	14·7166	188	
7 B—R	30,000	30,000	1,500 0 0	2,040 0 0	132 14 2	81 18 5	214 12 7	91 19 7	122 13 0	34·341	14·7166	233	
7 C—D	30,000	7,500	375 0 0	340 0 0	22 2 4	9 1 3	31 3 7	9 18 10	21 4 9	19·95	6·3626	313	
7 D—R	30,000	7,500	375 0 0	510 0 0	33 3 6	8 15 11	41 19 5	9 18 10	32 0 7	26·86	6·3626	422	
8 A—D	40,000	40,000	2,000 0 0	2,346 13 4	152 13 0	134 11 4	287 4 4	149 5 11	137 18 5	34·466	17·9155	192	
8 B—R	40,000	40,000	2,000 0 0	3,520 0 0	228 19 7	127 12 0	356 11 7	149 5 11	207 5 8	42·79	17·9155	223	
8 C—D	40,000	10,000	500 0 0	586 13 4	38 3 3	14 14 6	52 17 9	16 7 7	36 10 2	25·386	7·862	323	
8 D—R	40,000	10,000	500 0 0	880 0 0	57 4 11	13 19 4	71 4 3	16 7 7	54 16 8	34·102	7·862	434	

TABLE III.—continued.

No.	1.  Total Value of Estate. Just over—	2.  Total Value of Estate devolving upon Taxpayer.	3.  Annual Income at 5 per cent. from share of Estate (intact).	4.		5.		6.  Income Tax at P.E. Rate payable by Inheritor of Income from share of Estate (less Duty paid).	7.  Total Annual Payment or equivalent (Column 5 plus 6).	8.  Income Tax at P.E. Rate payable on Income shown in Column 3.	9.  Excess of Column 7 over Column 8.	10.  Effective Rate of Tax in Column 7 per £1 of gross Annual Income shown in Column 3.	11.  Effective Rate of Tax in Column 8 payable on whole Income if derived from Personal Exertion.	*12.  If the amounts in Column 8 and the Rates in Column 11 be each equal to 100 the amounts in Column 7 and Rates in Column 10 are equal to—
				Excise Duty.										
				Amount paid by Inheritor on his share of Estate.	Equal to the following sums payable annually for 30 years commuted at 5 per cent.									
	£	£	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	Pence per £1.	Pence per £1.	
9 A—D	50,000	50,000	2,500 0 0	3,600 0 0	234 3 8	192 19 6	427 3 2	219 18 11	207 4 3	51·696	21·1148	194		
9 B—R	50,000	50,000	2,500 0 0	5,400 0 0	351 5 7	187 4 4	538 9 11	219 18 11	318 11 0	51·696	21·1148	244		
9 C—D	50,000	12,500	625 0 0	900 0 0	58 10 11	21 2 7	79 13 6	23 14 11	55 18 7	30·595	9·1184	335		
9 D—R	50,000	12,500	625 0 0	1,350 0 0	87 16 5	19 13 11	107 10 4	23 14 11	83 15 5	41·286	9·1184	452		
10 A—D	60,000	60,000	3,000 0 0	5,120 0 0	333 1 4	259 5 3	592 6 7	303 18 6	288 8 1	47·386	24·314	194		
10 B—R	60,000	60,000	3,000 0 0	7,680 0 0	499 11 10	238 4 10	737 16 8	303 18 6	433 18 2	59·026	24·314	242		
10 C—D	60,000	15,000	750 0 0	1,280 0 0	83 5 4	27 3 7	110 8 11	30 19 10	79 9 1	35·342	9·9173	356		
10 D—R	60,000	15,000	750 0 0	1,920 0 0	124 17 11	25 7 0	150 4 11	30 19 10	119 5 1	48·079	9·9173	484		
11 A—D	72,000	72,000	3,600 0 0	7,200 0 0	468 7 4	348 19 5	817 6 9	422 5 11	395 0 10	54·489	28·153	193		
11 B—R	72,000	72,000	3,600 0 0	10,800 0 0	702 11 0	314 18 0	1,017 9 0	422 5 11	595 3 1	67·83	28·153	241		
11 C—D	72,000	12,000	600 0 0	1,200 0 0	78 1 3	19 5 10	97 7 1	22 7 11	74 19 2	38·941	8·9583	434		
11 D—R	72,000	12,000	600 0 0	1,800 0 0	117 1 10	17 16 3	134 18 1	22 7 11	112 10 2	53·961	8·9583	602		
12 A—D	80,000	80,000	4,000 0 0	8,000 0 0	520 8 3	422 5 11	942 14 2	511 17 6	430 16 8	56·562	30·7125	184		
12 B—R	80,000	80,000	4,000 0 0	12,000 0 0	780 12 4	380 14 2	1,161 6 6	511 17 6	649 9 0	69·879	30·7125	227		
12 C—D	80,000	20,000	1,000 0 0	2,000 0 0	130 2 1	40 15 10	170 17 11	47 19 9	122 18 2	41·015	11·517	356		
12 D—R	80,000	20,000	1,000 0 0	3,000 0 0	195 3 1	37 7 10	232 10 11	47 19 9	184 11 2	55·811	11·517	484		
13 A—D	100,000	100,000	5,000 0 0	10,000 0 0	650 10 3	635 16 11	1,286 7 2	773 2 10	502 4 4	61·745	37·1109	166		
13 B—R	100,000	100,000	5,000 0 0	15,000 0 0	975 15 5	572 3 10	1,547 19 3	773 2 10	764 16 5	74·302	37·1109	200		
13 C—D	100,000	25,000	1,250 0 0	2,500 0 0	162 12 7	57 13 1	220 5 8	68 6 4	151 19 4	42·29	13·1168	322		
13 D—R	100,000	25,000	1,250 0 0	3,750 0 0	243 18 10	52 14 5	296 13 3	68 6 4	228 6 11	56·91	13·1168	433		

40. It may be convenient if the comparative results of these examples be tabulated thus:—

If in each case the effective rate of income tax on the whole income (column 11) be 100 the effective rate of the total annual equivalent of estate duty and income tax paid by the inheritor (column 10) on the several Estates inherited is as follows:—

Total Value of Estate. Just over—	If Estate is inherited by—			
	One Person—		Four Persons—	
	Who is a lineal descendant.	Who is not a lineal descendant.	In the case of an inheritor who is a lineal descendant.	In the case of an inheritor who is not a lineal descendant.
	A.	B.	C.	D.
3,000 .. ..	227	292	No Income Tax	
5,000 .. ..	169	204	No Income Tax	
8,000 .. ..	172	207	No Income Tax	
10,000 .. ..	171	206	547	755
15,000 .. ..	176	214	340	460
20,000 .. ..	181	222	314	419
30,000 .. ..	188	233	313	422
40,000 .. ..	192	223	323	434
50,000 .. ..	194	244	335	452
60,000 .. ..	194	242	356	484
80,000 .. ..	184	227	356	484
100,000 .. ..	166	200	322	433
Ranging .. ..	from 166 to 227	from 200 to 292	from 313 to 547	from 419 to 755
One Person—				
72,000 .. ..	193	241	434	602
Six Persons—				

41. **Further Considerations.**—One would think this were differentiation enough, but even yet the whole has not been told, for—

(1) Of the 52 examples tabulated, 26 are estates which are assumed to pass from the holder to a single beneficiary—an unusual case—whereas most estates pass into the hands of several beneficiaries. This involves a noticeable alteration in the incidence of the taxes and the comparison between the total levy on property incomes with that on personal exertion incomes. The other 26 examples where the estates are left to four (in one case, six) beneficiaries are most closely typical of actual experience. In cases when wider dispersals are made the rate of estate duty is not reduced but the rate of income tax on the less income of the smaller shares is also less, and the degree of differentiation is substantially increased. Case No. 11 illustrates this.

(2) It has been assumed in each of these cases that the inheritor is a single person without dependant. If he were married or had a dependant the Estate duty would still be charged at the same rate, but the taxes on his own and the contrasted incomes would be reduced because of the joint action of an increase of the exemptions allowable and the lowering of the range of the incomes. If the inheritor be married or have a dependant the contrasting figures in column 12 would be increased.

(3) Numerous items are in the capital passing at death and taxable for Estate Duty that have been wholly or partially unproductive of income liable to Income Tax and some of these may continue unproductive in the hands of the inheritors, for example :—

- Cash in house or in bank at time of death.
- Idle land.
- Insurances.
- Pictures, statuary, jewellery.
- Libraries and other household goods.
- Expectant interests.
- Income due, but not yet collected.

All of these swell the value of the estate on which duty is paid and increase the degree of differentiation.

(4) The capital value of the estate may also (if the deceased were domiciled in Australia) include personal property in other countries, the income from which is not subject to tax in Australia, but the whole of the personal property swells the estate and increases the Estate Duty payable here.

It is evident that the comparisons shown in the Third Schedule—severe and striking as they are—are not exaggerated ; they are rather under-stated.

42. **Saving in Administrative Expenses.**—While cost of administration alone should not influence judgment on this question, it is worthy of notice that the adoption of one scale of rates and the exclusion of differentiation from direct action in the Income Tax Act would substantially reduce the worries of the taxpayer and the expense of administration. As to the latter the Federal Commissioner stated :—

“ The cost of collection per assessment may only be correctly appreciated after a minute study of the law under which the cost arises. The simpler the law the lower the cost of collection per assessment. The more complex the law (*e.g.*, differential treatment of various classes of income, whether by exemption of some and taxation of others, or difference in method of taxing different classes of income . . . ) the more costly will each assessment be, owing to the increased necessity for vigilance by the Department to see that neither the taxpayer nor the revenue is unfairly dealt with.”

A large number of the returns lodged now include both classes of income, and to some extent each becomes in effect two returns, for particulars of the income from property and its relative deductions have to be compiled separately by the taxpayer and dealt with separately by the Department from the income from personal exertion and its deductions. In many cases the general exemptions may cause one of them to be non-taxable, but at the initial stages each one of them must be treated in its two aspects. After all such returns have been weeded out, there still remain a large number which have to be assessed in respect of both classes of income. Of the total individual assessments (omitting assessments of Companies and Lotteries) made in 1918-19, 331,760 separate assessments were made in respect of composite incomes, and only 264,662 in respect of one class taxpayers. If one rate only obtained and differentiation disappeared from the Act, 165,880 of these assessments would not be required, in addition to the large saving—how large is not known to us—which would arise from the earlier blending of sources where now they have to be separately dealt with till one

proves on investigation to be non-taxable. On the other hand, the differential method recommended in the Report, which is in neither scheme nor measurement founded on sound principle, introduces a further element of complexity into the Act, for the differentiation diminishes at £1,500 with each £1 of income, and runs quite counter to the public demand for simplicity.

**43. Comparisons.**—These Tables and comparative statements and the comments thereon do not imply any criticism of the collecting of Duty on the estates of deceased persons, or the structure of the Estate Duty Act or its rates, which are accepted as they stand, and assumed to be just and reasonable. The object of the examples is solely to show the powerful action of these Duties when expressed in equivalent terms of Income Tax in creating well-defined and broad differentiation between the tax burdens borne by incomes from property and those borne by incomes from personal effort.

