



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Consideration of Budget Estimates

TUESDAY, 4 JUNE 2002

CANBERRA

BY AUTHORITY OF THE SENATE

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SENATE
ECONOMICS LEGISLATION COMMITTEE
Tuesday, 4 June 2002

Members: Senator Brandis (*Chair*), Senator Jacinta Collins (*Deputy Chair*), Senators Chapman, Murray, Schacht and Watson

Senators in attendance: Senators Brandis, Calvert, Collins, Conroy, Cook, Heffernan, Murphy, Schacht, Sherry and Watson

Committee met at 9.01 a.m.

TREASURY PORTFOLIO

In Attendance

Senator Minchin, Minister for Finance and Administration

Senator Abetz, Special Minister of State

Department of the Treasury

Mr Roger Brake, General Manager, Retirement and Personal Income Division

Mr Colin Brown, Manager, Costings and Quantitative Analysis Unit

Mr Russell Campbell, Manager, Financial Services Regulation Unit

Mr Joe Castellino, Intergovernment Relations Unit

Mr John Coleman, Chief Financial Officer, Accounting and Financial Management Unit

Mr Blair Comley, General Manager, Macroeconomic Policy

Ms Lynne Curren, Specialist Adviser, Financial Institutions Division

Mr Graeme Davis, General Manager, Strategy and Coordination Unit

Mr Damien Dunn, Manager, Economic Conditions Division

Ms Laurene Edsor, General Manager, Commonwealth State Relations Division

Mr Murray Edwards, General Manager, Board of Taxation

Mr Ron Foster, General Manager, Indirect Tax Division

Mr Steve French, General Manager, Financial Institutions Division

Mr Phil Gallagher, Manager, Retirement and Income Modelling Unit

Mr Peter Greagg, Manager, Revenue Analysis Unit

Mr Godwin Grech, Specialist Adviser, Financial Institutions Division

Dr Paul Grimes, General Manager, Budget Policy Division

Dr Jim Hagan, General Manager, Foreign Investment Division

Mr Rob Heferen, General Manager, Corporate Governance and Accounting Policy Division

Mr John Hill, General Manager, Consumer Affairs Division

Ms Natalie Horvat, Manager, Strategic Policy Unit

Mr Stewart Jones, General Manager, Structural Reform Division

Mr Bill Keown, HIH Royal Commission Task Force

Mr Chris Legg, General Manager, International Economy Division

Mr Paul Lindwall, Specialist Adviser, Domestic Economy Division

Mr Peter Martin, Australian Government Actuary

Mr David Martine, General Manager, Business Entities and International Tax Division

Mr Andrew Matters, Forecasting Unit
Ms Maryanne Mrakovcic, General Manager, International Finance Division
Mr Richard Murray, Chief Adviser, Corporate Strategy
Dr Paul O'Mara, General Manager, Domestic Economy Division
Dr Martin Parkinson, Executive Director, Economic Group
Mr Nigel Ray, Executive Director, Markets Group
Mr Ian Robinson, General Manager, Corporate Services Division
Mr Jason Russo, Economic Conditions Division
Mr Iain Scott, Manager, Fiscal Policy Unit
Mr Greg Smith, Executive Director, Budget Group
Mr Nick Stoney, Manager, Forecasting Unit
Mr David Tune, General Manager, Business Income and Industry Policy Division
Mr David Turvey, Specialist Adviser, Fiscal Policy Unit
Ms Sue Vroombout, General Manager, Financial Markets Division
Mr Wayne Poels, International Economic Conditions and Outlook Unit
Mr Stephen Miners, Manager, International Monetary Fund Unit

Australian Accounting Standards Board

Mr Keith Alfredson, Chairman

Australian Bureau of Statistics

Mr Rob Edwards, Acting Australian Statistician
Mr Peter Harper, Acting Deputy Australian Statistician
Mr Graeme Hope, First Assistant Statistician, Corporate Services Division
Ms Marion McEwin, Assistant Statistician, Policy Secretariat Branch

Australian Competition and Consumer Commission

Mr Robert Antich, General Manager, Compliance Strategies Branch
Mr Brian Cassidy, Chief Executive Officer
Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division
Ms Lin Enright, Director, Public Relations
Mr Tim Grimwade, Director, Adjudication Branch
Mr Gordon Lister, Management Accountant
Ms Helen Lu, General Manager, Corporate Management Branch
Ms Marlene McClelland, Director, Finance and Services
Mr Mark Pearson, General Manager, Mergers and Asset Sales Branch
Mr David Smith, Executive General Manager, Compliance Division

Australian Prudential Regulation Authority

Mr Greg Brunner, General Manager, Policy Research and Consulting Division
Mr Tom Karp, Executive General Manager, Diversified Institutions Division
Mr Les Phelps, Executive General Manager, Specialised Institutions Division
Dr Darryl Roberts, General Manager, Specialised Institutions Division
Mr Graeme Thompson, Chief Executive Officer

Australian Securities and Investments Commission

Ms Kate Harvey, Director, Public Affairs
Mr Carlos Iglesias, Executive Director, Infrastructure
Mr Ian Johnston, Executive Director, Financial Services Regulation

Mr Peter Kell, Executive Director, Consumer Protection
Mr David Knott, Chairman
Mr Andrew Larcos, Government Relations Adviser
Mr Ian Mackintosh, Chief Accountant
Ms Jan Redfern, Deputy Executive Director Enforcement
Mr Malcolm Rodgers, Executive Director, Policy and Markets Regulation
Mr Peter Wood, Executive Director, Enforcement

Australian Office of Financial Management

Mr Michael Allen, Chief Executive Officer
Mr Paul Ferris
Mr Andrew Johnson
Ms Erin Martin
Mr Peter McCray, Deputy Chief Officer
Mr Pat Roccosta, Chief Financial Officer
Mr Craig Thornburn

Australian Taxation Office

Mr Leo Bator, Deputy Commissioner, Superannuation
Mr Michael Carmody, Commissioner
Mr Paul Duffus, Deputy Commissioner, Excise
Mr Kevin Fitzpatrick, First Assistant Commissioner, Aggressive Tax Planning
Ms Jennie Granger, Deputy Commissioner, Personal Tax
Ms Erin Holland, Deputy Commissioner, Client Account Management
Mr Neil Mann, Deputy Commissioner, Small Business
Ms Donna Moody, Chief Finance Officer
Mr Barrie Russell, Deputy Commissioner, GST

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director

Financial Reporting Council

Mr Mike Kooymans
Mr Jeffrey Lucy, Chairman

Productivity Commission

Mr Robert Kerr, Head of Office
Mr Garth Pitkethly, First Assistant Commissioner

Takeovers Panel

Mr Nigel Morris, General Manager

CHAIR—I call to order this hearing of the Senate Economics Legislation Committee. On 14 March 2002, the Senate referred to the committee the particulars of proposed expenditure in respect of the year ended 30 June 2003 for the two portfolio areas of Treasury and Industry, Tourism and Resources. The committee will consider proposed expenditure for departments and agencies in the order in which they appear on the circulated agenda that was agreed to by the committee last week. Today the committee will commence to examine the Treasury portfolio.

While the Senate Finance and Public Administration Legislation Committee oversees the format of the portfolio budget statements, I remind you that the Senate Economics Legislation

Committee is continuing to monitor the format of the PBSs presented to it. This is in accordance with the recommendation of the Senate Finance and Public Administration Legislation Committee in its third report on the format of PBSs that the legislation committees report on the adequacy of the PBSs provided for their use.

The committee has authorised the recording and rebroadcasting of its public proceedings in accordance with the rules contained in the order of the Senate of 31 August 1999 concerning the broadcasting of committee hearings. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has a discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise. I also remind officers of the resolutions agreed to by the Senate on 25 February 1988 concerning the proceedings of committees and, in particular, resolution 1(9), which provides:

A chairman of a committee shall take care to ensure that all questions put to witnesses are relevant to the committee's inquiry and that the information sought by those questions is necessary for the purpose of that inquiry. Where a member of a committee requests discussion of a ruling of the chairman on this matter the committee shall deliberate in private session and determine whether any question which is the subject of that ruling is to be permitted.

And resolution 1(10) provides:

Where a witness objects to answering any question put to the witness on any ground including that the question is not relevant or that the question may incriminate the witness, the witness shall be invited to state the ground upon which objection to answering the question is taken. Unless the committee determines immediately that the question should not be pressed, the committee shall then consider in private session whether it will insist upon an answer to the question having regard to the relevance of the question to the committee's inquiry and the importance to the inquiry of the information sought by the question.

If the committee determines that it requires an answer to the question, the witness shall be informed of that determination and the reasons for the determination and shall be required to answer the question only in private session, unless the committee determines that it is essential to the committee's inquiry that the question be answered in public session. Where a witness declines to answer a question to which a committee has required an answer the committee shall report that fact to the Senate.

And resolution 1(16) states:

An officer of a department of the Commonwealth or of a State shall not be asked to give opinions on matters of policy, and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a Minister.

Witnesses should note that the evidence given to the committee is protected by parliamentary privilege. I also remind you that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. At the conclusion of the hearings, the committee will set a date for the receipt of written responses to questions taken on notice. The committee will prepare a report on its examination of the estimates, which will be tabled in the Senate on or before 19 June 2002.

[9.06 a.m.]

Department of the Treasury

CHAIR—I welcome to the table Senator the Hon. Nick Minchin; Mr Carmody, the Commissioner of Taxation; and officers of the Australian Taxation Office. Do you wish to make an opening statement?

Senator Minchin—Only to express Senator Coonan's apologies. On the occasion of her father's bereavement, I am filling in for her.

Senator CONROY—You may recall at the last round of estimates that we had a discussion about the timeliness of replies to questions on notice. Senator Brandis, was a letter forwarded on behalf of the committee to the tax office or to the Treasury?

CHAIR—Senator Conroy, you wrote to me and at your request I caused the committee secretariat to write to the minister. I thought copies of my letter to the minister had been forwarded to you.

Senator CONROY—They had. I was trying to remember who you wrote to—whether it was direct to Mr Carmody—

CHAIR—No, it was to Senator Coonan.

Senator CONROY—Unfortunately, there was a bit of a delay in getting our responses. Could I confirm that you were able to complete your responses within the time frame?

Mr Carmody—Yes, we did.

Senator CONROY—Within the relevant 30 days you had forwarded on all of your answers?

Mr Carmody—We had not completed them; we had referred them to the minister.

Senator WATSON—You might recall that, at the same Senate estimates meeting, I asked a question of particular relevance to Tasmania—I think the same procedure applies in other states—about construction employees who have their long service leave paid into a separate entity which is managed independently. There is an unusual fringe benefit tax ruling that impacted adversely on those particular arrangements. You undertook to get back to the committee about that, but I do not appear to have received a copy of that letter.

Mr Carmody—I apologise, Senator. We responded to everything that was pulled out by my staff. However, that particular issue does—

Senator WATSON—You said you would look into it.

Mr Carmody—Yes, and we have been. The matter raises policy issues and they have been referred to the minister.

Senator WATSON—Do we wait for the minister's response?

Mr Carmody—Our ruling is a public ruling and we have ruled that way. This particular aspect of it was raised with us and the representations raised policy issues that we felt were appropriate to refer to the minister.

Senator CONROY—Mr Smith, were the Treasury answers all completed within the time frame and forwarded on to the minister?

Mr G. Smith—Certainly the ones that I took, that I am aware of. I did check that.

Senator CONROY—Senator Minchin, I appreciate your standing in at the bar for Senator Coonan. It appears from the evidence of the officers that all the questions were forwarded on to the minister's office within the Senate's required time, but they filtered out of the minister's office only a short time before the estimates. Could you ask Senator Coonan what the delay was in providing the Senate with the answers that Treasury and the Taxation Office had forwarded on to her within the time frame? Clearly it is unsatisfactory from this side of the table.

Senator Minchin—I am keen for ministers' offices to answer questions from Senate committees. I will happily follow that up.

Senator CONROY—If they could all be as efficient as your office, Senator Minchin, we would be fine. Mr Carmody, I refer to a report in the *Sydney Morning Herald* on Wednesday, 27 May, which said that the ATO had to suspend the processing of debt demands for a period of five days, from 23 March to 28 March, because it ran out of paper. Is that fair dinkum? We could have had a whip around the office to collect you some!

Mr Carmody—I'm going to take back a few pads!

Senator CONROY—Search him before he leaves!

Mr Carmody—I am not sure about the exact time frame, but there was certainly a logistical problem in the pre-printed part of the paper. That did cause a short delay.

Senator CONROY—Could you clarify what it was that came to a stop? Was it the processing of debt demands?

Mr Carmody—I am not sure whether it was debt demands or lodgment. I am openly stating that there was a logistical problem in the pre-printed paper that we provide to our printers, and we had to ask them to reschedule. I assure you there was no loss of Commonwealth revenue or anything else.

Senator CONROY—Just a loss of face.

Mr Carmody—I think we issue roughly 50 million or 60 million notices. Sometimes there are slight logistical problems in getting that much paper pre-printed, but overall I do not think it affects the operation.

Senator CONROY—Have you changed your logistical arrangements to ensure that you have enough paper on demand?

Mr Carmody—I am sure my staff are right on top of it.

Senator CONROY—If a small business rang you and said, 'We couldn't lodge our BAS return because we have run out of paper,' would you accept that excuse?

Mr Carmody—We issue BAS forms—they are provided with the forms on which to lodge their BAS.

Senator CONROY—If they said, 'Look, we've run out of notepad paper to do our calculations to put the numbers into the BAS form to send back to you,' would that be acceptable?

Mr Carmody—You would be well aware that, over the past two years of implementation of the new tax system, we have adopted a very balanced and accommodating approach to the difficulties small business face in lodging their BAS statements and in meeting their debts. I do not think there could be any complaints about the approach that we have taken.

Senator CONROY—I will take that as a no.

Mr Carmody—I would not say that, Senator.

Senator CONROY—Was the contract between the ATO and the Australian Newsagents Federation for the distribution of tax forms from 1 December 1998 to 1 December 2001 successful?

Mr Carmody—For the distribution of what?

Senator CONROY—The *Tax Pack*.

Mr Carmody—I am not aware of any complaints about it.

Senator CONROY—I understand the newsagents continued to distribute the forms for the ATO after the contract elapsed. Have they been paid for that yet?

Mr Carmody—It is a matter of detail. I am not aware of any complaints.

Senator CONROY—Could you tell us the status of the new contract to distribute the forms? Have tenders been let?

Mr Carmody—I am sorry, I do not have that detail.

Senator CONROY—Is there anyone who can help us at all?

Mr Carmody—Apparently not here, but we will get onto someone and find out what the situation is.

Senator CONROY—Can someone come back to us with the details?

Mr Carmody—I am sure we will do that.

Senator CONROY—We are interested in the status of the new contract: whether tenders have been let for it and whether the newsagents are still distributing the forms.

Senator WATSON—Mr Chairman, I speak on behalf of the very small tax agents on a related matter. I note that 98 per cent of all agent returns are now lodged by ELS. Why isn't the tax return stationery ready to be sent out earlier than 17 June? That date does put a lot of pressure on these small, often single person, practitioners. Secondly, can you give an assurance that stationery will be delivered on 17 June to all tax agents? If not, what is the last date that all taxpayers can expect to receive their particular forms? I took up the issue with you last year after some of the information was provided in March and April, so there does appear to be a real slippage this year.

Mr Carmody—As far as production goes, *Tax Pack* was probably slightly late last year because of the introduction of the senior Australians tax offset, and we had to prepare additional schedules and information in *Tax Pack* for that. This year we have also had a number of measures that have been introduced fairly late in the process of preparation of returns. Issues such as the baby bonus have had to be accommodated, which I suspect has something to do with the distribution. If you remember, I gave a commitment to Senator Conroy that we would make sure the baby bonus was appropriately reflected in *Tax Pack*, and I can report that it has been. The logistics of measures that commence reasonably late in the financial year impact on the date of distribution of *Tax Pack*, but we are certainly conscious of the needs of tax agents in this area.

Ms Granger—We have already put most of the forms on the web site so that tax practitioners can become familiar with them early in the piece—in fact, we put earlier versions up. I believe that sample bags, for want of a better word, of all forms are going to tax practitioners quite soon. I do not have the exact date for that, but I can confirm that for you. As the commissioner mentioned, the issue for us is one of balance, particularly when we have new measures late in the year to complete before sending them out. Tax practitioners should get their sample bags quite shortly.

Senator WATSON—Also on the question of timing: if the tax practitioners' seminar is designed to discuss practical tips for tax time 2002, why isn't it held well before 4 July—that is,

prior to the earliest date for the lodging of tax returns which would commence for this financial year?

Mr Carmody—We schedule both the topics and the timings in close conjunction with representatives of the professional bodies. I think it is fair to say that professionals are still doing this year's work at the moment; they are still dealing with lodgments for the current year. Their attention would then turn to next year, very early in the next year. My understanding is that we do the scheduling of the timing and the topics in close conjunction with professional bodies. Given their existing workloads, that appeared to be the appropriate day for them.

Senator WATSON—Do you realise that some of the professional bodies probably do not give full weight to the difficulties faced by the very small practitioners—the two, three or four per cent who are very dependent on this sort of information to train their staff?

Ms Granger—We seek views within the profession as well. Obviously it is a balance. Last year some of the associations and the tax office tried to do some of this work earlier, and we found that the associations that held their professional conferences earlier than us had fairly poor attendance. So it is a balance. In addition to that—and obviously it is always a matter of degree—we are prepared to meet with particular groupings if we can get sufficient numbers, and we will do some briefings that way. That is more limited, simply because of the numbers, but we do respond to requests in that way as well.

Senator CONROY—Some extensions are available to registered tax agents for submitting BAS and IAS forms. Is that correct?

Mr Carmody—Yes. By and large, the due date is two weeks after the general due date and, if an agent is facing particular unusual circumstances, they can apply for a specific extension.

Senator CONROY—Is it a factor that individuals can have large numbers of clients and all of the forms are due in on the same day? Is that just allowing that flexibility to allow them to spread their work a bit?

Mr Carmody—Yes. For the BAS and IAS forms, it is a matter of size, yes.

Senator CONROY—Are these extensions available to bookkeepers who are not registered tax agents?

Mr Carmody—I do not believe so, but any individual taxpayer can approach us for an extension also. With the bookkeepers, I think the requirements are that they have to be—I am not quite sure of the term—registered with, or work with, a registered tax agent. So there is an association there.

Senator CONROY—A lot of tax agents do not complete the BAS forms, though. It is often the bookkeepers who do that service.

Mr Carmody—There are various work practices. Sometimes that would be the case; sometimes individual taxpayers get the assistance of their tax agent on a particular form but might lodge it themselves.

Senator CONROY—If a small business relies on a bookkeeper who is not a registered tax agent and who is not able to complete the BAS on time, will the small business be penalised?

Mr Carmody—If they are having difficulties, perhaps because of a bookkeeper, a small business person can approach us about an extension of time to lodge. I am not conscious that we have had any particular representations on behalf of bookkeepers.

Senator CONROY—I am not sure that there is an organised representation. I do not know whether there is a bookkeepers society.

Mr Carmody—Not bookkeepers in the sense we are talking about!

Senator CONROY—No, that is right! In the budget, what additional resources have been given to the ATO to reduce waiting times on your telephone inquiry lines?

Mr Carmody—We received an extensive number of resources for a range of things, including wait times on inquiries. I do not have the specific time break-up but, for example, on the business inquiry line, I recently authorised the recruitment of a further 160 operators to assist in that. We will continue to monitor those business inquiry lines to make sure that we are offering appropriate service.

Senator CONROY—So you have identified that there is a problem there that you need more resources for, in terms of specifically these—

Mr Carmody—Yes. As I mentioned briefly in my opening comments, we have experienced a large increase in the number of telephone inquiries we are receiving. We are running at something like 17 million per annum at the moment. That is over 100 per cent up over a year or two ago. Tax agent inquiries are running at a bit over 1½ million per annum, which is about a 300 per cent increase. At various times, people have experienced too long a delay and so we are, firstly, putting in additional resources and, secondly, looking at ways to provide information that will reduce the number of calls. For example, a lot of calls are about transactional matters; a lot of calls have had to do with understanding whether accounts have been appropriately posted, or instalments noted; and a number of calls have been about concerns with the running balance account form that we give to people and people have rung to make sure that it is up to date. To address that specifically, and avoid the need for calls, we have developed, for example, with the professions a new running balance account statement that we will start issuing in the new financial year, which we believe will address a lot of that. In the slightly longer term, we are looking at making securely available account details on line, so that we can remove the need for a lot of these procedural operational calls. That is the strategy.

ACTING CHAIR (Senator Watson)—Does the new format for the running balance account separate income tax from GST obligations?

Mr Carmody—The running balance account does not cover the income tax; it is the BAS and IAS type of obligations, not the income tax return type statements.

ACTING CHAIR—Given your response to Senator Conroy, about the 300 per cent tax agent increase, have you given consideration, for example, to lifting the number of ATO advisers in the Hobart office in particular, where I understand in recent years the number has dropped from about 25 officers down to one?

Mr Carmody—For tax agents, because of the number of inquiries we are dealing with now, we have adopted national approaches to ensure that we can best utilise the resources we have. So, for example, we have a couple of major centres that are dedicated to handling tax agents' telephone inquiries. We believe, as we have gone through this, that rather than having individual small cells located around the country we are able to offer a better service by

consolidating them. In addition, if the number of operators we have dedicated to tax agents is not meeting the demand, tax agents get priority on our general business line.

I mentioned before that notwithstanding that there have been some complaints about the level of service and that is why we have increased the number of operators. A lot of those calls I talked about—calls about the running balance account and the like—come from agents. So we are seeking to meet the needs of tax agents with a combination of things but we are continually working with them because meeting their needs is a high priority for us.

ACTING CHAIR—Under this new regime in relation to running balance accounts, when taxpayers are in credit do you now intend to issue a refund?

Mr Carmody—If they were in credit on their BAS or their IAS they would get a refund. I am not quite sure of the situation.

ACTING CHAIR—That is automatic, is it?

Mr Carmody—It depends on what you mean by ‘when they are in credit’. If they are lodging their BAS, there is a credit balance on the BAS and there is not another liability for it to be off set against, then they receive a refund.

ACTING CHAIR—That is GST liability.

Mr Carmody—The Business Activity Statement incorporates a range of withholding taxes—pay-as-you-go, and so on. If there is a net credit balance, and if there is no other liability that needs to be set off, that is refunded. Part of the BAS liability is the pay-as-you-go instalment. So while there is a liability for instalment they need to wait for their income tax return to see if there is a net liability or refund due on that.

Senator CONROY—Coming back to the phone waiting times, a number of my colleagues continue to receive various complaints from constituents about the length of time they wait. Some of them say that they spend a number of hours trying to get through, depending on the volume of traffic. Is that consistent with your findings in the worst case scenarios?

Mr Carmody—It is not common for that to occur. I have not heard of hours. We attempt to meet, in the worst case scenario, 80 per cent of calls within five minutes. Sometimes we are not meeting that, particularly where there is a particular due date or event that causes a higher number of calls. It is certainly not common for people to wait for an hour and on many days we meet our standards readily. But I have already indicated to you that we are not satisfied with the standard of service we are offering on the telephone and I have outlined some of the things that we are doing to address that.

Senator CONROY—People, when complaining, say that they just cannot get on. You acknowledge that in saying that you need all these extra operators, which I think is a fair response.

Mr Carmody—Yes. I have acknowledged that at times, in peak times, we are not doing what we would like to do, and we are taking steps to address that.

Senator CONROY—What are the benchmarks? You have mentioned 80 per cent in five minutes. Do you have a couple of other benchmarks?

Mr Carmody—That is generally the benchmark in busy times. I think it reduces in nonpeak times to 80 per cent in two minutes. That is our standard.

Senator CONROY—So in peak time it is 80 per cent in five minutes?

Mr Carmody—Yes. That does not mean that everybody has to wait five minutes. Many get in long before that.

ACTING CHAIR—I have been told that 30 minutes is not uncommon, particularly during the hours of 10 a.m. and 2 p.m., and people have been told, ‘We’re too busy; ring back tomorrow.’ Can you respond to that?

Mr Carmody—There have been occasions, as I have indicated, where there is a peak event. Calls do vary throughout the day and we have to try to best match our available people to the calls. Senator, you are right. Each of those individual points you have mentioned to me could have occurred—they are not standard, but they have occurred. That is the reason we are taking the steps that we are taking.

Senator CONROY—Obviously you are measuring your performance against the benchmark. How are you going?

Mr Carmody—I do not have the specifics at the moment. During the year we have not met it on every occasion, but I do not have the history of that. I think at the moment we are running pretty much close to it, but it can vary. For example, you would be aware that we have notified people that, if they have two or more activity statements outstanding, they need to get them in by 31 May to avoid penalties. About two days before that, we started to get very high numbers of calls and delays started to go up. So we transferred more staff into it and then we got back on track. It is a day-by-day, sometimes hour-by-hour, issue of matching according to demand. You can make the best projections you like—we do make the best projections we can—about likely demands, but they will not always prove to be true. So we have to be able to move resources to address the demands.

Ms Granger—Perhaps I could just give you a little more detail. I do not have the entire ATO stats with me, but perhaps I can use personal tax as an example. We take about 4½ million of those 17 million calls. We are averaging about 77 per cent across the entire year at the moment, in what has been a very big year for us. Right at this moment I think the tax agent line, which is the one in particular you are asking questions about, is roughly about 78 per cent. I only have one point in time for it, but that is what it was for the last week. It has just come off a peak, which was referred to by the commissioner. We know that there are days when there is no waiting time whatsoever, but there are others where, as I said, as the peak converges, we struggle in terms of time. That is why it is critically important that we develop this new running balance account and some other things. Our tax practitioners tell us that, if they can have the information in another way, their preference is not to call us, because obviously that is time away from their business. That is as important to us as also staffing those phones to deal with the peaks.

Senator CONROY—I want to talk about staffing in general. Approximately how many staff did the ATO hire in 1999?

Mr Carmody—I do not know; I am sorry.

Senator CONROY—Approximately how many staff did you dispose of in 2001?

Mr Carmody—You say ‘dispose of’. If we are talking about 2000-01, we had no redundancies that I am aware of. Also, our rate of people choosing to leave the organisation is not all that high. It possibly averages out around three or four per cent. That is about the best I can help you with.

Senator CONROY—My understanding is that 1,300 jobs petered out with you at the end of the 2001 financial year.

Mr Carmody—We talk about people. I am saying that, in 1999, there would have been a very large recruitment because of the introduction of the new tax system. That would have been in the small thousands, I think. In the build-up for the implementation of the new tax system, we had to find probably a bit over 4,000 new jobs. There was obviously a peak period with the implementation of the new tax system, and numbers were scheduled to reduce. In 2000-01, as I say, there were no redundancies as such, and any reductions would have been people who chose to leave naturally at any time. During the year, as I have indicated, they run at a fairly low level of around three or four per cent. We also engage a lot of nonongoing staff to handle peaks. They are engaged for a specific period to meet particular needs and, then as part of their contract, they are no longer with us. So, for example, even on this recent telephone issue, we have engaged some nonongoing staff to fill the hiatus while we develop up more ongoing staff. They are the sorts of parameters I can talk about.

Senator CONROY—This year's budget indicates that you are picking up another 2,200?

Mr Carmody—On average, that is the number.

Senator CONROY—I am looking at a newspaper article, dated 9 May, which talks about a \$35 million redundancy round last year.

Mr Carmody—You asked me about 2001, which I took to be 2000-01, and I have answered that. In 2001-02 there was a redundancy program of something over 900 staff, I believe—900, 950; it was somewhere around there.

Senator CONROY—So last year you had over 900, 950—

Mr Carmody—Yes.

Senator CONROY—and now you are picking up another 2,200, roughly?

Mr Carmody—Roughly, that is right.

Senator CONROY—Of the additional 2,200 staff you will be hiring, can you estimate how many will have previously worked for the ATO?

Mr Carmody—If people take redundancies, I think there is a 12-month period in which they cannot be engaged, and so I do not see a lot of scope there. If somebody who previously left the organisation of their own accord, or whatever, finds that they prefer to work in the tax office and have the necessary skills, we will be engaging them if they qualify.

Senator CONROY—If you are able to—after you have finished hiring the 2,200 again—could you take on notice how many had previously worked for the ATO?

Mr Carmody—Once we have done so. It will be a little while down the track.

Senator CONROY—I appreciate that; I am very patient. Please take that on notice. In terms of the comings and goings that you have had, we are really talking about a roller-coaster here, aren't we? You have picked up a lot, a lot have gone, a lot more have gone and you have picked up a lot. Do you see any advantages in trying to get a bit of smoothing in there? I appreciate some of it was the GST.

Mr Carmody—That is right. It is not often that you experience the level of reform that we have just been through with the introduction of the new tax system, and so that has to have transitional issues associated with it. During the current financial year we went through what is termed an 'output pricing agreement'. So we now have an agreement with government,

subject to our delivering and the assumptions on which it was based proving to be true. We now have a three-year projection of our staffing, which would not see a repeat of the experience that we had with the implementation of the tax reform.

Senator CONROY—With training and skills and all those sorts of things, it would be optimal or better than your current situation with the roller-coaster, if you had the ability to maintain. There are lots of oncosts with redundancy packages and then retraining people when they come back on, compared with having people with similar skills who are already familiar with the culture.

Mr Carmody—As I have indicated, the roller-coaster was a product of the massive reform and the transitional issues, and the implementation issues that go with that. But we now have a rolling pricing agreement with government over a three-year period, which we believe will offer the sorts of benefits that you have talked about.

ACTING CHAIR—Adult low-income taxpayers need not lodge a tax return, for example, where a refund of excess dividend imputation credits is available. However, that is not the case for minors, who must lodge a full return for a refund. Why the distinction?

Mr Carmody—I am looking for help and there is no-one here. Certainly, adult people below the threshold do not have to lodge a full return, but they can get imputation credits. Perhaps for minors it has to do with some of the rules associated with unearned income and rates applying to that. There is a different threshold if it is a sort of passive income or whatever, and perhaps it is associated with that. But I would have to look at the detail for that.

ACTING CHAIR—Even in circumstances where their only income is dividends? Could you take that on notice?

Mr Carmody—I will certainly take that on notice. I am not certain of that detail.

ACTING CHAIR—Thank you. How many people have dropped out of BAS and IAS, and what are the reasons for doing so?

Mr Carmody—You say ‘dropped out of BAS and IAS’, but many people chose to voluntarily register for the GST and, therefore, to meet BAS responsibilities generally on a quarterly basis. Generally, if it was under \$50,000, you did not have to register. By international standards, we have an exceptionally high voluntary registration rate; it is way above anywhere else in the world. Some people will have done that, then sought further advice and chosen not to continue with that. Others will go out of business, as businesses go out of business frequently, and therefore will cease to have to lodge a BAS return. There are some, as I have indicated with my announcement about those who have two or more activity statements outstanding, who need to lodge by 31 May, or else face penalties, and a number of them are tardy at meeting their responsibilities. So it will be a mixture of those issues that go to your question.

ACTING CHAIR—Do you do follow-ups in relation to people who have dropped out of both systems?

Mr Carmody—Certainly.

ACTING CHAIR—Could you take on notice to furnish us with the approximate numbers who have dropped out, either through going out of business or for other reasons?

Mr Carmody—I can take on notice those going out of business. But, just as an indication, we estimated that there were about 96,000 people who had two or more activity statements outstanding, and they were specifically the focus of that announcement that I made about 31

May. I think the response to one of the questions that came back to the committee—admittedly, I think it got to the committee very late—might give you some of the information. It will not give you a split of those who have stopped business. But, in the answers that were provided to questions from the last hearings, there is a split of lodged and late lodged for various industry types, and that should give you a good indication.

Excuse me, but a prompt answer has just been supplied. Senator Watson, perhaps I can read this: in 2001-02, people under 18 with dividend income of less than \$416 will be able to claim credits without lodging a return.

ACTING CHAIR—From when?

Mr Carmody—This is for 2000-01. I am being advised that if you are under 18 and have dividend income of less than \$416—and that might be the issue; that is the lower threshold for those people that was behind your question—you will be able to claim credits without lodging a tax return.

ACTING CHAIR—Do you put that on your web site?

Mr Carmody—I am sure we could do that.

Senator CONROY—I want to ask about the Wollongong tax office. Will Wollongong still have a tax office?

Mr Carmody—Certainly.

Senator CONROY—There is a growing uncertainty that you may be looking at pulling out.

Mr Carmody—Not in my mind. There is no intention to pull out of Wollongong or to close the Wollongong tax office.

Senator CONROY—There have been significant job losses in Wollongong in the past few years.

Mr Carmody—I do not know that overall the numbers have been significant at all; I think we have maintained it pretty much at a relatively stable level. There might have been some increases and it might have fallen back as part of that transition to a previous plateau, but I am not aware that other than that there has been any significant reduction. I can assure you that there is no intention to close the Wollongong tax office.

Senator CONROY—This is a purpose-built building, I understand.

Mr Carmody—Yes, it was built at the time for us to lease for a period of 10 years or something like that. I think we have probably been there that long, I am not sure.

Senator CONROY—I think that is the point. But I understand that it was purpose-built.

Mr Carmody—It was not built for us to own, but certainly it was built where part of the terms was a lease for a certain period. It was built under those arrangements, as I think a number were during that period.

Senator CONROY—So you can categorically rule out that that tax office in Wollongong will be closed?

Mr Carmody—I can only foresee as far as I can foresee, but I can tell you that there is nothing on my agenda or anybody else in the office's agenda to close Wollongong.

Senator CONROY—A lot of people in Wollongong will be breathing a sigh of relief at that.

Mr Carmody—I think they have been informed of that.

Senator CONROY—Could you outline the consultation and design process for the consolidation legislation?

Mr Carmody—The consolidation legislation has been developed over a significant period. There was an initial exposure bill some time ago. Then as part of moving towards a more open and consultative process we took a number of steps, late last calendar year I think. For example, we had a steering committee reviewing not only the development of the legislation but all that goes with it: the administrative processes and systems and assurance processes. The Board of Taxation had a representative on that steering committee.

In addition there was a group of practitioners and others that, in the redrafting of the initial bill and in further drafting, we had regular consultations with to ensure that as the legislation to give effect to the government's policy intent was being developed we were more conscious of the practical business applications and how it operated. That was an ongoing group, from my recollection, and I think on specific issues we might have consulted more broadly than that. The whole objective was to ensure that in implementing the government's policy initiative we did not do it in a vacuum from the practical business environment in which it operated.

Senator CONROY—I understand the consolidations process has been fairly well received.

Mr Carmody—Yes. For some time, I have strongly supported the need for more open consultation on the development of tax legislation once the policy parameters were initiated. Yes, I believe it has been well received. This has been partly because when the legislation was introduced into parliament on about 16 May not only did businesses get the traditional copy of a bill and explanatory memorandum but they now have a very practical guide. It takes businesses through all the steps of what you need to consider when thinking about whether or not you should consolidate and, if you decide to do that, how you would notify and how you would go on. That guide includes not only the elements of the legislation that were introduced on 16 May but also the government's announcements about further elements of the package that will be the subject of some legislation in June or later. Businesses now have a very practical and comprehensive guide to operate from. In addition, we have held what are called 'walk throughs' which are exhibitions that are going around the country. We have staff there so businesses can come and go through each of the stages of consideration and consolidation, and they can ask questions. The feedback on that has been extremely positive.

Senator CONROY—Would you say that it has been a best practice exercise in the consultation and design of tax legislation?

Mr Carmody—I would say that it is best practice to date. It could improve from there, because we were only able to do it part way through the process. Under the proposals put by the Board of Taxation and agreed to by the Treasurer, we are looking for that sort of consultation but also to have it earlier in the piece. But in our history to date, it would establish a best practice benchmark.

ACTING CHAIR—In response to a question that you took on notice, Mr Carmody, you advise that statistical information relating to the Taxation Relief Board was not included in the commissioner's annual report as the Taxation Relief Board was a separate entity from the

Australian Taxation Office. How many other agencies are there around the Australian Taxation Office whose information and activities are excluded from your report but are fairly integral to your sorts of activities? You might like to take that on notice.

Mr Carmody—I would, but the Taxation Relief Board is a relatively unique body in that sense. We obviously work with other agencies such as Centrelink and so on. We provide information and there is the matching facility, on which we provide a joint report. I am not aware that there would be any others, but I can make sure of that.

ACTING CHAIR—What about the Board of Taxation?

Mr Carmody—The Board of Taxation is not directly related to operational aspects of the Australian Taxation Office. It is an adviser to the Treasurer. It is not so much on the administration of the law, which is the nature of the reports that I would make; it is an adviser—

ACTING CHAIR—Don't you work closely with it?

Mr Carmody—I am on the Board of Taxation as an ex officio member. The Taxation Relief Board is directly relevant to the operational aspects of the administration of the law. The Board of Taxation charter is primarily to advise government on issues to do with the operation of the law and the law itself in terms of its policy. It is an adviser to government and you would see from its work program that it looks at things such as consultation in the development of the law. It is generally interested in issues on the development of law and policy. I do not think they would see themselves, in any sense, as part of my operations or the operations of the tax office. They are a separate board which reports to the Treasurer, mainly around the development of law itself.

Senator CONROY—You mentioned that you thought the consolidations were the best practice yet. Are you pleased that you have got it just about right? Are you losing the power to design?

Mr Carmody—It is nice to pass on a healthy baby.

Senator CONROY—Good answer.

ACTING CHAIR—Last year there was a deletion, for example, of the music teachers code from the employer codes, and where taxpayers used the old code their return was declared invalid when it was lodged. Can you give an assurance that such deletions will not inconvenience taxpayers? Can you also give us an assurance that corrections will be made to categories which previously had music teachers in the same category as ski clubs, freelance journalists in the same category as Turkish bath operators and outdoor consultants in the same category as merry-go-round operators? Have you made those corrections of this year?

Mr Carmody—I am not sure, Senator. These are ANZIC codings.

ACTING CHAIR—That is right, but a wrong coding can result in the rejection of the tax return. That is the problem with it.

Mr Carmody—We do a lot of work for the Australian Bureau of Statistics, and they set the ANZIC codes.

ACTING CHAIR—But you can see the problem it causes for taxpayers if an old code is provided.

Mr Carmody—If they put in a code, I am not sure that we would reject their return.

ACTING CHAIR—There have been instances, Commissioner.

Mr Carmody—If you would like to provide me with any of those instances, I will follow them up to understand the arrangements. It is important that we apply the ANZIC codings because, in utilising them, we are able to provide a lot of statistical information to the Australian Bureau of Statistics, which relieves them of the need to impose survey and other requirements on business. I think it is quite appropriate that we use the ANZIC codings, but I will follow up on those returns not being accepted—I was not aware that that was the case.

Senator CONROY—I am enjoying you exercising the prerogative of the chair—at regular intervals! Are you quite finished? Mr Carmody, did you see that the Prime Minister has denied that the proposed shift of legislative design from ATO to Treasury is punishing you for the BAS? Did you see him say that?

Mr Carmody—I read about that—I did not see him say that.

Senator CONROY—Do you think that tax office morale was comforted by the Prime Minister's denial?

Mr Carmody—I do not know. My people were getting on with the job of the remaining legislative requirements that they have got and working towards a smooth shift.

Senator CONROY—I see that Duncan Macfarlane in the *Australian* described this as a decision 'to emasculate the tax office'. Are you feeling emasculated?

Mr Carmody—Not at all.

Senator CONROY—Good. Under the old arrangements, are you responsible to a minister for your legislative design powers?

Mr Carmody—First of all we need to understand that we did not operate in a vacuum: we worked very closely with the Treasury in that legislative design. After the initial policy was developed, it then became our responsibility to take that policy and to work with the Office of Parliamentary Counsel to design the legislation to implement it. It was always the case that we did that in close consultation with Treasury so that, for example, as issues of further policy design emerged, there was a close working relationship between Treasury and us, and where policy decisions were made, they were put by Treasury and us to the relevant Treasury minister—be it the Treasurer or the Assistant Treasurer. So we were responsible in that way and we provided support to the legislative program.

Senator CONROY—So you had no policy development role? It was the Treasurer or Assistant Treasurer that had that role?

Mr Carmody—The government is always responsible for the policy, so once you got past the broad policy objective, you would be aware that then you get into issues that go to policy around that. To the extent that it does raise an issue of policy, then we would work closely with the Treasury and, in appropriate cases, we would refer the matter for determination by the Assistant Treasurer or Treasurer.

Senator CONROY—So those matters you did refer back to the relevant ministers?

Mr Carmody—Yes.

Senator CONROY—They were the relevant ministers you referred the matters back to?

Mr Carmody—Yes.

Senator CONROY—Did you see the Treasurer's press release of 2 May, which said that moving the powers to Treasury would:

... bring the accountability for tax policy and legislative design more directly under Ministerial control. You are already under that umbrella, from what you have described—you refer those matters back to him.

Mr Carmody—We worked with the Treasury. Under the new arrangements, Treasury will take direct responsibility for those. I should point out, however, that I think in that statement the Treasurer also made it clear that the tax office would continue to be intimately involved in this, so that, in the development of the legislation, administrative practicalities could be brought to bear to ensure that, as the legislation is developed, we are developing our administrative and assurance systems to go with it. So we are not exactly divorced from the process in the future.

Senator CONROY—How many staff are going across to Treasury?

Mr Carmody—It is 140 or something like that.

Senator CONROY—150 rings a bell.

Mr G. Smith—The estimate of the ASL is about 138. That is not specific people; it is a slice of a larger group. It is an estimate that has been used for the purposes of calculating the transfer of funds.