**44. Conclusion.**—For the alleged precariousness of earned incomes, as compared with the permanence of incomes from property, it is manifest that more than ample differentiation in favour of the former already exists in other parts of the system of taxation, and there is lacking any justification for accentuating it by making further differentiation in the Income Tax Act itself. Public demand (if it exists) for such a provision would be tempered if the action of the Estate Duties in burdening capital and the income from capital were realized. The conscience of the people, enlightened as to the facts, would indorse the inevitable conclusion from these figures that from the point of view of equitable dealing no substantial reason exists why differentiation in favour of incomes from personal exertion and against incomes from property should be made a general feature of an Income Tax Act in any system of taxation which includes a heavy tax on inheritance.

**45. I therefore respectfully Recommend :—**

- (1) That the principle of differentiation be excluded from direct operation in the Income Tax Act, and that there be not observed in this Act any distinction as between one class of income and another.
- (2) That all taxable incomes, whatever be their nature, be assessed in accordance with one scale of rates.

JOHN JOLLY.

## GRADUATION.

## RESERVATION.

While concurring in part of the Recommendations made in the Report on the above subject, we desire to submit the following statement :—

**2. Extent of Concurrence in Recommendations of Report.**—We concur in the Recommendations of the Report to the extent of—

- (a) The adoption of one scale of rates instead of the two scales now in force for personal exertion and property respectively.
- (b) The adoption of a straight line progression, with regular increases of rate as the income rises. (This, indeed, is already in force in the Commonwealth Personal Exertion Scale, but the fraction chosen for the progressive increase is an inconvenient one.)
- (c) The adoption of a commencing rate of 5d. (There is no special principle involved in the recommendation of this figure, but it is the present commencing rate—it appears to us a reasonable rate—it represents very closely the average of the commencing rates of all the State Income Taxes—it appears to be suitable for present Revenue needs—and taxpayers have become accustomed to it. We wish to be understood, however, as concurring with this commencing rate on the understanding that any increase or decrease of that rate shall normally be made only as part of a percentage movement up or down of the whole line of progression. See paragraph 6.)

**3. Desirable Characteristics of a Line of Progression.**—The first essential, we consider, is the regular movement of increase with each successive £1 up to the point where the gradient must be reduced, because (if for no other reason) it is considered that to continue it would tend to check enterprise and dry up the sources of income. The characteristic of regular increases is common to the scale prescribed by the present Act in relation to personal exertion incomes and to the scale recommended in the Report. The scale dealt with below (paragraph 5) is also of precisely the same type. The most important of the remaining characteristics of any decimal scale of graduation is simplicity. The highest practical test of simplicity in this connexion is that the fractional parts of a penny represented by the decimal scale shall also be capable of expression as common fractions in terms of a coin of the realm. There are only two scales which comply with this condition, viz., one which increases at the rate of  $\frac{1}{2}$ d. per £100 (which is the scale recommended in the Report) and one which increases at the rate of 1d. per £100. The latter scale is cited in the Report (paragraph 332), but apparently for the purpose of underlining the importance (which may easily be exaggerated) of considering the rate applicable to the highest £1 at any point of income, as well as the average rate over the whole of the income.

**4. Revenue Necessity for Frequent Change of Rates.**—The experience of the movements which have become necessary under the present Commonwealth personal exertion scale of rates and under the scales imposed by State statutes show that no scale is likely to produce the exact revenue required to meet the changing conditions of successive years without some adjustments. It is, therefore, necessary to look at any suggested scale of progression with this aspect clearly in mind. The scale of rates recommended in the Report, increasing by  $\frac{1}{2}$ d. per £100, or 1/200d. per £1, is a much lower scale than that of the present personal exertion rates. It is, therefore, obvious that it could only be adopted at present, subject to a large percentage increase being made. In our opinion, that increase would not be less than 50 per cent. The result would be that the initial commencing rate would rise from 5d. to  $7\frac{1}{2}$ d., and the fractional increase throughout from  $\frac{1}{2}$ d. per £100 to  $\frac{3}{4}$ d. per £100. A scale commencing with 5d. and ascending by 1/100d. per £1, or 1d. for each successive £100, would, if adopted without any percentage deduction, certainly produce more than the present revenue. That scale has the advantage over the one recommended in the Report of a higher degree of simplicity, but the suitability in other respects of either scale must, we submit, be judged chiefly in its relation to the incidence of the tax.

**5. Incidence of the Tax.**—The incidence of any proposed scale of graduation is, we submit, the most important issue to be considered. We have already pointed out that a rate of 5d. plus 1/200d. per £1 would need probably at least 50 per cent. increase before it could be expected to produce approximately the present revenue. If, instead of adopting that scale, the scale based upon 5d. plus 1/100d. per £1, or 1d. per £100, were adopted, a percentage deduction could no doubt be made, in order to produce the required revenue. If the lower line were increased by

50 per cent. and the higher line were decreased by  $17\frac{1}{2}$  per cent., the lines so swung upon their pivots would intersect—that, is, would carry the same rate of tax—at an income of **£4,500**. (See Graph Appendix No. 9.) The important difference between the two lines as thus respectively increased and decreased (assuming, as we think is the case, that they would produce approximately the same revenue) is in the effect each would have upon the distribution of tax-burdens below and above the point at which they intersect (**£4,500**). The lower line increased by 50 per cent. would have an initial or commencing rate of 7.5d., while the higher line reduced by  $17\frac{1}{2}$  per cent. would have an initial or commencing rate of 4.125d.—that is, the commencing rate if the lower scale plus 50 per cent. were adopted would be about 84 per cent. higher than if the higher scale less  $17\frac{1}{2}$  per cent. were chosen. **This means that the adoption of the lower line, as recommended in the Report, would have the immediate effect of throwing a considerably increased burden upon lower incomes.** The final responsibility of determining where the heavier burden of taxation shall lie is, of course, not upon our shoulders, but we are concerned with attempting to make clear the effect of any change recommended, particularly with regard to the two lines in question, one or other of which must apparently be adopted, if it is desired to introduce—

(a) A decimal progression;

(b) The simplest form of decimal progression, that is, one capable of expression also as a common fraction in terms of  $\frac{1}{2}$ d. or 1d.

Of the two, the line expressible in terms of 1d. is rather simpler, and, as we have already shown, to meet present needs it could be used by way of percentage decrease, thus somewhat diminishing the burden upon lower incomes, while the adoption of the lower line with its necessary percentage increase would have the opposite effect. A further fact bearing upon the question of incidence is that, if the Recommendations made in the Report under the heading “Differentiation” be adopted, incomes derived from property will be considerably relieved of tax, and this relief must necessarily be at the expense of incomes derived from personal exertion. In these days, when it is the exception for large businesses to be conducted otherwise than as Companies, it is reasonably certain that personal exertion incomes make up the larger part of the “lower” incomes—say, up to **£4,500**, the point at which it is recommended Differentiation should cease. It seems clear, therefore, that it is the lower incomes which would bear the larger part of the extra burden of which property incomes would be relieved.

**6. Adjustment by Alteration of Base.**—One of the modes of altering the weight of taxation suggested in the Report is that of an arbitrary deduction from or addition to the commencing rate, now 5d., independently of any percentage movement of the whole line of progression, and it may be said that by the use of this device the heavier incidence upon lower incomes which would be caused by the adoption of the line recommended in the Report might be at least partially overcome. We suggest that this mode of alteration is undesirable—it would cause an added complication—it would alter the character of the line of progression, which would cease to be a straight line—it is inconsistent with the major Recommendation and with the whole tenor of the Report—and, in our opinion, it is unnecessary. It may be added that it would render useless a Ready Reckoner based upon a line of regular progression.

## CONCLUSIONS.

7. To comply with the very wide public demand for simplicity of graduation, the choice appears to lie between two forms and two only, viz., what is known as the Step System, briefly referred to in the Report (paragraphs 330 and 331) and the straight line progression (changing with each £1 of income) of parts of a penny, amounting in each **£100** either to  $\frac{1}{2}$ d. or 1d. There are, we think, good reasons for preferring the straight line progression to the Step System, and, if the straight line be accepted, the choice is, we submit, between the two lines just mentioned. The advantage from the point of view of simplicity lies with the line moving by  $1/100$ d. for each £1 of additional income. **From the point of view of incidence of tax, if it is desired to diminish or not to increase the burdens upon the lower incomes, the line based upon the scale moving in a progression of  $1/100$ d. per £1 should be preferred.** If, on the other hand, it is desired to diminish or not to increase the burden upon higher incomes—those incomes, say, above **£4,500**, the point at which the Report recommends that Differentiation should cease—the line based upon the scale moving in a progression of  $1/200$ d. per £1 should be preferred.

8. This statement of the principal factor to be considered in the determination of the scale to be adopted is, in our opinion, sufficient to show that an unconditional recommendation of a particular scale is outside our function.

W. T. MISSINGHAM.  
S. MILLS.

## GRADUATION.

## RESERVATION TO PART.

1. I accept the principles laid down in the Report as to the basis of graduation in Income Tax, but am unable to accept the expression of those principles as demonstrated in the line of graduation recommended therein.

2. An examination of the line proposed in the Report shows clearly that it is not pure graduation, but a combination of graduation and a flat rate. The commencing rate of 5d. being applied to all incomes becomes a flat rate on every £1 of income and the graduation is added to this flat rate. This is very unfair to the small incomes, for a flat rate is not equitable at all and could not be recommended, and the addition of a graduation does not remove the injustice of the flat rate.

3. The theory of diminishing utility (accepted in the Report) means that the taxable capacity of each succeeding £1 of income is greater than the preceding one. Therefore, if the difference in taxable capacity between the 10th and 11th £ of income is expressed by the graduated line (expressed in the report as .005), then there is no reason why the difference of £1 at the commencement of taxable income should not be treated in a like manner. The first £ of taxable income is in the same relation to no taxable income as £11 of taxable income is to £10 of taxable income. In both cases the taxable capacity is £1 better than the other, and the rate of progression should be the same, or, if not the same, should be greater between the 10th and 11th £ than between £0 and £1. The method recommended in the report is equivalent to an advance from 0d. to 5d. on the first £, and only .005 difference on an additional £1 of income at any other point. The first £ of taxable income is, therefore, overloaded, and this makes the incidence of the tax harsh on the small incomes.

4. If the line of graduation commenced at 0 and was carried at whatever angle was necessary to obtain the necessary revenue no injustice could be done to any incomes, as each would bear its relative burden in accordance with requirements. If small revenue was required then the line would be nearer horizontal, and if large revenue was required the line would be more erect and necessarily take the greatest toll from the large incomes. The angle of the line would be determined by the amount of revenue required with equitable incidence in all cases. The line recommended in the Report will not produce the present revenue from Income Tax, and it will therefore be necessary to add a percentage of about 50 before the present revenue is reached, and this would mean an assumed taxable capacity of  $7\frac{1}{2}$ d. in the first £ of income, thus accentuating the injustice to the small incomes.