Senator CONROY—The tax office, presumably, given it is going to be intimately involved, will still be having a section that deals with this? Not every single person is going to go across?

Mr Carmody—As Mr Smith indicated, the 138, approximately—

Senator CONROY—Which poor person are you cutting in half!

Mr Carmody—was the slice of a larger group because, in any legislative development, there is both the drafting side and the design of the administrative systems. It was that broader field that the 138 ASL is drawn from. We will continue to have people who are involved on major projects, looking at the administrative side of that. We are in the process of designing with Treasury what is the best interface between the two organisations.

Senator CONROY—I am trying to get to that interface. Will you have to hire some new people? Presumably your main design people are going across, but you are going to need some people to be able to assess it. Are you going to have to hire some new people?

Mr Carmody—No, the skills in bringing the administrative side to the development of policy is there in the organisation now. There will not be a specific hiring as a result of this particular issue.

Senator CONROY—Presumably you are going to need somebody with the experience and skills to analyse what will be served up by Treasury now?

Mr Carmody—From the point of view of the assurance and administrative framework to put around it, but that is mainstream work for many people in my organisation, and it will be those skills that will be brought to bear in this process.

Senator CONROY—So there will be no duplication?

Mr Carmody—I do not believe so. We are working to make this work effectively.

Senator CONROY—What are the advantages of the proposal in your mind—this proposal of moving them across?

Mr Carmody—The advantages in my mind? At the moment we have people there who are working from the legislative side—and I can speak with personal experience, although long past, of working in this area—and a lot of that gets caught up in the legislative drafting and the policy issues. I think there is a risk when you do that that, if you are in the same organisation, you can become too focused on that and not give enough focus, curiously enough, to the administrative arrangements. So, in my mind, given these arrangements, what it will enable us to do will be to have our people with a much more distinct and clear focus on the administrative arrangements to bring to bear in this.

Senator CONROY—Do you think that this move will achieve a more realistic tax law—one that is more in touch with practical tax reality?

Mr Carmody—I do not think the shift of particular drafting instruction function from the tax office to the Treasury will achieve that, but that is not the totality of what has been proposed by government. To me, the most significant issue of the changed announcements by government is its agreements to the Board of Taxation recommendations for more open consultative arrangements, the value of which—in partial reflection—has been seen from the development of the consolidation legislation. So I think when you put the total package together—and specifically that more open consultation in the legislative design process—you will get better law as a result of it.

Senator CONROY—Do you think it is fair for people to say that this change will have a slightly broader economic approach and not just a technical tax approach?

Mr Carmody—I have no doubt that Treasury will bring their skills to bear. We have worked with them in partnership in the past. The potential positive from our point of view is that it will focus us more tightly on the administrative and assurance side. If you combine that with the consultation arrangements, you have a very good package to produce better tax legislation which is in my interests as well as those of the community.

Senator CONROY—What is the estimated cost of change, Mr Smith?

Mr G. Smith—There is no expected change in the cost to government because all that is happening is that some of the costs currently incurred by the tax office are transferring to the Treasury. There is no additional allocation.

Senator CONROY—Would you describe this a major change in the administrative arrangements for the portfolio?

Mr G. Smith—No. I would say that it is a significant development in the history of the integration process for policy and legislation in the tax area, but I think the reason I would say no is because, as the commissioner has said, we have always worked very closely together. I expect we will continue to work very closely together in that sense.

Senator CONROY—So there is no net increase in staffing?

Mr G. Smith—No. As I say, it is being done on a budget neutral basis across the portfolios. There is a transfer from one agency to another.

Senator CONROY—And you are in the same building, aren't you?

Mr G. Smith—No.

Senator CONROY—You are in a different building. Will people be physically moving across to Treasury?

Mr G. Smith—We expect some people will move across. It is currently being processed as to how many and so on.

Senator CONROY—So in your mind this is really just administrative reshuffling.

Mr G. Smith—No, I do not want to downplay it. It is not going to cost anything in terms of additional cost. We are going to seek to absorb the cost of the more extensive consultation arrangements. We are transferring funds from the tax office to the Treasury. The amount being transferred is the estimate of the cost of the function currently undertaken in the tax office. We expect the partnership to continue. What the Ralph inquiry focused on was a proposal to achieve greater integration of the policy legislation and administrative arrangements.

There are some elements of this which derive from that thinking. It is really about creating a closer relationship between policy and legislation and then using an interface with the tax office to bring the voice of administration and experience of administration into the process. The Office of Parliamentary Counsel will be in the same situation that they are in now. The actual laws are not drafted by the Treasury or the tax office; they are drafted by OPC on instructions from the agencies. That will continue to be the case.

What is happening here is that the tax laws will be instructed by a department of state in the same way that I think every other law for the Commonwealth is drafted, including other laws in the Treasury portfolio. We have all along drafted the laws for the financial system, for example, and in a number of other areas as well, such as foreign investment or whatever. You would find across government that it is generally departments that instruct for the development of laws, and then there are statutory agencies like the commissioner's which administer them.

Those statutory, administering agencies are always voices which are very critical in the development of the laws, and that is what we expect will continue. Again that applies across government. You will see APRA, the Reserve Bank or whatever the relevant agency is always involved in the laws that relate to them. But ministers have control of departments, and that is the preferred instructing source. Ultimately the parliament passes laws, not ministers or departments or agencies.

Senator CONROY—Mr Carmody, you mentioned getting the balance right between helping small businesses and enforcing the law. Could you outline your current stance on the enforcement of the BAS lodgment.

Mr Carmody—First of all, as I have mentioned to you already, we have not been imposing penalties as a general approach. The normal situation with penalties is that we have an IT system such that, if it is triggered by a particular point in time of lodgment or whatever, a penalty is imposed and then the person has the right to come and seek a remission of that penalty. Because of the significance for business of what has been involved in implementing the new tax system, we have not applied, automatically, late lodgment penalties, although the general interest charge still applies. At the same time, I have made it clear all along that there is a reverse onus of proof. If, however, evidence came to us that someone was blatantly ignoring their responsibilities, then we would impose penalties. I think we have imposed penalties, prior to this announcement, in 1,500 cases or something like that. Consistent with what I said about evidence of people not meeting their responsibility, I indicated a little while ago that, if there were two or more activity statements outstanding, unless they were lodged by 31 May there would be penalties involved. So that was a significant step in that.

As far as our practice goes, where an activity statement is outstanding we follow up. Currently we have moved to following up for monthlies within 28 days of the due date. If the activity statement has not been received, people can expect to receive a telephone call or written notification from us, and of course if they do not follow up on that we then escalate the activity. For quarterly we have now moved to a point where the same situation would apply within six weeks of the due date.

Moving towards activity statements that fall for the period from 1 July, activity statements in respect of periods from then on, we will be switching on our system's automatic application of penalties, although there are some parameters we have built into that. For example, if people have generally had a good history and just this one is late, then we are likely to approach them rather than automatically apply penalties. So that is the progression that we have been going through.

Senator CONROY—Once you have got to the end of the progression and the system is switched on, what would make you switch it back off—anything?

Mr Carmody—One can never say 'anything', because you are not always sure of what would happen. We have attempted to work through this transition phase over the two-year period, particularly with the notice that we have given on two or more outstanding, and we will continue to be very public about the need to lodge your statements over the interim period. So our intention is to switch the system on, and we would see it staying on.

Senator CONROY—I noticed recently that, if you are able to whip up a bit of a campaign publicly and get people talking about it, you get into situations where there is switching on and switching off, offers are extended and that sort of thing.

Mr Carmody—I think we have been particularly balanced over this period. We have now reached the point of transition where it is appropriate that the system be switched on in the new year, and that is what will happen.

Senator CONROY—When you say 'new year', do you mean the new financial year?

Mr Carmody—What we have said is for activity statements in respect of the new financial year.

ACTING CHAIR—Senator Conroy, can I ask a question before you jump to your next one?

Senator CONROY—Certainly, Senator Watson.

ACTING CHAIR—It concerns the movement of tax making law from the tax office more to the Treasury. Will the scope of the tax liaison meetings with what I call the coalface practitioners change as a result of many of the law making functions moving from the ATO to Treasury? That question is for you, Mr Carmody. Mr Smith, will Treasury conduct similar tax liaison meetings with these so-called coalface operators in the framing of the law?

Mr Carmody—In terms of our liaison arrangements, the peak professional liaison arrangement is the NTLG, which is—

Ms Granger—The National Tax Liaison Group.

Mr Carmody—There are too many acronyms! We consult so much that I lose track of the names. We have always invited a Treasury representative, and typically a Treasury representative goes to that. But liaison has not been a particular Tax policy; the arrangements

are typically about the administration of the law, where the interpretation is causing issues and so on. So if you look at the agenda, it has principally been about our administration.

We also have a national tax practitioners group. The peak body is typically made up of representatives from the professional bodies, but we also—perhaps this reflects some of your earlier comments, Senator—have another group of tax practitioners that are more typically a spread of hands-on tax practitioners. They deal much more with the nuts and bolts issues like lodgment programs and a range of issues like that. We have a series of working parties with them. They are very much focused on the administrative. The National Tax Liaison Group is also focused on the administrative, although perhaps at a different level. Treasury has typically been involved in those. So I do not think there will be any particular change in those arrangements.

In terms of the ability for practitioners and representatives to have an input to the development of legislation, I think their opportunities have been significantly enhanced by the government's agreement to new consultation arrangements as a result of the Board of Taxation recommendations. For specific measures, that will see much closer consultation from early on in the process with a range of people, including practitioners.

ACTING CHAIR—My concerns were really focused on that area of tax law making which is concerned with what I term technical corrections, where I believe that practitioners—those at the coalface—can have an impact.

Mr Carmody—We have maintained an ability for people to raise technical corrections, and—

Senator CONROY—Senator Coonan is working at the coalface.

Mr Carmody—we look to continue to develop that register. In the transition to the new arrangements, we will just have to make sure that that is suitably accommodated.

Senator CONROY—I am not sure the Royal Perth Yacht Club is a real coalface—

ACTING CHAIR—Senator Conroy, what is your question? What is your question to the minister?

Senator Minchin—I do not have a yacht!

Senator CONROY—What kinds of resources are you putting into pursuing unlodged BAS forms now?

Mr Carmody—When we were here last time, we had moved a bit over 300 additional staff in for the balance of this year. But as a result of our funding as announced by the government, there will be a further significant increase in resourcing for debt and lodgment issues. I do not have the precise figure, but it will continue to enhance our resources there.

Senator CONROY—Could you characterise the balance you have been talking about for the last few years—the iron fist with the velvet glove and now is the time to take the velvet glove off?

Mr Carmody—However you want to describe it. When you are implementing something as significant as this, you establish the highest basic platform of compliance by people understanding what they need to do. That sets a platform for the future that you need to build on. So, yes, we certainly spent a lot of our efforts in assisting business through that period. Because it is significant new law, we recognise that some genuine mistakes will be made and there will be some difficulties experienced by business. So we did adopt a supportive

approach while continuing to maintain, as best we could, a focus on those who set out deliberately to avoid it. We are seeing a transition now, so, for example, in our field activities, the vast bulk of those people were initially focused on advisory visits and other support. We will continue to support business as appropriate, but our field activities are probably now 80 per cent shifting towards verifying rather than—

Senator CONROY—Verifying would be audit?

Mr Carmody—It is a form of audit, yes. We carry out audits or verifications in a range of ways. It can be telephone contact or it can be direct visits. There is a variety. As I said, if you look at a broad level, there is now an 80 per cent emphasis on audit or verification of some form. The states agreed to \$40 million to \$45 million extra to enhance our compliance activities, and that will see another 300 or 350 staff in those activities. Together with the outcomes of the general funding for the tax office, our field staff will be shifting to a strong emphasis on, for example, income which is relevant for GST, income tax purposes and cash economy purposes. Probably 2,700 or more staff will be focused on those issues. There is quite a shift occurring, and I hope we will take lessons from the implementation phase in continuing to be able to distinguish between those who are setting out to avoid their taxes and those who are just trying to do the right thing.

Senator CONROY—Is the program we were talking about a minute ago—pursuing unlogged BAS forms—going to be prioritised or is it just a universal program to contact everybody? Are you blanketing or are you targeting?

Mr Carmody—Everyone will be touched somehow, be it by a letter, a telephone call or whatever. That is our objective within the time frames that I talked about, but certainly there is prompter and much more active management of the larger cases. So while there is an overall coverage, there is a greater intensity of contact and timeliness where the potential debts are more significant.

Senator CONROY—How does the level of resources you are putting into that compare with the resources available to your cash economy task force?

Mr Carmody—As I have indicated, the cash economy will be tackled in a number of ways. Equally as I have indicated, it is not necessarily a matter of discrete functions. For the cash economy we will probably have about 2,700 people out in the field. They will be looking at a range of GST and income tax matters, with a particular focus. If you look at income disclosed, it is relevant for cash economy, income tax purposes, GST purposes and so on. So it is a sort of mixed operation from that group of people.

In addition, we are enhancing our serious noncompliance area dealing with the more fraudulent and serious end of the cash economy. A cash economy goes to people who are not lodging returns, and some of our resources are to intensify our nonlodgment activities in income tax returns. With the new tax system, of course, we have much more timely information coming in regularly about expected returns or parameters for particular businesses. That will enable us to target our activities in a more timely way. So there is quite a mixture of activities directed at the cash economy.

Senator CONROY—I refer you to page 17 and page 162 of Budget Paper No. 2, discussing the expenses and extra revenue from enhanced ATO resources. Can you describe to us exactly what is meant by an ‘independent pricing review’? I have not come across the phrase before.

Mr Carmody—‘Independent pricing review’ refers to an output pricing review mechanism—the price the government is prepared to pay for particular outputs. It is a method by which government can systematically analyse the funding that it wishes to give to agencies and the outcomes and outputs that it expects to receive for that investment. The notion of an independent review came from the government deciding that there would be value in having someone with expertise from outside the public sector to guide that. Tony Sherlock was engaged to drive that output pricing review. Mr Sherlock applied particular rigour to the requirement for the tax office to analyse its expected workloads, the resources that would be needed to manage those to a particular standard, and the funding that would therefore be appropriate for particular outcomes that were set to be achieved. So there was quite a rigorous approach to that output pricing review guided by that independent person.

Senator CONROY—When was this done?

Mr Carmody—It was done from about October-November through to the sitting of the Expenditure Review Committee.

Senator CONROY—October-November last year?

Mr Carmody—Yes. I believe Mr Sherlock got on board around that time.

Senator CONROY—Roughly how long did it take? Was it a three-month thing?

Mr G. Smith—It went until about February, I think.

Senator CONROY—So about three months?

Mr Carmody—Yes. It was a three- or four-month exercise, by the sound of it.

Senator CONROY—What is Mr Sherlock’s background? Is he a consultant?

Mr Carmody—I think he was a member of one of the large firms and now does some consulting work.

Senator CONROY—So he was formerly with one of the big five, now four?

Mr Carmody—Something like that. I think that is his background, but I cannot be absolutely certain.

Mr G. Smith—He does take these consultancies. I do not know the name of his firm.

Senator CONROY—Did his consultancy firm win it, or did he win it? I am presuming he was an independent contractor, employed directly. How did it work?

Mr G. Smith—I think he was selected to do the job as a person.

Senator CONROY—Were there tenders?

Mr G. Smith—I know several people were considered, but I do not recall them.

Mr Carmody—I cannot recall. There was consideration of a range of people who had some expertise and experience in the field, and the decision was taken on merit.

Senator CONROY—Did the tax office engage this person, or was it Treasury or the government? What was the actual mechanism?

Mr Carmody—It might have been the Department of Finance and Administration.

Senator CONROY—So they paid the bill.

Mr Carmody—They engaged him so I assume they paid him.

Senator CONROY—How much did it cost?

Mr Carmody—I do not have that detail on me. It was with the department of finance.

Senator CONROY—But they were conducting a review into the tax office?

Mr Carmody—It was an output pricing review of the Australian Taxation Office, yes.

Mr G. Smith—Output pricing reviews are always overseen by Finance.

Senator Minchin—They are a fairly standard mechanism.

Senator CONROY—Minister, how much did it cost? Are you able to give your office a ring, to see if you can find that out—just to speed our journey?

Senator Minchin—I am happy to see if I can find that out for you. These output pricing reviews are a standard part of the new output and outcomes approach, which you will find most governments around the world have adopted

Senator CONROY—This new and wonderful accrual budgeting system! How do they cope with cash? Do they focus on cash? Do they just look at cash outcomes? Is he interested in accrual at all?

Senator Minchin—They are about the price we pay for the services provided by agencies like the tax office.

Senator CONROY—If you are able to find out how much it costs, that would be great.

Senator Minchin—I will see what I can do for you.

Senator CONROY—And—with apologies, Minister, for asking you more Finance questions—could you come back to us on the tender process. Are the terms of reference available? You must have been consulted and must be aware of what it was.

Mr Carmody—There is a documented set of terms of reference.

Senator CONROY—Are they available to the committee?

Mr Carmody—I would not be conscious of any reason why we could not provide them. I do not have them here, but there certainly are documented terms of reference.

Senator CONROY—If you could provide them to the committee, that would be great. Regarding the report itself, is it available?

Mr Carmody—I doubt it. That was a cabinet document prepared for cabinet, so I do not think it is typically available as such.

Senator CONROY—So Mr Sherlock's document was a document for cabinet? I presumed there would at least be a filter through the department of finance.

Mr G. Smith—The report was commissioned by the cabinet and returned to the cabinet.

Senator CONROY—Senator Minchin, would you have been on the related committees?

Senator Minchin—As you know, these matters are considered in a budget context by the Expenditure Review Committee of cabinet.

Senator CONROY—So you would definitely have been part of this?

Senator Minchin—I was.

Senator CONROY—Did Mr Sherlock's report go unamended? Did it just get passed straight to the ERC process? Did it not go through Treasury, Finance or you? I am trying to find out whether I can get his actual report—not the presumably amended version that

actually went to cabinet, because I appreciate that would be another cabinet document. If you are willing, I would be happy to take it.

Mr G. Smith—It would not have been amended.

Senator CONROY—So it just went straight into the process?

Mr G. Smith—What basically happened—and I think this is relevant to your cost question—was that he was appointed to lead the output pricing review work. The work is actually done by the agency concerned and by Finance, so most of the work and costs would have been absorbed by those agencies.

Senator CONROY—My apologies; I missed the last part of your answer.

Mr G. Smith—The drift of it was to say that, both in relation to the cost and in terms of the documentation, the basic process is this: the government sought a report; they appointed a consultant to lead the preparation of the report; the work, of course, was done by Finance and by the tax office, so most of the cost and most of the work would be absorbed by those agencies and there would not be a separate contracted cost; and the report was then provided back to the budget process of the government.

Mr Carmody—When you talk about the report, there is a lot of detail that all leads to the final report, and the final papers that went to cabinet are obviously a summary distillation of that.

Senator CONROY—I am happy to not take the distillation; I am happy to take the lot.

Mr Carmody—I think all of those documents are prepared for purposes of cabinet and would come under the same qualification of material.

Senator CONROY—Which areas in the ATO will receive the extra funding indicated under the line item ‘enhanced tax administration’?

Mr Carmody—Under the output pricing review—

Senator CONROY—Which we have not seen. We are at a disadvantage here.

Mr Carmody—Let me share it with you. The important point to note, first of all, is that it was a rigorous process that looked at the totality of work. It was not a case of, ‘This is what we do now; where do we need extra?’ It looked at the totality of the work we do, it set standards for the outcomes and it made assumptions about workloads and so on. So we built from the bottom up. As a result of that, there were a number of areas which will see increased resourcing into the future. They include enhanced resourcing to deal with the integrity of our tax file number register and our register of Australian business numbers. You would understand there are many millions of those, and it is important to our operations as well as to other government agencies that they be as accurate as possible. So there is quite a deal of effort. There is funding over two years to improve the integrity of those. The parliamentary committee report *Numbers on the run: Review of the ANAO report No. 37 1998-1999* indicated we need to improve the integrity of the tax file number register. Resources have been put into removing backlogs and improving our performance in processing activity statements and so on. Resources are going in to enhance our operations in debt and lodgment to get to the parameters that I talked about before.

Some resources will go into serious noncompliance, fraud activities and so on. There is some increased resourcing to assist in our superannuation regulatory role of self-managed super funds. We have already mentioned a range of improvements to our call handling

capabilities at our call centres. Mr Chairman, you will be pleased to know that we are going to improve our matching for superannuation guarantee purposes. As previously mentioned, resources will go into some areas of serious noncompliance. There were some other areas where we felt there was a basic need to enhance our capabilities. So it was a broad sweep across our operations.

Senator CONROY—I appreciate the point that has been made that they are all cabinet documents. Is it possible to get a sanitised description of those sorts of issues? Because of its comprehensiveness, I was wondering whether it was available for us to have a look through to get a sense of how comprehensive it was. I appreciate that it is a cabinet document.

Senator Minchin—It may be possible to provide you with a summary of the areas where we believe our operations will be enhanced as a result. We could do that for you. It is the sort of thing I would comment on publicly.

Senator CONROY—In the budget papers you say you will maintain the integrity of the PAYG withholding system. How much extra revenue will be raised through that measure?

Mr Carmody—It was about maintaining integrity; I do not think there was a specific increase in revenue. It looked at what we need to do to maintain the integrity of the PAYG withholding arrangements. I do not believe there was any specific additional revenue projected from that. The bulk of this was centred on offering a better standard of service and ensuring that we maintain integrity of the system into the future.

Senator CONROY—I want to come to the issue of maintaining integrity. From what you are saying, it seems that the revenue is already included in the forward estimates. You say there is no new revenue. Therefore you are protecting the existing revenue.

Mr Carmody—The way we approached this was: if you take an output pricing review, it is the price government is prepared to pay for particular outputs. What are the outputs? We have to determine what it is that government expects. We talked about some of our performance standards with telephones and the like, but at the broader level we took as the benchmark the forward estimates projected by government. So we had to make value judgments about what compliance activities were needed to maintain those forward estimates. That was the notion behind maintaining integrity. That was the general benchmark we set.

In addition, there were some areas where we believed our activities could improve compliance and some areas where government specifically determined—and you will see them in the budget papers—that there should be specific amounts over and above the output pricing review. If you are interested in the areas where we talked about revenue potential increases—

Senator CONROY—I will just stay with the integrity of the existing forecast revenue. Which were the areas you were worried about?

Mr Carmody—Does this question relate to prior to the budget? The budget includes some specific revenue outcomes.

Senator CONROY—As I said, I started talking about the PAYG withholding system and asked you if there was any extra revenue, and you said no. Therefore, there is an existing revenue stream projected that is in the budget papers, and you identified some areas where you said you thought you needed to enhance integrity to protect existing revenue streams.

Mr Carmody—Yes.

Senator CONROY—I will for the moment stick with the existing revenue streams. In which areas did you identify that your existing revenue streams were under threat?

Mr Carmody—In tax administration there are continually—

Senator CONROY—I am sure. They are tricky buggers out there.

Mr Carmody—Fine projections about the level of compliance to achieve this particular forecast outcome is not a precise science.

Senator CONROY—I am not trying to hold you to a specific dollar. I am more interested in which areas you felt there was a potential loss of revenue under existing structures.

Mr Carmody—We were interested in overall integrity of the system so many of these issues have to do with more medium-term concerns.

Senator CONROY—I understand.

Mr Carmody—At one level, if we were not able to handle people's inquiries properly, that would pose a threat to the medium-term revenue. So that was an area that we were concerned about. I have already mentioned to you that we were concerned about the quality of information on our Australian Business Register and tax file number register. They are not going to have an immediate effect but for wider government implications, including for matching purposes with Centrelink and others and for our own operations, it was important that they be raised to a higher standard of quality. So that was another area that we were concerned about.

I have mentioned to you a couple of times before that I was concerned about some of the more fraudulent activity. While in an overall revenue sense it is probably not a huge amount, if it is allowed to fester it can in the medium term have an impact on compliance generally and people's perceptions of the operation of the tax system. There was, I believed, a small investment necessary to deal with some of that serious noncompliance and fraudulent activity. In the personal tax area we have pretty much been in maintenance mode concerning issues like work related expenses but if that were allowed to go on for too long and a few people started to think about it and feel that we were not paying sufficient attention to it, there was a risk that into the medium term we could face difficulties there. So there is a small increase in those areas.

Senator CONROY—Are you seeing an increased trend in work expenses?

Mr Carmody—It is not an area that would cause me a knee-jerk reaction at the moment.

Senator CONROY—I was not suggesting that.

Mr Carmody—What I did say was that we have been in maintenance mode for this year in particular and we probably need to enhance our activities next year. So that was built in to that. They were the main areas of that level.

Senator CONROY—Do you find that in the early stages you accept a few of these workplace deductions for a few people and then the knowledge that this is okay spreads quickly? Is that how it happens?

Mr Carmody—It is not only in that area. Our experience is that many people analyse our operations much more than we do.

Senator CONROY—That was what I was coming to.

Mr Carmody—There is a very alert network of information sharing out there, and they do tend to notice things.

Senator CONROY—That was what I was trying to come to. Once a concession may have been won for one taxpayer, the transmission across the broad taxpayer population is a lot faster than it used to be, I guess.

Mr Carmody—It is reasonably fast. It is one of the very rigorous accountability mechanisms that the tax system has.

Senator CONROY—I do have some more questions in this general area, but I will come back to them after.

Proceedings suspended from 10.46 a.m. to 11.02 a.m.

Senator CONROY—You have taken us through the areas where you were increasing revenue, and the existing flows. I was wondering if you could talk about the areas where the new resources will enhance revenue.

Mr Carmody—Yes, there are a few areas. I have mentioned to you debt and lodgment; there is a significant increase in resources going into that area and that has increased revenue coming with it. I have mentioned not so much increased revenue but there will be improved matching for superannuation guarantee purposes and that, we believe, will have an impact on payment of superannuation guarantee where it is not presently occurring. There is also some specific investment in our large business operations which, equally, has a return attached to that. I have mentioned that the state treasurers agreed to increase resourcing for GST purposes for compliance activities, and that has increased revenue associated with it. Finally, there is further investment in some of our small business operations, probably with a particular focus around the cash economy as well as assistance there, and that has a projected revenue increase.

Senator CONROY—I am presuming from that that there will be extra audit staff employed as part of this program.

Mr Carmody—If you take, for example, a large business, that will be a combination of auditors plus continuing to enhance our analysis capability to make sure that we are identifying and focusing on the right issues in the GST and small business area—that is, primarily around people out in the field on our field activities in those areas.

Senator CONROY—How many extra field officers do you think this will mean?

Mr Carmody—It is a combination. A fair number of those will in fact be directed at the larger end of operations but, if you look overall at the small business and the GST area and our large business, there is probably between 600 and 700 or something like that. There are some that have better analysis than that to a target, but it is around that number.

Senator CONROY—So, of the 2,200, about 600 or 700 will be in the field.

Mr Carmody—On field activities; something like that.

Senator CONROY—What is the rough split there between large and small, did you say, or will they all be doing all of them?

Mr Carmody—No. The additional funding is phased in for our large business operations. For this coming financial year there is about \$10 million going up to about \$16 million, and that probably starts off at around 70 staffing positions. As I said, they are directed at the large business, larger end of the market. They are a combination of additional audit staff, improved

intelligence targeting and some assistance in GST. There are between 300 and 350, and I think a fair proportion of those are directed at the large end of the market. Then, of course, small business is directed at small businesses. I have given you discrete figures there, but that additional investment in small business and GST is about a combined field. A lot of that is about a combined field presence looking at, as I said, income for a variety of purposes.

Senator CONROY—I understand the fact that they are linked. What other resources will be going into larger business compliance, and what will they be used to do? You talk about officers with larger business compliance.

Mr Carmody—Yes. It is primarily around our field operations; it is primarily focused at compliance issues. There may be some additional support for assistance and rulings but, primarily, it is around the audit and the intelligence and analysis. That is to make sure that we are targeting the right issues and the right corporations, because that is obviously the most effective way to identify them.

Senator CONROY—How much revenue do you anticipate raising per audit? I am happy for you to break that down into individual small business and large business.

Mr Carmody—How much do I anticipate raising as a result of these additional resources?

Senator CONROY—Yes. As a result of these additional resources, how much revenue do you anticipate raising per audit? I am happy for you to break that down into the three categories of individual, small and large.

Mr Carmody—This additional revenue takes a phasing-in period—and these are rounded figures, and so they might be slightly outside what is in the papers. But with large business in the coming financial year, which is the first year, we are looking at \$50 million, but that will rise progressively to around \$190 million. In the area of small business with our integrated fieldwork, it is about \$35 million again rising to about \$90 million. The GST is \$90 million rising to about \$120 million, \$130 million.

Senator CONROY—Is it possible to average that across the number of increased audits that you will be conducting?

Mr Carmody—No, we have not gone to exact precision with the number of audits. It has looked at what we see as investment of resources and our analysis of the present risks and issues in the market.

Senator CONROY—But I am asking in terms of how you construct those figures. You must look at it and say, ‘We’re committing these extra resources to conduct more thorough checking or more checks in total and we’ll raise \$10 per review.’ You must have some notional figure that you are anticipating.

Mr Carmody—Yes; but taking the large businesses or, indeed, the small businesses at the moment, we analyse—if you want to put it in these terms—the return that you are getting for your investment, centring on those clients’ activities.

Senator CONROY—There is no point bringing in 10 extra officers if you are only going to raise an extra \$30, and so you must have a figure.

Mr Carmody—Yes, and that is reflected in the funding there. What we do is look at our current experience, whether our analysis suggests to us that there are further issues or a further number of taxpayers we need to look at and what we are doing. So, in our large business, we conduct quite rigorous risk analysis at a macro industry level and then at an individual firm level and identify issues. Then you identify potential results of that and you

say, 'Well, if we could do this extra, we would receive that.' We look at our experience with the GST and what is projected there. If you do the arithmetic, it turned out that in the GST area it was around two to one, possibly increasing to three to one, for your investment there. It is matter of analysing the current situation and what you project.

Senator CONROY—I appreciate that. Budget Paper No. 2, page 163, indicates that the funding is to be used to enhance the ATO's capacity to 'identify emerging risks and assist in improving compliance behaviour'. How do you currently identify emerging risks, and what risks do you currently anticipate? I know we have briefly talked about that.

Mr Carmody—They are the sorts of issues I have talked about, and they vary. For example, in our large business operations, it is a combination of looking at macroanalysis of industries—for example, the economy—and comparing that with returned income and so on. Probably in our largest 100 cases, we go out and do a risk analysis and look at that company or group in particular. We do an analysis of their returns and expenses as well as an analysis of their extent of international operations and so on. So, at the large end, it varies from quite intensive analysis at the individual—

Senator CONROY—What are these risk analyses finding that has caused you to want to commit these resources? What practices have you identified, and by whom have they been carried out, that has caused you to approach the government and get given extra resources?

Mr Carmody—Again that varies, according to the particular area we are looking at. I have outlined our approaches in the large business segment. I have indicated to you, for example, that some of these resources go to 'serious noncompliance' and 'fraudulent'—and tied up with that is promoters of schemes. We are experiencing particular behaviour there. We are working with other law enforcement agencies there. So there is that analysis. You will have seen that we have been conducting a range of access visits—

Senator CONROY—We have been reading about access visits.

Mr Carmody—That gives us further intelligence to determine the risks that are emerging there. I have outlined that in the personal tax area. We would monitor the level of claims and things. It is a wide range of issues that needs to be looked at.

Senator CONROY—I have finished that section and I am happy to move on, but I understand that Senator Cook is also interested in this area. Have we been able to speak to him?

ACTING CHAIR—Yes.

Senator CONROY—Is he on his way?

ACTING CHAIR—He is ready to come.

Senator MURPHY—I have some general questions, firstly, about tax effective investment schemes in the agribusiness area. What is the tax office now doing in terms of making its assessments for the issuing of product rulings for prospectus based investment schemes?

Mr Fitzpatrick—We still receive a number of product ruling applications in this area. We work with the various promoters and managers who apply for those rulings and look at the facts presented to us on the proposed investments. We analyse what is put to us before we rule on the proposal in the product ruling application.

Senator MURPHY—I have asked some these questions before—

Mr Fitzpatrick—You probably have, Senator.

Senator MURPHY—but I am still curious about the issue of forecasts that seem to be part of your assessment.

Mr Fitzpatrick—As we have discussed before, the forecasts are an area we look at. We try to get some guidance from industry benchmarks, for example. Obviously, ASIC plays a role in this area as well, in the context of forecasts in prospectuses, and we work as closely as we can with that agency. As you know, and as we have discussed before, our position is to rule on the application of the tax law in respect of proposed investment transactions. In a general sense, if we accept that there is an expectation of income flow on the proposed transaction, in simple terms a deduction is allowable.

Senator MURPHY—In the case of the olive industry, most of the prospectuses that I am aware of which have product rulings have forecast yields of 15 tonnes or more per hectare. You say that you take benchmarking into account. With the exception of one country, I cannot find where that sort of yield is being achieved anywhere else in the world. The Rural Industries Research and Development Corporation report of January 1998 on the potential of establishing an olive industry in Australia states that over the period 1983-94 the average yield in Queensland and New South Wales was around 2.5 tonnes per hectare. According to the report, only one country in the world achieved yields in excess of 10 tonnes per hectare. I am very curious as to how the tax office can issue product rulings for investments, particularly when it involves significant amounts of taxpayer dollars, because these are all claimed as tax deductions. It seems that on that forecast alone, let alone price, it is never going to be possible for these investors to get a return.

Mr Fitzpatrick—A return or a commercial return?

Senator MURPHY—To get a taxable return. Isn't that the assumption that the tax office works on?

Mr Fitzpatrick—In simple terms, as I have said, there has to be a real expectation of income to enable a deduction to be allowable under the tax law. As you know, we do not rule on the commerciality of a particular proposed investment.

Senator MURPHY—I will come to that.

Mr Fitzpatrick—That is not our position when we rule on the application of the tax law. I cannot comment specifically on the particular product rulings you have in mind in relation to the olive industry.

Senator MURPHY—I am talking about most prospectuses in the marketplace today.

Mr Fitzpatrick—Whatever number of rulings there have been on investments in the olive industry, I cannot comment on any particular product ruling application where we have examined what was put to us to determine our position under the tax law.

Senator MURPHY—Nevertheless, you have issued product rulings for prospectuses that have had forecasts of production yields in the range of 15 tonnes per hectare or above?

Mr Fitzpatrick—I do not know, but I accept what you say. I cannot comment on what factors we took into account in determining the acceptance of what was put to us. As I said before and as we have discussed in another forum, we would obviously look at what is put in the prospectus to determine whether they are realistic projections of income before we can determine whether the tax deduction is available to the proposed investors.

ACTING CHAIR—There are no other tax impediments, are there, like round robins and those sorts of things?

Mr Fitzpatrick—I assume that is the case, yes.

Senator MURPHY—I am talking about prospectuses that have been granted product rulings, and they go into the marketplace with the product rulings. The question I am raising is about whether the tax office works on the assumption that at the end of the day there will be taxable income. You are giving a tax deduction for the purposes of having taxable income with a view to getting back—as I understand it, and I do not want to misrepresent your previous explanation to me—the deduction that has been allowed in the first place and then some.

Mr Fitzpatrick—I am not sure about that. What we rule on in the product ruling is whether investors in proposed investments would be entitled to a tax deduction. That is what the ruling is about. Obviously in doing that we need to look at whether there is a real expectation of income to the particular proposed investors before we can rule.

Senator MURPHY—If you did not think there was a real expectation income, you would not issue a product ruling, would you?

Mr Fitzpatrick—That is correct because, in simple terms, that is what the tax law says.

Senator MURPHY—That is right; that is my point.

ACTING CHAIR—I am having trouble. If they have given a product ruling, there is not a problem, so what is your problem?

Senator MURPHY—Chair—and for you as well, Mr Fitzpatrick—if somebody has bought an investment that projects a production yield of 15 tonnes per hectare, the evidence would show—that is, the research would show—that that is simply not achievable. There was nothing like it, as I quoted before, between 1983 and 1994.

ACTING CHAIR—Are you talking about successful product rulings or unsuccessful product rulings?

Mr Fitzpatrick—All product rulings are successful in the sense that they are rulings.

Senator MURPHY—Except if they get reviewed and they are not being applied as they are intended to be applied.

Mr Carmody—Thank you for that, Senator. We need that on the record.

Mr Fitzpatrick—We do review them; that is correct. Then we will disallow deductions if that is the program of the law. What Senator Murphy is talking about is the commerciality of the proposed investments.

Senator MURPHY—Yes, exactly.

Mr Fitzpatrick—As I said—and as you understand—ASIC plays a role in looking at forecasts and prospectuses. That is as well as us playing a role on the tax deductibility of the proposal put to us.

Senator MURPHY—That is my concern.

Mr Fitzpatrick—Commerciality?

Senator MURPHY—Yes, commerciality—that you are issuing product rulings for investments that are simply not commercial and never will be. I think ASIC is slowly waking up to that fact, even though it has taken them a long time. In an article in the *Australian* on 12 March this year about Barkworth's, it says that ASIC has now taken a view that it is not possible to project the price of a product over a period of time, namely, 20 years. My question

is, what makes 20 years different to 10 years or 15 years? If the problem is that you are trying to project a price return over a period of time, how do you work that? It is not unlike how you deal with a yield which, on a commercial reality basis, has a forecast production yield of 15 tonnes per hectare, when no research indicates that that is possible. There is the exception of the United States, and it is true that they actually did get up to 12.29 times per hectare. The average is probably more like eight, which is half of what is being forecast in most of these projections for olive growth plantations that the tax office is issuing product rulings for. I am trying to look for a thread of evidence that you can give to me about the basis on which you are making this commerciality judgment.

Mr Fitzpatrick—As I said, we do look at what is put to us in applications for rulings to determine whether the forecasts are realistic within our understanding of various industry benchmarks and any guidance we might receive from ASIC. There are a number of cases where we get applications for rulings where we do not immediately accept what is put to us and we go back to the applicant to question particular aspects of what is proposed. We sometimes get criticised, I might add, for being too slow in responding to rulings in those sorts of cases where we seek further information.

There may well be debates with people about what is in the prospectus, including the forecasts, before we can satisfy ourselves—if we do at the end of the day, and sometimes we do not—that there is a real expectation of income. In some cases we do not give a ruling because of our concerns about particular aspects of what is put to us in the proposed transaction.

ACTING CHAIR—For the purpose of the *Hansard* record, Senator Murphy, are you suggesting that the tax office is giving favourable taxation rulings in circumstances where sometimes it is doubtful that the estimates over 20 years will be achieved. Is that right?

Senator MURPHY—No, I do not think that.

ACTING CHAIR—I think you have got to clarify it because we are all having trouble with understanding what you are getting at.

Senator MURPHY—I do not think Mr Fitzpatrick is, with the greatest respect to you.

ACTING CHAIR—The readers of the *Hansard* record will be.

Senator MURPHY—With the greatest respect to you, Mr Chairman, I do not think Mr Fitzpatrick is having trouble with what I am saying. There are two things: one is that prospectus based companies are putting information out into the market place, attached to which is a product ruling that I allege contains forecasts for production yield—how many kilograms, how many tonnes of olives per hectare that the plantation might produce—that are simply not achievable.

ACTING CHAIR—Perhaps the tax office might like to respond to that.

Senator MURPHY—Mr Fitzpatrick has. What he has not done is to produce any evidence. I have a report that was done by the Rural Industries Research and Development Corporation in 1998. I would have thought that it would have been at least a source of reference material for the tax office or for ASIC when making judgements. No country in the world, with the exception of the United States, has achieved anything like 10 tonnes to the hectare.

Mr Fitzpatrick—Just to clarify and amplify: we do not guarantee the commerciality of a proposed investment. That is not a job so far as the tax office—

Senator MURPHY—I know that, and you know I know that.

Mr Fitzpatrick—That is right, but I want to make sure that it is on the record that the commerciality of an investment is not guaranteed by a product ruling. We make that quite clear in all product rulings we issue in this area. In relation to the specific rulings you have referred to, I do not know what factors and what information we took into account in determining whether we could give a ruling. I cannot comment because I do not know which ones they were, or how we went about determining our position under the tax law.

Mr Carmody—I will make a couple of observations just to reinforce that point. We are not guaranteeing any commerciality. We are looking at the tax law, which in itself does not require that the business ultimately prove to be profitable. On that sort of analysis you would say that the numerous small businesses that go out of business every day are not entitled to deductions. So the question is to apply the income tax law, which can test whether things are carried out in a business like way and ensures there are no funny money arrangements caught up with it that would see anti-avoidance provisions apply. It is those factors that we need to take into account. In no way are we guaranteeing the commerciality. At the end of the day, whether or not something ultimately proves to be profitable is not necessarily conclusive of the tax position under the law. As I have said, many small businesses that go out of business would not get the deductions on that. It is a bit hard for us to answer the questions you raise when we do not know the specific cases. If you would like to give us some of the cases, we could provide you with a more detailed analysis and the sorts of considerations that we took into account.

Senator MURPHY—I could ask you for an analysis of all prospectus based applications for olives that you have issued a product ruling on in the last two years.

Mr Carmody—There is a question of proportion, if you have particular concerns. We receive many of these product rulings.

ACTING CHAIR—I think you have to focus a bit more clearly on the areas where you think there is a problem, Senator Murphy.

Senator MURPHY—In all of them I think there is a problem.

ACTING CHAIR—That is just your judgment. How about picking one or two that will prove the point?