5. In order to arrive at the line of graduation, it is necessary to arrive at what is considered the maximum taxable capacity on the last £ of income, and ascertain at what point of income this maximum should be taken in order to give the revenue required, then the line should be drawn from that point to zero.

6. Taking 10s. as the maximum taxable capacity on the last £ of income, it is estimated that the present revenue would be raised by making this operate at £6,000 and over, and the line would then run from £6,000 to 0 with the flat rate of 10s. applying to all income above £6,000 (see graph, Appendix No. 9). This line would make the graduation advance at the rate of .02d. per increased £ of income, and the average rate would advance at the rate of .01d., thus the average rate of tax on an income of £6,000 would be 60d. in the £1, and the average rate of tax on an income of £3,000 would be 30d.

7. As a line of graduation this would be exceedingly simple; the amount of taxable income divided by 100 giving the average rate of tax up to £6,000 of income, with a flat rate of 10s. in the £ above that mark. Thus the frequently voiced complaint of taxpayers regarding the complications of the present graduation would be met, as it would be only necessary to mark off two places of decimals in the taxable income, and the rate of tax would be shown, thus:—

Taxable Income.				Average Rate.
£500	..	..	..	5·00d.
£1,200	..	..	..	12·00d.
£1,536	..	..	..	15·36d.
£2,471	..	..	..	24·71d.

8. A comparison of this line of graduation with that recommended in the Report (plus 50 per cent.) is shown in a graph (Appendix No. 9). It will be seen, on reference to this graph, that at £3,000 the average rate of tax is the same in both cases, the difference being that below the £3,000 point the line recommended in the Report (with 50 per cent. added) is more severe, while in the area above that point the line herein recommended is more severe.

9. The following is a comparative table showing the average rate of tax on the whole income, as well as the rate on the final £, under—

- (1) The scale at present in the Commonwealth Act.
- (2) The scale recommended in the Report, with 50 per cent. added (to secure the present revenue).
- (3) The scale recommended in this Reservation.

Taxable Income.	1. Present Federal Act.				2. Report Recommendation.		3. Reservation.	
	Personal Exertion.		Property.		(5d. + .005 + 50%).		(0.0d. + 0.01d.).	
	Average.	Final £.	Average.	Final £.	Average.	Final £.	Average.	Final £.
		£		£			d.	d.
100 .. ..	5.7586	6.3922	6.0611	6.9917	8.25	8.9925	1	2
200 .. ..	6.3984	7.672	7.0035	8.8741	9.0	10.4925	2	4
400 .. ..	7.6781	10.2317	8.8883	12.6788	10.5	13.4925	4	8
600 .. ..	8.9578	12.7874	11.2203	21.7627	12.0	16.4925	6	12
800 .. ..	10.2375	15.3511	14.6691	28.0923	13.5	19.4925	8	16
1,000 .. ..	11.5172	17.9108	17.9724	33.9564	15.0	22.4925	10	20
1,400 .. ..	14.0766	23.0302	24.1422	44.5676	18.0	28.4925	14	28
2,000 .. ..	17.9156	30.7092	32.3049	57.0925	22.5	37.4925	20	40
3,000 .. ..	24.3141	43.5077	44.1823	76.8714	30.0	52.4925	30	60
4,000 .. ..	30.7125	56.3061	54.2303	90.6212	37.5	67.4925	40	80
5,000 .. ..	37.1109	69.1045	62.3179	98.3107	45.0	82.4925	50	100
6,000 .. ..	43.5094	81.9030	68.6291	101.0237	52.5	97.4925	60	120
7,600 .. ..	53.7469	102.375	75.7145	102.375	..	..	72	120
10,000 .. ..	65.4176	102.375	82.1130	102.375	..	..	84	120
20,000 .. ..	83.8963	102.375	92.2440	102.375	..	..	102	120
50,000 .. ..	94.9835	102.375	98.3226	102.375	..	..	112.8	120
100,000 .. ..	98.6793	102.375	100.3488	102.375	..	..	116.4	120

10. The following table shows the amount of tax payable by taxpayers under the methods above mentioned at the various stages of income:—

Taxable Income.	Present Federal Act.		Report.	Reservation.
	Personal Exertion.	Property.		
	£ s. d.	£ s. d.	£ s. d.	£ s. d.
100 .. ..	2 8 0	2 10 6	3 8 9	0 8 4
200 .. ..	5 6 8	5 16 9	7 10 0	1 13 4
400 .. ..	12 15 11	14 16 3	17 10 0	6 13 4
600 .. ..	22 7 11	28 1 0	30 0 0	15 0 0
800 .. ..	34 2 6	48 17 11	45 0 0	26 13 4
1,000 .. ..	47 19 9	74 17 8	62 0 0	41 13 4
1,400 .. ..	82 2 3	140 16 7	105 0 0	81 13 4
2,000 .. ..	149 5 11	269 4 2	187 10 0	166 13 4
3,000 .. ..	303 18 6	552 5 7	375 0 0	375 0 0
4,000 .. ..	511 17 6	903 16 9	625 0 0	666 13 4
5,000 .. ..	773 2 10	1,298 5 9	925 0 0	1,041 13 4
6,000 .. ..	1,087 14 8	1,715 14 7	1,312 10 0	1,500 0 0
7,600 .. ..	1,701 19 8	2,397 12 6	..	2,280 0 0
10,000 .. ..	2,725 14 8	3,421 7 6	..	3,500 0 0
20,000 .. ..	6,991 7 2	7,687 0 0	..	8,500 0 0
50,000 .. ..	19,788 4 8	20,483 17 6	..	23,500 0 0
100,000 .. ..	41,116 7 2	41,812 0 0	..	48,500 0 0

### RECOMMENDATION.

#### 11. I recommend—

1. That the line of graduation should commence from zero.
2. That the line be adjusted to revenue requirements by its angle.
3. That, as a graduated line of .01 (average) rising to £6,000 taxable income would produce current revenue, same be adopted for present purposes.

M. B. DUFFY.

## TAXATION OF INCOME OF AUSTRALIAN RESIDENTS DERIVED OUTSIDE AUSTRALIA.

## RESERVATION.

1. With due deference to the opinions of my colleagues I am unable to agree unreservedly with the conclusions and recommendations of this section of the Report.

2. In the taxing Acts of the Commonwealth and the States of Australia, as in other important parts of the British Dominions, the scope of income tax has always been confined to incomes derived from a source within the geographical area controlled by the taxing authority. Not only has no evidence been adduced to support the extension of the tax to ex-territorial income, but the attitude of witnesses generally when asked to express an opinion on this topic was one of approval of the established practice of confining tax to income derived within the territory.

3. Even in Great Britain which, we are told, "was first in the field and taxed on the principles of residence, origin, control, and every other pretext it could invent, on the Donnybrook Fair principle 'see a head, hit it,' " there is a growing conviction that the taxing of ex-territorial income is weak in principle and embarrassing in practice, a conviction which has been intensified because of the higher rates now ruling and the greater attention directed to the subject.

4. The attitude of the British authorities when asked to abolish the taxing of the Dominion incomes of British residents was not a vindication of the justice of continuing the practice, but rather an admission that it was continued only because it was impossible to give up the revenue during the war, and promise was given of probable abandonment when revenue needs were less pressing. Generally the taxing of income both at the place of origin and at the place of residence is not advocated, and so far Australian States have without exception confined taxation to incomes originating in—"derived from a source in"—the State.

5. The Report asserts that the taxation of the incomes of Australians derived outside Australia does not possess "complete theoretical justification." With equal accuracy it might have said there are strong reasons, both theoretical and practical, against its adoption. If, as is stated in the Report, "the only justification for the suggested extension would be revenue necessity," its defence is poor indeed, akin to the plea of the petty larcenist, a repetition of the practice of extortion followed by capricious Governments without regard to the inequity of the burden cast upon the taxpayer, and opposed to the pursuit of justice, which is an outstanding feature of modern development in the theory of taxation.

6. If then such a tax is inherently unjust or is of such doubtful character that no attempt is made to establish its justice, it should be at once rejected, and need not be subjected to the tests quoted in para. 365 of the Report. These tests are to be applied to determine whether it would be expedient in practice to collect a tax which has previously been shown to be just in principle.

7. Without protracting the trial as to the inexpediency in practice to levy such a tax, and in this part of the indictment there are many counts, I feel compelled to condemn the proposal as one at variance with the principle which has always obtained in all Australian Income Tax Acts, both Commonwealth and State, a proposal of which the best that can be said is that it is of doubtful character.

8. Instead of the conditional Recommendation of the Report, there should, I submit, be substituted a Recommendation that the taxing of the incomes of Australian residents derived outside Australia be not admitted into the Australian Income Tax Acts unless and until it is in principle fully justified as ethically, politically, and economically sound, capable of efficient administration, and affording effective safeguards against evasion, and unlikely to create difficulties with other taxing jurisdictions.

JOHN JOLLY.

## TAXATION OF PROFITS ARISING FROM SALES OF EXPORTS FROM AUSTRALIA.

### RESERVATION.

We regret that we are unable to concur in the recommendations made in the Report under the above heading.

**1. Effect of Judicial Decisions.**—The Report gives particulars of Judgments of the Privy Council in Kirk's case and of the High Court in Meeks' case, but in our opinion fails to apply the principles laid down in those cases. The Act upon which the Judgments in those cases were given was the New South Wales Act, which in the wording of the material section is practically identical with the Commonwealth Act. The Judgments in those cases seem to lay down clearly :—

1. That, where a business undertaking located in Australia realizes profits on the sale abroad of goods originating in Australia, the transaction must be regarded as one and indivisible from the initial processes in Australia until payment by the purchaser abroad.
2. That, for the purpose of Income Taxation, it is necessary to devise some method of apportionment, to ascertain what proportion of the resulting profit is attributable to and, therefore, taxable in Australia.

That the Commonwealth Crown Law Officers consider these cases an authority for the proposition just stated may, we think, be conclusively inferred from the fact that the Rules now in force imply such a construction, and were issued by the Commissioner on the advice of the Crown Law authorities. It must, therefore, be accepted that these Rules are consistent with an Act such as the Commonwealth Act, restricting the application of Income Tax to incomes "derived from sources within Australia."

**2. F.o.b. Method—General Effect.**—The adoption of the f.o.b. method recommended in the Report would effect an important alteration in the Income Tax Act. That method would, for taxation purposes, treat a buying and selling transaction, where the purchase is made in Australia and the sale occurs after export overseas, as if it were completed as soon as the goods forming the subject-matter of the transaction had been purchased and exported. The method rests, indeed, upon the fictional assumption that the goods have been sold before leaving Australia at the f.o.b. price ruling at time of export. For example, a merchant having by charter or otherwise secured freight space goes into the market and buys £20,000 worth of Australian products. These may be shipped and leave Australia very shortly after purchase. Then, for purposes of Income Tax, the transaction would under the f.o.b. system recommended in the Report be governed by what had happened in the Australian market during the interval between purchase and export. If there had been no change in the market price, the transaction would be regarded as showing neither profit nor loss, with the result that the exporter would not be liable for any tax, nor would he be entitled to claim any deduction. If the market price were lower at the date of export than at the date of purchase, the difference would be treated as a loss deductible from taxable income (if any) derived from other sources ; while, if the market price had risen during that period, the difference would be an addition to taxable income. If the exporter were also the producer or manufacturer of the goods exported, the position would be similar except that, for the purpose of taxation, cost of production plus charges would be the factor to take into account instead of purchase price. Any profit resulting from completion of the transaction by sale abroad would in either case not be treated as an addition to nor any loss as deductible from taxable income.

3. For the purposes of this discussion, exporters may be grouped into three classes, viz. :—

Class 1.—Overseas buyers who visit Australia for the purpose of buying Australian produce, or who buy through a local agent.

Class 2.—Australian producers (including manufacturers) who export their own products.

Class 3.—Australian residents who buy and export goods of which they are not the producers or manufacturers.

No statistics are available to show the actual proportions represented by each of these classes, but it is believed that Class 3 is much the largest, and that, relatively to the other two, Class 2 is quite small.

4. From the point of view of taxation, a person coming within Class 1, *i.e.*, an overseas buyer would occupy an anomalous and unsatisfactory position. If there was on the whole an increase in market value between the date of purchase and the date of export of the goods, he would become liable to taxation upon that difference, on the ground that he had made a profit, although in the circumstances that profit would be altogether theoretical. But, if the market declined between those dates, while he would on the same theory have made a loss, he would be in no position to obtain any deduction on account of that loss, since he would rarely, if ever, have other taxable income in Australia from which the loss might be deducted; nor could such a theoretical and unrealized loss be claimed as a deduction from assessable income in the buyer's own country.

5. Where the producer is also the exporter—Class 2—the question whether there would be (a) a taxable income, or (b) a deductible loss, or (c) neither taxable income nor deductible loss, would under the f.o.b. method depend upon it being shown to the satisfaction of the Department that the cost up to the point of export was (a) less than, (b) greater than, or (c) equal to the f.o.b. value at date of export.

6. Where the exporter is an Australian resident who is not the producer or manufacturer of the goods exported—Class 3—then in cases where there was a (theoretical) profit, he would be in the same position as to Australian Income Tax as the exporter in Class 1; but, in the case of a (theoretical) loss, he would almost certainly be in a position of greater advantage, as he would probably have an assessable income from other sources from which the loss could be deducted.

7. In cases coming within Class 3, a fact of cardinal importance is that in normal times values of primary products have but small fluctuations during any short period, such as usually elapses between purchase for export and actual export. There is also the fact that the small price movements in these limited periods may in a number of transactions be about as much in one direction as in the opposite, so that on the whole they might bring little or nothing into the taxable field. A fall of price between date of purchase and date of export would create a loss deductible from taxable income, while an upward movement would add to taxable income. There is therefore less likelihood of failure on the part of taxpayers to observe and record falls than increases in price.

8. **F.o.b. Method—Revenue Effect.**—Some idea of the amplitude of the change, from the revenue point of view, which would be effected by the introduction of the f.o.b. method may be formed from a consideration of the value of Australian exports. The figures for 1919-20, the latest year for which detailed information has been published, show that (exclusive of gold and silver, £6,500,000) Australian products, almost wholly primary, to the value of £130,000,000 were exported. The serious importance of the recommendations made in the Report is that the adoption of the proposed f.o.b. method would have the effect of largely freeing from taxation the profits upon a proportion of Australian exports which on the present scale of the national business probably represents a sum of the order of £70,000,000 to £80,000,000. It has been suggested that many of the transactions making up this large total finally result in loss; but (as was frequently and truly said during our inquiry) unless the successes considerably outweighed the losses, export would cease or be very greatly reduced. There can, we think, be no doubt that the aggregate profits from this volume of Australian exports amount in all but unusually unfavorable years to a very large sum. Under the f.o.b. method these profits would wholly escape taxation; under the present Commonwealth method they are taxed to the extent to which, in accordance with the Judgments referred to in paragraph 2 above, they are attributable to sources in Australia.

9. Some comment may here be made upon particular paragraphs in the Report.

**Paragraph 394—Fairness over a Series of Years.**—A taxpayer who continued export transactions during a series of years might or might not find the f.o.b. method work out fairly to him. Fairness in the aggregate may satisfy Revenue authorities, but if, as certainly would be the case, a great many individuals suffer detriment, while others are advantaged, those who suffer will undoubtedly complain. The Victorian State Commissioner of Taxes, in evidence on this point, said:—

“You cannot convince a taxpayer that on an article which made a loss (that is on sale abroad) he made a profit in Australia.”

But the f.o.b. method would make him taxable on the theoretical profit represented by any increase in f.o.b. value at time of export over cost or purchase price.

10. **Paragraph 395—Simplicity, Certainty, and Early Finality.**—The claim for simplicity of the f.o.b. method made in the Report seems to be a claim that it is simpler than the present Commonwealth method. But this greater simplicity is not, it seems, an absence of some element

of complexity which is present in the existing method, but is assumed to be established by the statement that the f.o.b. value can in the great majority of instances be fixed with greater readiness and certainty than the cost price. Now the evidence (Victorian State Commissioner) is that :—

“ The (Commonwealth) method is elastic enough to meet all cases,”

and (Commonwealth Commissioner) that :—

“ It works smoothly and without complaint.”

The evidence also is that the original f.o.b. method broke down partly because of cases where neither Australian market value nor world's parity prices were ascertainable. In our opinion the Commonwealth method is not less simple than the f.o.b. method.

11. The two attributes of **certainty** and early **finality** claimed for the f.o.b. method in the Report may be taken together, for they are hardly separable. What is meant by the claim is that under the f.o.b. method an exporter of goods, as soon as export occurs, can ascertain his position with regard to the taxation, if any, which will become payable upon the transaction, irrespective of whether the subsequent sale abroad discloses a profit, a loss, or neither. But the finality so ascertained can in many cases be only approximate. If the taxpayer's only source of income was the profit derivable from making one consignment or a series of consignments for sale abroad during any accounting period, he would, when the final shipment had been made, be in a position to set down his gains or losses for the purposes of taxation. But if such exports for sale abroad constituted a part only of his business, obviously he would be unable, until the end of the accounting period, to ascertain the rate of tax applicable to his export profits.

12. The “ finality ” said to be attained is attained by a highly artificial method. To take a buying and selling transaction and declare it closed for taxation purposes when all that has occurred is that a purchase has been made and the goods exported (though still unsold) is clearly arbitrary and artificial. The same remark applies where there has been no buying, but the exporter has produced or manufactured the goods exported. It has been suggested that there is an analogy with the taking into account of stock on hand at the end of the financial year ; but in reality the two cases are widely different. While the cost or market value of goods in stock at the end of the year affects the tax for that year, that same value will come into next year's account, and the final effect upon the owner's taxation will not be known until the goods are actually sold. Under the f.o.b. method, the result of the sale abroad, however advantageous to the owner, has no effect upon his tax. Again, as shown in paragraph 8, the “ finality ” desired would result in a final removing from the area of taxation of an important portion of the profits resulting from huge transactions by Australian residents.

13. **Paragraph 398—Equality of Opportunity.**—The paragraph in the Report so headed criticises the present Federal method as handicapping Australian residents. The criticism omits mention of the handicap imposed on a buyer visiting Australia, by the large expenditure in time and money which he must incur in reaching the Australian market and returning therefrom. It also omits the fact that nearly all the visiting buyers of Australian products come from countries in which the burden of Income Taxation is heavier than in Australia. In our opinion it is safe to say that on the two items of travelling expenditure and of Income Tax in the buyer's own country, the handicap in nearly every instance is upon the visiting buyer and not upon the Australian resident. But if the alleged handicap to Australian exporters as compared with visiting overseas buyers is **unreal**, the f.o.b. system would impose a **real** handicap upon one class of Australian trader as compared with another. Assume, for example, that A and B, two dealers in Australian products, go into the market on the same day and buy two similar parcels of goods at the same price. A exports his parcel almost immediately, the market remaining stationary meanwhile. B retains his parcel for a month or two, and, there being an advance in the market, then sells to an Australian manufacturer. In these circumstances, A, though he may have made a substantial profit overseas, would not be liable to Income Tax, while B would be liable.

14. **Paragraph 398A—Inequitable Operation.**—In this paragraph the report criticises the present Commonwealth method as operating inequitably in a type of cases which may often occur. Taking the same example as it would be dealt with under the f.o.b. method recommended in the Report, we find that A, who because of the superior efficiency of his equipment and management, produces at less cost than B, would be penalized for his greater efficiency by paying higher tax than his rival B ; though it might often happen in such cases that the ultimate profit derived by A when the goods were sold abroad would be less than that realized by B.

15. One further comment may be made. We are of opinion that the imposition of tax (as would occur under the f.o.b. method) upon purely buying transactions by persons who bring capital

into Australia for the purpose is unsound policy, as it would almost certainly have one of two effects—either it would tend to keep capital away from Australia, or the tax would be transferred to the Australian producer by a lowering of prices for his products. Whichever result occurred would be detrimental to Australia.

16. In our opinion, the disadvantages of the proposed f.o.b. method are such that its adoption would tend to be injurious to Australian producing interests; would create discontent as operating unfairly between one Australian trader and another; and would free from taxation large sums which are properly taxable.

17. The present Federal Cost method has some disadvantages, but it is free from the artificiality which characterizes the f.o.b. method, since it takes into account the final result of a trading venture, when actual and not merely theoretical profits or losses are ascertained, and, in our opinion, no substitutionary method yet proposed does equal justice to the taxpayer and to the Revenue, or is equally capable of general application.

#### RECOMMENDATION.

**We recommend—**

The retention of the present Federal Cost Method of dealing with exports.

(NOTE.—Attention is invited to the note at end of the section of the report dealing with Taxation of Income of Australian Residents derived outside Australia.)