Senator MURPHY—It is not my judgment, with respect, Mr Chairman. It is the judgment of other people, like van Eyk Capital. I am not asking the tax office to guarantee the commercial viability, and I have not alleged that it should, but I have been told by the tax office previously—and Mr Fitzpatrick said it again today—that when the tax office is considering the issuing of a product ruling it takes into consideration whether or not there is a possibility of the scheme delivering an outcome.

ACTING CHAIR—That is one of the issues.

Senator MURPHY—My question relates to how you can do that—

Mr Fitzpatrick—It is real expectation of income, which is gross income, assessable income. That is what the tax law requires us to do.

Senator MURPHY—My point is simply that, with the forecasts that are projected in these prospectuses, it is not possible.

Mr Carmody—I think there is a slight communication gap here. What Mr Fitzpatrick has talked about is the traditional tests as to whether it is carried out in a businesslike way, whether there is a real prospect of income and so on. The income there is gross income, not net profit, and we may see that something satisfies those income tax tests. They are not necessarily tests of whether this has a 100 per cent or whatever per cent likelihood of operating at a net profit; as I have already mentioned, that would not be satisfied, in the end event, by a lot of people. But I think I would reiterate, Senator, that we are trying to talk in generalities here, and if you have perhaps a small sample of ones that you are particularly concerned about, it would help us then to provide answers in detail, because there are a lot of factors that need to be taken into account in this.

ACTING CHAIR—Can you give one or two examples on that?

Senator MURPHY—I will provide the tax office with the examples on notice. It does not detract from the fact that all of them contain a yield projection of 15 tonnes to the hectare. That is the point. It is my only point in raising this issue. You say, in a submission that Mr Fitzpatrick wrote:

... overall income reasonably expected to exceed overall fees, and projections to appear to be arguable.

Mr Fitzpatrick—We put a submission to the previous Senate committee looking at mass marketed schemes—

Senator MURPHY—Yes. That is what I am reading from.

Mr Fitzpatrick—That would be our position of what we would do at that particular time and how we apply the law.

Mr Carmody—Again, if we can have the examples, we will explain how we got to that point in respect of those. That might help bring into account all the situations that we need to take into account.

ACTING CHAIR—Next question, Senator Cook, on mass marketing. Have you got a question?

Senator COOK—I just wondered whether Senator Murphy has concluded his questions.

Senator MURPHY—No, he has not, with the greatest respect. Commissioner, it does not really matter. I can provide you with the examples which will contain within them those growth projections, but that does not matter. My point is that whether 15 tonnes is in XYZ prospectus or ABC prospectus does not matter; the research suggests that it is not possible. Evidence from global research by the Rural Industries Research and Development Corporation would indicate that at best the global growth rates would be less than five tonnes to the hectare.

Mr Carmody—And again I am quite happy to explain how, in the particular cases, we took those projections into account. That will help us. I do not know, but perhaps even at a lower projection they might have looked as if they were going to return a profit. I just do not know in the absence of the specific cases. I understand the point you are making, and it would help us if we could analyse particular cases to explain the total approach that was taken.

ACTING CHAIR—Senator Murphy has agreed to give you several cases. Could we move on to the next question.

Mr Fitzpatrick—It might be helpful also if we knew about the forecasts you have got in that report there and whether we took that into account or not. If you will just let us know what it was, we can follow it through.

ACTING CHAIR—I think you had better give those on notice, Senator Murphy, so the tax office can do a proper analysis.

Senator MURPHY—With regard to the yields that are expected from forest plantations, I do not want to take up the time of the committee with questions that I have asked you before and the concerns that I have expressed before with regard to yields, but I would ask you: have you done any research, with regard to those plantations that have been harvested recently in Western Australia, to determine the yields that were projected for those plantations versus the yields that were actually achieved?

Mr Fitzpatrick—I do not know the answer to that question.

Senator MURPHY—Can you take that on notice?

Mr Fitzpatrick—Yes.

Senator MURPHY—I have a question about a film prospectus that I received on 22 June 2000—and I am asking this question in the context of the settlement process being offered by the tax office. It was from The Strategic Group about Barron Entertainment Ltd and it says:

The key elements of the Barron film prospectuses are as follows:

- The films and/or television series have already been pre-sold to Networks and/or Distributors.
- The Distributors have agreed to provide minimum Distribution Guarantees equal to 100% of investor funds.
- Security for the Distribution Guarantee is a letter of credit satisfactory to the financier.
- Australasia Investment Finance Pty Ltd has agreed to advance 100% of funds required against the security of the minimum guaranteed return.
- Investors are entitled to claim a 100% tax deduction under Division 10BA of the Tax Act.

In the prospectus is an income tax report by Horwath Tax Perth. In the preamble, it says:

An investment in a Qualifying Australian Film can attract taxation advantages under Division 10B of the Income Tax Assessment Act 1936, as amended (the "ITAA"), for taxpayers who are Australian residents at the time at their investment.

Then, under a subheading 'Availability of taxation concessions', it says:

Under Division 10BA of the ITAA, income tax deductions will be available in the year of income in which funds are expended by resident investors by way of contribution towards the cost of production of a Qualifying Australian Film ...

And it further goes on. For all intents and purposes, this implies that this scheme is eligible for a tax deduction. If I understand the submissions of the tax office to the Senate Economics References Committee, that is not the case.

Mr Fitzpatrick—I do not know about that particular film scheme.

Senator MURPHY—It is *Kat's Eye*, series 1 and 2; *Chuck Finn*, series 3 and 4; and *Wormwood*.

ACTING CHAIR—I think you will have to ask the tax office to take that on notice because it is about a particular case.

Mr Fitzpatrick—Have we given a ruling on that, Senator Murphy?

Mr Carmody—It does not sound like it.

Senator MURPHY—There is not a product ruling for it, but—

Mr Fitzpatrick—Have we said that it is a scheme that—

Senator MURPHY—on 27 June I contacted Mr Brett Petersen from the Product Rulings Division, who said the following, in effect, in respect of these schemes. I asked, ‘Are Barron correct to claim this deductibility under 10BA?’ He said, ‘Yes, they are, if the deduction being claimed is eligible—in this case, an Australian film.’ I asked, ‘If they claim deductibility under legislation, do they need a product ruling?’ He said, ‘Nobody needs a product ruling. All they do is confirm the ATO’s view that the laws apply in a certain way to allow the deduction.’ So it does not need further confirmation—no requirements to come to the ATO to get a ruling, no requirements to get the ruling for a deduction to be available under the law.

Mr Fitzpatrick—Mr Petersen is just stating what the law says.

Senator MURPHY—He is, but—

Mr Fitzpatrick—I am not sure that he is giving a clearance on a particular film scheme investment.

Senator MURPHY—I am sure he was not, and I would not like to infer that he was. Can you see the dilemma faced by taxpayers who are given a prospectus of this nature and a letter that clearly says—and this was sent to me—

ACTING CHAIR—Who from?

Senator MURPHY—The Strategic Group—Strategic Investment Marketing Ltd—as I said at the outset, Mr Acting Chair, in respect of Barron Entertainment Ltd films. Taxpayers are sent a prospectus that contains an income tax report from what one would consider to be a very reputable accounting firm. I guess, in terms of ringing the tax office, I am putting myself in the position that I already knew a lot of these things anyway because I had been dealing with them, but I think the layman out there would take it that this was okay. But in fact it is not okay.

Mr Fitzpatrick—I do not know whether or not it is okay, but—

Senator MURPHY—We both know it is not okay.

Mr Fitzpatrick—I understand the point you are making. We have been saying for some time now that people who are looking to go into proposed investments—whether it be films, agriculture or whatever—should either seek further advice independent from the promoter or manager of a particular investment scheme or seek a product ruling, if they want to get tax office clearance on a particular proposed investment. As Mr Petersen said, there is no requirement under the law to get a ruling, but it is in people’s interests to do so.

Senator MURPHY—I understand that—and we both know it from previous discussions—but what is ‘independent advice’? That is the problem for the investor.

Mr Fitzpatrick—I understand.

Senator MURPHY—Is it the Horwath Tax Perth accountant—and are they independent?

Mr Fitzpatrick—When we say ‘independent advice’, we mean independent from those who are promoting the investment scheme. That may well be in this case—I do not know whether Horwath are involved with the promotion or otherwise.

Senator MURPHY—If my memory serves me correctly, the prospectus was required to contain some report in respect of the tax implications.

ACTING CHAIR—The tax office will examine your problem and report back to you.

Mr Carmody—I think in that case, Senator Murphy, we have made available the product ruling system. This gets to the point: you are asking what investors are supposed to do. We have made available the product ruling system—and I do not think, if you look at any newspapers or publications we produce, we could be accused of not making it clear that our advice, in facing proposed investments like that, is to ask whether it has a valid product ruling. That is what we have put in place to assist.

Mr Fitzpatrick—I should add that we are trying to inform and educate the tax agents. Prospective investors in this particular arrangement would generally have a tax agent they can go to. We put on our ATO web site, concerning aggressive tax planning or product rulings, the warning signs that investors ought to be looking out for in particular investment proposals. So we are trying to educate not only investors and proposed investors but also the tax agents of those investors—about what to look out for when they are advising their clients or when investors are looking to invest in a particular arrangement. As the commissioner said, the product ruling, as you well know, is there for them to seek a ruling from the tax office.

Senator MURPHY—But, as I said, when I rang the tax office they said, ‘Nobody needs a product ruling.’ I am not wanting to be difficult. I am talking about a normal investor who has been given this by their financial adviser or somebody else and it contains a report, for all intents and purposes, from a reputable independent adviser in the form of an accounting company. You say that they should seek independent advice. How do we put that? We have got a product ruling system and, if you ring up the tax office and ask them, ‘Do I need a product ruling?’ the answer is, ‘No, you don’t, but you need to confirm the ATO’s view of the law.’ How do I do that? I seek independent advice. So I go to an accountant who says, ‘Horwath have written this report and that seems to say it is okay. With that, I recommend that you should go into this investment.’ It is really a double jeopardy for people.

Mr Carmody—I am not sure of the nature of the full details of the conversation with Mr Petersen. I suspect that you identified yourself, so he probably was not in the mode of giving advice to a potential investor; he was probably trying to explain the position under the law. As you have outlined, he did state quite accurately the position under law. So I am not sure whether that particular conversation is representative of the advice that people get. As I have said, we have gone to a lot of effort—through our publications and work with tax agents and others—to get a message out there that, in these sorts of arrangements, you need to see whether there is a product ruling. It still remains the position that people make their choice, but within our responsibilities under the law we have, we believe, put in place the best possible arrangements.

Mr Fitzpatrick—Independent advice is one aspect; you get advice independent from the promoter. But if you get tax office advice or ruling, you get a product ruling.

Senator MURPHY—I do know; I do understand that.

Mr Fitzpatrick—Good, we understand each other.

Mr Carmody—It is just that I am trying to put together your problems with the product ruling system and your position now.

Senator MURPHY—The problem that arose with the product ruling is totally different to the questions I raised in this respect. Commissioner, in respect of where the mass marketed schemes are at at the moment, what did Justice Conti say in the Budplan finding about the financial arrangements?

Mr Fitzpatrick—Justice Conti ruled in the Budplan scheme, having regard to all of the arrangements, that the anti-avoidance provisions applied to deny deductions, which includes the financing arrangements you referred to. He also said prior to that that the deduction was not allowable under the primary provisions in any event because expenditure was incurred essentially too soon before any business commenced.

Senator MURPHY—With regard to the financial arrangements vis-a-vis non-recourse loans and round robin, did he not reject the argument on the part of the tax office?

Mr Fitzpatrick—Not in my view. He applied the anti-avoidance provisions in part IVA of the tax law.

Mr Carmody—I think we should put the tax office's position here. There is that case and there is a subsequent case in Vincent, where I think the judge described the round robin and non-recourse as a fictitious arrangement.

Mr Fitzpatrick—He said the loan in the Vincent case was fictitious.

Mr Carmody—So we have those two positions on that. But those loan and round robin arrangements go equally to the considerations that go into the operation of the general anti-avoidance provision, as to whether when you look at the totality, including those financial arrangements, the dominant purpose is to gain a tax benefit. So in relation to those—and this has been our position all along—part of the significant features that would lead one to a conclusion that the general anti-avoidance provision applied were the financial arrangements associated with them. They give an effect that goes towards the consideration of part IVA.

Senator MURPHY—I have not read all of the decision, but on the question that goes to non-recourse and the financial arrangements it said:

Accordingly I would reject the contention of the Commissioner that the Applicants did not effect payment according to law of the relevant sums respectively of \$24,000 (or multiples thereof in the case of Messrs Harvey and Davidson) appertaining to the first two years of participation in the BPS (or for that matter together with interest thereon related to such period of time). The Commissioner's contention as to the absence relevantly of "commercial value", an expression used in a different revenue context in *Moreau v Federal Commissioner of Taxation* (1926) 39 CLR 65 at 70 (Isaacs J), an authority to which the Commissioner referred, should not be sustained.

Mr Carmody—I understand that. That was on the primary question of deductibility under the general deduction provision of the law, and Justice Conti did find that in the Budplan case. Equally, in the Vincent case, Justice French found that the alleged expenditure supported by those loans was a fictitious result. The more important issue, and the one that we have been taking all along, is that when you then go to the reserve general anti-avoidance provision—which applies irrespective of the general deduction provision—and look at the sorts of outcomes and tax benefits supported by the financial arrangements typically employed in these schemes, in both decisions the justices came to the very prompt response that part IVA, the general anti-avoidance provision, applied to these schemes. When we look more broadly at the types of schemes that we are concerned about, in our view, as we have indicated all along, it is that anti-avoidance provision that would deny deductions under these types of arrangements.

Mr Fitzpatrick—That is correct. In relation to the primary provisions, the decision in the Budplan scheme cases and Justice French's decision in Vincent the other day highlight the different factual circumstances. One judge in one scheme, on the facts of the particular case, said that essentially the expenditure was incurred, but it was incurred too soon—there was a deduction under the primary provisions in Budplan. French said in Vincent, in relation to the leverage deduction, with the financial non-recourse loan et cetera, that it was not even incurred, because it was never paid over to the manager of the investment project by the related financier with the promoter. That was why it was fictitious.

Senator MURPHY—I am not raising a question with regard to the decision in an overall sense; what I am coming to is the schemes that are in operation. Some of these schemes did not operate, as we know; some did not even eventuate in reality. In the case of the Budplan scheme, the circumstances were very questionable as to what was actually achieved and whether anything was really done. But, when you have schemes where a business has been established—

Mr Fitzpatrick—As it was in Vincent.

Senator MURPHY—and is operating—

Mr Fitzpatrick—As it was in the Vincent case.

Senator MURPHY—and is earning income—

Mr Carmody—That is the important thing: there was an element of business in Vincent. There may be other schemes where there is a higher element of business. If I can come back to the point: in both cases, the leveraging and the financial arrangements were part of the structures of the schemes that supported the tax benefits, which led to the conclusion that the general anti-avoidance provision applied. That has been our consistent view. There will be further court cases and that will be tested, but that is our view.

You have raised the question that there might be a business where you can go out—and I know that this is easy for some to do—and say, 'There are vines there, there is this and that there, so how could the tax office possibly deny deductions?' Let me give you an illustration of our concerns. You could have a situation—and this goes to the funding arrangements—where, on the face of it, people have put up \$10 million of their money. In fact, that was supplied by the tax benefit, but they put it in. You could have a situation where, with these round robins and non-recourse loans, you could add another \$30 million to that, so that the deduction claimed is \$40 million. It might be that, once the promoter's fees are taken out from the \$10 million that was put in, there are a few million dollars that could go into an activity.

The question here, however, is: when you take into account the total claimed deduction of \$40 million, are the arrangements designed to provide a tax benefit that is the dominant purpose? It could well be that there is a \$2 million, \$5 million or \$10 million business operating, but we would say that that is no reason to allow \$40 million as a deduction for that. The question then becomes: was the dominant purpose of that total structure to obtain the tax deduction? Typically in these the \$10 million that was said to be put up personally was in fact funded by the tax benefit that was pumped up, in my example, by the extra \$30 million. More often than not, not only did it fund that \$10 million but it gave a handy profit purely on the alleged tax benefit. So the mere fact that there is something operating in some of these schemes does not justify the view, in our humble terms, that the total arrangements justify the full deduction—in my example, \$40 million. Rather, we would say, to take that scenario, the dominant purpose of the overall arrangement was to obtain the tax benefit.

Mr Fitzpatrick—If there was income flowing back to investors from—in Mr Carmody’s example \$10 million or part thereof—actual activity, what happens is that that flow back to investors is offset against their outstanding limited recourse loan or ongoing management fees, so in fact the investor does not get anything in his or her pocket.

Senator MURPHY—Not in every case.

Mr Fitzpatrick—In the ones that we have seen that is certainly the case.

Mr Carmody—It is that essential element of looking at the totality of the arrangement that we need to look at. That is the basis of our position.

Senator MURPHY—I understand that.

ACTING CHAIR—Next question.

Senator MURPHY—Thank you very much, Acting Chair. That raises my point about the whole issue. If you take a scenario where you say that \$40 million was raised by way of tax deductibility and only \$10 million went into the scheme—

Mr Fitzpatrick—Something less than \$10 million, actually.

Mr Carmody—Fees.

Senator MURPHY—Whatever. I am not going to argue.

Mr Carmody—It is not a discussion on the level of fees.

Senator MURPHY—I am not going to argue the exact dollars.

Mr Carmody—You and Mr Fitzpatrick can go outside and have a private conversation.

Senator MURPHY—A percentage that is significantly less than what was raised went into the scheme. At the end of the day, there is no potential for this thing to realise some income with regard to the objective purpose test.

ACTING CHAIR—Senator Murphy, I do have some problems because you are trawling through some determined court cases.

Senator MURPHY—No, I am not.

ACTING CHAIR—The commissioner and Mr Fitzpatrick have given you the tax position and they have given you the law, and you are just trawling over obscure aspects of the judgment that in the totality did not affect the final outcome.

Senator MURPHY—I am actually asking questions about the administration of the tax law and I am only using aspects of the court cases to try and ascertain whether or not the tax law is being administered equitably and fairly. That is the reason for the questions.

ACTING CHAIR—The courts have ruled on that and, quite frankly, I think you are wasting the time of the committee trawling through aspects of the judgment.

Senator MURPHY—I am not trawling through.

ACTING CHAIR—You are. I am quite happy for you to ask questions in terms of the administration of tax law. I think the commissioner has given you a very detailed and clear exposition of the outcomes.

Senator MURPHY—I never said that he had not.

ACTING CHAIR—Other members of the committee are getting impatient too.

Senator MURPHY—If other members of the committee have got questions they want to ask on mass marketed schemes at the moment, they can intervene and ask those questions.

ACTING CHAIR—If you are finished—

Senator MURPHY—No, I have not finished.

ACTING CHAIR—I do have problems with you trawling through case law at the moment, because we do have limited time.

Senator MURPHY—With the greatest respect, I will say to you again that I am not trawling through case law. I mentioned one part of one particular case.

Senator CONROY—We might be able to solve this discussion by asking Senator Murphy how much longer he thinks he will be going for.

Senator MURPHY—I will not be going that long.

ACTING CHAIR—What do you call ‘that long’?

Senator MURPHY—Probably about 20 minutes.

ACTING CHAIR—Do you want to have a turn, Senator Conroy?

Senator CONROY—No, 20 minutes is fine.

ACTING CHAIR—We are not making a lot of progress.

Senator MURPHY—I can come back to this.

Senator CONROY—No, finish off what you want to do.

Senator MURPHY—I have got another matter that I want to take up, which is a totally separate one.

ACTING CHAIR—Proceed with your next question.

Senator MURPHY—In a submission to the Economics references committee—and this is my whole point about the application of the law—you said at page 5:

However, If the expenditure (i.e., project fees) produces no assessable income, or if the assessable income produced is less than the amount of fees over the term of the project then, on the authority of *Fletcher*, it may be possible to reduce/apportion a deduction otherwise allowable under the general deduction provisions.

You say further:

However, the fact that the ATO has issued a Product Ruling for a project is an indication that the ATO has accepted that there is a reasonable expectation of profit.

I do not want to drag it, but that is my point about this process: you are issuing product rulings for exactly the same sorts of schemes, with exactly the same sorts of outcomes—

Mr Carmody—No, no. The example I gave there of the leveraged pumped-up deductions: we do not accept applications for product rulings that have the leveraging, pumping-up effect of the funding arrangements. As to the more specific issue, we have already been to a position where we have offered, if you give us some practical examples, to take you through the analysis that was done.

Senator MURPHY—Commissioner—

ACTING CHAIR—Senator Murphy, I have got to rule against this. Come onto your next question, because what a court might have said is not affecting the administration of tax law,

and trawling through issues that have previously been debated and determined in terms of previous views of the Senate Economics committee—

Senator MURPHY—We will see in the fullness of time, Mr Acting Chair, and that is the purpose of asking questions with regard to assessments of what is actually being produced here in income. I understand you have taken questions on notice with regard to the research that you may or may not have conducted in respect of the plantation industry. You can read that report, and I would appreciate some advice back, because it is an important issue.

Mr Carmody—We have committed to giving you advice back, and we will do that.

ACTING CHAIR—Thank you. Do you have any more questions?

Senator MURPHY—Not at the moment.

Senator COOK—I have a few questions on the mass marketed schemes. As a preface to those questions, I am of course not in a position of defending people whose primary purpose is to defraud the revenue, but my electorate office is in Kalgoorlie, and a number of people in that area have specifically been targeted by promoters of these schemes. I will be pursuing elsewhere in these estimates what the government intends to do about legislation to deal with promoters who, in my view, are the primary evil here and the ones who ought to be addressed. In this area, a number of people who have benign or innocent motives have been caught—by virtue of those promoters—in these schemes, and that brings me to a couple of questions about the offer that has been made to settle. Is it too soon to make an assessment as to what the take-up rate of that offer is?

Mr Carmody—At the moment I understand we have around 26,000 acceptances.

Senator COOK—Out of—

Mr Carmody—That probably represents around 50 per cent, and they have been coming in in significant numbers over the last week.

Mr Fitzpatrick—Some people were waiting for the Vincent decision—last Friday week, I think it was. It was supposed to be handed down only towards the end of May. Since that decision, which was favourable to the commissioner, the number of settlement offers has increased significantly, as the commissioner has said. There is another 2½ weeks or so to go.

Senator COOK—Given the extension, there is another 2½ weeks to go.

Mr Fitzpatrick—Yes.

Senator COOK—So most of the settlements come in just on the dead knock of the last expiry date.

Mr Carmody—That does not surprise us, because a number of agents have said that they were progressively working them through and stockpiling them. Perhaps that was because they were waiting for the Vincent decision, or perhaps they just wanted to lodge them all together, for work practices or whatever. It does not surprise me that they were coming in near the end.

Senator CONROY—Can I just clarify? Was the deadline before or after the expected date of the Vincent decision?

Mr Carmody—The deadline of 29 May was announced after the Budplan decision and it is a question of judgment. The whole objective of this offer was, consistent with the Senate committee recommendations, to offer an alternative to the long and ongoing disputes that would go through the courts—to say to people, ‘Well, there is an alternative. We will offer

you this settlement and then you can put the matter behind you.’ So consistent with the original Senate committee recommendations, we offered that for some extra time, a bit over eight weeks, after the Budplan decision. Around that time we got advance notification that the Vincent decision would be coming out on 24 May. It was always our intention, in the circumstances of a favourable ruling for the tax office, recognising that some people were being advised to wait for this decision, that we would extend the offer.

Senator COOK—I acknowledge the extension. I now have a concern about the number of constituents and tax advisers in the Kalgoorlie area who have approached us on the basis that they are being asked to agree to a settlement. They do not know precisely the terms under which they are signing a waiver for their other rights at law in order to embrace that settlement; that is to say, they do not have the precise terms of what the settlement with the tax office would be in a money figure for them.

Mr Carmody—Let us take, as an example, the outcome in the Vincent case. A taxpayer there would get no deductions; a penalty which satisfied the judge at 10 per cent; and, while this would not be raised with the judge, they would face interest over a potentially extended time. On the face of it, I believe they are able to judge where they get a deduction for part of the money that they have put in—often that is around 20-25 per cent—and there would be no penalty and no interest. So, in that sense, there is a clear and decisive difference in what is being offered.

In addition, we have offered fact sheets on almost every one of the schemes that we have identified which state what rate of tax they would be expected to pay on that investment. A lot of these people are often not sure how much they put up. Inherent in that is an understanding that for a standard unit this is what you would face. We have also provided a calculator on our web site. Agents are certainly more than familiar with the operation of these styles of calculator. They can get past the fact sheets stage for a given rate of tax and go to the actual circumstance of that person to calculate the tax that would be payable.

We have recognised people’s circumstances in this whole offer and, in my view, not only does the offer stand in its terms and offer people a fair chance to make a decision but we have given them and tax agents the support necessary to be able to do it. As I have said, approximately 50 per cent have made that decision. We invite people to ring us on our particular number if they are having particular difficulties. We have not had any negative feedback about those calculators or other matters. In some cases, where people have approached us because they do not have access to the Internet, our people have taken them through that calculation. Overall, there is a reasonable amount of information available to people to make their decision.

Senator COOK—Notwithstanding all of that, can I tell you, Mr Carmody, that what I said earlier is true: a number of people have approached us. Their tax agents have approached my office, saying that they cannot precisely advise their clients, given the information available from the tax office on the offer, on what the money amount would be if their clients signed off on a settlement.

Mr Carmody—I accept your reporting that faithfully but I have outlined the support we have provided and the fact that increasingly people are making their decision, and that is not being seen as a barrier.

Senator COOK—Who knows on what basis those people have made that decision.

Mr Carmody—I cannot read people’s minds. You are right.

Senator COOK—All I can say, on the basis of the people in Kalgoorlie who have approached my office, is that these are people who ventured into these schemes as a first foray into investment to manage their retirement benefits and things of that nature, who trusted what was said about those schemes by the people promoting them and who are now in a situation of being uncertain as to what their best option might be. I do not think it is my job to advise them. It is for them to get the best advice from the experts available to them. This lack of clarity or, as your answer would suggest, perceived lack of clarity is an obstacle to them coming to grips with making a final option to settle or not.

Mr Carmody—As I said, there is a suite of tools available to people. One of the issues is that it is the taxpayers themselves or the investors themselves who have the information about how much they invested in whatever, and that is why we have made these tools available to assist them and their agents in doing this. If they want to get to a more precise estimate, we have that calculator available. Recognising what you have said, it was our intention to write out this week again to those who have not yet taken up the offer, to explain the revised date and to point them to the range of these tools available to them and their tax agents, and we hope that that will meet their needs.

Mr Fitzpatrick—I might add that we do have regular updates to tax agents, particularly on this matter, to assist them. They will be assisted by way of explanation as to how to do the calculations. I would have thought that a tax agent should be able to work out pretty accurately, once he knows how much was invested by the particular investor, what the liability would be if they accepted the settlement offer.

Senator COOK—All I can say is what I have said.

Mr Fitzpatrick—I understand that.

Senator COOK—There is no point in my repeating it. If I can take you up on one of the points that you made in your earlier answer: do I understand from what you have said that, if the taxpayer or his or her agent were to contact the tax office about a specific case, you would confirm with that agent or the taxpayer what the final money terms would be for them in the settlement?

Mr Carmody—The particular examples I gave were of people who did not have access to the Internet and, therefore, to the calculator. If people ring up in those circumstances—in the last three weeks there have been about 100 or 120 cases—and they tell us of their investment, we would go through that calculator with them, and that would give a reasonable estimation of the liability. Final liabilities depend on a whole process of amendment, what other debts are outstanding and so on; but the calculator does provide a reasonable estimate of the final liability. In cases where people have not had access to it and they have contacted us, we will go through it with them. Please, I am not encouraging everyone to do that, because we have had some examples of what seem to be mischievous behaviour in tying up our telephone lines with call centre type ringing and putting on hold and things like that. But where people are in genuine difficulties, we do provide that assistance.

Senator COOK—So, in essence, if they do not have access to the Internet and they contact you directly, the service you offer then is to explain how the tools on your program work, so they can calculate for themselves—

Mr Carmody—No.

Senator COOK—I am just trying to clear about this.

Mr Carmody—I want to try to be perfectly clear. As I said, we have not offered a general service of ‘Ring us up and we’ll take you through this,’ because it could take 20, 30 or 45 minutes to go through it and we have to be reasonable in what we can deliver. What we have done is to make these tools available to taxpayers and, in particular, to their agents. Almost invariably, people use agents in these circumstances. They can get a general guide from a fact sheet whereby, if they say the average rate of taxes that would apply would be whatever, that will give them an amount. If they want to get into more detail relevant to their year and the rate of tax applicable, there is a calculator available. Agents are reasonably familiar with that, and we have had a range of meetings with them, working through their issues, to do that.

As a reserve position, if people are in real difficulties—and we have had examples where people did not have access to the Internet—and they get on the phone and tell us their amount, then we use the calculator to calculate the reasonable estimate for them. But, for practicality, as I said, that is a reserve position. So we do not just turn them away; we do it there.

Senator COOK—The attitude these people have is that, by opting for a settlement, they are putting aside any illusions or beliefs they had about what this investment would return to them. When opting for a settlement, the predominant attitude is: ‘I want to cut this issue where it is, put it behind me, bear whatever pain there is about the previous commitments I had made and get on with life and just get rid of the issue.’ But in doing that, a clear understanding of the precise terms of the settlement is one of the obstacles, because there is a deep suspicion that, ‘Maybe I am not getting the full facts here.’ That is a suspicion, I would submit, that is reasonably well-grounded in the advice they have received from promoters and in the way in which, in the past, the inscrutability of the administration of the scheme by the tax office itself has helped to create a sense that these people are not across all the information. In cutting the Gordian knot—creating a situation whereby they can put it behind them—is there some way in which they can get from the tax office a clear money figure as to what their liability actually is under the terms of the settlement?

Mr Carmody—I think I have outlined the range of products we offer—

Senator COOK—That is as far as it goes?

Mr Carmody—and that is the practical balance we have tried to achieve.

Senator COOK—Is a settlement offer that does not contain the precise money liability a legally binding settlement offer?

Mr Carmody—Absolutely. The terms of the settlement deed go to deductibility and the application of any penalty, and they are incorporated in the settlement deed. That is quite typically the nature of a settlement deed.

Senator COOK—Even if people are not informed exactly of what their liability is?

Mr Carmody—The question at issue is what is available as a deduction, what is included in a settlement, what is included in assessable income and so on. The amount payable flows from the application of the law and the availability of those deductions, so that is quite typically the situation.

Mr Fitzpatrick—In all cases, when we settle a dispute on the terms which were agreed, we then give effect to that by issuing an amended assessment which gives you the final figure.

Senator COOK—I see. On 16 May, I put on notice some 22 questions which cover this area. Rather than my going through them all again, is it expected that these questions will be answered in the near future?

Mr Fitzpatrick—I think I have seen those. From memory, I was shown them late last week, Senator Cook. I think we can answer those. Some of those have been overtaken by events such as the extension of the settlement offer deadline. As I recall, some of them were grouped. I am sure we can answer those questions, and we are trying to do that as soon as we possibly can. We have touched on some of those a little bit today.

Mr Carmody—We will apply the same standards that apply to the timing of questions taken on notice here to those questions, so you would receive them in as short a time frame as if you were putting them on the table here. We will work to get them out as quickly as we can.

Senator COOK—To put it to you frankly, I would like to receive the answers to these questions before the expiry of the offer—

Mr Carmody—I have not seen the questions.

Senator COOK—and in reasonable time, so that people requesting information from my office can be informed authoritatively by me what the answers to those questions are.

Mr Carmody—I appreciate the circumstances you are in. We will do everything we can to achieve that.

Senator MURPHY—Of the 26,000 that have sought to take the settlement offer, do you have a breakdown of the areas of investment, vis-a-vis—

Mr Carmody—I do not have that available.

Mr Fitzpatrick—No.

Mr Carmody—And they are coming in in their thousands so perhaps, when it is all wrapped up, we will be able to do that sort of analysis if people want it.

Senator COOK—My final question on this is: is there some reason why the tax office did not in the first instance write to these people asking for the information so that it could provide them with an accurate figure as to their tax liability?

Mr Carmody—The whole situation has been around deductions, penalties and interests. The liability sort of flows from that. It is a bit like when you lodge a tax return: you fill out all your deductions and that, and then the bill is determined. The same thing applies here. We have approached this from the focus of the law itself and what is available as deductions, penalty and interest, and that has been our conscious effort all along. We have tried to give people all the information we can on that.

Senator COOK—A number of the people I have come across in the Kalgoorlie area have been inveigled into or attracted to these schemes on advice that has now proved to be wrong; nonetheless, it was presented to them, signed off by QCs and other high-powered ‘experts’ and supported plausibly by others in the field. They were enjoined at government level too, and by me from time to time, to make provisions for their future retirement in this brave new world of ours. This is their first experience of all of this—I differentiate this class of taxpayer from others who quite clearly were in it for whatever tax gain they could make—and the whole process seems to work against their interests. It would seem to me that a more understanding view from the tax office about being precise with these people about their liabilities would be of some considerable use in bringing this matter to a conclusion which, while people will not like it, they will nonetheless understand.

Mr Carmody—I am very conscious of the circumstances you have outlined to me and, indeed, that is the reason that they now have an option that they did not have before—and that

option is starkly different to what, if the courts continue to find as they have in Vincent and Budplan, the courts are finding. We have been very conscious of the circumstance of these people; that is why they have this opportunity to take a settlement which is on the basis of decisions so far very beneficial if they were to be continued. We have not been turning a blind eye to the circumstances faced by these people. In making this offer, in terms of the practicalities of the best that we can achieve in a reasonable way to give them the sort of information about what the tax consequence would be, we have striven to provide the tools that we can. I hear what you are saying but we have sought to recognise the circumstance of these people through not only the settlement and the tools I have provided but also a range of other things that we have done, and we will continue to provide the support we can.

Senator COOK—I understand and acknowledge your point, Mr Carmody, but the fact remains that a number of these people do not know precisely the amount that they are being asked to sign off on.

Mr Carmody—But they do know what deductions they are entitled to and what they would face if the courts continued to find as they have done, and their agents have a calculator which can take them through it. So we have tried, within the bounds of being perfectly reasonable to everybody, to draw a line that we think is appropriate.

Senator COOK—I think that it ought to go one little step further in the case of these people.

Mr Carmody—But there is a whole issue about getting the information and then processing it. It is not an insignificant workload to go through with that precision. As I say, we have striven to give people the tools to make a fair and reasoned decision and the benefit of a settlement offer.

Senator COOK—I understand all that. I do appreciate it and, as I said, I do acknowledge it. But many of these people do not have the resources, either, to respond. One would hope that this experience does not turn them off the primary motivation of looking sensibly at other prospects of enhancing their retirement benefits and so forth.

Senator MURPHY—Commissioner, I would like to ask you about a particular matter relating to the operation of the CDDA scheme.

ACTING CHAIR—Could you explain that term?

Senator MURPHY—It refers to defective administration in terms of a complaint against the tax office.

Mr Carmody—Compensation for defective administration.

Senator MURPHY—Compensation for defective administration. In particular, I want to go to the case of Mr Ian McCarthy.

Mr Carmody—I do not have that detail.

ACTING CHAIR—You will have to put that on notice, Senator Murphy.

Senator MURPHY—With respect, Mr Chairman, I do not want to put it on notice.

ACTING CHAIR—You cannot expect tax officers to go through a case that they are not aware of and do not have the information on.

Senator MURPHY—I want to put something on the record in respect of this case. I will ask the questions on notice if that needs to be the case, but I would appreciate a response within the next couple of days, if possible. It is fairly important.

ACTING CHAIR—If you give them all the information, they will be able to give you a response.

Senator MURPHY—The tax office has all of the information. It is the case of Mr Ian McCarthy from Wagga Wagga. In particular, I am interested in how the investigation under the CDDA scheme is progressing. As I understand it, the tax office gave a commitment to the Ombudsman's office that this would be resolved within a two-month period. The information I have is that the tax office is seeking to pursue Mr McCarthy for a range of other matters and using that pursuit to delay the settlement of the application that he has made for compensation.

ACTING CHAIR—Is Mr McCarthy happy about this being put on the public record?

Senator MURPHY—Yes, he is. I spoke to Mr McCarthy by phone just prior to the commencement of this committee.

ACTING CHAIR—Just a minute, Senator Murphy. Has this gone before a judge or a magistrate?

Senator MURPHY—Yes, it has, and the case has been determined.

ACTING CHAIR—So it is public record information?

Senator MURPHY—Yes, it is.

ACTING CHAIR—I think it is a very important principle that we establish that before we allow you to ask your question.

Senator MURPHY—I fully respect that, but this matter has been resolved in the court. It was in fact resolved in Mr McCarthy's favour. What I find interesting is that the Tax Agents Board wrote to Mr McCarthy on 4 August 1997:

At its meeting held on 22 July 1997 the Tax Agents Board considered this matter and decided that an advertisement to the effect that Tyson McCarthy Services Pty Ltd no longer holds registration as a tax agent should be inserted in the following papers:

The Narrandera Argus

The Wagga Advertiser

The Sydney Morning Herald.

That action was taken. Mr McCarthy then sought two lots of information from the Tax Agents Board: one related to the minutes of that meeting at which the Tax Agents Board apparently made a decision, and the second was the names and addresses of the persons who were present at the meeting. He sought that under freedom of information legislation; that freedom of information application was denied. I will read to you from a letter of 17 December 2000 from the Tax Agents Board, which says in part:

In respect of point (4) of your request a document does not exist showing the contact addresses of all the Board Members present at the Board meeting held on 22nd July 1997. Therefore, I am obliged to formally refuse you access in part to the documents pursuant to section 24A of the *Freedom of Information Act 1982* on the grounds that the documents do not exist or cannot be found.

It also says:

In respect to point (3), Ian Bruce McCarthy or Tyson McCarthy Services Pty Ltd were not mentioned in the Board minutes for the months of April, May, June and July of 1997.

And yet the board wrote a letter to this person and alleged to him that at its meeting of 22 July 1997 it made a decision to place an advertisement. I am curious as to exactly what the case is

here. I would like to be provided with the documentation that Mr McCarthy sought under FOI. If the provision of that information is being avoided by the fact that the matter was perhaps not dealt with in April, May, June or July then I would like a copy of the minutes from when it was dealt with, but the letter of 4 August alleges it was dealt with at the 22 July meeting.

Mr Carmody—First of all, we provide secretarial services to the Tax Agents Board and there is a representative on the board, but they operate independently of us so I will have to examine what we can supply in regard to that. I know nothing of this particular case and I do not know all the facts around it. We will take that on notice and attempt to get it. However, I am concerned about an individual taxpayer's affairs being on the public record.

Senator MURPHY—It was made very public by the tax office commissioner in the local papers; it basically destroyed this person's business. This person is seeking compensation for it and has a right to do so. I would like to read from the judge's statement; it might put it into context. This is public information; it has been published:

In those circumstances a jury in my view could not be satisfied of an essential element of the offences that the accused used dishonest means to achieve his object, knowing that he had no right to do so. I therefore propose to direct the jury to enter a verdict of not guilty in respect of each count on the indictment.

This person has waited some years and it seems to me that the tax office is doing nothing but stalling a settlement and that it is pursuing this person in contradiction of its own taxpayers' charter—

Senator Minchin—Acting Chair, can't Mr Carmody respond to this tirade?

ACTING CHAIR—The commissioner wants to answer the question.

Senator MURPHY—There is no question.

Mr Carmody—As I have indicated, I have no knowledge of the particular circumstances so I cannot comment on the particular case. I was raising the issue of an individual's affairs in the committee not in an attempt to prevent answering your question, Senator Murphy—

Senator MURPHY—Commissioner, I was not trying to assert that you were

Mr Carmody—I do not know what the circumstances are, but there may be some information in what we supply that might not be appropriate to be put on the public record. All I am signalling is that we will examine that—

ACTING CHAIR—You will have to use your discretion.

Mr Carmody—and, if there is some way of providing information in a way that satisfies without causing any difficulties, we will do that. I do not know any details of the case, so I do not know whether what you are saying represents the full facts and, as I have indicated, the Tax Agents Board does operate independently of us, but I will certainly follow up on the matters and provide all the information I can.

Senator COOK—Does the tax office have a view about the desirability and/or urgency of the introduction of legislation to regulate the affairs of promoters of mass marketed schemes or, as they call them, tax effective schemes?

Mr Carmody—Certainly we are on the public record as having raised the issue of penalties for promoters of tax schemes. The Assistant Treasurer has indicated that the government is looking at a new legislative regime for promoters. We do have a view. We have

been developing and refining a detailed approach to that legislative framework for promoters, and it will shortly be with the minister. So it falls into the realm of advice to the minister.

Proceedings suspended from 12.36 p.m. to 1.36 p.m.

Senator WATSON—In relation to the superannuation guarantee, we are still having a lot of problems collecting moneys from delinquent companies. It appears that there are some cases where employers are deliberately avoiding their obligations. The corporations are going into bankruptcy or insolvency and the directors are still running around in Rolls Royce cars. Is there a deficiency in the law which prevents the ATO taking action against delinquent directors in such circumstances? Is the law in terms of the superannuation guarantee collection different to the law relating to the collection of ordinary income tax debts?

Mr Bator—Are you talking about personal liability of directors?

Senator WATSON—Yes.

Mr Bator—The superannuation guarantee does not have personal liability of directors as does income tax.

Senator WATSON—So that means delinquent directors—unless they are prosecuted for failure to remit superannuation guarantee moneys on time—can walk away owing employees tens of thousands of dollars maybe even for a couple of years or more.