W. T. MISSINGHAM.

S. MILLS.

M. B. DUFFY.

## CASUAL PROFITS.

## RESERVATION.

1. I am unable to accept the recommendations of the Report in regard to Casual Profits.
2. Casual Profits may be difficult to locate in all instances, but that does not mean they are not profits, and, therefore, income to the recipient. Any person who sells an article for a price higher than the price paid for it *primâ facie* makes a profit, and, though the transaction may be isolated, it is not different from profit made by selling several articles at prices higher than cost, which is the result of business. A business man may sell his whole business, and make a profit in one transaction equal to that which he would have made in five years of ordinary trading, and surely it cannot be said he should be free from tax on the profit made in one transaction instead of bit by bit over a period. Again, a man may buy a leasehold, and, after working the property for some time, sell the lease for a considerable profit, and this is rightly recognised as taxable profit (or rent) ; but a person who buys a freehold property, and, after working it himself for some time, sells it at a profit, such profit is not considered taxable profit. It is very difficult to distinguish between the two cases in essence. In share transactions it is quite conceivable a person may buy shares now and again with no intention of holding them for dividends, but simply to make a profit should the market rise, and this profit should certainly be included in income, notwithstanding its casual nature.
3. The Report does not recommend the inclusion of Casual Profits in income, because of the possibility of evasion, and the necessity for allowing losses.
4. If taxpayers evade their responsibilities to the nation, it is no reason for excluding this class of income from taxation ; rather would the effect of the inclusion be to lighten the burden upon regular incomes, and take some of the revenue required from windfalls and casual gains, which may sometimes be very large amounts.
5. Transactions in real estate and stocks and shares cannot be said to be difficult to locate as the necessary machinery could be put into operation to deal with such matters at very little extra cost.
6. As to the allowance for losses, I cannot see but that it is reasonable. Nobody sets out on a transaction anticipating a loss on it, and if a loss is made he is so much the poorer, and should be entitled to set the loss off against income.
7. Undoubtedly the best method of arriving at a person's income for a period is to take into consideration every gain and every loss of whatever nature that has taken place during the period, and the nearer Income Tax law is brought to this ideal, the more equitable it will be to the whole body of taxpayers.
8. I therefore **recommend** that the present law should be extended from time to time to include such Casual Profits as the Administration may feel satisfied could be safely handled without undue expense in the collection.

M. B. DUFFY.

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## APPENDIX 4.

AN AGREEMENT made the.....day of December, One thousand nine hundred and twenty, between the Commonwealth of Australia (hereinafter called the "Commonwealth"), of the one part, and the State of Western Australia (hereinafter called the "State") of the other part.

WHEREAS it is desirable in the public interests and to avoid duplication of services that the Land Tax, Income Tax, Totalisator Duty, and Dividend Duty, payable from time to time to the State (hereinafter called the "State Tax") and the Land Tax, Income Tax, War-time Profits Tax, Estate Duty, and Entertainments Tax, payable from time to time to the Commonwealth (hereinafter called the "Commonwealth Taxes") should so far as practicable be assessed and collected by the one agency; and WHEREAS it is necessary that any arrangement for that purpose should preserve inviolate the respective sovereign powers and rights of the Commonwealth and the State; and WHEREAS the Commonwealth has offered to collect the State Taxes under the conditions hereinafter contained for one-third of the expenditure required for the assessment and collection of the State taxes, as set forth in the estimates for the financial year of the State ending the thirtieth day of June, 1921, submitted by the State Government to the Parliament of the State; and WHEREAS the State has accepted the said offer, now it is agreed as follows:—

(1) The Commonwealth shall collect the Land Tax, Income Tax, Totalisator Duty, and Dividend Duty payable to the State Government, and the State Government shall pay to the Commonwealth Government for doing so an annual sum equal to one-third of the total amount (less the salary of the State Commissioner of Taxation) as certified by the Auditors-General of the State of Western Australia and of the Commonwealth as being involved in the assessment and collection of the said taxes during the financial year of the State ending thirtieth June, 1921.

(a) The State may from time to time appoint any person to be State Commissioner of Taxation (hereinafter called the "State Commissioner"), and may remove any person so appointed.

(b) The State shall fix and pay the salary of the State Commissioner.

(2) If the State appoints as State Commissioner the person for the time being holding the position of Deputy Federal Commissioner of Taxation for the State of Western Australia—

(a) The State shall pay to the Commonwealth an amount equal to the salary of the State Commissioner, determined in the manner provided by Clause 7 (b) hereof, for the period of such appointment.

(b) The Commonwealth shall, out of the said amount, pay the salary of any assistant officer to the Deputy Federal Commissioner deemed necessary by the Commonwealth Commissioner of Taxation (hereinafter called the "Commonwealth Commissioner").

(c) The Commonwealth shall pay to the Deputy Federal Commissioner, while State Commissioner, as additional salary, such portion of the residue (if any) of the said amount as the State approves, and

(d) The Commonwealth shall provide at its own cost all increments of salary granted to the said Assistant Officer.

(3) If the Commonwealth appointed the State Commissioner as Deputy Federal Commissioner of Taxation for the State of Western Australia—

(a) The State shall pay the salary of the State Commissioner, determined in manner provided by Clause 7 (b) hereof, and

(b) The Commonwealth shall appoint and pay any assistant officer to the Deputy Federal Commissioner deemed necessary by the Commonwealth Commissioner.

(4) If at any time, and so long as the State Government should appoint as the State Commissioner of Taxation the person for the time being holding the position of Deputy Federal Commissioner of Taxation for the State of Western Australia, the State Government shall pay to the Commonwealth Government an amount not exceeding the sum ascertained in accordance with Clause (1) of this agreement as the salary of the State Commissioner of Taxation for the purpose of paying the salary of an assistant officer to the Deputy Federal Commissioner of Taxation as in the opinion of the Federal Commissioner of Taxation is necessary. Such portion of the residue, if any, of the said sum so ascertained as may remain after paying the salary of the said assistant officer shall be paid to the Deputy Federal Commissioner of Taxation for his services as State Commissioner of Taxation, as the State Government may decide. The Commonwealth Government shall provide, without further charge to the State Government, all increments in salary which may be granted to the said assistant officer.

(a) The State Commissioner shall be responsible to the State for the due assessments and collection of the State Taxes and the administration of the laws of the State relating thereto, and shall be free from interference or control by the Commonwealth or the Commonwealth Commissioner.

(b) All matters arising in connexion with the exercise by the State Commissioner of his powers and functions under the laws of the State shall be determined by him in accordance with those laws.

(5) In the event of the Commonwealth Government appointing a State Commissioner of Taxation as the Deputy Federal Commissioner of Taxation for the State of Western Australia, the State Government shall pay the salary of the State Commissioner of Taxation as ascertained in accordance with paragraph (1) of this agreement, and the Commonwealth Government shall appoint and pay the salary of such assistant officer as in the opinion of the Federal Commissioner of Taxation is necessary for the effective collection of the State and Commonwealth Taxes mentioned in this Agreement.

(a) The Commonwealth Commissioner shall be responsible to the Commonwealth for the due assessment and collection of the Commonwealth Taxes and the administration of the laws of the Commonwealth relating thereto and shall be free from interference or control by the State or the State Commissioner.

(b) All matters arising in connexion with the exercise by the Commonwealth Commissioner of his powers and functions under the laws of the Commonwealth shall be determined by him in accordance with those laws.

(6) The Federal Commissioner of Taxation shall have authority to control the staff required to assess and collect the Taxes mentioned in this Agreement, and to make such arrangements for the conduct of the work involved as in his opinion are best calculated to secure efficiency and economy.

(a) The Commonwealth shall transfer to positions in the permanent Service of the Commonwealth all officers who on the first day of July, 1920, were and at the date when this agreement comes into operation are permanent or probationary permanent officers in the Service of the State in the State Taxation Office, and who consent to be so transferred.

(b) Each officer so transferred—

(i) shall be subject in all respects to the laws of the Commonwealth regulating the Public Service ;  
and

(ii) shall preserve all existing and accruing rights and shall be entitled to retire from office at the time and on the pension, retiring allowance which would be permitted by the laws of the State if his service with the Commonwealth were a continuation of his service with the State ; and

(iii) shall so far as practicable be employed on duties of status equal to those now performed by him.

(7) The Federal Commissioner of Taxation shall delegate to the person for the time being holding the position of State Commissioner of Taxation all necessary authority over staff as will enable the State Commissioner to administer the State Laws mentioned in this Agreement in the manner required by the State Government ; and such powers and functions in connexion with any Commonwealth Laws mentioned in this agreement as the Federal Commissioner deems necessary to assist him in the administration within the State of Western Australia of any of such Commonwealth Laws.

(a) The State shall pay to the Commonwealth in such year during the continuance of this Agreement an amount equal to one-third of the total estimated cost (less the salary of the State Commissioner) to the State of the assessments and collection of the State Taxes during the financial year ending the thirtieth day of June, 1921.

(b) For the purpose of such estimated cost officers of the State shall be deemed to be in receipt of salaries at rates determined in connexion with classification made by the State Public Service Commissioner in October, 1920.

(c) The said estimated cost shall include—

(i) Salaries of officers other than the State Commissioner ;

(ii) All relevant contingent expenditure included in Parliamentary Estimates of the State for the year ;

(iii) All other expenditure properly referable to the assessment and collection of the State Taxes, including rent of and interest payable by the State on the cost of premises occupied by the State for taxation purposes.

(d) The said estimated cost shall be determined by agreement between the Commonwealth Commissioner and the State Commissioner or in default of agreement by the State Auditor-General.

(e) The amount payable by the State shall be paid to the Commonwealth on or before the thirtieth day of June in each year.

(8) The Commonwealth shall provide all officers (other than the "State Commissioner") and office accommodation and equipment, and do all things necessary or convenient for the purposes of the assessment and collection of the State Taxes.

(9) The Commonwealth Commissioner shall have full control of all officers (other than the State Commissioner) employed in the assessment and collection of the State Taxes and may make such arrangements for the conduct of the work as in his opinion are best calculated to secure efficiency and economy.

(10) The Commonwealth Commissioner shall delegate to the State Commissioner such of his powers and functions (including authority over officers) as may be necessary or convenient to enable the State Commissioner—

(a) to administer in the matter required by the State the laws of the State relating to the State Taxes ;  
and

(b) to assist the Commonwealth Commissioner to administer within Western Australia the laws of the Commonwealth relating to the Commonwealth Taxes.

(11) The State Government agrees that when the State Law on any point is identical with the Commonwealth Law, the State Law shall be interpreted in the same manner as the Commonwealth Law.

(a) The State Commissioner shall delegate to the Deputy Federal Commissioner of Taxation for the State of Western Australia such of his powers and functions under the laws of the State as may be necessary or convenient to enable the Deputy Federal Commissioner to assist the State Commissioner to administer the said laws.

(b) The State Commissioner shall delegate to an officer or officers nominated for that purpose by the Commonwealth Commissioner such of his power and functions under the laws of the State as may be necessary or convenient to enable such officer or officers to assist the State Commissioner to administer the said laws in connexion with matters dealt with at the Central Office of the Commonwealth Commissioner pursuant to any arrangement made between the State Commissioner and the Commonwealth Commissioner.

(12) Where a law of the State is in terms identical with or substantially similar to a law of the Commonwealth the State Commissioner shall, in the administration of the Law of the State, adopt and act upon the interpretation for the time being given to the Law of the Commonwealth by the Commonwealth Commissioner unless and until the Law of the State is otherwise interpreted by a competent Court.

(13) Nothing in this agreement shall be deemed to restrict or impede the State in the exercise of its rights and powers under the Constitution of the State and the Laws of the State now or hereafter in force.

(14) The State Commissioner shall from time to time supply to the State and to its Ministers—

- (a) Information, advice, and assistance in connexion with Taxation Laws of the State ; and
- (b) Information necessary or convenient for the more efficient administration of other Laws of the State, such as the " Stamp Act," the " Administration Act," and the " Mining Act," required by the State or its Ministers and which the State Commissioner is able and legally empowered to supply.

(15) In order that the work of assessment and collection of Taxes may proceed expeditiously and economically, the Government of the State and the Commonwealth respectively will submit to Parliament before the thirtieth day of September in each year or as early as practicable thereafter proposed Laws fixing respectively the rates of the State and Commonwealth Taxes for that year, and endeavour to have those proposed Laws dealt with by Parliament without delay.

(16) The State Commissioner shall in the manner from time to time required by the State Treasurer deal with and account for all State Taxes collected pursuant to this agreement, and the Commonwealth Commissioner shall make any arrangements necessary or convenient to enable the State Commissioner to do so.

(17) The Commonwealth hereby authorize the Commonwealth Commissioner to make such provision as he deems necessary for the compilation of all reasonable statistics concerning the State Taxes as the State may require.

(18) The Commonwealth Government shall enable the Federal Commissioner of Taxation to make such revision as in his opinion is necessary for the compilation of all reasonable statistics concerning the State Taxes mentioned in this Agreement as the State Government may require.

(a) In addition to or in lieu of the forms of return respectively from time to time prescribed for State and Commonwealth Land Tax, Income Tax purposes, there shall be prepared—

- (i) A joint form of Land Tax return suitable for both State and Commonwealth Land Tax purposes in Western Australia ; and
- (ii) A joint form of Income Tax return suitable for both State and Commonwealth Income Tax purposes in Western Australia.

(b) Returns furnished in the joint form of taxpayers owning land in or deriving income from sources in Western Australia only shall be accepted as sufficient so far as form is concerned.

(c) Taxpayers owning land in or deriving income from sources in Western Australia and elsewhere in Australia shall be given the option of furnishing—

- (i) Returns in the Commonwealth prescribed form only at the Commonwealth Central Office; or
- (ii) Returns in the Commonwealth prescribed form at the Commonwealth Central Office, and in addition, returns in the State prescribed form at the Office in Western Australia.

(d) Assessment of land or income for the purpose of State Tax may be made at the Commonwealth Central Office when returns have been furnished only at that office. Any assessment for State Tax made at the Central Office shall be notified to the State Commissioner, and any State Tax collected by the Commonwealth shall be accounted for and dealt with as the State Commissioner shall require.

(19) So far as practicable one form of receipt shall be issued when both State Tax and Commonwealth Tax are paid at the same time by the same taxpayer unless the circumstances of the case make separate forms of receipt advisable.

(20) When income derived from sources within Western Australia or land owned in Western Australia is being assessed in the Central Office of the Commonwealth Department of Taxation, on behalf of the State Government, the Federal Commissioner of Taxation shall make a separate assessment of that particular income or land for the purposes of the State Government, and shall separately account for it to the State Treasurer, and deal with it in such manner as the State Treasurer may direct.

(a) Prosecutions for offences against the Laws of the State relating to the State Taxes shall be conducted by and at the expense of the Commonwealth.

(b) When an act or omission constitutes an offence under both the Law of the State and the Law of the Commonwealth—

- (i) a prosecution may in the discretion of the Commonwealth Commissioner be instituted under either law ;
- (ii) as a general rule the prosecution shall be instituted under the law which provides the greater penalty ;
- (iii) any monetary penalty recovered shall be paid into the Consolidated Revenue of the party under whose law the prosecution is instituted ; and
- (iv) the party into whose revenue the penalty is paid shall pay or credit to the other party one-half of the amount of the penalty.

(c) When an act or omission constitutes an offence under one law only, any monetary penalty recovered shall be paid into the Consolidated Revenue of the party under whose law the prosecution is instituted, and be retained wholly by that party.

(21) Where, by reason of an act, default, or omission of a taxpayer a sum has been collected as penalty or additional tax by way of penalty (not being a penalty imposed by a Court) such sum shall be applied as follows :—

- (a) If the sum is recoverable under one law only it shall be retained wholly by the party under whose law it is recovered ; or
- (b) If the sum is recoverable under both the law of the State and the law of the Commonwealth it shall be divided equally between the State and the Commonwealth.

(22) If a taxpayer at any time pays less than the full amount then due and payable by him for State and Commonwealth Taxes the amount paid shall (unless the taxpayer otherwise directs) be credited to the State and to the Commonwealth respectively *pro rata* to the full amount then due and payable by the taxpayer to the State and the Commonwealth.

(23) The State shall arrange for the State Commissioner to receive from time to time from the State Attorney-General's Department, free of charge, all legal advice which the State Commissioner may desire in connexion with the administration of the laws of the State relating to the State Taxes.

(24) The State Commissioner shall not take any action to defend in the Courts an appeal instituted by a taxpayer against an assessment for State Tax unless and until the Commonwealth Commissioner has obtained the advice of the Commonwealth Law Officers on the matter in issue, and the State Commissioner shall deal with such appeal in the matter advised by the Commonwealth Law Officers.

(25) Before any appeal by a taxpayer against an assessment of tax under any of the State Laws mentioned in this Agreement is referred to a Court the appeal shall be submitted by the Federal Commissioner of Taxation for the advice of the Solicitor-General of the Commonwealth as to the correct interpretation of the law, and the appeal shall be allowed or disallowed, in accordance with such advice.

- (a) The State will, by its Government, take any action within its power to obtain such amendments in any of the laws of the State as may be necessary or advisable to enable this Agreement to be fully and effectively performed on its part.
- (b) The Commonwealth will, by its Government, take any action within its power to obtain such amendments in any of the laws of the Commonwealth as may be necessary or advisable to enable this agreement to be fully and effectively performed on its part.
- (c) Such amendments shall, *inter alia*, include any amendments deemed necessary or advisable by the Commonwealth Commissioner to provide for the custody of documents and records relating to the assessment and collection of State and Commonwealth taxes and the effective discipline and control of officers employed on such assessment and collection.

(26) Any notice to be given by either party to the other under this Agreement shall be deemed to have been duly given if signed by the Treasurer of the party giving it and sent by prepaid post addressed to the Treasurer of the other party.

(27) This Agreement shall come into operation on the first day of July, One thousand nine hundred and twenty-one, and shall continue in force until the expiration of not less than six calendar months' notice in writing by either party of intention to terminate it, which notice may be given at any time.

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# APPENDIX 5.

## COMMONWEALTH AND STATE REVENUE FROM TAXATION, 1920-21.

Government.	Population.	Indirect Taxation, Customs and Excise.	DIRECT TAXATION.												
			Estate and Probate and Succession Duties.	Other Stamp Duties.	Land Tax.	Income Tax.		Entertain- ment Tax.	Licenses.	Other Taxation.	Total Direct Taxation.			Cost of Collection.	
						Total Collections.	Per Capita.				Total Collection.	Per Capita	Total Cost.*	Percentage of Collection.†	Per Capita.
		£	£	£	£	£ s. d.	£	£	£	£	£	%	s. d.		
Commonwealth ..	5,455,423	C 21,731,210 E 10,078,696	1,179,513	..	2,155,699	2 12 7	649,828	..	£2,281,067	20,617,515	3 15 7	2 49	1 10 59		
		(Per Capita Payments from the Commonwealth Government.)													
New South Wales ..	2,101,384	2,533,234	734,352	1,414,468	2,717	4,399,360	2 1 10	..	212,744	624,492	7,388,133	3 10 4	\$0 71	\$0 6 01	
Victoria ..	1,535,938	1,878,449	702,468	928,367	331,756	1,591,198	1 0 9	..	274,020	19,024	3,846,833	2 10 1	1 64	0 9 86	
Queensland ..	768,964	912,628	328,204	332,559	469,175	2,410,171	3 2 8	..	88,567	53,966	3,682,642	4 15 9	1 52	1 5 50	
South Australia ..	497,525	588,603	158,107	370,288	168,020	852,001	1 14 3	..	37,212	36,448	1,622,076	3 5 2	2 35	1 6 42	
Western Australia...	333,117	564,735	42,407	177,404	57,791	579,289	1 14 9	..	41,020	57,448	955,359	2 17 4	3 55	2 0 40	
Tasmania ..	211,984	272,514	53,407	148,893	89,085	348,005	1 12 10	..	16,164	53,049	708,603	3 6 10	2 32	1 6 58	
		S 90,000													
All States ..	5,448,912	6,840,163	2,018,945	3,371,979	1,118,544	10,180,024	1 17 4	..	669,727	844,427	18,203,646	3 6 9	1 43	0 11 46	
Commonwealth and States ..	†5,455,423	31,809,906	3,198,458	3,371,979	3,274,243	24,531,432	4 9 11	649,828	669,727	3,125,494	38,821,161	7 2 4	1 99	2 10 04	

### SUMMARY.

Governments	Taxation.	Collections.	
		Total.	Per Capita.
Commonwealth	Indirect ..	£ 31,809,906	£ s. d. 45 16 7
	Direct ..	20,617,515	3 15 7
	Total ..	52,427,421	9 12 2
States ..	Direct ..	18,203,646	3 6 9
	Total—Commonwealth and States	70,631,067	12 18 11

G Customs Duty. E Excise Duty. S Special Subsidy.

\* Includes expenses of Commissioners of Taxation and Stamp Duties. Certain minor expenses are also incurred in connexion with the collection of Licence Fees, &c., by other than Taxation Departments. Such expenses are not ascertainable, but they would not however affect the percentage Cost to any appreciable extent.

† War Time Profits Tax, £2,083,139; War Postage, £197,928.

‡ These figures beyond being of Statistical Interest are of little economic value, as they are chiefly dependent upon the rates charged, thus the doubling of the rates by any particular Government, whilst the Total Cost remains constant would have the effect of halving the percentage cost.

§ Low Costs partly attributable to contraction of work consequent on high exemptions and allowances releasing from Taxation a large number of incomes which would be taxable in other States and by the Commonwealth.