Mr Bator—A different law applies to the superannuation guarantee. When the decision was taken to extend that personal liability of directors it was only, at the time, towards PAYE for a trial period to see just how successful that whole regime was. I am not sure whether that has been successful at this time. We do have success in collecting superannuation guarantee where it is outstanding. It is a No. 1 priority within the ATO in terms of our collection activities.

Senator WATSON—But sometimes it takes years and years to collect that money. Is there a problem for the tax office? Is the law deficient, in your view? In other words, should there be a means of making directors and officials personally liable in the circumstances I have just outlined? Why is there a distinction? It is not their money.

Mr Bator—That is right. At the time there was a distinction drawn. Prior to the super guarantee that original policy change to the law was made to make directors personally liable. I was involved in that at the time. Since then it has had variable success in making directors personally liable.

Senator WATSON—Can Treasury give us further information as to why directors are not caught in the same sort of net?

Mr G. Smith—The issue of director liability is essentially a broader question than just the tax law and superannuation law. It is an area of policy we have not looked at in the context of just superannuation. As an issue it is looked at in the Treasury under program 3. I do not have those people here today, but we could raise the question of director liability when we get to program 3.

Senator WATSON—Perhaps that was an issue that Senator Sherry and I overlooked a little bit in preparing the report on the superannuation guarantee. Thank you for your response.

Senator SHERRY—I have a few questions while we are in this area. Mr Bator, there is a proposal to change the SG from yearly to quarterly. You would be aware of that, wouldn't you?

Mr Bator—Yes, I am.

Senator SHERRY—As part of that proposal announced in the budget, it is proposed to change the \$450 a month minimum wage threshold—the wage salary for which SG is eligible—to \$1,350 a quarter. Have there been estimates made of the number of employees who would drop out of the superannuation guarantee coverage as a consequence of that proposed change?

Mr Bator—Certainly as far as the tax office is concerned, we have not done any estimates of that. I did meet last week with a group of small business people; we discussed the issue of the \$1,350. Some of them believe that it would be advantageous to some employees and disadvantageous to others. For example, if you got \$600 this month as a casual employee, \$600 next month and only \$200 or \$300 the month after then you would get your SG on that quarterly basis, whereas under the monthly arrangement you would not get it for one of those periods. It is a bit of a swings and roundabouts situation. I think it would be pretty difficult to come up with a number because we do not get information on people's monthly pay patterns.

Senator SHERRY—But you accept that some people would drop out of the system as a result of that change.

Mr Bator—As I said, there is a likelihood that some people will and there is a likelihood that other people will be benefited by it.

Senator SHERRY—On that issue of minimum, how would they benefit from it?

Mr Bator—You have a situation where it is \$1,350 a quarter, so for some quarters you would get superannuation—at the moment it is a \$450 regime. If you get \$600 and \$600 and then in the final month you get only \$200 or \$300, you would be benefited by the fact that it is \$1,350 a quarter.

Senator SHERRY—In all the consultation that I have had with industry on this matter, they would contend that there will be a significant net loss of people covered by superannuation as a result of this change. Do you accept that there will be a net loss of coverage?

Mr Bator—I do not have figures on that—it is not an area that it is very easy to get information on.

Senator SHERRY—I accept that it is not easy, but you can have consultations with people who are directly involved, can't you?

Mr Bator—We are. Through the process of developing this proposal, we are meeting with business people and individuals. Last week we met with people from the superannuation funds who had some views that people would drop out. They did not have any figures on it. At the moment I am in a position where I am listening to a view that some people will benefit and some people will not benefit.

Senator SHERRY—You mention the issue of consultation, which I was going to raise. Up until the budget at least, there was no public announcement of this particular proposal. Did your office have any consultation with anyone from industry about this change to the minimum income level over the three-month period and, if so, with whom?

Mr Bator—Senator Kemp facilitated a number of consultative meetings that we did have last year with business groups and others.

Senator SHERRY—On this specific issue?

Mr Bator—No, not on this specific issue; on the issue of the quarterly superannuation guarantee.

Senator SHERRY—No, I am not asking about the quarterly super. I know there has been widespread discussion about this for years, specifically about the change to the minimum eligibility for superannuation payment.

Mr Bator—I was not involved in any particular discussions on the \$1,350. I cannot recall that matter.

Senator SHERRY—Is there anyone else in Treasury involved? Mr Smith, do you have any information on this issue?

Mr G. Smith—I will ask Mr Brake to assist.

Mr Brake—I understand that a number of discussions have been had with various groups, who suggested that moving to a quarterly threshold as well as a quarterly payment regime would ease the compliance impact on those groups. The particular areas that were looked at were rural and regional areas, where you might have a large number of transient workers.

Senator SHERRY—Who were the groups that suggested a change to the minimum threshold vis-a-vis—not quarterly payments of superannuation; that issue has been around for a long time—a \$450 to \$1,350 a quarter? Who are the groups that have advanced this issue in the consultations?

Mr Brake—Like Mr Bator, I was not personally involved in discussions on that matter, but I can take that on notice for you.

Senator SHERRY—It seems to me that in the consultations that we have heard of to date no-one has been consulted on that particular matter. You do not have information and Mr Bator does not have any information. If you do not, who in Treasury or Tax would?

Mr Bator—There may be people who work for me who have heard people speak about that, but I personally do not recall that topic coming up. We were more interested in the benefit of the monthly arrangements. We all recognise—and have recognised for a long time—that that will be beneficial to the vast bulk of people, in particular around the sorts of questions that the chair was just asking. A smaller debt is easier to collect than a debt that has been around for a year.

Senator SHERRY—I am pleased to acknowledge that monthly issue. Is it about 85 per cent who pay quarterly or monthly at the moment?

Mr Bator—Yes.

Senator SHERRY—We are dealing with about 15 per cent of employers, as I understand, who pay more than quarterly, so we are dealing with a small number of employers as a proportion of the total, aren't we?

Mr Bator—We are, yes.

Senator SHERRY—Isn't it true that, if you moved to quarterly payments, there would actually be a substantial number of employers who would move from monthly payment of SG to quarterly payment of SG, who would in fact be better off as a result?

Mr Bator—That is a debatable point. If you are a casual employee and the employer is not sure of what they are going to pay over the next quarter, yes. But if you are an ongoing employee, why wouldn't they continue paying you monthly or fortnightly?

Senator SHERRY—Except that the law will be changed to require quarterly payment. It is going to override the award provisions, isn't it?

Mr Bator—I am not sure about that specific point. If a hypothetical person earns wages of \$70,000 a year, the employer will continue paying as they currently do. There is no need to worry about a monthly arrangement there.

Mr G. Smith—I think the scheme of the law is that a superannuation levy is imposed if certain payments are not made within a period. The current period is 12 months.

Senator SHERRY—And 30 days, isn't it? Don't you have 30 days from the end of 12-month period to pay the money?

Mr G. Smith—That may be, but the point is that the reference period is currently one year. Moving from one year to three months would not make sense because they are required under their award—which is fairly common under the awards—to pay monthly. It is also fairly common in ordinary industry practice to pay monthly. There would be nothing in the move from annual to quarterly SG to imply that you would move from monthly to some longer time frame.

Senator SHERRY—I am glad; you have assured me. So there will be no overriding provision to require people who are paying monthly, or bimonthly for that matter, to move to a quarterly basis?

Mr G. Smith—I think the intention of the scheme is simply to transfer what is currently a 12-month reference period to a three-month reference period.

Mr Brake—At the moment, it is a minimum requirement to pay annually. It will be a minimum requirement to pay quarterly.

Mr G. Smith—I think a lot of people pay automatically through their pay deductions, so it is even more frequent than monthly.

Senator SHERRY—There would certainly be a significant number paying monthly. I have not seen any results of surveys, but it would certainly be a significant number.

Mr G. Smith—I was around when this first came in. The trade union movement was keen on monthly. There was quite an active discussion about quarterly at that time and also about a quarterly threshold rather than a monthly threshold. The reason the decision was taken at that time to go monthly was that there was a close link to awards.

Senator SHERRY—Senator Watson raised the issue of SG compliance earlier, and I raise these issues from time to time as Mr Bator knows. The case of Mr Matthew Ryan, of Manly, Queensland, has been referred to me. Mr Ryan's former employer, Paradine IT Systems, and a related company, Paradine Systems did not pay any superannuation for 18 months. They are unlikely to pay for the first half of this financial year because Paradine Systems was subject to a wind-up order that was registered on 28 May this year. During this two-year period, Mr Ryan's employment shifted from Paradine Systems to Paradine IT systems. Paradine IT Systems was registered in September 2000 but applied for voluntary deregistration in November 2001. Mr Ryan contacted the ATO but as yet he has not received any SG vouchers. He has spoken to his local MP, Mr Con Sciacca, who has written to the Assistant Treasurer,

Senator Coonan, about this matter. Will you undertake to check on the circumstances of Mr Ryan and the non-payment of his superannuation?

Mr Bator—Yes, I will do that.

Senator SHERRY—Given that two companies that Mr Ryan was employed by are both being wound up, what sort of success rate does the ATO have in these circumstances?

Mr Bator—In circumstances where companies are being wound up and there is very little in the way of assets, it is very difficult to get superannuation guarantee for the people.

Senator SHERRY—The SG is not covered by the employee entitlement protection scheme, is it?

Mr Bator—No, it is not but, as I pointed out a bit earlier to the question from Senator Watson, we do have a very high priority for the collection of super guarantee debt in the ATO. It is improving. It is regrettable that some businesses go out of business and workers' entitlements are lost, but we do take this role very seriously.

Senator SHERRY—I was going to come to that, because we have discussed this before. At the additional estimates—I think it was 20 February—you told the committee that the ATO had identified an outstanding SG debt of \$104 million. Since that time, how much additional SG debt has been identified by the ATO?

Mr Bator—Since the last time we spoke, we have raised an additional \$58 million, so we now have a total debt of \$626 million that we have raised since inception of the superannuation guarantee. We have collected in the vicinity of \$440 million in that period and we now have about \$116 million outstanding.

Senator SHERRY—How much of that has been effectively written off?

Mr Bator—We have written off around \$78 million since the inception of the superannuation guarantee.

Senator SHERRY—When you say 'outstanding SG' does that include interest administration charges and penalties, or is that a separate figure on top of the one that you have given us?

Mr Bator—It does include that. On the amount that we have raised since inception, the administration charges are about \$33 million. The actual shortfall is about \$451 million. There is a nominal interest charge of \$73 million; a general interest charge on the shortfall of \$46 million; a part 7 penalty of \$23 million; and recovery costs, prosecution costs and assorted fines of \$16,772.

Senator SHERRY—In an answer to a question on notice at the additional estimates, the ATO informed us that it had conducted 141 prosecutions involving 177 charges in respect of SG over the financial years 1996-97 to 2000-01 inclusive. The ATO went on to say that from 1 July 2001 to mid-February 2002 there had been 10 prosecutions involving 10 charges. Have you got any update on prosecutions commenced since February 2002?

Mr Bator—I have. Obviously prosecution is the last resort, and these are prosecutions where employers failed to give us information. In the period from 14 February 2002 to 31 May, we issued 747 formal notices to employers in accordance with section 77 of the superannuation guarantee act. We took forward to prosecution around 37 employers, and four have been prosecuted as a result of that action. As you can see, the underlying work here—of 747 notices going out—does get a very good result, and that should not be forgotten when you

look at a figure like four for prosecutions in that particular period. So we did get good success out of our normal operations.

Senator SHERRY—In the period from 1996-97 until mid-February 2002, how many employers have been the subject of employee notification of insufficient employer contributions?

Mr Bator—From 1 July 1996 to 14 February, there were 38,548.

Senator SHERRY—That is a fairly substantial number.

Mr Bator—It is. But, bearing in mind that we are talking about a period of six years and we have 800,000 employers, that is not a large number. There are probably more than 38,548 that are not paying—I actually think that that is on the low side—and that is why we try to encourage employees to contact us early.

Senator SHERRY—I accept your point that it is a small proportion of the total number of employers, but for the employees affected by a relatively small number of employers—as a proportion of a much larger number—it is an important issue, isn't it?

Mr Bator—It is an important issue. As I said, we do take this work seriously. However, also when we look at the number of employees that relate to these 38,000-odd employers, it may well be that it impacts on one or two of their employees. As we know, about 28 per cent of all employers partially comply: they will pay for some employees correctly, underpay for some others and get confused about others. Then you have got others that blatantly do not pay.

Senator SHERRY—While we are on superannuation: there was an article in today's *Australian*—on which I had intended to ask some questions anyway—about a crackdown on do-it-yourself superannuation funds which are not lodging annual returns. Can you give us some information on the sorts of challenges that are being faced in this area?

Mr Bator—The material that I produced for that article would suggest that overall we are reasonably happy with our administration of self-managed super funds and their overall compliance. As you would be aware, we have taken over the regulation of self-managed super funds and this is our second year. It has taken us some time to, essentially, verify the client base that we have. We have now got to a point where we are pretty confident of the group that have not been lodging returns, since they did not lodge them when we first took it over. We are seeing, I think, close on 40,000 funds that have not lodged.

Senator SHERRY—That is 40,000 out of how many?

Mr Bator—Out of 217,000.

Senator SHERRY—That is a high proportion, isn't it?

Mr Bator—It is a high proportion. We do not know whether they are still operating. I met with a tax agent just the other day who talked to me about the fact that he has been approached by a number of trustees of self-managed super funds who have up to this point been unaware of their obligation to lodge—they had not previously lodged—or else were being advised that it was not that important for them to lodge. We have taken the approach with self-managed super funds that we will get as much information out to them as possible so they understand their obligations, and we have now gone through this process of saying, 'It is time for us now to ask you to lodge your returns and to get tough if necessary.' We believe that we will get a fairly good response.

Senator SHERRY—That 40,000 is a big number, given the number of DIY funds, but invariably these people are advised and have people advise them to take out these funds—it might be an accountant, a lawyer or a mixture. What is the problem here? We have professional advisers, advising people about running DIY funds, and yet failing to lodge is a pretty basic breach.

Mr Bator—It is, yes.

Senator SHERRY—In this area, why are advisers not fulfilling that basic requirement? Have you been able to ascertain why this is happening?

Mr Bator—I do not want to refer to an earlier period before we were looking after self-managed super funds, but I guess there is a possibility that they had not been aware of their obligations or that there had not been sufficient chase-up action in the past. When we took over the regulation of these self-managed super funds, we did go very much into a public education-communication approach. We contacted as many new trustees and trustees of funds as we possibly could. Among new funds trustees we find compliance is very good. A total of 217,000 to get in contact with is a large number, but we are now starting that exercise in earnest. I guess the purpose of this press release and the material you were reading in the *Australian* today is to try to alert people to the fact that we are now getting serious. I am hoping that will produce a very good result.

Senator SHERRY—I am not criticising your role in any way, because I think you are doing the best you can. But, according to APRA, there are more than 1,000 new DIYs coming on the market each month.

Mr Bator—They are coming to us so, probably, according to us, they are coming on-stream. As I say, within that group we have every confidence—and our records at the moment show—that the compliance levels of the new trustees are pretty high because we are speaking to each of them, because we are going through their obligations and because of the quality of our new trustee kit. I accept that we have a group of people who may have been doing the wrong thing inadvertently for a number of years. They may feel that if they come forward we will make them noncomplying superannuation funds, and they are fearful of that.

Senator SHERRY—I was reading a comment by Mr Ben Smythe, who is the managing director of Trustee Service Australian Superannuation Nominees Ltd. He said that many of them probably do not know they are trustees. Not looking at the period in the past, prior to your taking over responsibility, can you assure us that the new funds that are being established at the rate of approximately 1,000 a month are receiving adequate information about their duties as trustees?

Mr Bator—I have been complimented on the quality of the material we are sending out to trustees. One of my assistant commissioners has carried out 20 or 30 seminars across the country to new trustees in order for them to understand the way we operate and their obligations. Obviously we are reliant upon the advisers to make sure that trustees are aware of their obligations, but I am pretty confident of our role so far.

Senator SHERRY—You mentioned advisers, and I raised it earlier. Is it invariably correct that there is an adviser in the mix, or might a person decide to individually go off and set up their own trustee structure and do it themselves without any legal or accounting advice about the structure? What happens?

Mr Bator—I think there is a bit of both. I think people look at the fees and charges over the last couple of years, they look at the returns that are there and say, ‘I could do it better, or

more cheaply, myself.’ So they go to somebody to set them up. As some people from the financial planners association were commenting to me only last week at their national conference, the fact of the matter is that, when people come along to the financial planners, oftentimes the financial planners will say, ‘There might be a better product for you’—not a self-managed super fund at all—but the people somehow have it in their minds that it is the best product for them. Then there is another case where an adviser sees the financial situation of somebody and says to them, ‘Look, the best thing for you to do is to get yourself in a self-managed super fund.’ I am not sure which is the greater proportion of people.

Senator SHERRY—Certainly there is a strong element of advisers saying to people, ‘Look we think it is in your interest that you have a DIY fund,’ whether it is or not.

Mr Bator—There is an element of both.

Senator SHERRY—What are the tax implications of the outstanding returns?

Mr Bator—Of course, the ultimate implication is to make those superannuation funds noncomplying.

Senator SHERRY—But are you able to identify a tax figure outstanding as a consequence?

Mr Bator—The actual revenue that is not there?

Senator SHERRY—Yes.

Mr Bator—I do not have that figure to hand. The other complication is that we do not know whether these funds are not lodging because they were not receiving contributions in the year, because they were not earning investment returns or because they were not actually operating. Let us not forget that we are dealing with a list given to us of 220,000 funds or thereabouts, and some of those funds may no longer exist or no longer be operating.

Senator SHERRY—I think that is highly likely, but there is also going to be a proportion of funds that are operating.

Mr Bator—Yes.

Senator SHERRY—So what sort of ballpark figures are we looking at here? You must have some idea: are we dealing with tens of millions of dollars or hundreds of millions of dollars?

Mr Bator—I would have to check on that for you.

Senator SHERRY—What is the average tax collected through a DIY fund? Do you have any idea?

Mr Bator—I had the papers with me, but I did not bring them. No, I do not.

Senator SHERRY—Can you take that on notice?

Mr Bator—Yes.

Senator SHERRY—Going back to the numbers that are outstanding, can you make any observations about the length of time? For some I assume it would be a year, for others two years and others even longer. Are there any observations you can make about the length of time and the numbers?

Mr Bator—The group that we are talking about now that we are actively pursuing have not lodged the second return since we have taken over regulation.

Senator SHERRY—Thank you for that, Mr Bator. You are always very informative.

Senator CONROY—I want to return to mass-marketed schemes. I understand that Senator Murphy was speaking about a specific issue rather than generally. If I cover ground he has covered, just let me know, but I do not think I will be. Commissioner, back in February you announced a settlement offer for mass-marketed tax scheme investors. Could you describe the details of that offer.

Mr Carmody—The offer, if it is accepted, means that taxpayers will be entitled to a deduction for what we describe as their personal outlay in the scheme. That is often around 25 per cent of the originally claimed deduction. Penalties would not apply, interest would not apply and they would have a two-year period over which to pay off the debt, which would be interest free and established as a result of accepting that settlement arrangement.

Senator CONROY—Did you describe that offer as ‘striking a balance, offering a speedy and just resolution for investors as well as a tough stance on tax avoidance’?

Mr Carmody—Whether I used exactly those words, it is the sort of balance that we strive to find.

Senator CONROY—Did you see Mr Fitzpatrick’s description to the Institute of Chartered Accountants of Australia of the kind of aggressive tax planning which gave rise to these mass-marketed tax schemes as ‘a significant risk to the tax system and a key hot spot for the ATO’?

Mr Carmody—I did not read the particular article.

Senator CONROY—That was a recent speech of Mr Fitzpatrick’s to the ICA.

Mr Carmody—I have not read the particular speech. I have described the mass-marketed schemes and the techniques used as a ‘hot spot’ and a ‘threat’.

Senator CONROY—How about ‘a real cancer in our tax system’?

Mr Carmody—I am not sure whether I used those words—perhaps I did—but they were certainly a threat to the community’s revenue system if left unintended.

Senator CONROY—I can probably get the quote sourced for you. I think you might even have used the words ‘real cancer in our tax system’.

Mr Carmody—I might have. Certainly, the schemes—and I distinguish between the schemes and the people investing in them—if they were allowed to succeed, would pose an incredible threat to the community’s tax system. You could put a number of adjectives around that.

Senator CONROY—Were you aware that Senator Coonan was meeting some of these investors in the mass-marketed tax schemes on Friday, 24 May and Saturday, 25 May in Perth?

Mr Carmody—Yes, I understood that to be the case.

Senator CONROY—Before she went?

Mr Carmody—I think I was probably aware of that. It is a bit hard to test my memory exactly.

Senator CONROY—Does she often let you know that she is meeting disgruntled taxpayers? Is that normal?

Mr Carmody—My office is often made aware when people involved or their representatives are seeking to meet with or make representation to the minister. That is fairly normal.

Senator CONROY—Was a Tax officer present?

Mr Carmody—In Perth?

Senator CONROY—Yes.

Mr Carmody—Not as far as I am aware, no.

Senator CONROY—You did not ask to have somebody involved in the discussions?

Mr Carmody—No, I did not.

Senator CONROY—You did not think it was necessary or appropriate? You did not want a witness?

Mr Carmody—None of those things; it was just that Senator Coonan was in Perth and I assume people asked to see her. It is not uncommon for a member of parliament or a minister to meet with people who have made those representations.

Senator CONROY—Are you aware of the Western Australian Liberal Party's resolution at their conference calling on you to cease and desist?

Mr Carmody—A number of emails were sent to me.

Senator CONROY—I got a few of those myself, and I am glad you got some as well. They were drawing to your attention the Western Australian Liberal Party's resolution.

Mr Carmody—Drawing my attention to that resolution, yes.

Senator CONROY—You were not drawn to adopt their position?

Mr Carmody—No. I am here, as you understand, to administer the law and I am doing that in the way I think most appropriate.

Senator CONROY—Did you have any discussion with Senator Coonan before those meetings, when they phoned up and said, 'We're off to Perth and we're having a chat with the Western Australian individuals who have concerns'? Did you have any discussions?

Mr Carmody—I personally did not have a discussion, no.

Senator CONROY—Did you have any discussions with Senator Coonan after those meetings?

Mr Carmody—On the Monday after, I met with Senator Coonan and two of her staff about those, yes.

Senator CONROY—Did she inform you about any undertakings she made at those Perth meetings?

Mr Carmody—We had only general discussion about feedback—in fact, it was very similar to the discussion Senator Cook had just before lunch—in that she conveyed to me concerns raised by people, most specifically the issue that was raised by Senator Cook as to understanding the amount that they would be liable for. It was in the nature of passing back some of that feedback.

Senator CONROY—So she did not give you any indication that she had given any undertakings to the meeting?

Mr Carmody—No, it was feedback about the things that had been raised with her and about issues like those Senator Cook raised.

Senator CONROY—Did she tell you about any undertakings she made at the meeting on your behalf?

Mr Carmody—No, and I do not believe she would make any undertakings on my behalf.

Senator CONROY—Is she in a position that she can make undertakings on your behalf?

Mr Carmody—If she had discussed the matter with me beforehand then I guess she would be, but in this case there had been no discussions beforehand.

Senator CONROY—If you agreed, she could.

Mr Carmody—You can only do something on someone's behalf if they have agreed to that. It may well be—and I suspect that she would have indicated this—that she undertook to raise with me some of the issues of the kind raised by Senator Cook.

Senator CONROY—Did you see the *Australian Financial Review* report on her meeting?

Mr Carmody—Yes, I did.

Senator CONROY—Did she press for an extension and possibly a revision of the offer, as was foreshadowed in that article?

Mr Carmody—I had announced on radio that morning—before I met with the senator—that I had decided to extend it, and we have discussed earlier the reasons for that. They had to do with the fact that many people had been waiting for the Vincent decision, that it was only a few days before the original deadline was due to expire and I wanted to give those people every opportunity to consider their positions. We had also had some feedback from agents saying that they were seeing the deadline as difficult given the number of clients they had.

Senator CONROY—Did she raise the idea of allowing taxpayers a deduction for 66 per cent of the total deductions claimed, as was foreshadowed in the newspaper article?

Mr Carmody—No.

Senator CONROY—You are saying that the minister never raised any of the issues that it was purported in the *Financial Review* she was going to raise with you?

Mr Carmody—The *Financial Review*, as I understand it—and I do not know where they got their information from—suggested that two issues were going to be raised. One was the extension—and, as I said, before I met Senator Coonan I had already announced the extension on radio that morning—and the other, from recollection, was the issue of the 66 per cent; and, no, that was not raised with me.

Senator CONROY—Did she raise with you the resolution from the Liberal Party Federal Council in April? Is that binding? I am talking about the Liberal Party Federal Council resolution about 66 per cent.

Mr Carmody—No, I do not believe that the 66 per cent issue was raised at all.

Senator CONROY—Minister, did you have any thoughts on that at the time when you were at the Liberal Party Federal Council? Did it occur to you to try and defend the integrity of the tax system against the pack of spivs?

Senator Minchin—I was not a delegate to the council.

Senator CONROY—I thought all ministers and politicians were automatically involved.

Senator Minchin—Unlike the Labor Party, the Liberal Party Federal Council does not bind the MPs or the government.

Mr Carmody—I can certainly assure you that she did not press with me any suggestion of that.

Senator CONROY—I would hope that was right and that that was the case. I would be very disappointed otherwise.

Mr Carmody—I cannot recall. It might have been that in canvassing the issues raised with her there was reference to it—I cannot recall specifically. But I can recall quite specifically that in no sense at all did Senator Coonan press with me or suggest in any way that I adopt that.

Senator CONROY—Or raise it?

Mr Carmody—She did not raise it with me. Senator, we had a discussion. I am sure she canvassed a range of comments made to her by a range of people and she may have canvassed the fact that this was raised with her. In fact, I would be very surprised if it was not raised with her, given the number of emails that you have received, that I have received that and anyone who sat down with some of these representatives received.

Senator CONROY—Yes, we are all getting heaps.

Mr Carmody—I am sure it would have been raised with her, and she may have mentioned that it was raised with her, but I can absolutely and categorically assure you that she did not press on me, request of me or suggest to me that I should adopt it in any way.

Senator CONROY—Are you aware of the comments of Clive Ross that I think were in that article—the paid representative of the tax minimisers? He said that the minister did undertake to request an extension and an extension had been announced. So you had no conversations with her at any stage before you made that announcement subsequent to her meetings in Perth? So she went to Perth, then you made the announcement on Monday morning before you had any conversations with her? This is an important issue involving the integrity of the tax office. I am happy for you to clear it up.

Mr Carmody—Absolutely. I am glad you give me the opportunity to do it. I did not have any personal discussions with Senator Coonan at the time when I understood that she was going to Perth. She did not raise any of those issues with me beforehand. Sometime before that there may have been discussions about extensions, but it was only to the extent of what I was planning to do.

Senator CONROY—So you may have indicated, before she went to Perth, what you were going to do?

Mr Carmody—No. In my mind, the reason I took the three-week extension was a direct result of the Vincent decision. In any discussions we might have had about my position on extensions—and it would not surprise me if there are now discussions—I informed her of my position. It was not in the context of the Vincent decision or the three weeks. There was no discussion immediately preceding the senator going to Perth. As far as the extension goes, I have already explained the reasons that I granted that and the fact that I announced that on radio before I met with Senator Coonan on the Monday. I have assured you that Senator Coonan did not press, push or request that I adopt the motion allowing 66 per cent, or whatever it is.

Senator CONROY—I am glad you have been able to put that to bed. I wanted to make sure that your sequence of events was clear and on the public record. I am sure you saw a report in the *Age* newspaper on Tuesday, 28 May that the ATO extended its settlement offer at the request of the Assistant Treasurer, Helen Coonan.

Mr Carmody—I saw that, but I have explained precisely to you what happened and, as you know, not everything that occurs in newspapers is necessarily accurate.

Senator CONROY—That is absolutely true.

Senator SHERRY—Get that on record!

Senator CONROY—The *Fin Review* does not have to leave!

Senator SHERRY—The *Fin Review* is always more accurate!

Senator CONROY—There seemed to be a perception, that was perpetrated by some people in Perth, about what Senator Coonan was going to do, so I thought it was important for you to have the opportunity to slam dunk that so people understood that the tax office cannot be pushed around in the way that some people were hoping it was going to be.

Mr Carmody—Thank you.

Senator CONROY—I actually then had a string of questions for Senator Coonan, but she has escaped scrutiny, Senator Minchin.

ACTING CHAIR—Senator Minchin is not batting an eyelid.

Senator Minchin—I beg your pardon, Senator Conroy?

Senator CONROY—I was saying that I had a string of questions for Senator Coonan. I do not know that there is any point to them now.

Senator Minchin—She was not trying to avoid you; she has had a death in the family. She would have loved to have been here.

Senator CONROY—I know that; I understand the circumstances. I will have to wait until next time to have a chat with her about that. I want to go back to a couple of questions that I asked you earlier, Commissioner. Your answers were very comprehensive, and that caused a bit of chaos in my filing system. I am not used to getting comprehensive answers when I ask questions. I do not mean from yourself; I am talking about other departments.

ACTING CHAIR—He has been very patient today.

Senator CONROY—I am doing my best to speed the journey. I wanted to briefly talk about the extra resources for the GST and the harnessed resources for the GST administration. I know you did cover some of the issues. You gave a very broad ranging answer which, as I said, caught me totally by surprise. What assumptions were made in relation to the estimate of \$90 million to \$120 million? How many extra audits have you assumed will be needed to raise that sort of revenue?

Mr Carmody—We do not have the specific number of extra audits or other visits. As I have indicated, our experience to date together with what we see emerging meant that the estimate was based on a two to one return rising to a three to one return.

Senator CONROY—I think you mentioned that. Is that a revenue figure of just primary tax or does that include penalties and interest?

Mr Carmody—That is the total revenue that would come out of those.

Senator CONROY—When you say revenue, are you incorporating penalties and interest?

Mr Carmody—That would be the nature of the estimate; it is the total revenue collected.

Senator CONROY—I am sure you will not be able to answer this; I am happy for you to take it on notice. Is it possible to get a breakdown between the primary tax revenue and the penalties and interest?

Mr Carmody—I think that is a level of precision in the nature of this estimating that would not be realistic to provide.

Senator CONROY—If you do not have one, would you take that on notice?

Mr Carmody—I am sure we have not.

Senator CONROY—I know we talked around this, but because you gave such a comprehensive answer earlier I wanted to clarify it in my mind. We were talking about the small business income tax and fringe benefits tax field services, and I think I was asking about how many audits it is assumed will be made to generate the estimated revenue in that area as well. Is there a figure?

Mr Carmody—Again, the nature of this is that we look at the number of staff and the investment that we would put into a particular activity. The estimate would have been done based on previous experience of the amount of investment we put into a particular area, and that was the broad estimate that was done.

Senator CONROY—I am happy for you to take that on notice.

Mr Carmody—I cannot give you too much more information. That is just the nature of how these things are estimated. You would see that they are fairly conservative estimates. They do not add in any compliance effect, any indirect revenue effect, that would flow from—

Senator CONROY—I am trying to help you get more compliance, effective immediately. We are hoping that the *Financial Review* is going to help you get improved compliance right now.

Mr Carmody—greater presence in the field. So they are fairly conservative in their estimation. Again, what you will see, as I have indicated, is around 2,700 staff in the small business area out in the field covering services such as GST and income tax.

Senator CONROY—On page 165 of Budget Paper No. 2 it says that you received \$184.5 million in 2002-03 for enhanced resources for GST administration. I am just trying to gain an understanding of whether we are spending \$184 million to raise \$90 million.

Mr Carmody—No. The \$184 million is a combination of the \$45 million that has gone directly into compliance activities with the return that I suggested to you plus the \$140 million that was the second leg of additional resourcing given to us a couple of years ago—in other words, it will be ongoing—which was put into the general administration of the GST. You will remember we have had discussions about the additional number of registrations and the costs that went to running the GST system. That is in our present operation, so for this year that \$140 million is there but it was granted only for last year and this year. We have had put into our base a continuation of that \$140 million, and it was that \$140 million that is already here now but is continuing. The \$185 million comes from that, plus the \$45 million additional for compliance.

Senator CONROY—Will small business be audited in relation to the GST at the same time they are audited in relation to the enhanced resources for small business income and fringe benefits field services that we talked about earlier? Or will there be two? Will they have different people coming down? Will there be one audit covering them both?

Mr Carmody—Obviously if it becomes a more intensive income tax or FBT issue it may be that other people engage, but the intention is—I was going to say a ‘one stop shop’, but they probably do not see it quite like that—that our field staff will be out there and they will cover the basic levels of income tax and GST around income and pay-as-you-go. We are not looking to have someone come in and have a look at the GST one day and someone else come in the next day and look at pay-as-you-go. That is the general principle.

Senator CONROY—That is what I am trying to get to. An example is one group coming in and to look at the GST and then phoning the other group to come in on the same day to look at pay-as-you-go. I appreciate your point about the basic level of skill, but you will not be able to do a proper audit. You will need the experts in the different areas to come in. While I accept your point that one group of people will not be knocking on your door one day, with a different group of people turning up the second day, it is likely that two sets of people will need to visit to get to the bottom of any issues.

Mr Carmody—I am sure someone will race up and correct me if I am wrong, but I would not expect that to be the prevalent position. For the vast bulk of these, I would expect our people to be able to handle the issues of pay-as-you-go and GST. It would be in a smaller number of cases if what is discovered when we are out there raises some more significant issues, but it may be that we would call in someone else.

Senator CONROY—That is the set of circumstances I envisaged as well. The first group will not necessarily have the technical expertise if it comes up.

Mr Carmody—They should be able to cover the general issues. There are a limited number of cases where it might necessary to be more intensive.

Senator CONROY—Welcome, Mr Russell. He is coming running to correct you.

Mr Russell—Not a correction; just confirmation. The thing to keep in mind here is that what we are trying to do with these single visits is to look at the obligations on the BAS. It is not an income tax audit as such; it is looking at the recurring taxes such as PAYG. We are looking to build a capability with our officers in the small business area that in 90 per cent of the cases would be able to deal to finality with those, with perhaps some telephone based technical support.

Senator CONROY—Your officers, in that sense, are not trained to look at a complex issue in the other area. It would be unusual because of the sort of training involved.

Mr Russell—That is right. There is a limit, particularly when we are dealing at that level with relatively junior officers.

Senator CONROY—As you say, they are relatively junior officers. They would be on the phone saying, ‘Can you help us with this over the phone? If not, can you come down? Send someone in to give us a hand with this area.’

Mr Russell—At the small end of the spectrum, it would be unusual that there would be a need to have a second officer come in, because you are not dealing with the complex issues there.

ACTING CHAIR—But you will be matching your GST sales revenue, for example, with your income tax sales revenue?

Mr Carmody—Absolutely. That is an important part of intelligence.

Senator CONROY—Yes, that is a key part.

ACTING CHAIR—It could be OPEC coming down.

Mr Carmody—Obviously, if there is an understatement of turnover for GST purposes, that will be raised for income tax purposes, and that is an important part of the visibility out on the field.

Mr Russell—We are now commencing data matching some income tax returns with BAS returns. It has taken a little while for the income tax returns to come in but we are doing things such as matching for sales of business assets—that type of thing.

Senator CONROY—I want to address some matters around GST tax administration.

Mr Carmody—Good; stay there.

Senator CONROY—I would like to look at some anomalies with respect to the application and collection of the GST. Is it correct that when Ansett collapsed the ATO informed customers who had paid cash for worthless tickets that they would not receive any refund on the GST they had paid on those tickets?

Mr Russell—We gave advice on the technical aspects of the situation, which was quite complex. I would need to go back and check on the detail. I could give you a dissertation on that. But we gave advice, and from memory it was to that effect. I would need to check that.

Senator CONROY—I am conscious that it is quite complex. I am happy for you to take that on notice. I would be interested in the dissertation but I appreciate that it is complex and that you want to check. Did you make an estimate of how many people would be affected at the time?

Mr Russell—I would need to take that on notice, too. We probably got details from the liquidators but we could come back on that.

Senator CONROY—How much GST payment did that correspond to? You could take that on notice too.

Mr Russell—Sure.

Senator CONROY—I understand that the tax office has released a draft ruling on GST treatment of prizes.

Mr Russell—That is correct.

Mr Carmody—Yes.

ACTING CHAIR—On what?

Senator CONROY—Senator Watson, you have to keep that part-time business of yours up to speed.

Mr Carmody—On prizes.

ACTING CHAIR—Oh, prizes.

Senator SHERRY—Surprising prizes.

ACTING CHAIR—Negative prizes.

Senator SHERRY—Does the prize include Senate preselection?

Senator CONROY—You have won a big prize, do not worry; Senator Abetz is still hunting you. Can you explain the implications of that ruling?

Mr Russell—I will give you a little of the history on that. The draft ruling was issued last year. It caused quite a bit of comment, as you know. We have received a number of submissions about the implications and effect of the ruling. The draft ruling sets out all of the various suppliers that can occur, for instance, with a competition. It depends on things like whether it is a monetary or non-monetary prize. The GST rulings panel is currently working through those issues with interested parties. There was a meeting last week at which a number of stakeholders were invited to attend and present their cases. We believe we are getting to a situation where we can deal with most of the ‘administrative irritants’ in the situation: things like ribbons and trophies et cetera. The agricultural shows, we believe, will not be caught by the final ruling. We are also looking, at the moment, at the issue of things like radio competitions—the fifth caller et cetera.

Senator CONROY—I was going to come to the radio competition.

Mr Russell—Those issues were presented to the panel last week. Again, I cannot pre-empt the final ruling but I think we are reaching a resolution of that.

Senator CONROY—On the radio issue, at this point a prize that is awarded to a listener by a radio station is a consideration as payment for the supply of the service of entering the competition, which means it is GSTable.

Mr Russell—Yes. That would have been the impact of the original draft ruling but as I said we are looking at that one closely and I believe we will move—

Senator CONROY—Did it make any difference whether it was a monetary prize or a set of golf clubs?

Mr Russell—A monetary prize is not a taxable supply.

Senator CONROY—A set of golf clubs would have been?

Mr Russell—Yes.

Mr Carmody—Under the draft ruling. That is not a final ruling. As has been indicated, a number of these sorts of show prizes and that we doubt will ultimately be subject to GST.

Senator CONROY—It will or will not be?

Mr Carmody—Will not be. We have indicated on a range of those, ribbons and things like that, that the indications are that the final ruling will be such that they will not be subject to GST. But we are going to go through the final processes—

Senator CONROY—So you have not yet caught up with that young kid who won the half million on *Who Wants to be a Millionaire*?

Mr Carmody—I think cash prizes are different. As you would know, a draft ruling went out, there was concern raised about some of these issues and, as has been indicated, we are working through those with the community and the representatives. As further indicated, those sorts of minor prizes we doubt will, in the final ruling, be seen to be subject to GST.

Senator CONROY—What about the TV phone-ins, like the Channel 9 cricket invitation to people to call in to say which is the best catch, the classic catch? Where does that type of thing stand?

Mr Carmody—I am not sure whether we have had representations on that. You might have to wait till the final ruling, I am sorry, Senator.

Senator CONROY—I am not so sure. Sometimes you win a bat signed by Greg Chappell or something. Will we have a ruling on each individual one?

Mr Russell—We are looking to include in the final ruling as many examples as possible—

Mr Carmody—As many as are raised with us.

Senator CONROY—How long is a piece of string!

Mr Russell—to give a clear indication.

Senator CONROY—What about the radio station promotional four-wheel drives that drive around, giving out prizes—tossing packs of Twisties out the window? Will that constitute a taxable supply?

Mr Russell—If they are straight giveaways, my understanding is that they are not taxable supplies, even under the draft ruling. But again these will be covered in our final ruling.

Senator CONROY—Just because they hit people on the head rather than people walking up and asking for them. God, I love our simple tax system. I understand there is a bill currently before the House which allows a transitional special input tax credit to rental car businesses that held rental cars on 1 July 2000 and disposed of them before 1 July 2002. Can you explain to me the situation that this measure is meant to address?

Mr Russell—My understanding is that in that situation there was an element of, effectively, double taxation. There was a lot of noise in the industry about that one, and this measure is meant to put them back on a normal footing with a normal trader in that situation.

ACTING CHAIR—A good move.

Senator CONROY—In truth, this special input tax credit that one industry has now gained at the expense of everybody else, as part of our enhanced, simple tax system, is really just a compensation measure for a fall in their asset value, isn't it? It is called an input tax credit but it is calculated on the basis of the sale of the cars rather than their purchase.

Mr Russell—As I said, the measure is meant to remove what was an unintended consequence of the original legislation, in terms of a disadvantage in that industry. I do not think I could go beyond that.

Mr G. Smith—Mr Foster may be able to assist since it is a policy question, Senator.

Mr Foster—I can give you some background to the measure, Senator. When the GST was being designed, one of the basic design principles was to allow credits for items of trading stock and consumables but to isolate the existing capital equipment, the capital stock, and not to allow input tax credits for those. The rental cars are, effectively, in terms of the businesses that operate those rental businesses, generating the income of the business and in the nature of the capital stock. However, they are in an unusual situation because they are turned over so quickly. There is therefore an unfortunate impact on the rental car companies, so in their particular circumstances they were denied any sorts of credits for the cars that they had on hand at the time GST started and then they had to pay GST on the disposal of those cars fairly soon afterwards. So they were actually disadvantaged, by comparison with other companies that were turning over stock quickly.

Senator CONROY—We have called this an input tax credit, but the point I made to Mr Farrell was that it is calculated on the basis of the sale of the car rather than the purchase. You

can call it something else if you want, but it is not the same as any other input tax credit I have seen.

Mr Foster—I think the effect of it is to eliminate the tax on the first sale of the car, so it is calculated with reference to the sale of the car.

Senator CONROY—Isn't the effect of this measure simply to say to rental car businesses, 'You collect the GST on the sale of these cars but you don't worry about remitting it to us'? They are keeping the GST.

Mr Foster—On the sale of the car, yes, it effectively eliminates the GST.

Senator CONROY—So they get to keep the GST.

Mr Foster—It eliminates the GST.

Senator CONROY—No, they get to keep it; they do not have to remit it to you.

Mr Foster—They have already remitted it to us. This is a credit that is going to be allowed to them once the legislation has passed through the parliament.

Senator CONROY—On what basis was the measure restricted to rental car businesses only?

Mr Foster—From the information that was provided, the representations that were made to us and the discussions that we had with the industries, it was considered that this particular group had actually suffered as a result of the introduction of the GST in a way that other businesses had not.

Senator CONROY—What about mobile home rental businesses? It is exactly the same issue.

Mr Foster—I do not think it is exactly the same. The reason why this particular industry suffered in the way that it did was that it turns over the cars very quickly. People want to drive a car which has low mileage and is virtually new, so they are constantly selling the cars and buying new ones, whereas things like mobile homes are actually held for lengthy periods of time. Going back to my original comparison of whether you are talking about consumables or capital stock, the assets that are held for longer periods of time are more in the nature of the capital stock.

Senator CONROY—Did anyone else get a credit for assets? You are drawing the distinction—did anybody else?

Mr Foster—I am not aware that anybody did, but it is a question of a borderline. They are very close to the line of what you would call an inventory stock or an asset.

Senator CONROY—Inventory stock is fine; this is a question of assets, though. What about charities which are heavily reliant on vehicle fleets—are they getting an exemption? They lost their wholesale sales tax exemptions at the onset of the GST and suffered a similar loss of value in their assets price. Is any special measure planned for charities?

Mr Foster—Not that I am aware of.

Senator CONROY—So it is just rental cars? Rental car companies get it; charities do not. They turn their fleets over.

Mr Foster—I do not think the situation is comparable. The particular impact of the GST on the rental cars was particularly severe. They suffered in three ways.

Senator CONROY—It is not double taxation; it is triple taxation.

Mr Foster—That is true. You alluded earlier to the reduction in their assets, and that was also a problem.

Senator CONROY—Yes, but everyone in the country suffered that problem. Some were compensated in different ways.

Mr Foster—Not to the same extent that this particular industry did. Most of their assets are these rental cars, so you effectively put them in a very difficult position from a liquidity point of view.

Mr Russell—To clarify, charities that were previously able to buy a car free of sales tax were able to claim a full input tax credit from day one.

Senator CONROY—We are talking about the resale here.

Mr Russell—Right, but there is no double taxation on them. They carried that over.

Senator CONROY—I am referring to your earlier comment that the rental cars were subject to double taxation. Mr Foster has got it up to triple taxation. It is such a well-deserving group!

Mr Foster—It is different from the charities in the sense that the charities get an input tax credit up front and, yes, they are taxed on the sale. In the case of these vehicles, they did not receive an input tax credit up front and they have been given a one-off relief for the first disposal of the cars that they did not get an input tax credit for. From this point on, they get input tax credits and pay tax in the same way as everybody else.

Senator SHERRY—Mr Foster, this discussion reminds me of another group—veterans. I think they got their cars wholesale sales taxed. Is that correct?

Mr Foster—They were entitled to an exemption.

Senator SHERRY—Yes, from wholesale sales tax.

Mr Foster—Certain veterans. It was not all of them. Veterans with disabilities.

Senator SHERRY—I am confident the category was veterans who had been physically injured. They might have had one leg or one arm. There were conversion costs in making the vehicle possible for them to drive. There is certainly a category. What has happened to them in respect of the GST on motor vehicle purchase?

Mr Foster—My understanding is that they are still entitled to an exemption.

Senator SHERRY—A GST exemption?

Mr Foster—Yes. Sales tax exemptions generally in those cases—I can take this on notice and get you a definite answer—were replicated with the GST.

Senator CONROY—I want to talk about public rulings.

Mr Carmody—While we are changing over topics, I would like to go back to our previous discussions in relation to Senator Coonan. I remember that there was a further discussion. For completeness of my answer, I will share that with you. On the Saturday evening of that weekend, I did receive a telephone call in the course of which—

Senator CONROY—From Senator Coonan?

Mr Carmody—Yes. I informed Senator Coonan of my decision to extend the date for acceptance of—

Senator CONROY—Appreciating that she would have been on Perth time and you are saying that it was Saturday night—

Mr Carmody—Yes.

Senator CONROY—Had she finished her meetings?

Mr Carmody—I do not know. It was Saturday evening—

Senator CONROY—Surely, she did not call you from the meeting?

Mr Carmody—No. On Saturday evening she did call me and I informed her of the decision that I would be announcing on Monday morning to extend the time to agree to the settlement. That was about the extent of my conversation with Senator Coonan. I spoke to one of her staff members, and we talked about how their visit had been going. I think the only issue of substance raised was feedback on the same issue that Senator Cook raised with me. I agreed with her staff member, in the course of that telephone conversation, that we would meet on Monday.

Senator CONROY—Did the staff member call you first or did Senator Coonan call you first? Did they pass the phone to each other?

Mr Carmody—I think I spoke to a staff member first.

Senator CONROY—And that was roughly at the same time? It was not a few hours earlier?

Mr Carmody—If you want the full details, I was actually over at the supermarkets when they first called, and so I was not able to take the call. When I rang back, they were not able to take my call but there was a message left to say that—I think it was 8 p.m. Eastern Standard Time—they would ring me again. I believe the person on the other end of the phone was a member of the staff of Senator Coonan. Then I spoke to Senator Coonan very briefly in which I said, ‘How are things going?’ and she said, ‘Fine.’ She indicated that it would be worth our while meeting because she wanted to give some feedback from the meetings, and I think she might have been having a further one—I am not sure.

Senator CONROY—Does she often ring you on a Saturday night at 8 o’clock?

Mr Carmody—No, she does not. She does not at all.

Senator CONROY—Is that the first time?

Mr Carmody—Probably the first time on a Saturday night. As I said, the purpose was, in the end event, for her staff member to set up a meeting with me on the Monday morning—

Senator CONROY—But you did have a conversation with her when you informed her—

Mr Carmody—I informed her that I would be announcing on Monday morning on radio the extension of time for agreeing to the settlement offer.

Senator CONROY—Have you ever had a minister, any minister, call you on a Saturday night before?

Mr Carmody—I cannot recall. I have had calls at different times of days and evenings, but I cannot recall that specifically.

Senator CONROY—It is very unusual to come out of a meeting like that and call up the tax commissioner.

Mr Carmody—I do not know whether she came out. Perhaps I could say that the overall tenor was that she was interested in giving me feedback on issues that some of these investors were seeing as impediments and then taking up the offer.

Senator CONROY—And it could not wait until Monday?

Mr Carmody—I do not know. She just wanted to set up a meeting I had discussed with her staff member. We held that meeting, and so be it.

Senator CONROY—Her staff could not wait until Monday morning to phone your office to say, ‘I need to have a meeting with you about a meeting in Perth’?

Mr Carmody—I do not know.

Senator CONROY—Minister, would you often phone your—

ACTING CHAIR—You will have to ask her, Senator Conroy.

Senator CONROY—I would love to, and I appreciate the circumstance, and so I am not in any way having a crack about that. But, Minister, would you often phone your department at 8 o’clock—

Senator Minchin—If you ever are a minister, you may have the experience that I often have.

Senator CONROY—I live in hope.

Senator Minchin—In the far distant future when you are a minister, you will find that you do ring officials on weekends, Senator Conroy.

Senator CONROY—I might be as grey as you are.

Senator Minchin—I have done it often.

Senator CONROY—I am sure that is the case.

Senator Minchin—And Senator Coonan is a hardworking minister who works on weekends.

Senator CONROY—But I just find it extraordinary that it is not some massive security—

Senator Minchin—If she feels it is appropriate for her to ring the tax commissioner on a Saturday, that is perfectly appropriate.

Senator CONROY—It is not like President Bush phoning the Prime Minister to say, ‘Look, we’re about to go to war on Afghanistan and I urgently need to talk to you.’

Senator Minchin—If she is working on a Saturday, it is perfectly proper for her to call officials if she feels she has something to discuss—as I have done often.

Senator CONROY—So you do not think there is anything wrong with calling an independent statutory authority head?

Senator Minchin—Not at all. I will not be surprised, though, if you are about to ask the commissioner what he was buying at the supermarket. This is really getting a bit facile.

Senator CONROY—I am just trying to defend Mr Carmody’s right to have a weekend to go shopping by himself.

Mr Carmody—As I said, Senator, the general tone of that and signalling that, and of the meeting on Monday, was very similar to the points being made by Senator Cook.

Senator CONROY—Yes, but Senator Cook waited until a public forum. He did not call you at home or at the supermarket. That is borderline in trying to influence the tax commissioner.

Senator Minchin—Cut it out.

Senator CONROY—It is absolutely on the borderline.

Senator Minchin—That is ridiculous. Come on.

Mr Carmody—Senator, we have made the sequence of events clear. These are my decisions. I have never been inappropriately or otherwise influenced in performing my duties.

ACTING CHAIR—Next question.

Senator CONROY—I was asking about public rulings—or I was about to ask, before you wanted to correct the record on your supermarket trip. Could you tell me how many GST public rulings the ATO is currently working on?

Mr Carmody—We will have to take that on notice.

Mr Russell—We have a formal public rulings program that is published, and we can give you the details of that.

Senator CONROY—And I have a copy. Can you tell me how many of these rulings relate to issues that arose more than six months ago?

Mr Russell—I would need to go back, look at the topics and get advice from our tax council on that. I will take that one on notice.

Senator CONROY—According to your web site, it is nine.

ACTING CHAIR—You have got your answer there?

Senator CONROY—I just wanted to make sure that I have the most up-to-date information, Senator Watson. I am happy for Mr Russell to take that on notice and, if I have misled the Senate, I am sure he will come back and correct me.

ACTING CHAIR—This is not a quiz as to how accurate their figures are on their web site, Senator Conroy.

Senator CONROY—Sometimes it is about whether they are running an up-to-date web site. I had to have a chat with the Office of Small Business about that last night. I think the Prime Minister's web site recently was demonstrated to still have Senator Bronwyn Bishop as a minister—a horrific prospect for all concerned. It caused all sorts of merriment in PM&C, and Mrs Bishop got quite excited when she heard about it.

ACTING CHAIR—A question on rulings?

Senator CONROY—One of the rulings that came up as an issue before the introduction of the GST was on the treatment of barter transactions, which your program says was notified in November 2000. Can you tell me whether you have issued a draft ruling in relation to that?

Mr Russell—I am sorry I did not hear that question.

Senator CONROY—Do you have a ruling on barter transactions yet? Your web site says no.

Mr Russell—I would need to check. We will take that on notice.

Senator CONROY—As I have said, I do not think one has been issued yet. This was notified in November 2000, but can you tell me when you expect a final ruling?

Mr Russell—Again I would need to check with our tax council.

Senator CONROY—I think the indication is December 2002. That would be a full two years. Is there a problem?

Mr Russell—A range of rulings have been issued around what we call the core principles of the GST. There is a nonmonetary consideration ruling that has been published. I would need to check whether that actually covers any of the elements of barter or not.

Mr Carmody—I think also, in some of our general publications, we have outlined the application of the GST in those circumstances.

Senator CONROY—The key question here is: how are taxpayers meant to have any idea of how to apply the law in this regard, when it will possibly take you guys 2½ years after the introduction of the GST to work it out yourselves?

Mr Carmody—As I have indicated, my recollection is that, in a range of our publications, we do refer to the application of the law in barter situations, and so people would have that information. I am not sure of all the detail that is required—

Senator CONROY—I am just picking one on barter.

Mr Carmody—I know. I am just trying to make the point that, as far as general information goes for the vast range of taxpayers, we provide a whole range of publications. We then, as with all taxes, get into some very detailed technical dissertation on issues that come in the form of rulings.

Senator CONROY—Do you think two years is a satisfactory length of time?

Mr Russell—But, in the meantime, we will issue a private binding ruling if a taxpayer puts to us a particular set of circumstances.

Senator CONROY—But that is not going to help anybody. With private binding rulings, as I will come to in a minute, it is very hard for other taxpayers to access accurately these situations.

Mr Carmody—Private binding rulings are clearly only binding on the individual who applies for them. But I think, in the area of publications on GST, in nature they are more binding on the tax office, unlike the income tax law. We do have a range of publications on these issues.

Senator CONROY—Do you think two years to complete the ruling—and that comes to about 2½ years after the GST has been introduced—is best practice?

Mr Carmody—As I have said, there is a range of information out there. I do not know exactly what is further required under this ruling. But, in our public rulings, priorities need to be set. Generally, input to discussion on the priorities is given by professions and others. It is like income tax: there will be a long program that will need to be gone through.

Senator CONROY—How do you plan to treat taxpayers who get it wrong on the treatment of barter transactions or on the other 19 issues that the tax office is supposed to issue public rulings on? How are you going to handle that? Nineteen is a lot, and so potentially a lot of taxpayers could just be getting it accidentally wrong.

Mr Carmody—As I have indicated, it is not necessarily the case that there are not ATO positions out there. In terms of a whole range of these practices, we have a wide range of published material and web site material that covers what the bulk of people need to understand. We have made it clear on the issues of penalties that, during this implementation phase, if people are genuinely trying to do the right thing and there is some legitimate confusion, we would not ordinarily apply penalties in those cases, although a general interest charge may apply.

Senator CONROY—When a penalty of 50 per cent is imposed on an entity which has underpaid its GST, can you confirm that it is either because: one, they have been found to be reckless as to the operation of the taxation law; or, two, they have been found to have engaged in a tax avoidance scheme?

Mr Russell—With our penalty guidelines, it would be highly unusual in the current climate for us to be applying a penalty of that quantum. So, if a penalty of that quantum has been applied, it would require those types of circumstances.

Senator CONROY—So if a 50 per cent penalty has been imposed, it would be under one of those two tests; is that right? I appreciate you are saying it is unusual, but could I confirm that those are the two tests: they have been found to be reckless as to the operation of a taxation law or they have been found to have engaged in a tax avoidance scheme.

Mr Russell—My understanding is that they are our guidelines at the current time.

Senator CONROY—So when Lynton Crosby tells the media on 23 November 2001 that the Queensland division of the Liberal Party has paid a penalty of \$156 on a \$312 underpayment—that is a penalty of 50 per cent—it can be fairly assumed that the Queensland Liberal Party has either been reckless as to the operation of a taxation law or engaged in a tax avoidance scheme.

Mr Carmody—Senator, as you are aware, we cannot comment on anything that goes to a named taxpayer.

Senator CONROY—But given that the penalty is 50 per cent—

Mr Carmody—I cannot confirm or say otherwise what the penalty is, Senator.

Senator CONROY—Lynton Crosby has identified that it is \$156 on a \$312 underpayment. Mr Russell has indicated that 50 per cent penalties are unusual—

ACTING CHAIR—Senator, you are seeking information about an individual taxpayer, and I have got to disallow the question.

Senator CONROY—A 50 per cent levy is only levied on the basis that they were reckless as to the operation of a tax law or they were found to have been engaged in a tax avoidance scheme.

Mr Carmody—As I have indicated, I cannot comment on what level of penalty was applied. I cannot comment on the level of penalty applied in any individual circumstance and I cannot comment on the individual taxpayer here.

Senator CONROY—Minister?

Senator Minchin—I have nothing to add to the answer from the commissioner.

Senator CONROY—Was the Queensland Liberal Party engaged in a tax avoidance scheme?

Senator Minchin—I have nothing to add to the commissioner's comments.

Senator CONROY—Fifty per cent penalties are pretty—

Senator Minchin—That matter is finished, over.

Senator CONROY—It might be for you but, politically, Australian taxpayers are keen to know that the Liberal Party in Queensland, backed up by the federal Liberal Party, are engaged in a tax avoidance scheme.

Senator Minchin—I am not going to add to any comment on that matter. It was dealt with by the federal director in the statement from which you are reading. The matter is finished.

Senator CONROY—Has the federal secretary of the Liberal Party spoken with the—

ACTING CHAIR—You can raise these questions in the Senate as a whole, but the tax commissioner has pointed out the privacy provisions—

Senator CONROY—I am asking the minister; I am not asking the commissioner.

ACTING CHAIR—But he is representing the minister who is responsible for the administration of the tax laws.

Senator CONROY—But I can still ask him the question and he can say no.

ACTING CHAIR—He is bound by the same considerations.

Senator CONROY—I am entitled to ask the question if I want. They do not have to answer, but I can ask the question. I was interested in the answer that the tax office gave on 24 May to the hypothetical that I posed. I am sure you remember it. The second paragraph of the response says:

Legal advice obtained is that there is little substantive difference between disclosing the taxation position of an actual person, and disclosing the taxation position of a hypothetical person who has the same characteristics as an actual person where those characteristics can disclose who the actual person is.

Who provided that advice?

Mr Carmody—The Australian Government Solicitor.

Senator CONROY—Is a copy of that advice available?

Mr Carmody—I do not have it on me, but I can see whether it is appropriate to provide it.

Senator CONROY—Thank you. Did the legal advice state what you have written in the third paragraph—'Providing a specific response to the question would therefore be inconsistent with the strict secrecy provisions of the taxation laws'—or was that the ATO's spin on what the advice stated?

Mr Carmody—We did not put any spin on the advice. I would have to go back—

Senator CONROY—Is it verbatim out of the legal opinion or is it part of a press release or an answer to me?

Mr Carmody—I would have to go back and look at the advice, but I am sure it is consistent with the advice.

Senator CONROY—You might not have seen the final response, but I wanted to confirm that the written response you provided was the same one that was provided to me.

Mr Carmody—I am not aware of any material or other difference—

Senator CONROY—Can you just confirm that for me and take that on notice?

Mr Carmody—I am sure I can, but as far as I am aware what was provided is what has been provided to you.

Senator CONROY—Unfortunately, it passes between a set of hands before it gets from you to me, so I just want to be confident—

Mr Carmody—I am just indicating to you that I understand that is the case. If it is not, I will advise you.

Senator CONROY—Thank you. Commissioner, could you outline your arrangements in the ATO for pursuing compliance of high net worth individuals? Do you have a dedicated unit for this purpose?

Mr Carmody—We do, and I could give you some general information.

ACTING CHAIR—Order! Senator, you have raised a very serious allegation. I do not know whether you wish to withdraw that.

Senator CONROY—I have not made any allegation at all, I have just asked to confirm that—

ACTING CHAIR—The implication, as I understand it, was that there may have been a change as it passed through various hands.

Senator CONROY—No, I just asked to confirm that they were exactly the same. I was not suggesting there was a change.

ACTING CHAIR—So long as you did not suggest that, it is okay.

Senator CONROY—I would not suggest such a thing. Commissioner, we were talking about high net worth individuals.

Mr Carmody—I will get Mr Fitzpatrick to give you a bit of detail there.

Mr Fitzpatrick—What would you like to know, Senator?

Senator CONROY—You have a dedicated unit for the purpose?

Mr Fitzpatrick—Yes, we have a High Wealth Individuals Taskforce.

Senator CONROY—What resources are available to that unit in terms of money and people?

Mr Fitzpatrick—We have 100 to 110 people I think nowadays.

Senator CONROY—And in terms of the budget of the section?

Mr Fitzpatrick—I do not know the exact dollars. If you want the exact dollars and how it is funded, I can give you that.

Senator CONROY—I am happy for you to take that on notice.

Mr Fitzpatrick—It is about 110 people and whatever salary and administrative expenses. Plus we have money for legal costs of cases we take to court et cetera.

Senator CONROY—You would have a few of them with this bunch, wouldn't you?

Mr Fitzpatrick—Some cases go to court or the AAT, some cases are settled and some taxpayers concede.

Senator CONROY—Your output pricing review has come forward with a whole string of suggestions in, it seems, just about every other area, indicating that, if you put some more money in here, you get some more revenue out. What revenue gains would you expect as a result of more resources being available for that unit?

Mr Fitzpatrick—We put resources into what we call the High Wealth Individuals Taskforce about six years ago, to increase our focus on this area of the population. We have published over the last four or five years in the annual report of the commissioner the revenue gains from that task force. They include direct revenue gains from audits of particular cases, for example. We have also published the outcomes of an analysis of what we believe to be an improvement in voluntary compliance largely as a result of our focus, which we call indirect revenue gains. We have published results of the extent of losses being claimed, which have been reduced substantially over a period of time.

The task force also looks at areas of the law which may require amendment. There have been some changes to the law that the parliament has passed over the period that the task force has been in place, some of which have resulted from the work and the evidence gained by the task force in its examinations of what some high wealth individuals have been doing to minimise tax.

Senator CONROY—Thanks for that. The point I was making was the output pricing review seems to have looked at your whole operation, recommended an increase in funding in a whole range of areas and said that from that increase in funding you are picking up revenue in all these different areas, but there does not seem to be any additional resources for this unit that have arisen out of that review. Is that correct?

Mr Fitzpatrick—To my knowledge that is correct.

Mr Carmody—I do not believe there are any additional resources. When we looked at these—

Senator CONROY—So this is the one section where there is no gain to be made by increasing resources?

Mr Carmody—No, it is not the one section where gains could be made. What I indicated to you before in relation to the output pricing review was that the basic benchmark was maintaining an integrity of the system sufficient to deliver the forward estimates. So it was not the absolute maximum or optimum position; it was the position—

Senator CONROY—So all of those small businesses are tricky and require more funds and more resources to have auditors knocking on their door, but high wealth individuals are not?

Mr Carmody—No. In fact, as has been indicated, we have a task force for high wealth individuals, which we have had for some years now. So it was a matter of looking across the board and making value judgments to deliver an appropriate level of integrity where, at the moment, we are perhaps not resourced sufficiently to deliver it. Given our particular focus on high wealth that we have had for some years now—and that continues, with the level of resources mentioned—that not was seen as a pressure point relative to some of the others that were chosen.

Senator CONROY—We mentioned the baby bonus earlier.

Mr Carmody—Yes, in the *Tax Pack*.

Senator CONROY—Could the officials please describe in detail the methodology of calculating the cost of the rebate?

Mr G. Smith—Are you talking about the revenue cost?

Senator CONROY—I am talking about things like the number of persons commencing each year, the number of persons who subsequently re-enter paid employment each year within the five-year eligibility date and that sort of thing.

Mr G. Smith—I was not sure whether you were talking about the calculation of an individual rebate or—

Senator CONROY—I want to get to the underpinning assumptions. Mr Gallagher, could you tell me the number of persons commencing each year, in terms of calculating the cost of the rebate?

Mr Gallagher—You have surprised me; I thought we went over these issues at the last Senate estimates.

Senator CONROY—We did go over them; I just wanted to confirm some details. It seems to be a moveable feast out there in terms of estimates, so I really just wanted to double-check them with you.

Mr Gallagher—In doing the original costing, we used the 1999 publication from the ABS, *Births, Australia*, and we estimated the total number of confinements at 245,000 a year. Initially, because it will be confinements after a particular date, we estimated the first confinements at about 117,000. That will come into increasing focus as the program matures because some people will have second rather than first confinements after our date.

Senator CONROY—I am not sure that ‘confinements’ is the appropriate word. You might want to refine that word for public consumption.

Mr Gallagher—These are the words of the ABS. It means live births.

Senator CONROY—What is the number of persons who subsequently re-enter paid employment each year within the five-year eligibility period of the rebate?

Mr Gallagher—I am not sure that I can give you that estimate. In the costing, we estimated the rate of the payment from the differences in the income distribution. I do not have that number to hand, nor the number of those who re-entered paid employment. Some people would of course just have a reduction in their income. They may not be out of the work force full time; they may just take a short period off.

Senator CONROY—Is it possible, through the use of proxy data such as assessable income of women by age and by postcode, to estimate the geographical distribution of the payment of the measure?

Mr Gallagher—The issue with estimating that from taxation statistics is that taxation statistics do not have details on family composition. Therefore, we do not have details on the numbers and characteristics of dependent children in taxation statistics. Certainly in the Treasury there is no way that we could do that.

Senator CONROY—But you can get the address though; when they send you an application form, there has got to be an address and a postcode.

Mr Gallagher—You are asking about the costings. More data may be becoming available through the administrative system.

Senator CONROY—I had probably moved on there in terms of the geographical distribution; I was trying to find out whether Senator Minchin is right.

Mr Gallagher—Certainly there is no way that we could have done a geographical distribution for the purposes of the costing.

Senator CONROY—Would it be possible to do it now, with the information that is coming through on the applications? Do you receive that information?

Mr Gallagher—No.

Ms Granger—We would not have it yet. I believe we will be able to do some analysis eventually. You might also be interested to know that this tax time we are planning to send the forms to most new mothers. We can get that information via their Medicare registration so we will be able to identify them and send those out. In the end, it will be a matter for them to self-assess whether they are eligible. It will become available, but obviously only after most of them claim.

Senator CONROY—How long will it be before we can get a picture?

Ms Granger—The lodgment season for self-preparers is until October. If they are lodging through an agent, it will be throughout the year. So we will have an early picture probably some time early in the next calendar year, but it will not be a complete one. Obviously, after the first year we will have a better idea.

Senator CONROY—You never know, Senator Minchin, we might know within 12 months whether you are right.

ACTING CHAIR—If a child dies in childbirth, are the parents entitled to the baby bonus?

Ms Granger—The child has to be born alive.

ACTING CHAIR—So if it dies a few hours after, the parents would still qualify?

Ms Granger—I will check precisely what the definition is, but that is my understanding. If the child is born alive, the parents are entitled. There are special rules in relation to the death of a child within a year. Essentially, the rules will allow for a full claim for that year and the transfer of that eligibility to a later child for the remaining claim. Obviously, this is to be sensitive to what is a very difficult time for parents.

Senator CONROY—How many people have been given the first home owners grant?

Senator Minchin—Mr Chairman, is this relevant to the Australian Taxation Office? If so, could someone explain it to me?

ACTING CHAIR—Can we go to tax administration?

Senator CONROY—I am happy to hold this off.

Mr G. Smith—The Commonwealth-State Relations Division will be here tomorrow.

Senator CONROY—What about the tax audit of Treasury? Are you happy to take questions on that?

Mr G. Smith—We do not have anyone here. I know nothing about it, but I will have a go.

Senator CONROY—That is very kind of you to offer, but could we organise to have somebody here tomorrow who knows a bit more about it than you?

Mr G. Smith—It depends on what you want to know.

Senator CONROY—Are you aware of the Auditor-General's report on the GST administration by Commonwealth organisations?

Mr G. Smith—Yes, I am.

Senator CONROY—The Department of the Treasury was one of six agencies that were audited; is that correct?

Mr G. Smith—That is correct.

Senator CONROY—From transactions examined in each agency, the Auditor-General found that there were error rates of between three per cent and 17 per cent by volume. Did Treasury have the error rate of 17 per cent?

Mr G. Smith—I do not believe so. I think we had six errors and I think they added up to \$200 or something of that order.

Senator CONROY—What was Treasury's error rate?

Mr G. Smith—I think it was in the middle of that range: about seven per cent. It was from a very small sample of 160, I think. There were 12 errors or something like that. One of the errors was 55c.

Senator CONROY—The Auditor-General identifies four types of errors in his report: invalid tax invoices, coding errors, inadequate documentation and data entry errors. What types of errors was Treasury found to be making?

Mr G. Smith—As I said, I think there were only a handful of errors in the sample. Often, they consisted of the invoices not having all of the data on them. I would have to check the breakdown.

Senator CONROY—The Auditor-General says that all agencies had coding errors where they misclassified transactions between GST-free and out-of-scope supplies. What was Treasury doing wrong?

Mr G. Smith—As I say, there was only one area of any substance in terms of dollars. I do not have any of the details.

Senator CONROY—I am happy to pause at this point until we can get somebody who is a bit more familiar with it.

Mr G. Smith—We will have to get someone on those details for you tomorrow.

Senator CONROY—Okay, I will come back to those tomorrow. Thank you.

Proceedings suspended from 3.26 p.m. to 3.43 p.m.

Senator SHERRY—I want to go back, Mr Bator, to deal with one outstanding issue on SG compliance. There was a report in the *Age* of 7 May that the ATO was preparing a report to the building industry royal commission on tax avoidance through so-called 'phoenix companies', where the same principals start and wind up companies as part of a deliberate strategy of avoiding tax and/or SG obligations. Can you give me a status report on this report?

Mr Bator—Probably the best person to answer that question would be Neil Mann from our small business area, and he is on his way.

Senator SHERRY—We will put it aside and come back to it later.

Mr Carmody—I can tell you a little bit about our operations. It has been a matter of concern. Over the last four years we have raised something like \$140 million in tax and

revenue and collected more than \$60 million of that. As I understand it, a number of cases have resulted in company directors and promoters receiving jail terms. Neil has now arrived and he will be able to give you a bit more detail.

Senator SHERRY—Can you confirm that you are putting together a report for the building royal commission on this issue?

Mr Carmody—We are putting together a submission to the building royal commission on issues of alleged avoidance.

Senator SHERRY—Do you have any idea when that submission will be put to the royal commission?

Mr Carmody—Very shortly.

Senator SHERRY—Mr Mann, can you give us some further details?

Mr Mann—Yes. In respect of the phoenix companies that we have been investigating, since July 2000 the figures are that \$17 million in tax and penalties have been established and there is about another \$3 million or \$4 million involved in cases in progress. We are finding that we are getting onto these cases earlier—individual matters involving smaller amounts—but the practices themselves are still continuing to some degree. We have had two directors of unrelated companies which defrauded revenue, basically by the non-remission of employment instalment deductions, jailed for a total of 14 years. Our view is that we are certainly making headway there, getting onto the cases earlier, but the practice is still continuing to some extent.

Senator SHERRY—Are there any particular industries that stand out?

Mr Mann—Most of our activity has been in relation to the building and construction industry, but it is not the only industry. Clothing and manufacturing would be another example.

Senator SHERRY—You may not have been here when I referred to a case earlier about IT companies, which seemed to be engaging in this practice. Are there practices that you have been able to identify in the IT industry as well?

Mr Mann—It has not been our particular focus, but let me say that there is no industry specific nature of the practices to the extent that—

Senator SHERRY—But you believe that there is a problem in the building industry that you have identified in particular.

Mr Mann—Yes, for some years. Basically, if you look at any particularly competitive industry, you will find some people that either deliberately or through their poor management practices end up in liquidation with outstanding debts. We have some evidence of people using that as a deliberate approach to win jobs; we have other evidence of people simply biting off more than they can chew and being unable to turn a profit on the price they have tendered.

Senator SHERRY—Yes, but in this case we are talking about individuals who are deliberately setting up structures to avoid tax. There is little question that that is the modus operandi, as distinct from legitimate businesses that are struggling because of the commercial environment.

Mr Mann—The companies we are looking at would include both groups, and it is hard to establish from the simple face of the situation whether it is in fact a deliberate attempt.

Senator SHERRY—There are elements of both.

Mr Mann—Yes.

Senator SHERRY—You cannot give us some sort of figure in respect of those that are deliberately set up as a tax avoidance vehicle.

Mr Mann—Most of the adjustments we have made would be in those categories.

Senator SHERRY—Does this avoidance of tax include avoidance of SG obligations?

Mr Mann—It has come up in terms of our compliance programs—not just in terms of the phoenix arrangements but in other cases of payment of non-declared cash wages, for example.

Senator SHERRY—But presumably, in a phoenix situation, they are trying to avoid any tax. As a result of that sort of mechanism being adopted, it is highly likely that SG contributions are not being made and in fact are never going to be made.

Mr Mann—Yes, and any other company tax obligations—GST, for example.

Senator SHERRY—Thank you for that. I want to go back to a conversation we had at the estimates in February this year. It involved yourself, Mr Carmody, and Mr Bator. I asked a series of questions about the contributions tax on superannuation. I will not go into the full detail of the conversation, but you were able, Mr Bator, to give us a historical figure based on the commissioner's annual report. I will not go back through those figures, but in the subsequent conversation it became apparent that the figures you gave me included surcharge tax, exit tax, contributions tax and salary sacrifice. I did ask you whether it was possible to give us a breakdown of the contributions tax separate from the other taxes that are collected in respect of superannuation. Arising out of those estimates on 20 February, I had a response to the question that I put on notice. I said in respect of the breakdown of funding income tax figures:

If you have any indicative ratio that can give an indicative figure I would not hold you to it, but I would just be interested in seeing what that was. So you will take that query on notice?

I got an answer back—I am not sure of the date—which said:

Contributions and earnings are not taxed separately but are included as income against which deductions are claimed to derive a superannuation fund's taxable income. Therefore the ratio between superannuation tax collections on contributions and collections from earnings cannot be calculated.

That was the response I got. Are you able to give us an update on the issue of contributions tax on superannuation as distinct from the other elements that I referred to earlier?

Mr Bator—We have been working on it, basically, since you asked that question, to see whether we could get something meaningful out of the statistics that we have. I am not finding it particularly easy or useful to try to come up with a figure from within the tax office on contributions, tax on contributions or taxes on earnings. We know the taxes roughly on ETPs and we certainly know the surcharge.

Senator SHERRY—The surcharge has subsequently been disclosed in the budget figures. That is quite clear now.

Mr Bator—The issue for us of course is that some life officers also have superannuation. The extent of tax they pay on superannuation benefits on contributions and earnings is very difficult to get out of that lot, and they are not small players in the game. I am really at a loss to provide anything that I would think, at least from my point of view, could help you very much. I could certainly provide information on the value of contributions, and I could provide information on capital gains, interest earned and so forth, but the level of expense against the

contributions part of the superannuation fund business and the level of expense against other earnings I am not finding very easy to calculate.

Senator SHERRY—So you have not reached a definitive figure yet?

Mr Bator—No, I have not. I must not say that others in other agencies might not have, but I certainly have not.

Senator SHERRY—Has anyone else in Treasury reached a definitive figure?

Mr G. Smith—I think what Mr Bator is dealing with is an attempt to produce statistical quality data from the past. For our purposes of making estimates and policy advice, in the Treasury we do seek to identify the yield from different components of tax, including these different components. We also do it for the tax expenditure statement, which is where I think we even published.

Mr Gallagher—We published the difference between contributions and earnings as a tax expenditure statement. Although for the reasons that Mr Bator has outlined that is merely one approximation and one estimation, because if you are doing that then you have to make a decision about how to allocate the expenses in making any estimate of the difference between a notional contributions tax and a notional earnings tax.

Mr G. Smith—To that extent—and, if you like, in a broad estimate sense—we make the split, but the tax office cannot produce an unambiguously reliable, historical series.

Senator SHERRY—What figures have you been able to calculate?

Mr Gallagher—We have looked at the level of contributions from a variety of sources, including the use of the surcharge data and aggregate tax return data. On that basis, I have formed a view about the likely level of taxable contributions in 2002-03 and in subsequent years using the growth allocated to contributions in our models.

Senator SHERRY—Just before you go on, have you done that in recent weeks? When have you been able to identify these figures?

Mr Gallagher—I have pursued the issue in recent weeks.

Senator SHERRY—You were present, I think, on the last occasion when I asked—in what I thought was a fairly logical approach—the tax office for this data.

Mr Gallagher—The problem with the data is that the statutory funds of life insurance companies are not covered by the data, and because there is no good coverage of those I think Mr Bator is correct in being unable to give you a historical estimate. It is still the case that there are no firm, administratively reliable statistics on that significant component of the revenue because it is collected under the company tax header ‘revenue’ and not under ‘superannuation funds’.

Senator SHERRY—When I was pursuing this issue with Mr Bator and Mr Carmody, did you see the question about this issue I put on notice? Did that stimulate your interest? The tax office just say, ‘It can’t be done.’ I have read out to you the response. They just say they cannot do it, that it cannot be calculated.

Mr G. Smith—I think we just confirmed that we cannot do it, either.

Senator SHERRY—But you can calculate it?

Mr G. Smith—No, we can make an estimate.

Mr Gallagher—We can make a rough estimate. There is a variety of sources that allow us to get an idea of the size of the number.

Senator SHERRY—Can you run me through your sources?

Mr Gallagher—Historically, we can look at surcharge data which will give us an average of taxable contributions. It tells us nothing about deductions, of course. From the funds point of view, there are individual tax returns from funds. An estimate of contributions comes out of our RIM group model, but there is always an issue about how well that model is actually benchmarked. Those would be some of our major sources for getting a handle on the size of a relevant number. Going forward, you would have to include allowance for the fact that the Superannuation Guarantee will go up by one per cent on 1 July this year. You would have to make an allowance for that, which is something again that has to be estimated.

Senator SHERRY—You referred to individual tax returns. Have your consultations involved anyone representative of the superannuation industry, either individual funds or organisations?

Mr Gallagher—We keep an eye on what various groups are saying about taxation of superannuation. We look at what ASFA is saying and at what Phillip Fox Actuaries is saying. If anyone else comes out with a statement about what they think the quantum in terms of superannuation revenue is, we will see what they have had to say in the press clippings. In terms of discussions, the issue would have been raised with me in discussions via people from ASFA.

Senator SHERRY—There are a number of other organisations that I am aware of that have given estimates—the Australian Bankers Association. Have you had any discussions with them?

Mr Gallagher—Not on that issue.

Senator SHERRY—I would certainly agree with you that ASFA have done estimates. I notice the economics editor for the *Financial Review*, Mr Mitchell; the Australian Institute of Superannuation Trustees; the Retirement Futures Forum; the Council for the Aged; the Association of Independent Retirees; and the library research officer, Mr Kehl—I think he used to work for the tax office or the Treasury, didn't he?

Mr Gallagher—Yes.

Senator SHERRY—These are all people or organisations that are familiar to you in the context of superannuation?

Mr Gallagher—Yes, but the difficulty for everyone has remained the issue of the statutory funds of life insurance companies.

Senator SHERRY—Yes. Have you reached some sort of estimate?

Mr Gallagher—I have a view of what contributions will be in 2002-03 and in subsequent years.

Senator SHERRY—When did you reach that view?

Mr Gallagher—After the budget.

Senator SHERRY—What date did you have the figures available?

Mr Gallagher—I think I finally decided on my view about May 17.

Senator SHERRY—That is an interesting date. I notice a figure was given publicly on 17 May by none other than the Prime Minister. He used a figure in the context of a reduction in the contributions tax on superannuation of \$350 million. Just to give you the context, on the ABC's *World at Noon* the Prime Minister responded to a question about superannuation taxation. He said:

Now, on my preliminary advice that is not so. You save about \$50 million a year out of the surcharge, if you knock that back. But I'm told that it's about seven times more than that, about \$350 million in order to fund a cut of 2% in the contributions tax.

Can you confirm whether the Prime Minister was correct in his estimate of \$350 million?

Mr Gallagher—I think that the Prime Minister's number was an underestimate. I think there was a misunderstanding when that number was provided. The number in the Treasurer's press release was closer to the mark. The Treasurer's press release gave a full year, full accrual number—the total amount of revenue at stake from a two per cent cut—at \$480 million.

Senator SHERRY—Can you give me the basis of the figures for your contributions tax estimate for 2002-03 and the forward years?

Mr Gallagher—Essentially, looking at a number of sources in terms of what total contributions may be, I took the view that the best estimate that I could come to was \$24 billion. That would mean that a one per cent reduction in that would be \$240 million, and a two per cent reduction would be \$480 million.

Senator SHERRY—Sorry, \$24 billion?

Mr Gallagher—\$24 billion in taxable contributions. This would be in the context of attempting to vary contributions only. You would think if you went to a system in which earnings were more heavily taxed that contributions that as many deductions as possible would be claimed against the more highly taxed source of revenue. That is the order of magnitude that I could see.

Senator SHERRY—So the figure the Prime Minister gave was wrong?

Mr Gallagher—It was an underestimate.

Senator Minchin—It was conservative.

Mr G. Smith—It was a conservative preliminary estimate.

Senator SHERRY—Was it a preliminary estimate?

Mr G. Smith—That is how he described it.

Senator Minchin—The cost of your policies were even worse than he thought. That is the position.

Senator SHERRY—We will get to that.

Mr Gallagher—Similarly, when the \$480 million was advised, it was stressed to be a preliminary estimate and it was stressed that there had been no revenue timing, because at that stage we had no timing details on any proposed reduction in policy—but we are looking at the two per cent issue.

Senator SHERRY—We will get to that shortly. In your calculations for contributions tax, did you take into account a reduction in contributions tax leading to a higher revenue from fund earnings? Obviously, there is more money in the fund as a result of a contributions tax and, therefore, higher fund earnings that accrue from the contributions tax.

Mr Gallagher—No, we did not. That is a second order issue. In terms of immediate impact, it would not have an immediate impact. It has an impact eventually.

Senator SHERRY—But it has an impact in subsequent years, doesn't it?

Mr Gallagher—There would be an impact in subsequent years.

Senator SHERRY—Because there are more moneys in the fund because there is less contributions tax, there is more revenue received by the higher fund earners.

Mr Gallagher—If we were doing a longer term costing.

Senator SHERRY—That is logical, isn't it?

Mr Gallagher—Yes.

Senator SHERRY—But you did not take that into account?

Mr Gallagher—No.

Senator SHERRY—The second issue that I wonder whether you took into account relates to the contributions tax from defined benefit funds.

Mr Gallagher—That would be included in the estimate of total taxable contributions.

Senator SHERRY—Why didn't you take that figure out?

Mr Gallagher—There is always an issue about whether or not defined benefit funds are on contributions holidays.