† Includes Northern Territory, 3,928; Federal Territory, 2,563

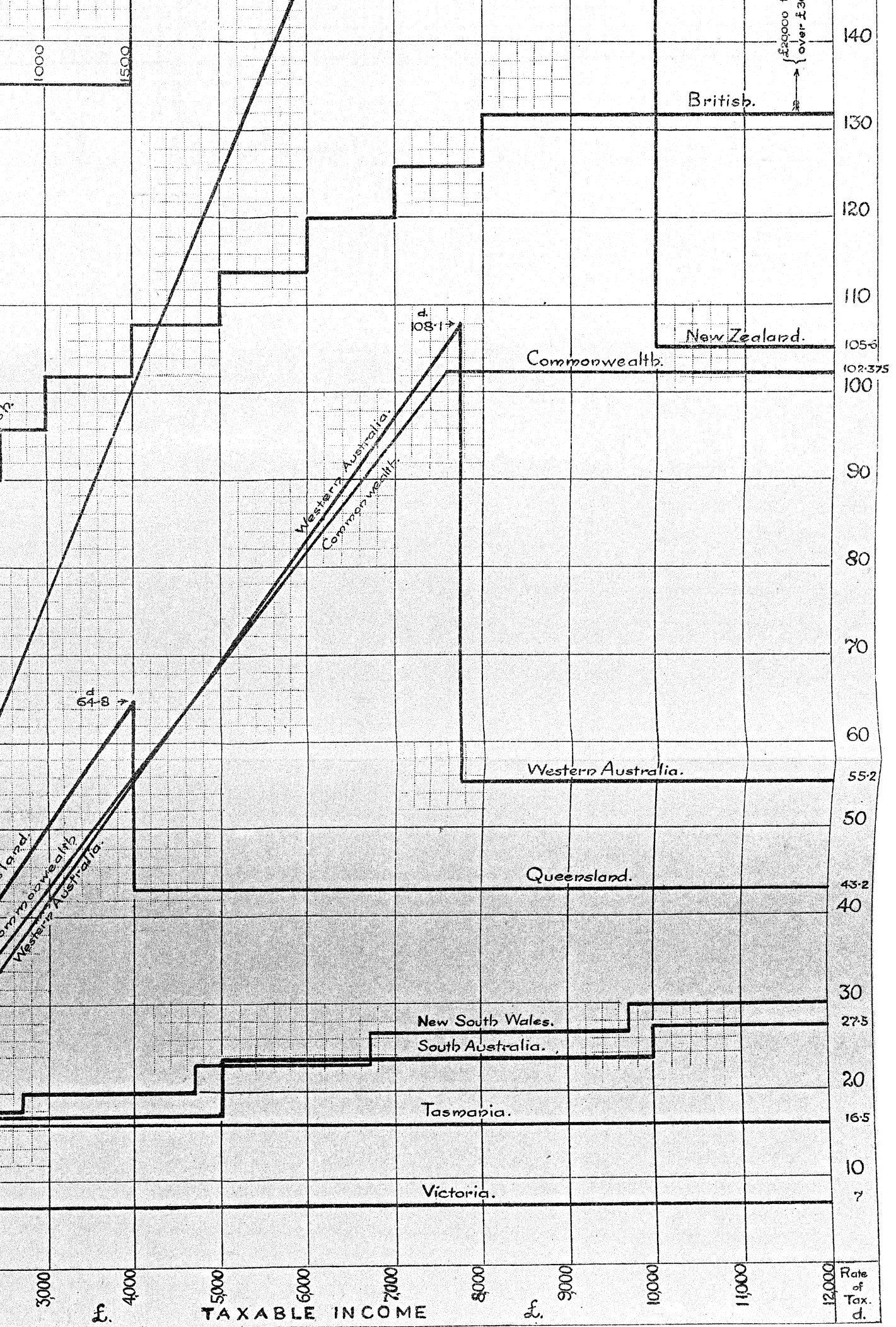
† The Commonwealth does not retain the whole of these collections, but distributes portion amongst the States on a basis of £1 5s. per capita, subject to minor adjustments.

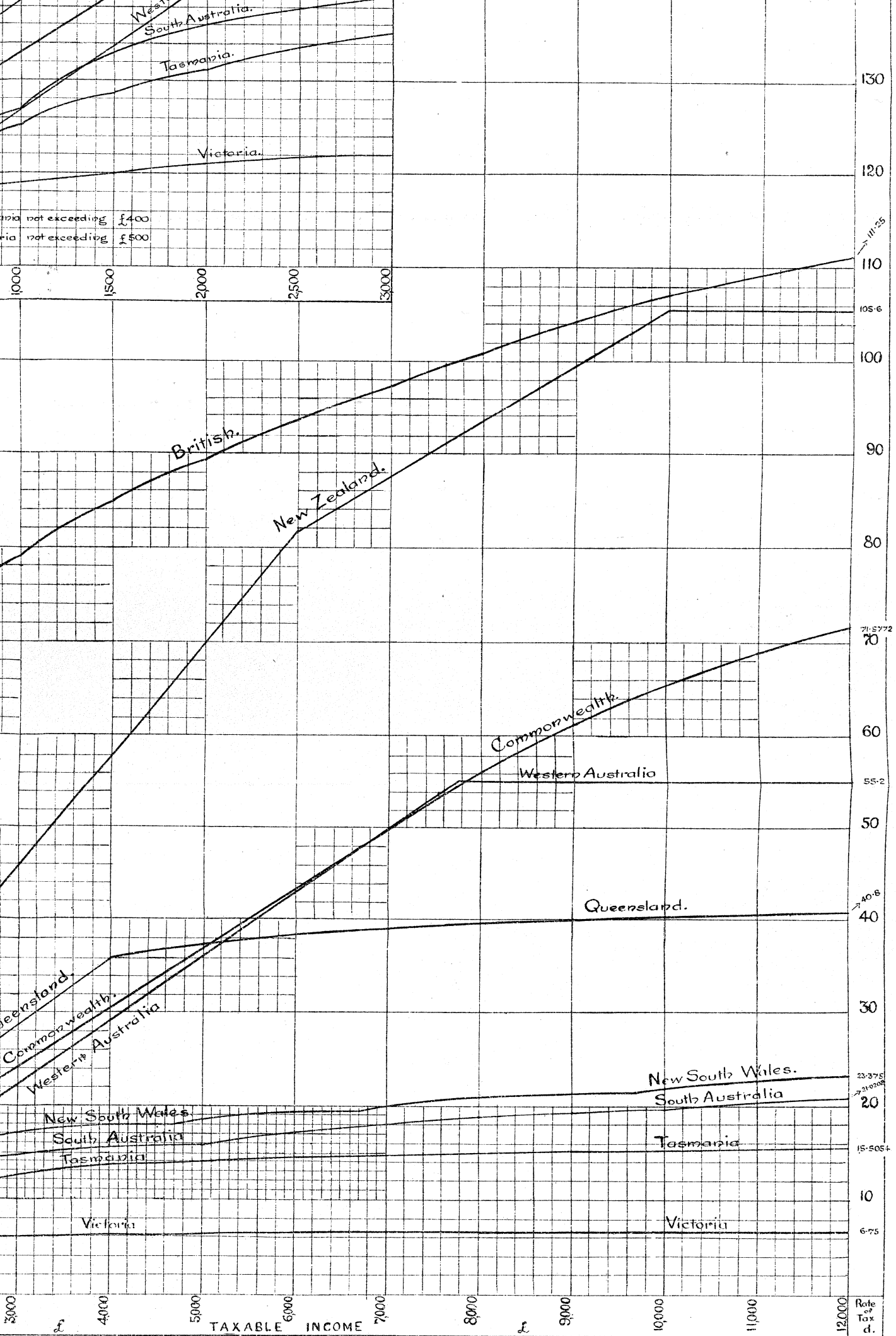
## APPENDIX No. 6.

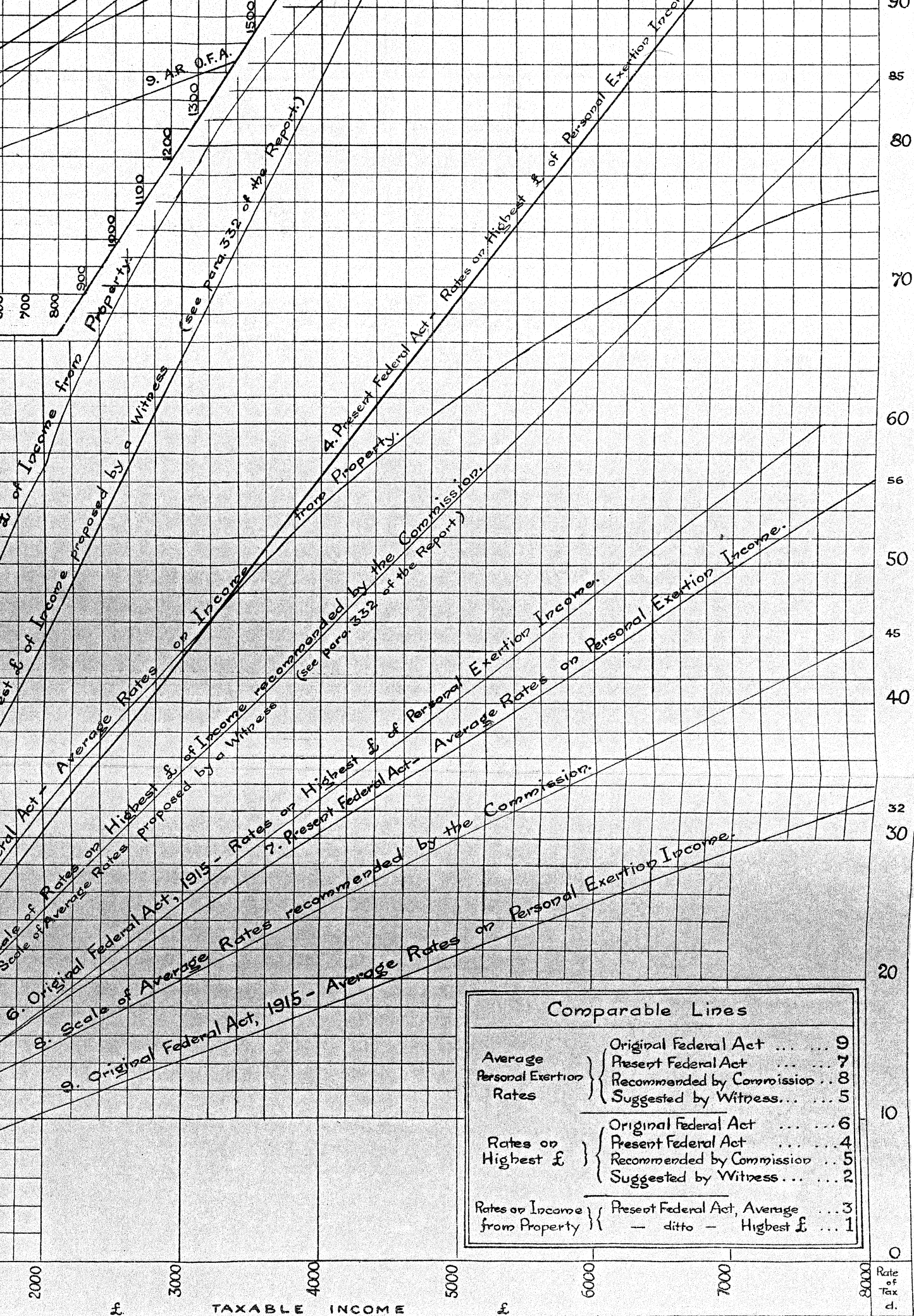
## SUMMARY OF PROVISIONS DEFINING THE SPHERE OF TAXATION IN THE VARIOUS INCOME TAX ACTS IN FORCE IN BRITISH DOMINIONS.