Senator SHERRY—That is one issue. They may not be.

Mr Gallagher—That would be an issue. In this context, the reason I did not make an adjustment for that reason was that earnings at the moment are low and, therefore, it did not seem to me that there would be many defined benefit funds on contributions holidays.

Senator SHERRY—If they are paying contributions tax on a defined benefit fund, it is not the member who benefits from a reduction in that case, unless the trust deed has a provision for a higher benefit which takes into account some sort of tax reduction? There are very few funds, if any, that I know of that have that provision, aren't there?

Mr Gallagher—I would not expect that there would be many funds which would have that provision.

Senator SHERRY—You have not taken out a contributions tax reduction in a defined benefit fund; you have not been able to estimate what that impact would be?

Mr Gallagher—No, I think that there are particular issues for us in estimating defined benefit fund revenue. We were looking at the contributions as a whole in order to get a handle on what the relevant number would be.

Senator SHERRY—You have done a lot work so far. Are you able to calculate contributions tax from defined benefit funds?

Mr Gallagher—RIM group will provide an estimate. I am not sure how accurate that estimate will be, and I think we would need to fully benchmark it. It is also a somewhat volatile issue, unlike surchargeable contributions which are more constant from defined benefit funds because of the nature of their calculation.

Senator SHERRY—The exclusion of contributions tax from defined benefit funds would obviously have an impact on the total contributions tax reduction, wouldn't it?

Mr Gallagher—Yes, but it is not clear to me why then they would not be taxable contributions if it were a tax fund.

Senator SHERRY—Isn't it true—we have already touched on this—that a contributions tax reduction on a defined benefit fund does not benefit the members? The employer is paying the defined contribution.

Mr Gallagher—Yes, but it is not an issue. Here we are not doing an estimate in relation to the surcharge and therefore the benefit which accrues to an individual. We are looking at the issue from the point of view of the fund.

Senator SHERRY—But why would a contributions tax reduction for the benefit of a member include a defined benefit fund, where there is no benefit to the member?

Mr Gallagher—That is going to the issue of how a tax is administered in some detail, I think.

Senator SHERRY—It is an important part of it, isn't it? Contributions taxes from defined benefit funds—

Mr Gallagher—It would certainly be an issue that one would consider in developing a more detailed policy.

Senator SHERRY—You have not considered that in calculating the contributions tax reduction in respect of a reduction that directly benefits the members? You have not included that factor, have you?

Mr Gallagher—No.

Senator SHERRY—You said earlier that you had come to a view on Friday, 17 May. Why did you start attempting to calculate the contributions tax before that? You said it was a result of the budget.

Mr Gallagher—You asked me when we looked at it. It was after the budget—17 May was after the budget.

Senator SHERRY—On what day did you start to make these calculations?

Mr Gallagher—I began thinking about how I would do it on, I think, the evening of 16 May.

Senator SHERRY—You began thinking about it on the evening of 16 May—

Mr Gallagher—Yes. I heard Simon Crean make a speech.

Senator SHERRY—and you came up with a figure on 17 May.

Mr Gallagher—An untimed, full accrual estimate.

Senator SHERRY—What about a cash number?

Mr Gallagher—It is not a cash number, inasmuch as we were not working with any timing.

Senator SHERRY—So, effectively, the same or very close together?

Mr G. Smith—No, that is not the correct interpretation. Effectively, what was done was to estimate the impact on an accrual tax measure, but no attempt was made to estimate the cash flow.

Senator SHERRY—Have you got a cash figure today?

Mr G. Smith—It does not sound as if we have a clear policy. We would need a very clear policy before you could estimate the cash effects. You would need a precise commencement date.

Senator SHERRY—I am asking if we have got a cash figure. We know you have done it on an accrual basis. What about the cash figure?

Mr Gallagher—Accruals for revenue were done in the budget papers on a tax liability method, and on that basis we have subsequently looked at it. A tax liability method will be closer to cash than a full accruals number, because full accruals will look at the proposed timing of the actual underlying transaction rather than when assessment of revenue is made, which a tax liability method will do.

Senator SHERRY—But you have not got a figure in that area yet?

Mr Gallagher—We have subsequently advanced our estimates, because on 20 May I received the attachment to your press release, which I had not seen before. That meant that I then knew—

Senator SHERRY—That press release was released on the evening of 16 May, wasn't it?

Mr Gallagher—Yes. The unfortunate thing, Senator, was that the attachment was not on the web site and was really not heralded in the body of the press release itself, so I did not understand the timing of the ALP proposal at that stage.

Senator SHERRY—We will get to the timing issue in a minute. With regard to the contributions tax calculation on an accruals basis but not a cash basis, I referred earlier to the Prime Minister as giving a figure of \$350 million. Was that your preliminary estimate that he was working on?

Mr Gallagher—I think that number corresponded to the view that the policy was a 1½ percentage point reduction in the tax rate, rather than a two per cent. Therefore, it is equivalent to about \$360 million.

Senator SHERRY—Where on earth would you get a 1½ per cent—

Mr Gallagher—I think it was summarised that way in the ABC news bulletin on that night.

Senator SHERRY—Did you give the Prime Minister a figure of 1½ per cent?

Mr Gallagher—I did not give the Prime Minister any numbers.

Senator SHERRY—Did you come up with a figure of 1½ per cent based on the ABC news bulletin? Is that where the \$350 million came from?

Mr Gallagher—I think there were original estimates done of that order of magnitude.

Senator SHERRY—So there were original estimates done of \$350 million?

Mr Gallagher—Yes.

Senator SHERRY—Based on a two per cent reduction, not a 1½ per cent reduction?

Mr Gallagher—No—

Mr G. Smith—I was associated with the figure of \$350 million. We were asked for an order of magnitude and I selected \$350 million as a reasonable order of magnitude.

Senator SHERRY—How did you select it?

Mr G. Smith—I consulted with Mr Gallagher; I spoke to Mr Brake; we formed a view about what would be an order of magnitude—

Senator SHERRY—So your order of magnitude was \$350 million?

Mr G. Smith—and then the next day Mr Gallagher produced a more complete estimate.

Mr Gallagher—The next day I had access to far more data in order to form a view.

Mr G. Smith—As well as the press release. But we did not have the attachment to the press release.

Senator SHERRY—That deals with the issue of timing and cost offsets, which we will come to. Did you consult with any of the organisations that we were talking about earlier which have given estimates of contributions tax collected on superannuation?

Mr Gallagher—No.

Senator SHERRY—We had a discussion about this earlier. ASFA is one organisation; are you aware of their research in this area? This is considered research over a long period of time.

Mr Gallagher—There have been a variety of estimates which have come from ASFA in terms of—

Senator SHERRY—But we have had Mr Smith, in consultation with you, coming up with a figure of \$350 million, and you then revising the figure the next day. The ASFA Research Centre have published a paper on the taxation on superannuation. Their estimate for contributions tax and surcharge in the year 2002-03 is \$3.06 billion, which includes—as we subsequently find out, because it is now published—\$600 million in surcharge. Therefore, the contributions tax estimate is \$2.46 billion. Does that figure surprise you, Mr Gallagher?

Mr G. Smith—Does that include life offices?

Senator SHERRY—Yes, it does.

Mr Gallagher—My view is that the ASFA number has been low and it is only recent numbers which have come closer to what I would regard—

Senator SHERRY—I have some other examples, which I will come to. Anyway, they gave the figure at \$2.46 billion in 2002-03. This is the ASFA Research Centre. I assume you are aware of the ASFA Research Centre—the superannuation fund centre?

Mr Gallagher—Yes.

Senator SHERRY—They do a lot of considered research over a long period of time, and you come up with a figure in one day that differs from theirs.

Mr Gallagher—I checked a variety of sources and made a judgment on what the likely scale of the number would be.

Senator SHERRY—Yes, but your preliminary judgment—or at least Mr Smith's—was wrong, on your subsequent rechecking.

Mr Gallagher—One of the things that occurred was that I rechecked the scale of the number from the surcharge data, which meant that I had a basis for moving forward with an estimate.

Senator SHERRY—And you came to a conclusion early that afternoon? Do you recall when it was?

Mr Gallagher—I think it would have probably been in the morning.

Senator SHERRY—So we had the PM giving a figure of \$350 million based on Mr Smith's figure, and apparently in consultation with you.

Mr Gallagher—These were preliminary numbers.

Senator SHERRY—A preliminary figure of \$350 million, which you subsequently revised upwards late in the morning of the next day after carrying out a range of consultations. Have you, since that time, had any contact with the ASFA Research Centre on this issue?

Mr Gallagher—Not that I am aware of, no. I cannot recall any contact on this issue.

Senator SHERRY—Does it surprise you that Alan Mitchell, the economics editor of the *Financial Review*, said on 7 November 2001 in reference to the years 2001-02 that the government:

... could, for example, have abolished the 15 per cent tax on superannuation contributions. That would have cut the Government's cash surplus by about \$2.5 billion ...

Does that surprise you?

Mr Gallagher—I think economic editors write what economic editors write. It does not surprise me that they write it; it just surprises me that he would have a reasonable basis for estimating it.

Senator SHERRY—It bears a reasonable similarity to the ASFA estimate, doesn't it?

Mr Gallagher—Yes.

Senator SHERRY—Thank you. The Australian Institute of Superannuation Trustees, in their submission to the Senate Select Committee on Superannuation dated 24 April 2002, state:

AIST proposes that the 15% tax on contributions be phased out.

They continue:

The annual "cost" to revenue, approximately \$2.1 billion (if implemented in 2001/2002) ...

Mr Gallagher—Yes, I have read those estimates. I consider them to be low.

Senator SHERRY—The Australian Bankers Association, in their submission to the Senate select committee in May 2002, state:

... the Retirement Futures Forum ... estimated the short-term Budget cost of removing the 15 per cent contributions tax at approximately \$2.5 billion p.a. ...

Mr Gallagher—It seems to me that this is the ASFA number doing the rounds again. It seems to be a fairly common number that they are using as a source.

Senator SHERRY—They do not attribute a source.

Mr Gallagher—They do not attribute it, but the Retirement Futures Forum was a group of well-respected people brought together by ASFA.

Senator SHERRY—Do you know if that is the case with the Australian Institute of Superannuation Trustees or Alan Mitchell, the economics editor of the *Financial Review*?

Mr Gallagher—It appears that Alan Mitchell's estimate of \$2.5 billion is remarkably similar to the ASFA number. I do not know the source of the Australian Institute of Superannuation Trustees' number.

Senator SHERRY—No, it is not apparent from their submission.

Mr Gallagher—It is not apparent. One of the issues which continues to lead to underestimation in this area is the fact that the superannuation tax revenue collected from the statutory funds of life insurance revenue is not separately reported in the budget papers. It is collected as company tax.

Senator SHERRY—Have you read the ASFA research paper in this area?

Mr Gallagher—I have read a lot of ASFA research papers. I am not sure exactly which ones.

Senator SHERRY—This is a particular issue of the moment. You have not gone back and re-read the issues?

Mr Gallagher—The most recent paper I have read was ASFA endorsing a paper that came originally, I think, from Phillips Fox Actuaries. That was interesting, because they had tried to allow for the life insurance company issue in doing their estimates. What they had not allowed for in doing their estimates was that there was a bring-forward of tax revenue by the pay-as-you-go system; so they had not allowed for the timing in revenue such that, in actual fact, for super funds, there has been a decrease in taxation received because of timing effects in the revenue.

Senator SHERRY—ASFA, in carrying out its research, would consult with the superannuation funds which pay the tax, wouldn't they? That is their constituency.

Mr Gallagher—It may be with those that respond, but we have seen that they have had poor response rates to a number of their surveys.

Senator SHERRY—Do you know if they had a poor response rate to this?

Mr Gallagher—No, I do not. The one that springs to mind, where there is published evidence, is the one on superannuation fees and charges. They had a 2½ per cent response rate from small super funds and they multiplied it by 40 to get an estimate.

Senator SHERRY—But fees and charges are a very different issue from tax, aren't they?

Mr Gallagher—No, but they are related issues.

Senator SHERRY—They are a very different issue, aren't they?

Mr Gallagher—You are asking me about ASFA survey processes and that one springs to mind.

Senator SHERRY—Yes, but the issue of fees and charges is a sensitive issue for funds in terms of declaration—

Mr Gallagher—As is the issue of tax, which is why, in doing a survey of funds, you would be careful about your response rates.

Senator SHERRY—I had not concluded my question. The issue of tax is certainly a sensitive issue for superannuation funds and, if anything, you would expect them to be very open and forthcoming in the tax impact on the superannuation funds, wouldn't you? It is a different issue. The superannuation industry, or elements of it, has pursued an issue of the tax on superannuation for some time. You certainly would be aware of that, wouldn't you? If anything they would be inclined to overinflate the taxation, wouldn't they?

Mr Gallagher—I do not see why they would. If they are proposing a measure, it is in their interests that it costs less not more.

Senator SHERRY—But they are continually highlighting the problem of the taxation of superannuation, aren't they?

Mr Gallagher—And they are often using arguments about hypothetical individuals to advance that. They are not doing an aggregate projection analysis when they make those claims.

Senator SHERRY—You carried out your consultations on the morning of the 17th. You were giving us an outline of your consultations. Is there anyone else you want to add to the other individuals or any other source of the information that you want to put on the record?

Mr Gallagher—No. I had a look at the sources available to me at the time for a preliminary estimate.

Senator SHERRY—I thought you already had the preliminary estimate.

Mr Gallagher—No, I think the \$480 million estimate was also a preliminary estimate. I think the Treasurer's press release said that.

Senator SHERRY—So that is a preliminary estimate. Have you come to a final estimate? We have had two preliminary estimates—

Mr Gallagher—I do not think we have reached a final estimate.

Senator SHERRY—Here we are two weeks later and you have not reached a final estimate. Do you think you will ever be able to do that?

Mr Gallagher—I am sure that if we were asked to produce a final estimate we could do so.

Senator SHERRY—You have had two weeks since the two preliminary estimates. Have you got a time frame on the final estimate?

Mr Gallagher—It depends. It can be produced. I think we could get agreement on a fairly solid estimate.

Senator SHERRY—At the moment there have been two preliminary estimates. You are in strong disagreement in terms of the estimate for ASFA. Let us assume that is the source of the others; I do not know whether it is the source of all the other estimates, but certainly that is the published research data. Would you intend to consult with ASFA on their approach to these tax estimates?

Mr Gallagher—I will probably ask Ross Clare what his approach is at a suitable time.

Senator SHERRY—I did refer to Mr Kehl, who worked for Treasury at some time, didn't he? I do not know what division he was in. Do you know Mr Kehl?

Mr Gallagher—I think have met Mr Kehl.

Senator SHERRY—He is now a research officer in the area of tax and superannuation in the Parliamentary Library. Have you seen his published paper on this issue?

Mr Gallagher—I saw a paper a number of years ago from David Kehl.

Senator SHERRY—These are the calculations of Mr Kehl and he is an informed officer formerly working with the department. He gave them at \$3.5 billion, including the surcharge.

Mr Gallagher—For which year?

Senator SHERRY—I think it was for the year 2000-01, but I would have to double-check that. If you take into account the surcharge—and Mr Kehl did his own research through the

parliamentary library—you get a similar figure to the ASFA research figure. It is not identical but similar.

Mr G. Smith—It seems to me it is quite similar to the Treasury figures with \$3 billion excluding the surcharge in 2001?

Senator SHERRY—I will have to check that date.

Mr G. Smith—And our figure is \$3.6 million.

Senator SHERRY—Excluding the surcharge? What year are you talking about?

Mr G. Smith—Ours is two years later and is \$3.6 million, I think. Is that right?

Mr Gallagher—Yes.

Mr G. Smith—So, if we put a growth factor into his \$3 million figure, we would be pretty close to the Treasury figure. We should have a good look at that.

Senator SHERRY—Yes, we should have a good look at it.

Mr Gallagher—You must allow for the fact that there will be a one per cent rise in the SG on 1 July.

Senator SHERRY—I understand that. But there are two factors you have not yet included. We talked about these earlier. One is the factor of the increase in fund earnings as a result of a reduction in the contribution. You have not factored that in. You have not excluded contributions taxed from defined benefit funds either, have you?

Mr Gallagher—No.

Senator SHERRY—That would mean an adjustment to the preliminary figure that you have calculated to date, wouldn't it?

Mr Gallagher—If we included those things. Obviously, we need a very clear policy for defined benefit funds.

Senator SHERRY—The policy is clearly, in terms of contributions taxes, to benefit the members, isn't it? The contributions tax reduction is to benefit the members.

Mr Gallagher—But as the tax office has explained, the contributions tax is levied at the level of the fund and not at the level of the member.

Senator SHERRY—I understand that, but the nature of the contributions tax and its application to defined benefit fund means any reduction does not benefit the member unless the trustee provides for any tax reduction to be passed on to the member via a higher benefit. So it does not assist the member, does it?

Mr G. Smith—But is that the policy? Is it to exclude defined benefits?

Senator SHERRY—The policy is that benefit through a tax reduction is for the member of the fund—the individual, not the employer—in terms of the tax reduction.

Mr G. Smith—But is the plan to achieve that by requiring that the tax saving be passed to the members?

Senator SHERRY—But the point in a defined benefit fund is that there is no pass on unless the trustees change the benefit level for the member because of a tax reduction because the cost is lower. I certainly do not know—Mr Gallagher may be aware of a fund that has that particular provision in it.

Mr G. Smith—It would probably vary from case to case.

Senator SHERRY—I think it would be extremely rare that there would be such a defined benefit fund.

Mr G. Smith—And you were not going to legislate to provide for that?

Senator SHERRY—We are not in government so we are not legislating.

Mr G. Smith—I think that illustrates the point that the policy has to be clear before we could—

Senator SHERRY—I think it is clear.

Mr G. Smith—What you are saying is that you want us to work on an analysis which excludes defined benefit funds from the measure.

Senator SHERRY—Correct, in terms of the contributions tax. I would think that is obvious because the stated position is to benefit the member of the fund, not the employer. That apparently has not been included in the calculations.

Mr Gallagher—I think that, if the defined benefit funds are excluded from the measure, there would be changes in the preliminary costing. There would be issues of interpretation and precise details about exactly what a defined benefit fund was in terms of the application.

Senator SHERRY—I think that is certainly right. But as a general practice there would be very few defined benefit superannuation funds where a contribution tax reduction is passed on to the member. That is right, isn't it?

Mr Gallagher—I imagine that is the case.

Senator SHERRY—The intention of a policy to reduce contributions tax is to benefit the member, isn't it?

Mr Gallagher—Yes. On a related issue, for members of unfunded defined benefit schemes, the issue did arise as to whether there would be an adjustment in the ETP taxation rate which was equivalent to the reduction. There are parallel issues for ETP taxation for unfunded defined benefit schemes. But I suppose if you exclude them, there would not be such an issue.

Senator SHERRY—Yes, that is right.

Mr G. Smith—So it is an explicit exclusion. That is information that we had not assumed.

Senator SHERRY—But it is an issue that you had not factored in.

Mr G. Smith—No. I do not believe that it was said in the press release that explicitly.

Senator SHERRY—The press release is very clear about benefiting the member.

Mr G. Smith—There is more than one way to do it. Maybe you want to benefit the members so that—

Senator SHERRY—It is very clear: a tax reduction on contributions, as stated by the Labor Party, is to benefit the member—no-one else. I would have thought that that is pretty obvious, but apparently it is not to you. It is not included, so you need to rectify the figures. Going back to the issue of a time line, are you able to give us a time line for your final calculation, Mr Gallagher, having given us the two preliminary estimates?

Mr Gallagher—It all depends if I am asked to finalise a costing.

Senator SHERRY—The Senate estimates committee is asking you to finalise the costing.

Mr Gallagher—I will take that on notice.

Senator SHERRY—I am a bit concerned about things being taken on notice because on the last occasion when I asked this question of the tax office, who actually collect the tax, they said they could not calculate it. I took the tax office on their word—and I am not criticising the tax office—because I believe that they quite genuinely could not calculate this, and they are collecting the tax from superannuation. They have the contact with the superannuation funds, they follow up any tax queries in respect of tax paid by superannuation funds, and they could not tell us a figure.

Mr G. Smith—I think we clarified that earlier, Senator, in that that was being interpreted as the production of an actual figure out of the historical data series, whereas this is an estimation process.

Senator SHERRY—I put this to Mr Carmody: do you think it is reasonable to pose a question to the tax office about the issue of the contributions tax? Do you think that you are a reasonable source to request that information from? Whether you can give it or not, do you think that is a reasonable source to get the information from?

Mr Carmody—I think what we will point out here is that the tax office was looking back at actuals.

Senator SHERRY—At a historical figure.

Mr Carmody—Yes. If you were looking at estimates, it would be more common for the Treasury to provide that estimate.

Senator SHERRY—But working out the ratio of contributions tax as distinct from other taxes on superannuation funds on a historical basis—if you had in fact done that, Mr Bator, which you have not, because you say you cannot do it—still gives a historical proportion based on facts of a contributions tax level vis-a-vis other taxes on superannuation, doesn't it?

Mr Bator—I guess the problem we were facing was that there is no such thing as a contributions tax and there is no such thing as an earnings tax. There is a 15 per cent tax on the earnings of a superannuation fund.

Senator SHERRY—That is what is on every member's statement, isn't it?

Mr Bator—I understand this break-up between earnings and the contribution made, because people talk to me about it all the time—but then there is the correct apportionment of the data coming through to us and all the information on other expenses. I could have said, 'The contributions look to be \$23 billion'—or the number that was quoted there—and said what the earnings were and provided the expenses, and maybe you could have made an estimate on that.

Senator SHERRY—The 15 per cent contributions tax is there on the fund statement that members get every six months or every year, is it not?

Mr Bator—Yes.

Senator SHERRY—It is usually on the fund statement. I have not seen a funds statement that it is not on.

Mr Bator—They normally charge 15 per cent, but they actually only pay an effective rate of seven or eight per cent.

Senator SHERRY—I understand the effective rate; I do not think a lot of the members do, but they certainly see that 15 per cent on their fund statement.

Mr Bator—Yes.

Senator SHERRY—Can you in the tax office at least make an attempt at an estimate? You deal with these funds much more than Mr Gallagher does in any direct way; you collect the tax.

Mr Bator—It is not an unreasonable question that you ask, and it was not unreasonable the last time you asked it. I had people looking at it, but even yesterday they were scratching their heads and saying, ‘There is a whole lot of numbers I can give you. What would you like me to say was the life offices and the other schemes that are not reporting there, which are large?’ We then started to look at the surcharge information; it was getting us into another mire of additional information. Ultimately, I can keep doing it—it is probably reasonable that the tax office should know—but I would want to continue working with Treasury and our revenue analysis branch, and I would have to qualify it endlessly. Whether we want to get additional information from the funds, which is a cost to them, I am not sure—

Senator SHERRY—I understand that you have to qualify it. I think you know me by now; I am not going to say, ‘Provide it to the nearest million dollars.’ You make your best effort. Apparently, Mr Gallagher has derived some data from you with respect to surcharge information, for example.

Mr Bator—Yes. I will continue working on it with Mr Gallagher.

Senator SHERRY—I am glad about that, because otherwise I would be a bit worried. You are collecting the tax at the tax office, you are in communication with the funds and you query it if there is a particular problem. Yet you cannot come up with a figure. I know it is difficult. Mr Gallagher has come up with two preliminary figures, but there is significant variance in the two preliminary figures, so we are trying to find an accurate figure. There are two factors that Mr Gallagher did not take into account, which he is now aware of. We have a billion dollar tax—whatever the exact figure may be—but we cannot get a final figure.

Mr Bator—I will continue working on it.

Senator SHERRY—That would be appreciated; we might get a final figure at some point in time. Since the response I received on notice, Mr Gallagher, Mr Smith or Mr Carmody, are you aware of the number of questions that I have put on notice about tax revenue and estimates of tax—including this issue, I might say—with respect to superannuation?

Mr Bator—I saw some final information yesterday. Are those recent ones that you refer to?

Senator SHERRY—Yes.

Mr Bator—We are working on those, and some have been prepared.

Senator SHERRY—I am not going to criticise you for not having a response today, but many of them relate to issues that I have raised on previous occasions, including the contributions tax levels, which we had a discussion about in the past. Mr Gallagher, you have indicated that you have done a second preliminary calculation of the opposition’s superannuation policy. Where are the cash savings from the proposal not to pass the government’s restructuring of public sector superannuation? Why are they not in the costings?

Mr Gallagher—I was not aware of that at the time. As I said, on 17 May I had not seen the attachment to your press release and I think that was the day on which there was another press release on these issues.

Senator SHERRY—Which other press release?

Mr Gallagher—I think there was a Simon Crean press release in the afternoon of 17 May. I certainly could not have been aware of that at the time, because I was not aware of that until the following Monday.

Senator SHERRY—Okay. Now that you are aware of that—and I think you should have been at the time, but you apparently were not aware of that—do you have the figures for the cash savings if the reform to the Commonwealth superannuation fund is not passed by the parliament?

Mr Gallagher—I checked the estimates against those published in the Charter of Budget Honesty costings by the department of finance.

Senator SHERRY—What were the figures?

Mr Gallagher—Those figures stood up. The Charter of Budget Honesty costings did not give you the 2005-06 estimate. I think you or someone subsequently asked—

Senator SHERRY—I asked for it.

Mr Gallagher—They gave a number for 2005-06, which was higher than the number you originally assumed.

Senator SHERRY—We had actually been conservative, hadn't we?

Mr Gallagher—Yes.

Senator SHERRY—In fact, the figure they gave was \$300 million, which was some \$40 million higher in terms of savings. Is that correct?

Mr Gallagher—Yes.

Senator SHERRY—That had not been factored in on Friday, 17 May, had it?

Mr Gallagher—No, not on Friday morning and certainly not on Friday afternoon. I did not know about that.

Senator SHERRY—I have not seen any subsequent data that has been factored in at all and here we are two weeks later. Where is it?

Mr G. Smith—We are not publishing—

Senator SHERRY—I accept that you are not publishing. It is the Treasurer's responsibility to publish, isn't it?

Mr G. Smith—We are asked to provide costings to the government and we provide costings to the government in the normal way. Sometimes we are asked to do them with much shorter time frames than the Charter of Budget Honesty time frames and when we do that we sometimes say, 'With this time frame we can only provide a preliminary figure.' That is what has happened here.

Senator SHERRY—We got two preliminary figures—

Mr G. Smith—The first one was an order of magnitude to give them an idea of the figure on the night.

Senator SHERRY—An order of magnitude is different from a preliminary figure.

Mr G. Smith—I think so.

Senator SHERRY—We have moved on to an order of magnitude. It is an interesting distinction.

Mr G. Smith—It is interesting how close they are in some ways.

Senator SHERRY—So you got those figures in respect of the public sector superannuation. Did you pass them on to the Treasury's office?

Mr Gallagher—Yes. Although they would have already had them at that point because they were included in the press release of 17 May.

Senator SHERRY—How? I have my copy here.

Mr Gallagher—Isn't there an attachment where you outlined—

Senator SHERRY—Are you referring to my press release? I thought you were referring to the Treasurer's press release.

Mr Gallagher—No, it is not in the Treasurer's press release.

Senator SHERRY—They are not there at all, are they? There is some \$740 million in savings over three years, which is not in the press release.

Mr Gallagher—That is only in cash terms, not in accrual terms. The department of finance made it clear in their Charter of Budget Honesty costings that in accrual terms all that is happening is that money from the future, which would have been paid, is being moved forward in the costings. So in their Charter of Budget Honesty costings they said, 'In accrual, there is no saving; however, if the measure is not proceeded with, in cash terms there may be a saving.'

Senator SHERRY—So in cash terms, at least on this occasion, the press release prefers to use accrual rather than cash. That is the call of the Treasurer's office, isn't it?

Mr Gallagher—I do not think that the Treasurer was particularly referring to that issue at all in his press release.

Senator SHERRY—I look at the press release and on the top it has 'Preliminary accrual'.

Mr Gallagher—Yes.

Senator SHERRY—That is the call of the Treasurer's office, isn't it? It is not your call. But did you pass the cash figures on in respect of the public sector savings on that day?

Mr Gallagher—No.

Senator SHERRY—Have you subsequently passed them on?

Mr Gallagher—I have let the Treasurer's office know that I have confirmed the numbers with the department of finance.

Senator SHERRY—It is not your responsibility to issue a clarifying press release, is it?

Mr Gallagher—No.

Senator SHERRY—That is for the Treasurer's office. In relation to the timing of the phase down over the same three years as the proposed phase down of the surcharge tax, have you since carried out new figures based on that phase down?

Mr Gallagher—I have given preliminary estimates based on the phase down, yes.

Senator SHERRY—And you have passed them on to the Treasurer's office?

Mr Gallagher—I have passed them to the Treasurer's office.

Senator SHERRY—When did you pass them on, approximately?

Mr Gallagher—It was sometime in the next week.

Senator SHERRY—So, it was last week sometime or the week before.

Mr Gallagher—Yes.

Senator SHERRY—Some time ago. I have not sighted a clarifying press release from the Treasurer on that matter, have you?

Mr Gallagher—I have not sighted a clarifying press release. I sighted a subsequent press release from the Treasurer on that issue.

Senator SHERRY—We have sighted one press release on Friday, 17 May, which does not have the phase down over the three years—because it is a phase down—and it does not make it clear that you have done two preliminary estimates and you have not got a final estimate. It does not make any of those things clear.

Mr Gallagher—It is very clear that it is preliminary. It makes it very clear that the numbers in the press release are done on a different basis. It makes it very clear that there are no timing effects in the reduction in the contributions tax but there are timing effects as per the budget in the surcharge estimates.

Senator SHERRY—It is interesting because it does say as a footnote:

Adjusting for timing effects would result in the movement of revenue gains or losses from 2002-03 ...

So it acknowledges the issue of an adjustment for timing effects but does not include it.

Mr Gallagher—As I said, I was not aware of the timing of the proposed policy until 20 May.

Senator SHERRY—So why would there be a reference to adjusting for timing effects?

Mr Gallagher—Because it was very clear that the budget number did have timing effects and that the preliminary full accrual revenue number did not have timing effects in it.

Senator SHERRY—The earlier quote from the Prime Minister said:

... you save about \$50 million dollars a year out of the surcharge, if you knock that back. But I'm told that it's about seven times more than that, about \$350 million ...

Can anyone confirm for me whether the reduction in the surcharge as proposed by the government is \$50 million a year?

Mr Gallagher—It is obviously built up over time and the surcharge costing in the budget papers increases because, as I said, it is a time costing and includes aspects of revenue timing inside that costing.

Senator SHERRY—It is not \$50 million a year, is it? Look at page 1-25—

Mr Gallagher—In the first year affected, that was the estimate.

Senator SHERRY—Ah, the first year effect. But it is not an ongoing \$50 million, is it?

Mr Gallagher—It increases—

Senator SHERRY—Yes, that is right.

Mr Gallagher—as the phase out increases.

Senator SHERRY—That is interesting, isn't it? It starts at \$50 million in the first year—I am looking at page 1-25 of the budget paper—increases to \$120 million in 2004-05 and to \$200 million in 2005-06. That is the correct figure, isn't it?

Mr Gallagher—The numbers produced in the budget papers are correct.

Senator SHERRY—Yes, I have just read it out from the Budget Paper No. 1, page 1-25. You did not advise the Prime Minister's office, I hope, that the cost of it was \$50 million a year.

Mr G. Smith—We did not advise the Prime Minister's office directly at all. We provided that figure to the Treasurer's office on the evening of the 350. That was the only thing we were asked to do.

Senator SHERRY—Not the \$50 million though.

Mr G. Smith—We did not address that issue at all.

Senator SHERRY—So you had no involvement.

Mr G. Smith—It had nothing to do with the Prime Minister.

Senator SHERRY—Did you have anything to do with the Treasurer quoting the figure of \$50 million? Or again, was that just—

Mr G. Smith—I do not even know if he did.

Senator SHERRY—He did.

Mr G. Smith—As I say, I am not familiar with that. The only thing that I am personally familiar with is that, on the evening of the 16th, in order to get a very quick understanding of the sorts of costs of a 13 per cent contributions tax, we gave an order of magnitude figure of 350 and said that we would have to do the costing later on.

Senator SHERRY—That was the Prime Minister's call.

Mr G. Smith—I am surmising, by the way, that that is the source of the 350; I do not know that. It sounds pretty familiar.

Senator SHERRY—You gave advice; the figure is quoted. I think it is a reasonable assumption.

Mr G. Smith—I think it is a reasonable assumption, yes.

Senator SHERRY—But, in the case of the Prime Minister stating that it was \$50 million a year for the surcharge reduction, you did not give any figure to the Prime Minister.

Mr G. Smith—He was obviously quoting the first-year cost.

Senator SHERRY—That is not apparent from the public record, is it?

Mr G. Smith—I have not seen the public record.

Senator SHERRY—I will read it out. Do you want a copy of it?

Mr G. Smith—I would not take anything from it, because you would have to understand the context of it, and I am not familiar with that. Nor can I comment on the Prime Minister's comments; I would not add to those. But that is obviously the first—

Senator SHERRY—What I find interesting about your explanation, Mr Smith, is that you have talked about preliminary advice that you gave about the \$350 million on the—

Mr G. Smith—On the evening of the 16th.

Senator SHERRY—But the Prime Minister says:

Now on my preliminary advice that is not so, you save about \$50 million dollars a year out of the surcharge, if you knock that back. But I'm told that it's about seven times more than that, about \$350 million in order to fund a cut of 2% in the contributions tax.

So you maintain that the figures you gave only related to the preliminary estimate on the reduction in the contributions tax.

Mr G. Smith—That evening, as I say, I had no contact with the Prime Minister, his office or his department—just basically provided a \$350 million figure. The only information that I had was, in fact, that there was a proposal to cut the contributions tax two per cent.

Senator SHERRY—So you did not give information about the cost of the surcharge tax reduction?

Mr G. Smith—It was not an issue that was raised with me. But that was a published figure; the government has published that figure in the budget.

Senator SHERRY—‘First year’, not ‘a year’. There is a big difference.

Mr G. Smith—But each year is published, I think, in the budget papers.

Senator SHERRY—It is not \$50 million ‘a year’, is it?

Mr G. Smith—It was \$50 million in the first year.

Senator SHERRY—Correct; but it is not \$50 million ‘a year’. There is a big difference.

Mr G. Smith—The figures for each year are provided in the budget papers, and so they have been on the public record since 14 May.

Senator SHERRY—They are on the public record. But the Prime Minister used \$50 million ‘a year’—not ‘the first year’—rising to \$200 million ‘a year’ in the third year. There is a big difference.

Mr G. Smith—The figures are as published in the budget.

Senator SHERRY—Exactly.

Mr G. Smith—I am sure that was the context of his remarks.

Senator SHERRY—While I am on the tax figures and with respect to superannuation, it was pleasing to note the separation of the surcharge collection tax figures in the forward estimates. What was the catalyst for publishing those figures separately in the budget papers on this occasion? We have had the historical figures in the past, but we now have forward estimates for the first time.

Mr Bator—I think it was just to reflect the impact of the reduction of the surcharge rate over time. I think that is why it was in the budget papers: it reflects that reduction.

Senator SHERRY—But you have the separate surcharge figure that is collected. For the first time, it is clearly identified in the forward estimates. That is the first occasion that has happened, isn't it?

Mr Bator—I think it was in there also in 1996.

Senator SHERRY—In the forward estimates?

Mr Bator—In 1996 it had the figures from the surcharge.

Senator SHERRY—For 1996, yes, but it disappeared the following year, didn't it?

Mr Bator—Probably. I think it did.

Senator SHERRY—It got subsumed in this total tax collection figure for superannuation taxes.

Mr Bator—And as you said, it is a tax.

Senator SHERRY—We know what a tax is, I think. We wore that argument out long ago. On the issue of the surcharge tax figure and the projections, the government's proposed reduction of the surcharge is approximately 30 per cent over three years. Is the revenue reduction that is projected for 2003-04 through to 2005-06 a 30 per cent reduction?

Mr Gallagher—I do not think full timing would have fed through the estimates by that stage.

Senator SHERRY—Not even by 2005-06?

Mr Gallagher—No.

Senator SHERRY—Would it be the following year?

Mr Gallagher—Yes.

Senator SHERRY—There would be some growth in the surcharge tax collection, wouldn't there?

Mr Bator—We are seeing growth every year.

Senator SHERRY—Is there still some growth occurring despite the tax reduction and the 30 per cent rate?

Mr Bator—There is an increase, over time, in the number of people who are being surcharged.

Senator SHERRY—Salary increases are indexed, aren't they? Would that impact on it at all?

Mr Bator—We are seeing an increase, from year to year, in the number of people who are surcharged. Obviously that is to do with an increase in incomes.

Senator SHERRY—Coming back to my original question, what was the rationale for publishing the figure for the first time?

Mr Bator—I think that would be a Treasury document.

Mr G. Smith—It has been published in the commissioner's annual report and basically it is just an addition to the information now also published in the budget.

Senator SHERRY—Other than the 1996 budget papers, why has it been separated out in these papers?

Mr G. Smith—I think in 1996 it might have been the measures. When we introduced a new measure we would have put in all of the out years. It has not been done until now but it is available for us to do it. The figures have been published in the annual report, looking back.

Senator SHERRY—Those are historical figures. We could never get an estimate.

Mr Gallagher—As numbers go, it is a reasonably firm number. It is a number that is calculated.

Senator SHERRY—I am not questioning that.

Mr G. Smith—It makes sense, particularly in the context of a policy change in the budget, to put the aggregates in going forward.

Senator SHERRY—I thought that might be the reason.

Mr G. Smith—It is more complete disclosure.

Senator SHERRY—Why didn't we have more complete disclosure after 1996?

Mr G. Smith—You could break these numbers up in all sorts of ways, I imagine.

Senator SHERRY—You have certainly been struggling to break up the contributions tax and earnings, based on the discussion we have had so far.

Mr G. Smith—We have not broken them up either; they are combined. They relate only to super funds, do not forget.

Senator SHERRY—That is right. It does not include the insurance.

Mr G. Smith—It does not have the insurance sector.

Senator SHERRY—I am well aware of that.

Mr G. Smith—We have not broken that out. It takes a lot of work and it costs a lot to produce the budget. It is incredibly hard work, as you probably know.

Senator SHERRY—I understand that but the point that I made is that I have raised this issue about detail on a number of previous occasions. I cannot even begin to calculate the number of occasions, prior to this, I have raised the issue of separating out the surcharge revenue.

Mr G. Smith—We will produce the estimate separately this time.

Senator SHERRY—Will we see an improvement, in future budgets, in the separation in respect of the other taxes on superannuation funds?

Mr G. Smith—I would be surprised if we could get that with the current data. This is the whole point of that earlier discussion. If you have a reliable data source, you can do this. But it is very difficult if the data heads have been amalgamated. It is particularly difficult when the expenses are deducted against an aggregate rather than against separate components.

Senator SHERRY—There is just one other issue on superannuation tax. In Budget Paper No. 1, on page 5-35, under the heading 'Major categories of receipts as a proportion of gross domestic product', the percentage of income tax collected for superannuation funds starts in 1991-92 at 0.3 per cent. It peaks in 1998-99 at 0.7, then drops down to 0.6, then goes up slightly to 0.7, then its down to 0.6 again. Do you have any available projections beyond 2002-03 as a percentage of gross domestic product?

Mr G. Smith—For super funds?

Senator SHERRY—Yes.

Mr G. Smith—I do not have it, but because it is simply a run it would not be hard to calculate, I would think, because we have the forward projections of GDP. We could simply run the forward projection of the revenue head against it. In fact, anyone could do that with a calculator.

Senator SHERRY—Take it on notice if you do not have the figures here now. Isn't it a fact that since 1995-96 super tax as a percentage of gross domestic product has doubled?

Mr G. Smith—That was a low year.

Senator SHERRY—It was 0.3 per cent in 1995-96, then it went up to 0.6 per cent in 2002-03.

Mr G. Smith—It was 0.4 per cent in 1994-95. That probably reflects the vacillation of earnings, I imagine, but I do not know.

Senator SHERRY—I think you are right. I do not know whether that was the only factor, but it certainly would have been a factor.

Mr G. Smith—It was probably a lot of factors.

Mr Carmody—I think there have been variable capital gains tax results through the period, which can have a significant impact on that.

Mr G. Smith—It actually fell that year from the year before, so obviously it was not a good year.

Senator SHERRY—In concluding this area, the tax office will endeavour to identify the contributions tax figures, and, Mr Gallagher, you will endeavour to come up with a final figure?

Mr Gallagher—I am sure we will work together.

Senator SHERRY—Thank you.

Proceedings suspended from 5.08 p.m. to 5.19 p.m.

ACTING CHAIR—It appears to the chair that there is not a lot of difference in terms of the magnitude of the figures that we are talking about. So we are seeking a precision that I am not sure is really attainable. But that is just my rough assessment from looking at it.

Senator SHERRY—I think you are right, Chair. I think you make a useful observation. The bottom line figures look like it is pretty much line ball, but we will continue to refine it for future occasion. I notice in the budget that the ATO is to conduct an education campaign in respect of so-called choice of superannuation. An allocation of \$28.7 million has been made to undertake an extensive community education campaign in relation to so-called choice of super, to inform employees and employers of their rights and obligations in relation to so-called choice of superannuation and to inform superannuation funds and their members about portability of existing superannuation balances. Perhaps I could just deal with this issue of portability of existing superannuation balances for a moment.

ACTING CHAIR—The second question is about a choice. Wouldn't that be more applicable to APRA?

Senator SHERRY—No, this is the ATO's education campaign. There are lots of questions on choice, but I am not going to put them to the tax office.