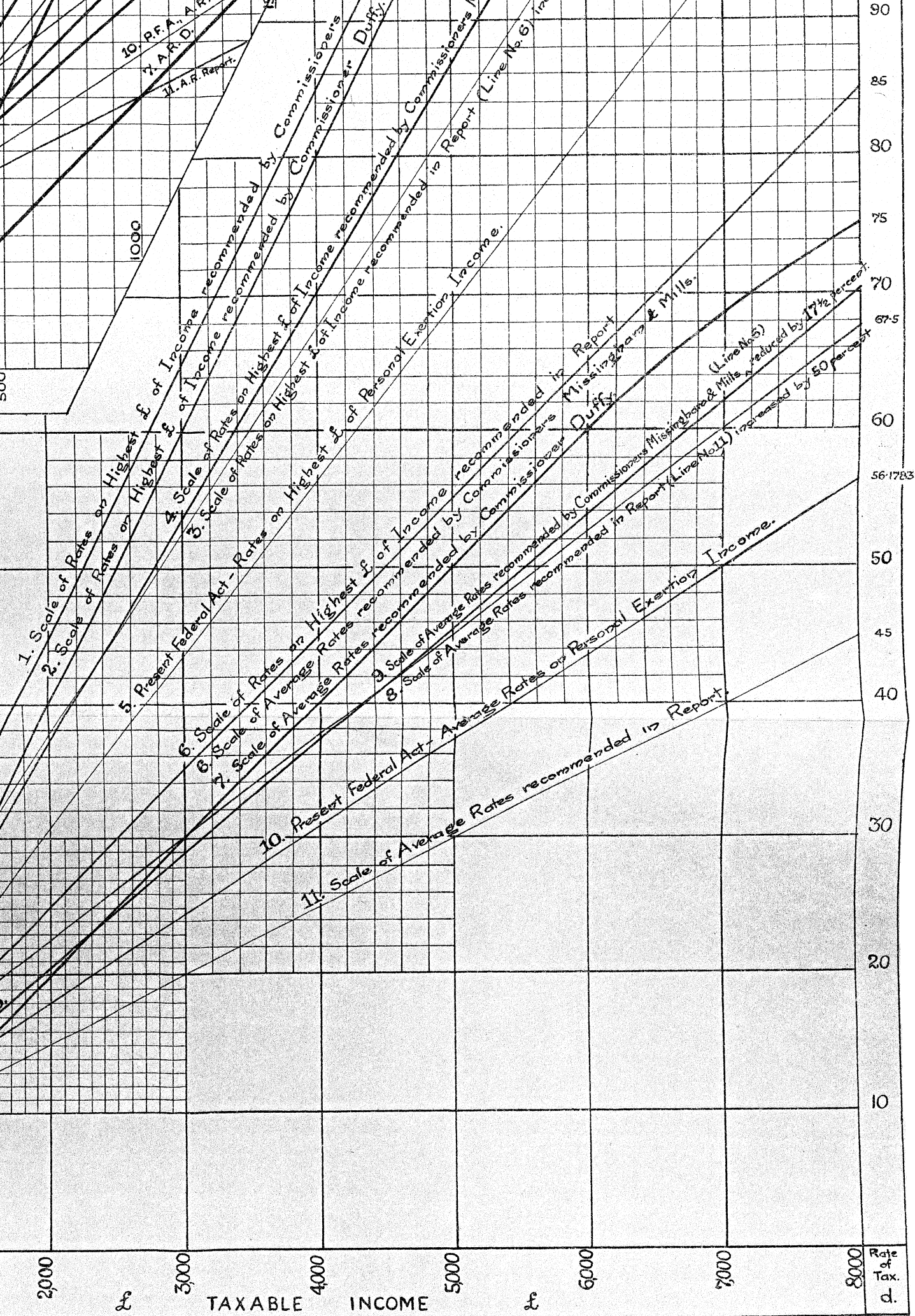
Commonwealth of Australia	Income derived directly or indirectly from sources in Australia.
New South Wales ..	Income derived from any source in the State or earned therein. Income derived from sources outside the State is specifically exempted.
Victoria ..	Income earned in or derived in or from Victoria, and income arising or accruing from any trade carried on in Victoria
Queensland ..	Income earned in or derived in or from Queensland, and income arising or accruing from any business carried on in Queensland.
South Australia ..	Income arising or accruing in or derived from the State.
Western Australia ..	Income arising from or accruing in Western Australia. Income earned outside the State is specifically exempted.
Tasmania ..	Income arising, accruing, received in or derived from the State. Where a taxpayer residing in Tasmania derives any income from a source outside Tasmania, he may deduct from the Tasmanian tax such sum as he shows to have been paid by him by way of Income Tax elsewhere on the same income. Where income is derived from mortgages of land assessed to Land Tax elsewhere, the Land Tax on the mortgages may similarly be deducted.
New Zealand ..	Income received by residents in New Zealand wherever derived. Income derived by a person resident in New Zealand, but not derived from New Zealand, is exempt from Income Tax, if and so far as the Commissioner is satisfied that it is derived from some other country within the British Dominions, and that it is chargeable with Income Tax in that country.
Fiji ..	Income derived by a resident from some other country within the British Empire, except the United Kingdom, if charged with Income Tax in such country, is specifically exempted. Any person who proves that he has paid Fiji Income Tax and United Kingdom Income Tax for the same year in respect of the same part of his income is entitled to relief at a rate equal to the excess of the appropriate rate of Fiji Tax over half the appropriate rate of United Kingdom Tax, or if the Fiji rate exceeds the United Kingdom rate at half the United Kingdom rate.
Union of South Africa	Income from any source within the Union or deemed to be within the Union. Income is deemed to be derived from a source within the Union, if it is received or accrues from any country outside the Union where the income is not chargeable to Income Tax owing to the fact that such person is not domiciled or ordinarily resident therein.
Southern Rhodesia	Income from any source within the Union or deemed to be within the Union. Income is deemed to be derived from a source within the Territory if it is received by or accrues to or in favour of any person ordinarily resident or carrying on business within the Territory, and is received or accrues from any source except banking or insurance business in any adjoining territory, provided that it is not chargeable with income or any other tax therein.
Northern Rhodesia ..	Income from any source within the Territory or deemed to be within the Territory.
Basutoland ..	Income from any source within the Territory or deemed to be within the Territory. Income is deemed to be derived from sources within the Territory, if it is received or accrues from any country outside the Territory where, owing to the fact that such person is not domiciled or ordinarily resident therein, the income is not chargeable to Income Tax.
Kenya ..	Income received by or accrued to any person or brought into the Colony or the Protectorate. Income brought into the Colony or the Protectorate and accruing or arising in any part of the British Empire or in any territory under His Majesty's protection is liable to tax at a rate equal to the excess of the rate in force in the Colony or the Protectorate over the rate paid in the country from which such income is derived. Any person resident in the United Kingdom who has paid by deduction or otherwise, or is liable to pay Income Tax under the Kenya Ordinance for any year of assessment on any part of his income, and who proves to the satisfaction of the Commissioner that he has paid Income Tax in the United Kingdom for that year in respect of the same part of his income, is entitled to relief from Income Tax under the Ordinance paid or payable by him on that part of his income at a rate equal to the amount by which the rate of tax appropriate to his case under the Ordinance exceeds half the appropriate rate of United Kingdom tax. If, however, the rate of tax appropriate to his case under the Ordinance exceeds the appropriate rate of United Kingdom tax, he is entitled to relief at a rate equal to half the appropriate rate of United Kingdom tax.
Seychelles ..	Income from any source, whether in or out of Seychelles. Exemption is allowed in respect of income charged with Income Tax in some other country of the British Empire.
British India ..	All income (except from agricultural and a few other sources), if it accrues or arises or is received, or is deemed to accrue, arise or to be received, in British India.
Straits Settlements	Income from any source. Exemption is allowed in respect of any income <i>not arising in the Colony</i> on which Income Tax has been or will be paid in the United Kingdom or in any British Possession, Protectorate or Protected State at a rate not less than that chargeable under the Ordinance.
Canada ..	Income from sources within Canada or elsewhere. Deduction from the tax is allowed of the amount paid to Great Britain or any of its self-governing colonies or dependencies for Income Tax in respect of the income of the taxpayer derived from sources therein, and the amount similarly paid to any foreign country, if such foreign country treats Canada reciprocally, provided that such amount does not exceed the Canadian tax which would otherwise have been payable on the income in question.

British Columbia ..	Income derived in the Province, and income earned elsewhere received in the Province.
Prince Edward Island	Income derived in the Province, and income earned elsewhere received in the Province.
Jamaica .. ..	Income from any source whatsoever. Income Tax paid in any part of His Majesty's Dominions or in any country under His Majesty's protection on any income liable to Income Tax in Jamaica may be deducted from the tax payable in Jamaica upon such part of the income. Insurance Companies are not allowed the benefit of this provision.
Trinidad and Tobago	Income from any source. A person liable to Income Tax, both in the United Kingdom and in the Colony, is entitled to relief from such part of the tax for which he is liable in the Colony as will, together with the relief to which he may be entitled in the United Kingdom, amount to the lower of the two taxes for which he is liable.
St. Vincent ..	Income derived in the Colony, and income derived elsewhere if received in the Colony. Income Tax paid in any part of His Majesty's Dominions or in any country under His Majesty's protection may be deducted from the St. Vincent tax payable on the same income.
Grenada .. ..	Income derived in the Colony, and income derived elsewhere if received in the Colony. Any person who proves that he has paid Grenada Income Tax and United Kingdom Income Tax for the same year in respect of the same part of his income is entitled to relief at a rate equal to the excess of the appropriate rate of Grenada tax over half the appropriate rate of United Kingdom tax, or if the Grenada rate exceeds the United Kingdom rate at half the United Kingdom rate.
St. Lucia .. ..	Income derived in the Colony, and income derived elsewhere if received in the Colony.
British Honduras ..	Income derived in the Colony and income derived elsewhere if received in the Colony. Any person who proves that he has paid British Honduras Income Tax and United Kingdom Income Tax for the same year in respect of the same part of his income is entitled to relief at a rate equal to the excess of the appropriate rate of British Honduras Income Tax over half the appropriate rate of United Kingdom Income Tax, or, if the British Honduras rate exceeds the United Kingdom rate, at half the United Kingdom rate. Relief is granted in similar terms in respect of Income Tax paid in any other British Dominion, Colony or Protectorate.
Dominica .. ..	Income wherever derived.
Isle of Man .. ..	Income wherever derived. It is provided that:—"Whether derived from sources out of or within this island, with regard to income in respect of which Income Tax is payable by law in any place other than this island being part of the Dominions of the Crown (the same being hereafter in this Act referred to as 'elsewhere') the Income Tax payable under this Act shall be only at such rate and for such amount (if any) as the Income Tax payable under this Act shall be in excess of the Income Tax payable elsewhere."
Guernsey .. ..	Income wherever derived. Profits or income other than profits or income arising from sources in or connected with the Island of Guernsey upon which English ( <i>sic</i> ) Income Tax has been paid or deducted is exempt from the Guernsey tax to the extent which the Guernsey tax, if paid, could not be recovered from the English ( <i>sic</i> ) Inland Revenue.









56-1783