ACTING CHAIR—I just did not want Mr Bator being required to answer questions outside his jurisdiction, that is all.

Senator SHERRY—I am aware of that, Chair. Mr Bator, just on this portability of existing superannuation balances, my understanding is that in most cases you can consolidate your account and move your superannuation from one account to another. Legally that is allowed, isn't it?

Mr Bator—In many cases you can transfer.

Senator SHERRY—Not all, but in many.

ACTING CHAIR—It sometimes comes at a huge cost.

Senator SHERRY—The chair raises a very valid point. There are some commission fees impediments which effectively are barriers to shifting your money out, if you wanted to, aren't there?

Mr Bator—I understand that is the case, yes.

Senator SHERRY—There are some exit fees in some funds—and I do not know how many, but they certainly do exist.

Mr Bator—Yes, that is right.

Senator SHERRY—But, as a general rule—there are obviously exclusions to this—if a person wants to consolidate in moving employment, they can consolidate their funds, if they wish to, can't they?

Mr Bator—Provided the trust deeds allow for it and the costs, if any, are not inhibitive, yes.

Senator SHERRY—Do you have any figures? My understanding is that the vast majority can do that, if they wish to.

Mr Bator—As I understand it, the vast majority of people are in funds which allow it.

Senator SHERRY—Can you throw any light on why people do not do it? Where you do not have a trust deed that prohibits you from doing that, which are very much a minority, and where you do not have exit fees—and, again, they are very much a minority—why don't people consolidate?

Mr Bator—It was not an area that we had done any research on when we did the initial research on choice of fund. Portability did come up as an issue linked with choice of fund. If you have a choice of fund or are in some way offered a choice of funds, portability becomes an issue if you have more than one fund, and so that came up as an issue. Why people were not currently combining accounts was not an issue that we covered in research. However, when we start to open up some of our systems—such as the lost member register information, and the work we have done with Australian Retirement Funds in respect of the vouchers and the SHAR amounts—we are finding now that people are willing to combine.

As you would probably be aware, funds ranging from BT through NRMA to the industry funds are promoting the fact that they will enable you to combine accounts and reduce your fees and charges. We have not done any specific research on it. I would imagine that as the legislation becomes clearer on how the portability will work, which Mr Smith may or may not want to comment on, we would be going through—

Senator SHERRY—That was the quickest pass of the buck I have seen, and the quickest withdrawal!

Mr Bator—We would be doing research around the sorts of issues that you are talking about.

Senator SHERRY—So, as part of the education program, there will be some research being carried out in this area, amongst others?

Mr Bator—Definitely.

Senator SHERRY—So you are planning to do some research; I assume that this would be contracted to some private consultant.

Mr Bator—Yes, we would no doubt get an external, as we have always done, in terms of our research.

Senator SHERRY—What is your time frame on that?

Mr Bator—On portability, I do not have any time frame but, certainly on choice, given the time frame we have been given for implementation, we would be looking at doing research progressively over the next six months to try to get a better understanding of the issues that are confronting people. As I have mentioned, the previous research gave us fair insight into how people would use the document we had at that stage, which was the key feature statement.

Of course, the [Financial Services Reform Bill 2001](#) now has slightly different requirements of the statement that should be provided to people. We would be carrying out research on that and working with Treasury, who would be facilitating the formation of a community consultative group, which was one of the undertakings we gave for this. We would be progressively working through research, trying to understand the areas where people were likely to have difficulties and to overcome any perceptions or weaknesses that were identified in other jurisdictions.

Senator SHERRY—What is the nature of this community consultative group?

Mr Bator—One of the undertakings that Senator Kemp gave was that we would have a group of people representing various walks of life and different community sectors, who would form the campaign and help through the course of the campaign to see whether it is meeting the needs of the community, whether the messages we are giving out are being heard and being understood and whether people can use the tools available to them for choice of fund and portability.

Senator SHERRY—Have you set a date yet for the commissioning of a consultant?

Mr Bator—No.

Senator SHERRY—In the research, will you be examining the issue of the financial literacy of the general population or the general fund membership?

Mr Bator—The last time we undertook wide ranging research on the key feature statement, it was aimed at whether a group of people selected at random from the community could select a fund based on information before them. At that particular time, of about five different types of key feature statements that we provided to people, most people selected about two of the five as the sorts of funds that they would select, based on the fees, exit and entry, charges, other features that the fund was offering, portability and those sorts of things. I am going from memory here, but there was quite universal recognition of the sorts of things that people needed to look at or be aware of. We are never going to be held to make people financially literate—that is not the purpose of the exercise—so if you are saying—

Senator SHERRY—Financial literacy is certainly a help in making an informed choice, isn't it?

Mr Bator—What we will be trying to do is to allow people to evaluate the tools and make reasonable and informed decisions, but not to say whether or not they could then go out and make a whole range of other—

Senator SHERRY—I do not want to explore this in huge detail. Will the report or research you referred to be released publicly?

Mr Bator—No, but at the time Senator Kemp asked us to do briefings for some of your former advisers.

Senator SHERRY—But it has not been released?

Mr Bator—No.

Senator SHERRY—What is that research known as? What is its title, so as to reference it?

Mr Bator—I cannot remember at the moment.

Senator SHERRY—What was the approximate date?

Mr Bator—It would have been about 1997 or 1998.

Senator SHERRY—Would you take on notice to see whether that could be provided to the committee?

Mr Bator—Yes, I will take that on notice.

Senator SHERRY—There is one issue on this that frightened me. I was at a seminar where the British Consumers Association gave a paper on their experiences about choice in the UK. One of the frightening statistics was that 50 per cent of the people—and they did a representative survey of the British population—did not know what ‘50 per cent’ was. That is a pretty frightening statistic if you think about financial literacy and making informed choices. I do not think, frankly, there is much reason to believe it is different in Australia.

Mr Bator—I will go over and check that out.

Senator SHERRY—I do not know why the minister is laughing, but it is one of the reasons we do not put percentages in press releases. In the campaign—the \$28.7 million—there will be research. Do you have a preliminary budget on the research component of that?

Mr Bator—Yes. We anticipate that research, evaluation and monitoring would be around \$800,000 in 2002-03 and go down to about \$160,000 in 2003-04. These are very preliminary.

Senator SHERRY—I accept the caution that they are preliminary. Do you have any further breakdowns in the other elements of the campaign?

Mr Bator—Yes. These are the general headings: consumer information centre, and we are looking at about \$2 million in 2003-04; research evaluation, and I have indicated that; product generation and placement, and that will be \$2.9 million in 2002-03 and \$580,000 in 2003-04; marketing and education, and that will be \$5,700,000 in 2002-03 and \$1.1 million in 2003-04; and strategic media management, and that will be \$570,000 in 2002-03 and \$114,000 in 2003-04. I can add up, but somebody has just told me that those are old figures so they do not add up to the number. But those are roughly the proportions.

Senator SHERRY—If you look at those figures, we are still considerably short of \$28.7 million.

Mr Bator—These were very preliminary, but indicatively some of them are probably about right.

Senator SHERRY—I accept that caution. Please take on notice the later figures when they become available.

Mr Bator—Yes.

Senator SHERRY—What is the consumer information centre? Who will be running this consumer information centre? Will consumer organisations be subcontracted or will there be a

centre set up within the Taxation Office or Treasury or some government bureaucracy? What is intended?

Mr Bator—It is not clear from my notes. I can provide further information on that.

Senator SHERRY—Can anyone else help me?

Mr G. Smith—I think that is an initiative that is still at the formative stages.

Senator SHERRY—But to have a formative stage and a concept, there has to be some understanding of what a consumer info centre is.

Mr G. Smith—It is at a very early stage.

Senator SHERRY—I think I know what it is, but I am interested in how you would implement this concept.

Mr Brake—As Mr Smith said, it is at a very formative stage. The idea came out of the discussions that the government had with the Democrats a while ago. The proposal was essentially to test the feasibility of a consumer centre. The government committed to put in seed funding of \$2 million to that effect.

Senator SHERRY—Was the concept to be within the government bureaucracy or to be contracted to a consumer organisation of some sort—one that exists or may be set up? Do you have any idea of either of those options?

Mr Brake—Those are all matters to be explored further.

Senator SHERRY—What is product generation and placement?

Mr Bator—Product generation is the development of whatever the material is that we are going to provide to people. If it is brochures, commercials or material that we put through funds, I guess that would be a major leverage opportunity to get material through the funds. ‘Placement’ is where we will provide some of this material if there is a cost associated with the access points for people.

Senator SHERRY—Does that include the cost of the advertisements and where they would be placed, or is that under marketing?

Mr Bator—There is some element of that.

Senator SHERRY—So it might include advertisements in newspapers, industry journals or things of like that?

Mr Bator—Yes.

Senator SHERRY—What comes under the category of marketing? Is it TV advertising or radio advertising?

Mr Bator—When we looked at this campaign earlier on, we thought that direct contact with people through funds and facilities that people could contact for further information were likely to be better than, for argument’s sake, television commercials. Let us not forget that there is a level of choice already available to consumers out there.

Senator SHERRY—Is that a reference to investment choice?

Mr Bator—There is investment choice and there is also choice under state legislation that has existed for a number of years. So some people already have choice.

Senator SHERRY—And some people have picked their own master trust funds as individuals, particularly if they are self-employed. They have been doing it for a long time.

Mr Bator—That is right. We need to work out a very targeted campaign that ensures that those people who need to get the information get it without clouding the radio waves, so to speak, with information that others may only be confused by. So we were looking at things like education campaigns for school leavers, university students, people who are about to take on work and people who were in particular industries that this new legislation applies to.

Senator SHERRY—What about people who are functionally illiterate, of which there is a very substantial proportion. I think the last figures I looked at were 12 per cent of the population, which surprised me. Functionally illiterate people can read and write but they cannot follow a basic instruction. The tax office must have had some experience with this when it comes to filling out tax returns.

Mr Bator—Obviously, we will draw on all the experiences of the tax office. No doubt, what you say does exist; we know that. We need to find out through our research and other mechanisms what the best practices are for getting information out to people. But let us not forget that people can already organise loans and a whole range of different things not dissimilar to the sorts of information that was going to be on this initial key feature statement.

People were able to deal with this document and make what appeared to be a very consistent choice—and what we thought was the right choice—from the material we previously gave them. We had a random selection of the community. We do need to understand that some people might not be able to make a choice. Part of the campaign that we were talking about at an earlier stage was that you do not have to change. You may well want to stay in the fund you are in, and you should seek financial advice.

Senator SHERRY—And pay for it, presumably.

Mr Bator—Some funds may offer information.

Senator SHERRY—For nothing?

Mr Bator—And some people may choose to stay where they are until they get that advice.

Senator SHERRY—People are going to offer them information for nothing, are they? Is that your experience in this industry?

Mr Bator—People will tend to charge for advice but not for information.

Senator SHERRY—The cost has to be paid somehow, hasn't it?

Mr Bator—Yes, in fees and charges.

Senator SHERRY—Yes, that is right. Are you intending to have or have you had any discussions with overseas governments instrumentalities about the implementation of similar types in other jurisdictions? Obviously, they would not be the same.

Mr Bator—We are. You would be aware that earlier on ASFA went to the United Kingdom and to some other countries that offer choice. They did a report on that which we are aware of and which we tried to address in our then communication strategy. We are also talking with the UK authorities again about the sorts of issues that they confronted and the sorts of reasons why their campaign and approach had some difficulties.

Senator SHERRY—It was an utter disaster, wasn't it? We are being modest in describing it as 'some difficulties'. It was an utter disaster.

Mr Bator—It is quite different from what we have here though.

Senator SHERRY—We will see what the final outcome is. I think the last count was £11 billion compensation. They are still trying to sort it out eight years on.

Mr Bator—It is a quite different structure from ours.

Senator SHERRY—It is still choice.

ACTING CHAIR—Very more sophisticated.

Senator SHERRY—Consumers are more sophisticated in the UK?

ACTING CHAIR—No, here because they get annual statements.

Senator SHERRY—We will see.

Mr Bator—We will try to work through to find out what went wrong there and we will try to avoid those situations.

Senator SHERRY—Good. Have you had any of these discussions yet?

Mr Bator—No. I did send an officer over about two years ago. We have had discussions with ASFA on their discussions with the UK people.

Senator SHERRY—I am referring here to direct discussions rather than to indirect ones through ASFA. You have had an officer go over?

Mr Bator—Yes, and we are planning to do more.

Senator SHERRY—And there will be more done. Did he give a report on the UK, assuming there was a written report given?

Mr Bator—She did so.

Senator SHERRY—Sorry, I should not have assumed it was a male. I apologise for that.

Mr Bator—She did give me a report on it. She was doing negotiations over it at the same time and probably needs to do a little more work on that. But she gave me some initial assessments.

Senator SHERRY—It is still being sorted out; they still have not finalised the compensation yet. You would be aware of that, though.

Mr Bator—Yes.

Senator SHERRY—What about Chile? That is the other choice model that is often looked at.

Mr Bator—I do not want to go there.

Senator SHERRY—I do not blame you, when you look at the outcomes, although the temptations are the mobile phones and the women who walk around selling the products and the bicycles that are given away and all those sorts of things.

Mr Bator—Our financial services regulation bill provides quite a deal better protection for the consumer than they have in Chile.

Senator SHERRY—I think in Chile a lot of people wanted those products.

Mr Bator—I imagine there are a whole lot of different drivers over there.

Senator SHERRY—There certainly is, but it is still choice. So you will be ongoing. I suppose the last question should be: what happens if the legislation is not passed?

ACTING CHAIR—The money is not spent.

Mr Bator—I feel that it will go through. I just carry on doing my work.

Senator SHERRY—I understand you do as you are instructed. That is perfectly understandable.

Mr Bator—The research is always good research to have at the end as well.

Senator SHERRY—It has been around for a long time. In terms of expenditures, what will you go ahead with, regardless of whether or not you have knowledge of the legislation passing? You are obviously doing some work at the moment, so you are spending some money, but the legislation has not been passed.

Mr Bator—Our focus will always be on doing the research first to try to give us some feeling for how we would do a campaign and what the new factors are. We have research, so I do not need to do a lot on some areas and I need to do more on other areas. We will obviously be very mindful of the money and the fact that the legislation may or may not get through parliament, but we will try to do research that will be enduring and useful for other work that we do as well. We have got a lot of use out of the previous research.

Senator SHERRY—That is why I would like to see it.

Mr Bator—That approach?

Senator SHERRY—Is there a date set down for the consideration of the legislation in the parliamentary program?

Mr Brake—Not that I am aware of.

Senator SHERRY—I did not think that I had seen on it the program. What about an operative date? Is there a proposed date for operation?

Mr Brake—The amendments that the government moved to the bill last year had a start date of 1 July 2003.

Senator SHERRY—It rings a bell. I certainly have not seen anything to the contrary. Could you take it on notice?

Mr Bator—I am accepting what Treasury tell me.

Senator SHERRY—I think Mr Brake is calling the shots. I am sure that is the case.

Mr Brake—There has been no announcement subsequent to that.

Senator SHERRY—I know there has been no announcement. Clearly, whatever one thinks of choice—and I am trying as best I can to avoid getting into that debate today—you do need some significant time period to implement the elements that you identify as necessary in any campaign, don't you?

Mr Bator—Yes, the longer the period we have the more understanding we can get and the better targeted campaign that we can run.

Senator SHERRY—There is one other point I want to raise. What about liaison with industry? Have you been or will you be liaising with the banks, the industry funds, the corporate funds and the life companies about the education campaign and what they may do in this area?

Mr Bator—I would think that would be a definite requirement. Previously, when the legislation was first mooted, we did have a range of get-togethers where we discussed the requirements and the implementation of an education campaign. We established at the time a

superannuation education group comprised of people from the banks, various types of funds, various groups like the Australian Consumers Association and business. I would imagine that we would continue in that sort of vein.

Senator SHERRY—But you are not at that point yet?

Mr Bator—We are not at that point yet.

Senator SHERRY—Are the administering costs included in the \$28.7 million?

Mr Bator—Yes, they are. Beyond the campaign, we have requirements on employers who fail to provide choice to their own employees.

Senator SHERRY—This is the specifics of the legislation?

Mr Bator—Yes.

Senator SHERRY—We have not seen that yet.

Mr Bator—If it operates in the same way as the earlier legislation then there would be a requirement on us to ensure that employers are offering choice. We have an element of administration; it will be part of our super guarantee work.

Senator SHERRY—Will the liaison with the private sector—who will obviously operate the funds—include advertising parameters to ensure that there is no misleading or unjustified use of the themes in the government advertising? How is that going to be overseen?

Mr Bator—As we had intended previously, we will need to work very closely with APRA in relation to that.

Senator SHERRY—In reality, how can you ensure that there are advertising guidelines? If a life company or bank wants to go out and run a very vigorous advertising campaign to entice customers, they are entitled to do that, aren't they?

Mr Bator—Yes, within the constraints and requirements of the financial service regulation bill, which is a fairly responsible piece of legislation setting required behaviours of funds, advisers and others.

Senator SHERRY—Does the Financial Services Reform Act, at least in its application of superannuation, include a provision to ensure that the total management fees and charges are disclosed?

Mr Bator—You should probably be asking APRA about that; I am not sure.

Senator SHERRY—It is just that your comment about the Financial Services Reform Act—

Mr Bator—My understanding of the broad scheme of that legislation would be that it is really aimed at trying to ensure that the correct behaviours and prudential controls are in place to avoid the sorts of circumstances that you might be referring to as having occurred in Chile, for example.

Senator SHERRY—Or the UK. Whatever the final details of any legislation, should it pass, one of the features of these changes—I call it deregulation—is that there is a massive advertising campaign by the private sector that is run at the same time and in conjunction with this change. That has been a feature of every country, whatever the detail of its change. They have been doing it in Sweden and Germany: there are massive advertising campaigns.

Mr Bator—This is an area where we need to work closely with Treasury and APRA to make sure that there is sufficient consumer protection.

Senator SHERRY—Are you going to be looking at ensuring that there are some parameters with respect to advertising by the private sector?

Mr Bator—Again, that is a good point you are raising. They are the sorts of areas that we need to be very mindful of, to ensure that they are properly catered for and to ensure that those sorts of things do not occur.

Senator SHERRY—This may be more appropriate for APRA, but are you familiar with the Investment and Financial Services Association's latest paper on fees, charges and competition, that was released in April?

Mr Bator—I am familiar with it. You are right: it is an APRA issue.

Mr G. Smith—A lot of the things you have been referring to APRA may, in fact, be ASIC and/or, in the case of financial services legislation, program 3 of Treasury tomorrow.

Senator SHERRY—Yes. It is just that they have been touched on on the way through.

Mr G. Smith—Yes. I just want to mention that ASIC, I think, is responsible for the financial services legislation.

Senator SHERRY—Yes. Do you have any estimates of the compound impact of a fee or a charge on the final balance? Have you done any work in that area?

Mr Bator—No, we have not.

Senator SHERRY—Have you done any work on the impact of the tax level on the final balance?

Mr Bator—No.

Senator SHERRY—I have some questions about growth pensions. Is this the appropriate area?

Mr G. Smith—Depending on where you are going, we probably could assist you.

Senator SHERRY—There are some tax elements to it. On page 7 of the government's superannuation policy document that was released, 'A better superannuation system', a reference is made to growth pensions, examining:

... whether certain market linked income streams (known as growth pensions and sometimes referred to as account-based income streams) should receive concessional tax and social security treatment with a particular view to the revenue and social welfare impacts of such a proposal.

Is there any examination of growth pensions currently being undertaken?

Mr Brake—Yes, we are examining those issues.

Senator SHERRY—What does that involve?

Mr Brake—As the policy statement said, we are looking at it particularly with a view to the revenue and social security impacts of those proposals. The basic idea of the growth pension would be to provide another type of product that would receive the concessional tax and social security concessions that are presently available to what is called 'complying pensions'. These are noncommutable lifetime and life expectancy products that also provide for a guaranteed return, and so they are effectively fixed income type products. The

proponents of both pensions argue that providing, effectively, a noncommutable market linked product has the potential to offer higher returns overall to their consumer.

Senator SHERRY—But the proposals that are on offer in this area do not currently meet the parameters for the tax concessions. Is that correct?

Mr Brake—That is correct.

ACTING CHAIR—Is it true that, as far as taxpayers are concerned, there is a decreasing preference for these pensions? The popularity of these pensions is a little bit on the decline, isn't it, because there is no residual benefit if you die early, for example?

Mr Brake—It is true that, in terms of the annuity market, the allocated pensions that are market linked are much more popular than the complying pensions.

Senator SHERRY—What tax concessions are available at the moment for products that are appropriately designed in this area?

Mr Brake—There are social security and tax concessions. On the social security side, they are exempt from the assets test; on the tax side, you can access the higher pension RBL, if you take more than half of the total benefit as a complying pension.

Senator SHERRY—I have seen recently a lot of advertisements—not just in the *Financial Review* but in my own local newspaper—claiming that a retired couple can earn up to \$53,000 a year tax free. I have seen a huge number of them in the last six months. Is it correct that products, through a combination of social security and tax concessions, can provide an income of \$53,000 in retirement, tax free?

Mr Brake—I think what is happening there is a combination of factors. Broadly speaking, those sorts of amounts can be achieved. That is partly due to a couple of factors associated with annuities. One is the undeducted purchase price: that amount is returned tax free, so you receive a deduction for that. There is also the 15 per cent superannuation pension rebate. Also, as you would be aware, in last year's budget the government introduced a senior Australians tax offset, which provided higher rebates for persons of aged pension age.

Senator SHERRY—Mr Gallagher is approaching the table.

Mr Gallagher—I just wanted to add to that answer. Typically the calculations which are done are about income tax. The Medicare levy liability is not offset by rebates and the ads forget to mention that. In fact, many of those people would be paying the Medicare levy before they would be paying ordinary income tax.

Senator SHERRY—What would be the figure?

Mr Gallagher—I have not done the calculations recently but it is a significantly different number. The Medicare levy threshold for a single senior Australian is \$20,000. So the Medicare levy thresholds are appreciably lower and not offset by other rebates.

Senator SHERRY—Are you suggesting that these ads are misleading?

Mr Gallagher—I wonder, on the basis of whether they have included the Medicare levy in their notion of income tax.

Senator SHERRY—I have looked at the fine print, and certainly some of them do not mention the Medicare levy. Maybe that is an issue for the ACCC or ASIC. Do we have any numbers of how many people are taking up these annuity products in their various designs, and how many couples are supposedly getting \$53,000 a year tax free in retirement?

Mr Brake—There is certainly data available on the number of people who take up the various types of income streams. I do not have any of that information with me today.

Senator SHERRY—Is it on the increase?

Mr Gallagher—It depends exactly which class of product you regard as being on the increase. Definitely, as more people retire, there are more income stream products sold. There would be an issue of splitting life expectancy and whole of life products from allocated pensions. Allocated pensions continue to be popular. Recently I think the Australian Retirement Incomes Streams Association—or maybe it was DEXX&R research—were saying that life expectancy products may not be as large a part of the market as they have been in recent times.

Senator SHERRY—I am glad Mr Carmody has joined us. I referred earlier, Mr Carmody, to these numerous advertisements advertising up to \$53,000 a year in retirement for couples. Have you seen these advertisements?

Mr Carmody—The figure rings a bell with me. I have not studied them but I have seen that figure quoted, I think.

Senator SHERRY—A lot of these products are being promoted. I do not know whether the claim that is being made is correct or not, but have you had a look at the product? It does remind me a little bit of the mass marketing approach.

Mr Carmody—It is advertising, and advertising can be used for a range of things. They have passed my eye; I have not gone behind them to work out the specifics of it. I am happy to do that, and if we have any concerns we will make them known.

Senator SHERRY—I am asking on the basis that the claim is made that couple in retirement can earn \$53,000 tax free.

Mr Carmody—Which has to do with the senior Australians tax offset, I think.

Senator SHERRY—There is a combination of factors, and we have discussed those. But that must have an impact on some people, in terms of drawing them in to these products.

Mr Carmody—I am not suggesting that there is anything sinister in that. There would be a lot of advertising done for various products. If you are suggesting that there might be something of concern in the numbers, we will have them checked.

Senator SHERRY—No, I am not. I am trying to find out whether or not—and I think we have largely got there—these claims are correct, that you can have a couple in retirement earning up to \$53,000 a year tax free, which is ad nauseam in the advertisements I have seen in the last six months in particular.

Mr Carmody—All I am saying is that I have not personally checked those figures; I am conscious that the senior Australians' tax offset would have a significant impact on that. I am more than happy to run the ruler over the exact figures, and if there is any problem then we will make that known.

Senator SHERRY—Thank you for that. I think it would be worthwhile having a look at the claims that are being made, because if anyone got caught and the claim is not correct or not totally correct then they could get burnt.

Mr Carmody—As I said, I do not know precisely and we are certainly conscious of that. We will check the figures just to make sure.

ACTING CHAIR—I think Mr Brake gave the answer about—

Mr Carmody—Medicare.

ACTING CHAIR—Not only about Medicare but also about the higher threshold for retired people and the fact that that does involve people committing some of their capital into income, which is not assessable—or that there is a generous deduction because of the self-provision there.

Mr Carmody—Yes.

Senator SHERRY—I assume it includes some part pension access, too, doesn't it? Do you know if there is some part pension access in these arrangements?

Mr Gallagher—It would depend on how the pensioner is assessed. The pension cut-out was about \$48,800 but it depends on exact definitions of incomes. There is a particular issue with these products, so it is something you would have to look at.

Senator SHERRY—Some of them must access some part pension.

Mr Gallagher—Yes, because the social security system gives a full purchase price deduction, whereas the tax system only gives an undeducted purchase price deduction, which is based on undeducted member contributions. That can be a significant difference between the two systems.

Senator SHERRY—Going back to the growth pensions issue, what is the detail of the work you are looking at at the moment, Mr Brake?

Mr Brake—As I said, we are looking particularly at what the social security and tax revenue implications would be of providing these products. There are other issues, such as the variability in returns to the retirees. One of the factors with the existing complying pensions is that they provide a certain income stream. These market-linked products can provide a variable income stream. So there is a range of factors that we are looking at in trying to achieve as broad a view as possible about the potential merits—the pros and cons—of these products having complying pension status.

Senator SHERRY—Are there any other government departments involved in these examinations?

Mr Brake—We have been having discussions with the Department of Family and Community Services.

Senator SHERRY—What areas of input are they involved in?

Mr Brake—They are quite centrally involved. As I said, one of the potential attractions of having complying pension status is that it is exempt from the assets test component of the social security means testing arrangements. They are very heavily involved in that.

Senator SHERRY—Do you have a time frame for the completion of this examination?

Mr Brake—There is no time frame being set. It is something that we are actively working on, along with all of the other election commitments.

Senator SHERRY—Have you identified impediments to the introduction of growth pensions?

Mr Brake—We are still working through the examination. As I said, we are still working on, in particular, the revenue and social security aspects of the proposal.

ACTING CHAIR—Isn't there a short-term cost that diminishes over time as it filters through the system?

Mr Gallagher—I think there would be an ongoing cost in the social security system. There are counterbalancing issues. One of the issues is the level of returns. Although they are being called growth pensions by the industry, I think they are more properly characterised as market-linked pensions. And, of course, if a few people had had a market-linked product over the last six months, they may not have been happy with the results.

Senator SHERRY—But conversely, if they had had it over the previous six years, they may have been happy.

Mr Gallagher—They may have been quite happy, so it depends. There should be no implication that ‘market linked’ meant one direction in terms of how they would compare to another product.

ACTING CHAIR—But over time it would outperform.

Mr Gallagher—Over time you would expect the income stream from an asset backed by shares to have higher returns than one essentially backed by bonds.

ACTING CHAIR—That is right.

Senator SHERRY—Except that people tend to focus on the here and now and what is being earned and forget about five or 10 years ago.

Mr Gallagher—Myopia is always an issue in superannuation.

Senator SHERRY—Mr Gallagher, I want to return to the issue of the costings you have done and the discussion we had earlier. Two areas have been drawn to my attention. Did you do the costings for—and I do not want to go over the debate about the phase-in and all that again—the proposal to reduce the contributions tax for persons over the age of 40. And if so, what assumptions did you make?

Mr Gallagher—Yes, I am responsible for that costing. We had a look at our sample of surcharge data. We do not have a full data set, but we have some sample information on surcharge. It would appear that about 63½ per cent of taxable contributions were made by people over the age of 40, and that was the factor which underlined that particular costing.

Senator SHERRY—Is that in respect of surcharge contributions?

Mr Gallagher—No, because all contributions are part of the assessment for surcharge purposes it provides data on all taxable contributions.

Senator SHERRY—I am interested in the coincidence of figures in this press release from the Treasurer. Looking at the year 2004-05 and the two per cent reduction in superannuation contributions—do you have the figures in front of you so we can examine the coincidence of figures?

Mr Gallagher—I have a copy of the Treasurer’s press release in front of me.

Senator SHERRY—In 2004-05 there is a figure of \$530 million, then \$560 million for the year 2005-06.

Mr Gallagher—Yes.

Senator SHERRY—If we go down to the next line, we have the same figures.

Mr Gallagher—I think it is just a coincidence. There is no relationship and it is not the way that it was worked out. I have explained that the call I made was on the level of contributions in 2002-03 and then we grew it according to the growth factors from our RIM

group model. The level of contributions in 2002-03 was estimated at \$24 billion and one per cent of that was \$240 million.

Senator SHERRY—We have been through all that. There have been billions of dollars of tax collected in this area and in all of calculations that you have done—and we have traversed over that—we get two figures that are identical, albeit to the nearest million dollars.

Mr Gallagher—These numbers are always rounded.

Senator SHERRY—Rounded to the nearest 10?

Mr Gallagher—Normally rounded to the nearest 10. I do note there is one in the document which is rounded to the nearest five. But normally we would round to the nearest 10 on a number of this magnitude.

Senator SHERRY—So they are rounded to the nearest 10. Even then, and you are experienced in numbers, what are the chances of those two figures being identical? It seems to me an extraordinary coincidence.

Mr Gallagher—I think it is such a random process that I would not like to put a probability on it. It is hard to know what the distribution of the random process is.

Senator SHERRY—It must be an extraordinary coincidence.

Mr Gallagher—There is no coincidence. As I said before, the only link between these two numbers is that they start being calculated from the same estimate of taxable contributions.

Senator SHERRY—Yet we get the same figures.

Mr G. Smith—It is extraordinarily likely that you would get them the same actually. When you have years that are two years apart, a nominal growth factor therefor of 10 per cent and two series which are roughly 10 per cent apart, it is extremely likely—rounding to 10—that you will get exactly the same numbers in the second of the two years of the first series as in the first of the two years of the second series. It is an extremely likely event, statistically, that you will.

Mr Gallagher—Any implication that we took the first numbers and then fed them back through would be wrong.

Senator SHERRY—I was just struck by the extraordinary coincidence but apparently it is not quite so mathematically unusual.

Mr G. Smith—Mathematically, it is extremely likely.

Senator SHERRY—A rough 50-50?

Mr G. Smith—I reckon it is a 50-50.

Senator SHERRY—I think 50-50 is reasonable.

Mr Gallagher—You assumed when you started that the numbers would be somewhat similar, which is why the policy was raised the way it was.

Senator SHERRY—There is obviously a ratio between the two figures. It is just extraordinary that it came out to the nearest million dollars. But you have explained that you have rounded to the nearest 10, so I think that does cover it. The proposed children's account in the election package gave a costing of \$42 million but I noticed in the budget papers that it is only \$3 million over three years.

Mr Gallagher—We have reduced the costing on the children's—

Senator SHERRY—I am sorry but, just before you go on, rounding out might be the answer. But do you have in front of you page 1-25 of Budget Paper No. 1?

Mr Gallagher—No, but I will have in a second.

Senator SHERRY—Superannuation measures, table 7?

Mr Gallagher—Yes.

Senator SHERRY—You have super for life—I do not know how many lives but, anyway, we will get to that in a moment—and children's accounts: \$1 million in the first year of operation, \$1 million in 2004-05, \$2 million in 2005-06, and a total of \$3 million. So we have one plus one plus two equals three.

Mr Gallagher—I think that has been affected by rounding.

Senator SHERRY—I thought that might be the explanation.

Mr G. Smith—It is in the footnote.

Senator SHERRY—You love this rounding, Mr Gallagher. The trouble is that on this occasion it does not add up.

Mr Gallagher—The notes to the table indicate that they may not add up due to rounding.

Senator SHERRY—Whether it is \$3 million or \$4 million, I take your explanation on rounding. Why is there a difference between that as a total cost and the \$42 million that we discussed at the previous estimates hearing? That is a very significant difference.

Mr Gallagher—I had a look at the original estimates provided under the Charter of Budget Honesty. My view was that the take-up assumed in that costing was too high, and we significantly lowered the expected take-up of those accounts.

Senator SHERRY—Were you involved in the original costing of the election promise?

Mr Gallagher—I was. But the original costings were done very quickly and, when we had time to reflect, we decided that they may not be that popular.

Senator SHERRY—What amount of time did you have to do the \$42 million costing?

Mr Gallagher—It occurred in a one- or two-day period, along with a number of other costings—because all of the coalition's costings came to us at the same time. It was an extremely frantic period.

Senator SHERRY—You have been through a frantic period working on the contributions tax too in one day.

Mr Gallagher—It happens.

Senator SHERRY—And we have suddenly hit on—

Mr G. Smith—We got that very right there too.

Senator SHERRY—That is not our doing; the government wants a figure you have to give it to them. Six months later, I could understand \$5 million or \$10 million, but it has dropped from \$42 million to \$3 million.

Mr Gallagher—The original costing assumed a 10 per cent take-up rate of the measure amongst a population who we thought likely to contribute on the basis of their incomes. On reviewing it, I decided that a one per cent take-up would be more appropriate.

Senator SHERRY—So back in September or October, you did the original costings. Then, on reflection, six months later there is that very substantial revision of a figure—and it is a very substantial revision, isn't it?

Mr Gallagher—Yes, but in the budget, it is still quite a small number in the scheme of things.

Senator SHERRY—I understand that, but in terms of the measure itself—

Mr Gallagher—Yes, it is a substantial revision.

Senator SHERRY—To go from \$42 million to \$3 million is a very major revision of assumption.

Mr Gallagher—Yes.

Senator SHERRY—So you assumed a 10 per cent take-up in the original estimate of what proportion of superannuation fund members?

Mr Gallagher—I think we may have mentioned it in the original estimates, and I did previously mention it. Certainly the original assumptions are discussed in the Charter of Budget Honesty costings, which I have misplaced at the moment. You have me shuffling through papers here, but I can retrieve it for you. In the original assumption, we looked at those families in the population with children up to the age of 18. We found that about 18 per cent of those families had capital income of \$500 or more per year, suggesting that they had financial assets of around \$10,000 a year and, therefore, were in a financial position to make voluntary contributions to superannuation.

Senator SHERRY—Before you go on, what working income level would that equate to approximately?

Mr Gallagher—It varied. It was certainly weighted towards those with higher incomes, but we find that families with capital incomes can be at a number of points in the income distribution scale.

Senator SHERRY—What is the range?

Mr Gallagher—It is the full range. I certainly do not have that.

Senator SHERRY—Sorry, the range where the substantial take-up would be?

Mr Gallagher—We would expect substantial take-up for families with incomes in excess—pick a number, any number—of \$60,000. Certainly at a higher income you would expect there to be more capital income and more capital income received.

Senator SHERRY—‘Pick a number, any number’—that is your expression.

Mr Gallagher—Not here. At that time, we did it on the basis of the actual distributional information available.

Senator SHERRY—This is why we got \$42 million six months ago and we are back to \$3 million today.

Mr Gallagher—Our estimate and the way we estimate the capital incomes of families has not changed; what has changed is the take-up assumption. The take-up assumption is always a very difficult thing to do. How do you estimate the take-up for a measure that has never been in place before?

Senator SHERRY—Okay, but you made a call back in September-October of last year about the take-up assumption?

Mr Gallagher—Yes.

Senator SHERRY—You made that call. What is the new take-up assumption? What is the new call six months later?

Mr Gallagher—One per cent: one per cent of the group had the financial capacity to do so.

Senator SHERRY—So, in six months, on your judgment, the take-up rate has dropped from 10 per cent to one per cent. What has happened?

Mr G. Smith—In a Charter of Budget Honesty setting you have got very little time and you have got a lot of things to do. When that happens, you would probably err—given that the total number is not big anyway—on the side of being conservative; that is, putting a worst view. That is reasonable. What else would you do? But when you have time to reflect on it—you look at the nature of the policy, you think about it and you take on whatever evidence you can—you form perhaps a more sanguine view about the take-up of this particular measure. I remember the capital gains tax estimate that we did in '85: we were out by about 1,000 per cent or something. So this does happen when you have got a completely new measure with nothing much to go on. Obviously, in an election setting, we would not want to underestimate the cost.

Senator SHERRY—Thank you for that, Mr Smith. You have taken a similar approach on the contributions tax. Can we expect a major revision when you finalise your figures?

Mr Gallagher—There will be a major revision and the numbers will be revised with the timing I now understand that proposal to have. If defined benefit funds are to be excluded from the policy, you would expect that that would have an impact as well.

Mr G. Smith—The big difference there is there is no behavioural assumption required. It is a straight-out base question.

Senator SHERRY—What I find interesting, Mr Gallagher, is that you are the person who made the call six months ago about the take-up assumption. Mr Smith has correctly pointed out the experience of the capital gains tax: experience showed that later—when it was actually collected—the figure was wrong. But you have made a totally and very substantial new call six months later on the assumption of the take-up rate before the measure has even been implemented.

Mr Gallagher—Superannuation contributed to child accounts would be preserved. If there is no variation in preservation policy, I think families would look at other forms of investment, if they were setting aside money for children.

Senator SHERRY—In that analysis I think you are correct. I am just interested as to why there is such a variation six months ago, given you did the figures.

ACTING CHAIR—Order, it being 6.30 p.m., we have to call a temporary adjournment. We will not require the Australian Taxation Office or Treasury tonight. We will be looking at the Australian Prudential Regulation Authority.

Senator SHERRY—Are we actually going back to this program after dinner or are we going straight to APRA?

ACTING CHAIR—We are going straight to APRA. We are coming back to this program tomorrow morning. After dinner we will be looking at APRA and at the Australian Office of Financial Management. We will not be looking at the Foreign Investment Review Board; that will be done on Thursday morning. Time permitting, we will be looking at the Australian Accounting Standards Board, which, I presume, Senator Conroy will have some questions for, and we will be looking at the Financial Reporting Council for about 10 minutes. That will be tonight.

Senator Minchin—Chair, can you tell us anything further about tomorrow? It is Treasury and Tax, but what else? Does it then revert to the program as drafted?

ACTING CHAIR—Pretty much back to the program, except that Tax will be the first priority in the morning.

Proceedings suspended from 6.31 p.m. to 8.02 p.m.

Australian Prudential Regulation Authority

CHAIR—I am advised that, by arrangement, we will now proceed to the examination of officers of the Australian Prudential Regulation Authority. I welcome to the table Senator Abetz. Senator Abetz or officers, do you wish to make an opening statement?

Senator Abetz—No, I do not, thank you.

Senator CONROY—APRA has received an increase in funding this year. Your funding comes from the levy on the financial sector. Is that right?

Mr Thompson—That is right, yes.

Senator CONROY—I understand that the superannuation sector and the general insurance sector are facing increased rates in the relevant levy but the rate applying to ADIs is to decrease. Could you just explain how you come up with the balance of the rates of the levy?

Mr Thompson—The rates are determined by the minister, Senator Coonan. As background, we estimate the amount of expenditure that we will undertake in supervising each of the main industry sectors. The estimates for this year and for next year show us spending more time on the general insurance sector and on the superannuation sector relative to the others.

Senator CONROY—So you do not just do a general across-the-board calculation? You try to target which one you are going to spend more time on so their part of the levy should go up?

Mr Thompson—The structure of the legislation requires at least an approximate recovery of relevant costs from each of the sectors.

Senator JACINTA COLLINS—Is it a risk based assessment?

Mr Thompson—It is an estimate that we make of the supervisory resources that we will be allocating to each sector. Obviously assessment of risk in the different sectors is one factor that feeds into those estimates.

Senator JACINTA COLLINS—Can you give us a breakdown of that by sector?

Mr Thompson—The estimated disposition of our spending by sector for next year is as follows: authorised deposit-taking institutions, just over 35 per cent; superannuation, 39.5 per cent; life insurance and friendly societies, just over 11 per cent; and general insurance, just under 14 per cent. I think that comes to 100 per cent.

Senator CONROY—You indicated that you are just going to be doing more generally in general insurance. Could you take us through the sorts of things you are anticipating.

Mr Thompson—There is a lot of work associated with the implementation of the new regime. A lot of that is happening now, because the regime comes into effect on 1 July this year. We expect that there will be a continuation of that into the next financial year as we need to bed the new system down. So there is some increase in our front-line supervision resources allocated to general insurance for that reason. We have also decided to expand our specialist insurance risk analysts in our consulting group. So we are creating a new team of insurance risk experts to supplement the existing teams that deal with credit risk.

Senator CONROY—How many people do you reckon you need?

Mr Thompson—I think it is a team of approximately six or seven.

Senator CONROY—And will they be specialists in reinsurance issues?

Mr Thompson—They will specialise in reinsurance, evaluation of insurance liabilities and those sorts of things. So they will be the supplementary expert team that the front-line supervisors can call on for on-site visits to insurance companies and so forth.

In the superannuation area, the increases come about from our efforts to conduct on-site visits of superannuation funds more frequently than was done in the past. We are aiming for an average two-year cycle there. We are also anticipating some policy development work coming out of the report of the Superannuation Working Group, which the government presently has. In the superannuation area as well there is a combination of front-line hands-on supervision work and policy development work that feed into that estimate of the expenditure that we will be making on each of those sectors.

Senator CONROY—I know we have had this discussion with you, Mr Thompson, as well as with Mr Phelps at various times. I think you are moving in this direction, so I just wanted to try to flesh out the question of how you assess what the investment portfolios of various super funds are. Senator Sherry might want to jump in on this as well. We have talked about how you are trying to get behind just the bland statements that they give you. I think CNAL is probably the best example. They just say, ‘We have invested in this,’ and on the surface the simple description fitted the guidelines. Is that the sort of thing you are talking about?

Mr Thompson—Yes. There are two ways in which we hope to get a better handle on the investment strategies of funds. One is through conducting on-site visits, where we have the opportunity to actually sit down and talk with the trustees—talk about their strategies and inquire in more depth into their investment strategies in their portfolios. A slightly longer-term project is to reform the statistical collections that we get from superannuation funds. Part of that would be to collect more relevant information on investment portfolios from a prudential supervision point of view than we collect now.

Senator SHERRY—I appreciate you indicating that the work you have done to date is not fully developed, but have you been able to identify any trends in any particular type of superannuation fund? We have talked about smaller corporate funds on previous occasions. Is there any update on what is happening in this investment area that is an area of concern?

Mr Thompson—I do not think I could identify any broad trends. Les, is there anything you can add to that?

Mr Phelps—It is probably three or four months since we last spoke about this, but our effort to get around to actually visit every fund on a two-yearly basis means that we are doing

a lot of visits to a lot of small corporate funds. The types of issues which we see are consistent and include in-house assets. There are still attempts to use the money to further the business rather than being purely in the interests of the members of the fund. As I have probably mentioned previously, an awful lot of these funds are very small, with less than 10 members. Three or four principals of the firm and five or six staff—that is a very common structure for these funds. If there are in-house assets, we can do something about it and we are doing things about it.

Senator WATSON—What are you doing?

Mr Phelps—In the case of one in Melbourne we have got an injunction directing that money be repaid, which is happening. In other cases we get commitments from the trustees on behalf of the firm to repay loans. There are certain dates that are critical from the legislation which was introduced three years ago.

Senator WATSON—Do you give them deadlines?

Mr Phelps—Yes, and we follow it through. That is an issue which we are still coming across. There are certain things we have come across which are not in-house assets. They do not meet any of the definitions, but we still have taken the view that they do not seem to us to be in the best interests of members, and we have pursued the trustees and convinced them to reallocate the portfolio.

Senator WATSON—How many of these delinquent funds are there that you have looked at?

Mr Phelps—We risk rate the funds that we cover. It has been fairly consistent, I think, since the ISC days that somewhere around six or seven per cent of funds that we visit have behaviour that we would want to change and we do get changed.

Senator WATSON—How significant is that behaviour? Can it result in loss of capital or is it just purely technical breaches? What is it?

Mr Phelps—It is a combination. With some of the instances we come across to do with in-house assets, nobody has suffered any loss. We are just saying that the motivation in making that investment is not—

Senator WATSON—These rules have been in place for years now; they are not new rules. The funds can hardly claim innocence or lack of knowledge.

Mr Phelps—No. Some of these funds are extremely small and the trustees really only get educated by us going and visiting them, questioning them and asking them how they are fulfilling their responsibilities.

Senator SHERRY—But in these cases, Mr Phelps—you have been talking about small corporate funds—is it clear that there is in reality an equal relationship in decision making between the employee trustees and the employer trustees?

Mr Phelps—No. That is a very difficult thing to have when there is such a small number of people involved in the fund. If there are two or three principals and perhaps only three or four workers, the equal representation is there on paper but it is a matter of opinion as to how effective it is. Some of these funds have been visited for the first time. There were 5,000 funds only six years ago and now there are 3,000. We expect to do around 900 to 1,000 visits this year. We are visiting some people for the first time. Part of that process is sometimes to say that we will move our workers on to some other superannuation fund and the principals will just go off to the tax department.

Senator WATSON—Why is your statistical analysis of the questionnaires you get on an annual basis, or sometimes more frequently, from these funds not automatically picking up these malpractices and weaknesses? You cannot rely on just going out to visit them every two, three or four years. You are not going to pick up too many in terms of 5,000, but your paperwork should be telling you the weaknesses. This is our worry.

Mr Thompson—It is one of our worries as well. That is why we want to—

Senator WATSON—It is in your court, because it is up to you to devise the forms that are going to provide the sort of statistical information to disclose these weaknesses.

Mr Thompson—That is exactly what we are doing.

Senator WATSON—Well, it has taken a while, because these in-house asset rules have been in place for a long time.

Senator SHERRY—On a slightly more positive note, I was present at a conference of major superannuation funds. One of your officers gave an outline of the changes in supervision processes and procedures at APRA. On the basis of that speech, I thought there was a significant improvement and shift, which was good to see. So I put that on the public record. Has that speech been placed on the public record? It was given at a public conference, so I assume it would be available. I have not been able to get a copy of it.

Mr Thompson—If it is not on the public record, we will make sure that it is. There is no reason that it should not be.

Senator SHERRY—Having got that out of the way, I raise the more distressing case of CNAL. I understand that Mr McGrath has been carrying out the inspection of the enhanced cash management trust and its dealings with the smaller funds. Has he provided you with a copy of the report?

Mr Phelps—Yes, he has.

Senator SHERRY—Was that report provided on 3 April this year?

Mr Phelps—Yes.

Senator SHERRY—So you have the report. Does it conclude that the losses incurred by these funds were as a result of theft or fraudulent conduct so as to render them eligible losses under section 228 of the SIS Act?

Mr Phelps—I will have to take advice. This report is part of our advice to the minister on this subject. I am not sure whether that means it should stay confidential.

Senator Abetz—It might be best if we take that on notice.

Senator SHERRY—Okay. Have you sent advice to the minister?

Mr Thompson—We have provided advice to the minister, and that report is attached.

Senator SHERRY—When did you send that to the minister's office?

Mr Thompson—I think it was on 27 May.

Senator SHERRY—On the SBS *Insight* program—I do not know whether you saw the interview—the minister said:

There wouldn't really be a week go by that I haven't done something in relation to this matter—to make sure that it is moving along, that the report came in from the inspector, that APRA are looking at it, that

I get the official request to APRA. That will be tabled in parliament and, as I say, my decision will be pretty quick—I would think very early June.

You got the report on 3 April. We are apparently going to get a decision from the minister in very early June. Could you refresh my memory? When was the initial application? Was it March last year?

Mr Phelps—This is the application for compensation from the acting trustee?

Senator SHERRY—Yes.

Mr Phelps—There were applications made at that time. That application of course had no substantiation of fraudulent conduct, which was the subject of the report which was commissioned from KPMG. There were subsequent applications made by the acting trustee around Christmas when it was clear that the legislation required a separate application for every individual fund.

Senator WATSON—What about theft? You said fraudulent conduct. Was there theft?

Mr Phelps—I am saying that the applications which were made by the trustee did not have evidence of fraudulent conduct or theft. That part of the decision making process was to come out of the report from KPMG, which we had commissioned and which was received on 3 April.

Senator SHERRY—The time it was replaced as the trustee of the 475 small funds was in February 2001?

Mr Phelps—Yes. It was February.

Mr Thompson—Sorry, that was Oakbreeze; that was not KPMG.

Senator SHERRY—Yes. Did CNAL satisfy the \$5 million capital requirement for an approved trustee?

Mr Phelps—The legislation says that an approved trustee has to have either \$5 million capital or a bank guarantee or use the services of a custodian which meets APRA's requirements. APRA's requirement in that case is that the custodian is to have \$5 million capital.

Senator SHERRY—Did they have the \$5 million capital?

Mr Phelps—CNAL did not have \$5 million capital in their own right, no.

Senator SHERRY—How did that escape APRA's attention?

Mr Thompson—They had the custodian.

Senator SHERRY—They used a custodian?

Mr Phelps—Yes.

Senator SHERRY—So APRA had to approve the custodian or the \$5 million capital. Did it approve the custodian?

Mr Phelps—The requirement for the custodian to be acceptable is that they have \$5 million capital in their own right.

Senator SHERRY—And you were satisfied with that at the time?

Mr Phelps—That is the legislation.

Senator SHERRY—But were you satisfied by that at that time?

Mr Phelps—As was included in our submissions to the select committee, we attempted to move CNAL to a position where they had \$5 million capital in their own right. The legal opinion at the time was that that imposed a condition which was above the law—that the law said they could have \$5 million capital or use this custodian and to insist that they have. How that would pan out in a court of law I do not know, but that was the advice that was received at the time.

Senator SHERRY—That \$5 million capital effectively was of no use in this circumstance.

Mr Phelps—No.

Mr Thompson—One of the areas that we have advocated be looked at afresh in the reviews of superannuation arrangements over the past year or so is that capital requirement and the question of whether that custodian requirement is an adequate substitute for the trustee having capital in its own right.

Senator SHERRY—If a trustee had \$5 million capital, what purpose would that serve? Would that \$5 million be used to pay off part of the debt?

Mr Thompson—It could be available as a first port of call against misadventure.

Senator SHERRY—Let us say it was a much larger fund than Commercial Nominees. Let us say it was a fund—God forbid it ever happened—of \$200 million or \$300 million. In the context of a much bigger fund it would be, frankly, peanuts, wouldn't it?

Mr Thompson—That is right. Capital can never be the sole protection against loss, but \$5 million is better than nothing.

Senator SHERRY—Is APRA able to provide the details of the rectification costs and administration fees charged by Oakbreeze so far since its appointment?

Mr Phelps—We have the details, yes.

Senator SHERRY—Can you provide them to us?

Mr Phelps—Yes. I cannot see why not.

Senator SHERRY—Thank you. What are these fees as a proportion of the total losses incurred by the funds?

Mr Phelps—It varies tremendously from fund to fund, but the total amounts that appear to have been lost with CNAL generally, across all of the activities it was involved in, are of the order of \$25 million. These fees are of the order of \$5 million.

Senator SHERRY—That is about 20 per cent, isn't it?

Mr Phelps—Yes.

Senator WATSON—So far.

Senator SHERRY—So far, yes. Thank you, Senator Watson. If the application is granted by the minister—it is the minister's call, isn't it? You have carried out the report and you have sent it to her. If the minister does order rectification, can it include the rectification costs and the administration fees charged by Oakbreeze?

Mr Phelps—Those rectification costs are certainly part of the claim that has been lodged.

Senator SHERRY—So it can be? If the minister makes the call, it can be included?

Mr Phelps—Yes. The decision is, firstly, that there has been fraudulent conduct—otherwise nothing can flow—and, secondly, what is consequential upon that having happened.

Senator SHERRY—So really it is the threshold test that has to be passed, which is the fraudulent conduct?

Mr Thompson—I think that is a fair statement. As Mr Phelps has said, there are two tests. The first is fraudulent conduct or theft and the second is what costs or losses were consequential upon that.

Senator SHERRY—If the minister concludes fraudulent conduct, I think that would be useful information for the CNAL members who have certainly been contacting me about this. Their concern is that, if fraudulent conduct is concluded by the minister, the fees and rectification costs will not be covered, but you are saying they certainly can be covered.

Mr Thompson—Yes.

Mr Phelps—I have had meetings every four or five weeks with the CNAL action group, which has understood this point since before Christmas.

Senator SHERRY—Yes, but not everyone is a member of the action group.

Mr Phelps—No, but they have undertaken to pass on information to the rest of the group.

Senator SHERRY—I seem to recall that one of the people who was involved in CNAL is overseas. I think it was Guatemala or somewhere. It was some Central American country.

Mr Phelps—Yes. One of the people who was a director in about 1997 is overseas.

Senator CONROY—Costa Rica?

Senator SHERRY—I know it was a Central American country.

Senator WATSON—It is true that he went to New York with a certain amount of money and requested further moneys, which were sent to him. He has reputedly gone off to Central America with—

Senator SHERRY—Can you give us an update? I know it sounds a bit amusing, but it is actually pretty serious. Do we know where this person is? He was last sighted in Central America somewhere.

Senator WATSON—If that is not fraud or theft, I do not know what is. It has taken a long time to establish.

Senator SHERRY—Have people tried to track him down?

Mr Phelps—There were a lot of allegations made about that, about what happened.

Senator SHERRY—We know as a matter of fact that one of the persons involved in the operation of the fund is in Central America somewhere.

Senator CONROY—And not coming back.

Senator SHERRY—Well, who knows? It depends whether there is an extradition treaty with the country he is in, I suppose. I assume the police are investigating this. Has there been any liaison? Can you give us any update about where this person is?

Mr Phelps—No. Together with ASIC we have been looking—as I explained at the time, there were lots of downstream investments which went beyond the superannuation part of this—to see exactly what could be proved. That has not gone to the police or to potential extradition at this stage.

Senator WATSON—Why is it taking so long? It was 1997 and you have been looking at it for years.

Mr Phelps—It is a question of whether there is sufficient evidence to take action.

Senator WATSON—The sending of money, withdrawals from bank accounts, authorisation through board minutes and these sorts of things—I would have thought it would be fairly circumstantial.

Senator SHERRY—Or certainly enough to warrant an investigation. Do you know if the Federal Police have conducted an investigation into this individual's activities?

Mr Phelps—I am not aware that they have, no.

Senator WATSON—If they have not been referred—

Senator SHERRY—Have you had meetings with the Federal Police to give a report about issues relating to the fund?

Mr Phelps—No. As I said, we have been working with ASIC to establish what evidence there was of the activities of CNAL and some of the things in which they invested, but that has not produced any court proceedings or dealings with the Federal Police that I am aware of.

Senator SHERRY—Do you see that as ASIC's responsibility?

Mr Phelps—It is a joint responsibility. As we discussed here on previous occasions, this is a situation where we both need to work together. There are superannuation aspects to it and there are aspects which are beyond superannuation. So we need to share, which we do, all the information that we have. But it is a question of whether there is sufficient evidence to be pursued through things like extradition and the police.

Senator WATSON—Twelve months ago we went through this episode of whether it was your responsibility or whether it was ASIC's responsibility and there was a no-man's-land. As a result, CNAL fell through them both. Now you are coming back to us and saying that the same thing still applies, despite the history. You are still working out whether it is their responsibility or your responsibility as to who should lay the charges or what should happen. Everybody's patience is really starting to run out a little, with respect.

Mr Thompson—Mr Phelps said we are working with ASIC. Now we have this report, which we have had for only a relatively short time, we will be determining what other uses can be made of it.

Senator SHERRY—Has the report been sent to the Federal Police?

Mr Phelps—Not at this stage, no; and this report does not cover the period in 1997.

Senator JACINTA COLLINS—What period does it cover?

Mr Phelps—It essentially covers the period of fraudulent conduct from which this section of the legislation would be applicable to small funds. The excluded funds were not covered. There was the change in 1999 from excluded funds to funds that went to the tax office and those that went to APRA, and it was only the funds that became small APRA funds that were covered by the compensation arrangements. The excluded funds and the ones that went to the tax office are not covered by the compensation arrangements.

ACTING CHAIR—Is that an issue for APRA at all? All the DIY funds are not covered. Why is that?

Mr Phelps—That is the legislation.

Senator JACINTA COLLINS—Yes, but do those limitations apply to ASIC as well in this matter?

Mr Phelps—The arrangements under which there is compensation for fraud or theft are applicable to funds which are supervised by APRA, but they are not applicable to funds which are regulated by the tax office.

ACTING CHAIR—But at the time they were being supervised by APRA. At the moment, they are not supervised by APRA, so do not tell us that there is no compensation for all of these DIY funds simply because at the time they are not regulated by you; they were regulated by you at the time of the problem.

Mr Phelps—I have not been clear. What I am saying is that the report, which was looking for evidence of fraudulent conduct, applied at this time from when these funds were supervised by us and eligible for the potential for compensation. The KPMG report does not go back to 1997-98.

ACTING CHAIR—Why not? Sure, it is central, if they are producing reports saying ‘We looked at it from now and they are not under your jurisdiction.’ The point at issue, which the members of the DIY funds want answered, is a report on the situation of the DIY funds at the time you were managing them to make sure that they got protection provided by the fraud or theft provisions of SIS.

Mr Phelps—It covers that period, yes, but—

ACTING CHAIR—So they are covered?

Senator JACINTA COLLINS—The report covers that period?

Mr Phelps—Yes, what I am saying is that the gentleman who is in South America—the activities that that relates to—was concerned in 1997. The questions of superannuation fund money being placed into the Enhanced Cash Management Trust happened much later. It is that later period which has been the focus of the attempt to prove there had been fraudulent conduct.

Senator SHERRY—But there may have been fraudulent conduct earlier, which you have not investigated.

Mr Phelps—That is being investigated not by KPMG but in close consultation with ASIC to see, between the two of us, what evidence we can marshal.

Senator SHERRY—But that does not involve the Federal Police at the moment.

Mr Phelps—It does not involve the Federal Police.

Senator SHERRY—I am surprised at that. There has been no meeting with the Federal Police to date when, *prima facie*, at least Senator Watson was aware of it. We on the superannuation committee were all well aware that there was very peculiar behaviour that occurred at that time, to say the least.

Dr Roberts—It has always been the case in APRA and the ISC, the predecessor, that when any material is looked at by our internal lawyers and appears to represent a case of fraud it is our responsibility to refer that to the relevant police, who normally would, I think, be the state police. It has never been the case that you would ring up the state police just because there is a question mark over someone’s head. Internal lawyers would have to make the assessment every time material comes across their desk as to whether there is a sufficient case to be made to make an approach to, normally, the relevant state police.

Senator SHERRY—But certainly the evidence that we gathered at the Senate committee was of concern—let me put it that way—in relation to that individual's activities at that particular time. You or ASIC are not examining that period?

Mr Phelps—We jointly, with ASIC, have been examining that period. What I am saying is that that has not produced anything which would be sufficient to embark on extradition.

Senator SHERRY—No, extradition is a later phase. Whether or not there is a police investigation—you say state—I am concerned whether there has at least been some consultation and discussion with them about the investigation starting from a police perspective.

Mr Phelps—As I say, I am not aware that it has got beyond us and ASIC together to try to see which elements of that period 1997-98 could be the source of prosecutions.

ACTING CHAIR—What about prosecutions under SIS? Why have they not been launched? They are fairly obvious, inappropriate investments. A whole raft of issues were in breach there, were there not? Why the delay there?

Mr Phelps—Our primary focus has been to get this report from KPMG to settle the question of whether the compensation could be utilised and we will be using that as a basis for further action under the SIS legislation.

ACTING CHAIR—Are you looking at suing directors at the time for—the trustees?

Mr Phelps—We will be looking at all of those things. My understanding is that the potential for suing people could be quite limited, but other administrative actions—

ACTING CHAIR—Limited by what?

Mr Phelps—Actions that disqualify them, and those sorts of things could be commenced.

ACTING CHAIR—I can understand you appointing a liquidator to the CNA or cash management fund, but what was the rationale for appointing a liquidator to all the DIY funds at great cost? Why did you not appoint a superannuation administrator, or why did you not just write to the people and say, 'Appoint your own,' in relation to the moneys that are already there? The costs have blown out disproportionately for the administration of all of these DIY funds and it just seems to be a very bad call on your part.

Mr Phelps—Our intentions were to maximise the possibility of people getting their money back. These people, as you know quite well, have lost in some cases just about all of their retirement savings. There did not appear to be much chance of recoveries from any of the assets that we could see, but we needed to have people who were best skilled in pursuing that to get evidence of things like fraudulent conduct to have the best chance of recovering assets and getting some value out of them. This was meant to be a reasonably short-term process of having an acting trustee. Getting the report completed by KPMG on the question of whether there had been fraudulent conduct took much longer than any of us anticipated at the start, which meant that the acting trustee has remained in place for longer than any of us anticipated. But they were the skills that we were looking for at the time, which we thought were the most important and would maximise the chances of people getting some of their money back.

ACTING CHAIR—There has been a concern about lack of communication between the Pricewaterhouse group and the members. That has been of some concern to us. Could you also verify that there have been moneys taken out of some of those funds which has been contrary to the wishes of the members of those funds? They have withdrawn moneys when

the members of those funds would have wished otherwise; in other words, they would have preferred a different choice of assets? In other words, he has made decisions contrary to the best interests of the members. Is that true?

Mr Phelps—The trustee argues that he has not made decisions that are not in the best interests of members, that the trustee takes the responsibilities very fully and strongly. I am not aware of the trustee doing the opposite of what somebody has asked. What I am aware of is situations where—

ACTING CHAIR—Do you mean to say that has not been raised with you during these many meetings you have had with the committees? Has that been raised with you?

Mr Phelps—What has been raised is—

ACTING CHAIR—Just answer my question first. Has that been raised with you?

Mr Phelps—I have not had that—

ACTING CHAIR—You have not had that raised with you?

Mr Phelps—What I have had put to me is that they have liquidated assets without getting authority from the individuals. Of course, the trustee says that the trustee has to meet the obligations of the fund and is the trustee and, therefore, has an obligation to liquidate assets when that is necessary. If they try to coordinate with the member and they cannot get the member to answer, they have to go ahead and do it. That has happened.

ACTING CHAIR—And you believe that is the scenario that has applied?

Mr Phelps—That is what I am informed.

ACTING CHAIR—That is what you have been told by the liquidator?

Mr Phelps—Yes.

ACTING CHAIR—Yes, by the trustee.

Senator SHERRY—We have obviously discussed CNAL and problems with smaller corporate superannuation funds. What is the current fee that is charged for supervision in this area on those types of accounts?

Mr Phelps—The fee for small APRA funds is \$400.

Senator SHERRY—Only \$400?

Mr Phelps—Yes.

Senator SHERRY—We do know that there are a greater degree of problems in this area, and the fee is only \$400.

Mr Thompson—That is determined by the minister.

Senator SHERRY—Just on a happier case, TED Engineering—

ACTING CHAIR—Can we finish CNAL?

Senator SHERRY—I thought we had. On a happier note, are you familiar with the TED Engineering case?

Mr Phelps—Yes.

Senator SHERRY—Very briefly, in 1987 the owners, Mr Tab and Mrs Eva Fried, who were directors of TED Engineering and of Eva Tab, the trustee of the company's superannuation fund, sold a commercial property they owned to the fund for \$600,000, which

resulted in a loss to the fund of \$272,770. That was back in 1987. Finally, on 19 December 2001, the Victorian Supreme Court awarded damages and restitution. That was from 1987 through to 2001, and there was a happy outcome. I might say in passing that it was the union, the AMWU, fortunately, that took up the case and funded it. Can you tell me why either you or the ISC would not have prosecuted this type of case? Why was it left to the union? I understand that some of the workers involved did approach the ISC—it certainly does pre-date APRA's time—in order to attempt to get them to engage in a prosecution.

Mr Thompson—That was pre-SIS. I do not know the answer. It may be that there was no—

Senator SHERRY—Even though it was pre-SIS, it has had a happy outcome. They won their case in court.

Mr Thompson—Under the relevant legislation at the time, there may not have been scope for the ISC to take action of the kind you are referring to.

Senator SHERRY—You might take it on notice and give us a view.

Dr Roberts—It was before the ISC. The predecessor to the SIS Act, which was the OSS Act, the Occupational Superannuation Standards Act, and the creation of the ISC itself, were in late 1987. Before then I think you would have just said that trust law or common law were available to you. There really would not have been anyone in terms of a regulator to prosecute that.

Senator SHERRY—Could you just have a look at it, because it was a happy outcome and a very old law. It was of interest to me that they were successful in the court case in getting the win that they had. I will refer to two other matters. In relation to the sole purpose test, I have been looking at the regulations, and a range of insurances are allowed for superannuation funds. You would be familiar with them—death and disability and loss of earnings insurance. They are allowed under the current regulations, are they not?

Dr Roberts—That are ancillary—

Senator SHERRY—For an ancillary purpose?

Dr Roberts—Yes.

Senator SHERRY—Under the current regulations, would insurance for the purposes of protecting employee entitlements be considered an ancillary purpose?

Dr Roberts—We would have to ask our technical people to consider that. We can take it on notice.

Senator SHERRY—The process would be that a fund would write to you to seek a view, where it was within the existing regulations. Do you have power to determine the matter or would it require a change in the regulations? Would you need to take it on notice?

Dr Roberts—Our people would determine whether it could currently be considered an ancillary benefit. If they concluded that it was not under the current regulation, you would need a change in the SIS legislation.

Senator SHERRY—Could you take that on notice and have a look at it for me. Finally, we had some discussion about the collection of data relating to fees on the previous occasion.

Dr Roberts—Yes. That would be an ASIC matter.

Senator SHERRY—Do you collect any data on any sorts of fees, management costs, et cetera?

Mr Brunner—As part of our proposed new data collection we are proposing to break out some aggregate information in relation to overall fees and charges of the super funds, but that is really just at an aggregate level. However, we are examining options for collecting some more detail of fees and charges information as part of our whole new suite of returns for super funds. This suite of returns comprises the ones that we are proposing to introduce from July 2003. We have almost completed the draft set of forms and we will shortly be engaging in extensive industry consultation on those. During that industry consultation we will also involve ASIC to gauge its views about whether the sort of information we are collecting is suitable both for its purpose and our purpose. As you are probably aware, under the data systems that we have, APRA has taken on some data collection roles both for the Bureau of Statistics and for the Reserve Bank. In some ways, there may be logic in APRA also being a single point of entry for some additional information on fees and charges, but that is yet to be fully discussed with ASIC.

Senator SHERRY—We can see it developing further and we will hear from the industry players about that. Finally, have there been any justified proven complaints about any superannuation fund donating any money to any political party?

Mr Thompson—Not that we are aware of.

Senator SHERRY—You are not aware of any?

Mr Thompson—I am not aware of any.

Senator SHERRY—So you did not provide advice to the minister that, as she claimed on 14 May 2002 in the Senate:

... Labor's union masters are responsible for \$200 billion in investment assets—
a reference to superannuation—

This, of course, is a wonderful fund for the union movement's political wing here in the Senate.

I found that quite an extraordinary statement to make. You are not aware of any evidence that can support such statements?

Mr Thompson—I am not aware of it, and I am not aware of that statement by the minister either.

Senator SHERRY—I am drawing it to your attention now. You have got no evidence about donations from super funds to any political party?

Mr Thompson—Not that I am aware of. We may need to expand our proposed collections to pick up that one.

ACTING CHAIR—Going back to the CNAL case, has the trustee agreed to look at or agreed to moderate some of his charges? If so, in what area and could you give us more detail?

Mr Phelps—Where we are trying to get to is to get the funds moved to the trustee of their choice. In the process of the final work by the acting trustee they have agreed to review all fees charged at that point.

ACTING CHAIR—What is their current charge-out rate per hour?

Mr Phelps—It varies according to the level of the individual that is doing the work, but it was \$250 for one level and \$150 for another level.

ACTING CHAIR—Is it true that some of the costs incurred by the members and those costs that were raised by the trustee have exceeded the losses incurred by some of the funds?

Mr Phelps—Yes, in some cases.

ACTING CHAIR—In how many cases do those costs of administration exceed the losses?

Mr Phelps—I would have to take that on notice. But there are cases where the losses have been quite small.

ACTING CHAIR—That is right. Are there 500 funds?

Mr Phelps—It is 470.

ACTING CHAIR—Some of those funds have had minimum impact in terms of losses—is that right?

Mr Phelps—Yes.

ACTING CHAIR—But others have had more significant impacts?

Mr Phelps—Some of the funds had lost everything.

ACTING CHAIR—Why, then, has it taken so long to set apart those funds with minimum losses and put them in the hands of their own nominated administrator or an administrator whose cost structure was far less than a liquidator's?

Mr Phelps—The acting trustee has been attempting to move funds across to other trustees since before Christmas. It has been quite difficult—the other trustees have insisted on engaging in what they term 'due diligence', which is to ensure that the funds that they are taking on have assets of a type which they would find acceptable.

ACTING CHAIR—Surely there is no problem with the likes of people like Perpetual?

Mr Phelps—The approved trustees which look after small APRA funds have developed lists of assets which they offer to the people with the small funds, and saying that to have assets other than these types of assets, 'We are not prepared to condone your superannuation money being in those sort of assets.' So there have been some problems with that, because a lot of the funds associated with CNA had particular trusts set up for each particular fund. Some of the funds are waiting on distributions from the Confidence Trust, which is another one where the losses are not anywhere near as dramatic as they were with the Enhanced Cash Management Trust. The distribution from that has not been possible yet; they are still dealing with the courts there.

ACTING CHAIR—Did you seek tenders, knowing it was going to be a large job, before appointing the current trustee?

Mr Phelps—We sought expressions of interest. In relation to being in a position where you are moving towards replacing a trustee but it is not public knowledge, the view has been taken that it would not be possible to have an open tender, because that would be nominating exactly who was likely to be replaced before the decision had been taken that they had to be replaced.

ACTING CHAIR—How long has the current trustee been in place?

Mr Phelps—Since February last year—16 months.

ACTING CHAIR—In other words, who has been pushing them along trying to get a speedy outcome? Trustees in such circumstances have a vested interest in keeping the thing going. The history of Ansett was not all that marvelous either, was it?

Mr Phelps—We have been pushing them along, as you say. The meetings I referred to previously with the action group have been three-way meetings between the action group, ourselves and the trustee. Various complaints have been aired and attempts have been made to expedite this. As I say, the other trusts in which some of this money has been invested have not been able to be cleared. They are still awaiting court orders for distributions and things. Getting the dollar amounts of what each person's assets are worth has really only been possible in recent times. There is a big push to get everybody into a shape in which they can go to the trustee of their choice before the end of the year.

ACTING CHAIR—The end of this year?

Mr Phelps—The end of the financial year. That is what we are trying to do.

ACTING CHAIR—What sorts of financial offers have been made by the trustee in terms of moderating his fees?

Mr Phelps—All that has been offered is to review and check the fees that have been charged.

ACTING CHAIR—What does that really mean to a person who is getting bills and, for example, does not have any assets there?

Mr Phelps—If the superannuation fund does not have the assets, I do not see how the trustee can extract their fees. But it does not—

ACTING CHAIR—They have had to provide money from outside sources—is that right?

Mr Phelps—Some of them have done that, yes.

ACTING CHAIR—That is the story we have been hearing.

Mr Phelps—Some of them have done that, yes.

ACTING CHAIR—Isn't that pretty unacceptable—people having to pay for something when they have got zilch left?

Mr Phelps—The alternative would then have to be that the government was prepared to pay for acting trustees when there are large losses in superannuation funds, which is different to the way it has been done to now. Replacement trustees are put in place and, to now anyway, the members of the funds have paid for the services of the acting trustee.

ACTING CHAIR—It hardly seems like cricket, though, to have a situation where a person has either lost everything or there is nothing there and he is being charged big fees in terms of a wind-up.

Mr Phelps—Personally, I do not find it fair.

ACTING CHAIR—I think it is abominable.

Mr Phelps—Some of the people who have not got any money in the fund are subject to claims for compensation since they have lost all their money in the Enhanced Cash Management Trust.

ACTING CHAIR—Yes, but many of these people have to live in the meantime. People have been hoping for money for 12 months now.

Senator SHERRY—I think you have acknowledged it is unfair. To be fair to you, it is not your role. You can make recommendations to the minister on changes in this area. Have you done that at all?

Mr Phelps—No, we have been too busy trying to see how we can make this legislation work.

Mr Thompson—This is the first instance of a claim like this.

Senator SHERRY—Yes, I know it is the first.

Mr Thompson—It would be more than reasonable to expect us to have to review in conjunction with the Treasury how this has worked.

Senator SHERRY—Yes, or has it worked or partly worked?

Mr Thompson—It is the first time since SI(S) came into being that this provision has been activated.

Senator SHERRY—There will be some useful lessons to draw out of this experience.

Mr Thompson—There will be.

ACTING CHAIR—Have you discussed with the trustee this charging where there is nothing there and they have had to pull from their own resources, from moneys elsewhere?

Mr Phelps—I have not discussed that precisely, no.

ACTING CHAIR—Perhaps we should.

Senator SHERRY—Can I raise a concluding issue. It is a matter on fees and charges where I am a bit puzzled as to whether it does fit the sole purpose test or not. I have had a person who, under a workplace agreement, was in a master trust arrangement. I am checking out the details. They have sent me a copy of their superannuation statement. They had contributions of \$1,609.02 SG over the period from 1 September 2000 to 31 August 2001. As I understand, that was the correct contribution level. According to the statement, they were charged \$1,313.39—and there was minus \$44.34 in contributions tax—for insurance premiums, leaving a balance of \$251.29. The outcome clearly is not a superannuation retirement benefit, if you look at the outcome and the insurance premium charged. Do you have a view whether or not an insurance premium of such a size warrants an investigation in terms of the sole purpose test?

Mr Phelps—It certainly seems out of proportion. I would agree, yes.

Senator SHERRY—I must say that I almost fell off my chair when they sent me a copy of it. I just could not believe it.

Mr Thompson—We would be happy to have a look at it.

Senator SHERRY—I will talk to the member and I am going to give the fund—it is a major superannuation fund—the opportunity to explain themselves. I have suggested that the individual write and complain to the fund to see what they say and then I will refer it on to you, provided I get their permission to do so. But I just found it quite extraordinary that there could be such an insurance premium.

Senator CONROY—I was talking to you about the levies, we wandered into the superannuation levy, and that led us off to Central America. You had explained what you were going to be doing with the increased super levy. My rough look at this indicates that the costs of supervising the ADI sector will decrease. I know we talked at some length previously about the Auditor-General's report and the view the Auditor-General had which, to be fair, you disputed heavily.

Mr Thompson—No, to be fair, Senator, the Auditor-General made a number of recommendations, most of which we accepted.

Senator CONROY—I said you disputed some of them heavily; I was not suggesting that you accepted them. It just seems a bit at odds though, in terms of that discussion, to end up spending less time on ADIs in terms of the particular criticism—

Mr Thompson—It is not less absolute; it is less in relative, as a proportion of the total. And if something is going up and we are being encouraged to spend more time on it, as we have done, under considerable pressure to do more in the area—

Senator CONROY—It is always hard with limited resources to do more, so I am very pleased to see that you are—

Mr Thompson—If you were talking percentages they have got to add to 100, and if one goes up something has to come down. Some of the additional resources we are getting in aggregate will be devoted to ADI issues.

Senator CONROY—I am particularly thinking about the on-site visits argument. I know we had this argument and you rejected the view that you needed more on-site visits. So I am just wondering whether this is part of addressing some of that. Perhaps I am being unkind when I say you rejected the idea. I am not trying to verbal you.

Mr Thompson—Some of the figures that the ANAO quoted on visits were not typical because they were drawn from a period when APRA was building up its staffing resources. Some of the additional resources that we will be taking on board are going into Mr Karp's division to be involved in on-site work with conglomerate groups, which obviously picks up both ADIs and the larger insurers. There will also be funding going into our policy research and consulting group to work on the implementation of the reform capital accord that is coming out of the Basel Committee on Banking Supervision. So in absolute terms we will be spending more on ADIs. It is just those relativities that are shifting around.

Senator CONROY—I want to come to an answer to a question on notice where I asked about the bonus pool and you took me through that. Then I asked you about individual staff and you sent back a letter saying that you object to providing the Commonwealth with a list of performance bonuses. I might get Senator Watson to read section 9 of the standing orders if he could. I wish Senator Brandis was here to read it.

Senator JACINTA COLLINS—I think that is one of his favourites.

Senator CONROY—It is one of his favourites.

ACTING CHAIR—Section 9 states:

A chairman of a committee shall take care to ensure that all questions put to witnesses are relevant to the committee's inquiry and the information sought by those questions is necessary for the purpose of that inquiry. Where a member of a committee requests discussion of a ruling of the chairman on this matter, the committee shall deliberate in private session to determine whether any question which is the subject of the ruling is to be permitted.

Senator JACINTA COLLINS—Is that the one?

Senator CONROY—The section about information available to the Senate.

Senator JACINTA COLLINS—You might have the wrong one.

ACTING CHAIR—Yes; I cannot see where that has any relevance.

Senator CONROY—It is read out at the start of each meeting—Senator Brandis's favourite.

Senator JACINTA COLLINS—Is it 23?

Senator CONROY—Sorry, I had the wrong one.

ACTING CHAIR—The section on public funds states:

The Senate reaffirms the principle, stated previously in resolutions of 9 December 1971, 23 October 1974, 18 September 1980, 4 June 1984 and—

I do not think this is the one.

Senator CONROY—That is the one.

ACTING CHAIR—It continues:

... that there are no areas in connection with the expenditure of public funds where any person has a discretion to withhold details or explanations from the Parliament or its committees unless the Parliament has expressly provided otherwise.

Senator CONROY—Are you aware that parliament has expressly provided otherwise in this matter?

Mr Thompson—No, I am not. I guess I have been guided by the paragraph here which says:

Where a witness objects to answering any question put to the witness on any ground ... the witness shall be invited to state the ground upon which objection to answering a question is taken. Unless the committee determines immediately that the question should not be pressed, the committee shall then consider in private session whether it will insist upon an answer ...

et cetera. I believe we were completely within our rights to object as we had on any ground. We had been expecting the committee effectively to come back to us—

Senator CONROY—I was happy to wait till today.

Mr Thompson—to progress this issue if it wanted to pursue it.

Senator CONROY—Okay. Perhaps it may solve this dilemma without having to go into a committee meeting to press. How many direct reports do you have?

Mr Thompson—Me?

Senator CONROY—Yes.

Mr Thompson—I think it is nine.

Senator CONROY—If I amend the question to just say yourself and the nine direct reports, are you happy about that?

Mr Thompson—I would be happy to provide that information.

Senator CONROY—Do you have it handy?

Mr Thompson—No.

Senator CONROY—So yourself and the nine direct reports would be fine?

Mr Thompson—Yes.

Senator CONROY—Great. That will avoid us having to go into any—

ACTING CHAIR—So there is not a problem?

Senator CONROY—No. That is satisfactory. I am happy to limit it to that.

Mr Thompson—Can I just confirm, Senator, that was for last year or all years?

Senator CONROY—No, I was talking about 2000-01. I am happy if we can go back to the previous year as well, so the last two financial years.

Mr Thompson—Okay.

Senator CONROY—I presume you have not done this year's.

ACTING CHAIR—Senator Conroy, can you just clarify your request?

Senator CONROY—Mr Thompson was just asking which year. I am saying 2000-01 and the previous year.

Senator JACINTA COLLINS—The chair is actually seeking to understand precisely what is being provided.

ACTING CHAIR—What is being provided? What is the request?

Senator CONROY—I had asked for a list of the performance bonuses over the last two years for staff—all staff individually—and Mr Thompson had written back indicating that they objected to providing all 400, approximately. I am happy if you want to have a procedural discussion that the committee is entitled to press that. But if it solves Mr Thompson's problem, I was only really after his and his nine direct reports, and I am happy to accept that.

ACTING CHAIR—So you are restricting the question?

Senator CONROY—I am happy to restrict the question to a narrower focus. If the committee wants to object and actually press on with the original request, I am relaxed about that. But I am happy if it solves Mr Thompson's problem, and he has indicated that it does.

Senator JACINTA COLLINS—Can I just ask before you move on from that: if you are providing just yourself and nine others, what proportion of payroll associated through bonus payments does that represent? You might need to take that on notice as well.

Mr Thompson—Yes.

Senator SHERRY—Chair, there is one issue I just want to clarify. I have had a query relating to the comments that you made earlier today when we concluded the session on the contributions tax. You will recall you made some comments on the record which, someone has drawn to my attention, could perhaps reflect on the questioning—words to the effect that you did not know what we were questioning about or arguing about, given that the costings were lineball. Can you recall the context of those comments at the time?

ACTING CHAIR—I think the comment that I made was in relation to a series of questions that you had asked a number of witnesses. As a result of the responses from the witnesses, there was not a material difference, I did not think, in the responses of each of the different people who responded.

Senator SHERRY—That was in respect of the costing scenarios.

Senator WATSON—Yes. I made the comment that overall there did not appear to be a significant difference in terms of the answers provided by the various witnesses, although they each approached the answers from a different perspective.

Senator SHERRY—Okay. That is fine.

Senator CONROY—Mr Thompson—

Senator JACINTA COLLINS—I am sorry to interrupt, but the chair was just raising a question as to why that information would need to be placed on notice. How many days on this committee do you need to wait—about 30? What is the standard?

Senator WATSON—Is there a hurry? As long as we get the information.

Senator JACINTA COLLINS—You do not mind? Okay.

Senator CONROY—Is it the board of APRA?

Mr Thompson—We have a board.

Senator CONROY—Do the board receive bonuses?

Mr Thompson—I do not believe so.

Senator CONROY—The chairman does not? He is a full-time remunerated officer, I think.

Mr Thompson—He is not full time.

Senator CONROY—What is his remuneration—Dr Carmichael's?

Mr Thompson—It is set by the Remuneration Tribunal. From memory, it is of the order of \$105,000.

Senator CONROY—\$105,000?

Mr Thompson—Something of that nature. It is published in a remuneration determination.

Senator CONROY—I just could not remember; I thought it was actually more. Just vaguely in my head I thought I had seen a figure and I did not realise that he was not a full-time chair for the sort of salary that I saw. That is all. There are no bonuses for the board?

Mr Thompson—Not to my knowledge. I am certainly not involved in any decisions about bonuses for the board.

Senator CONROY—Yes, that is fine.

Mr Thompson—I do not believe so. I think the remuneration is set by the Remuneration Tribunal. I do not believe there are bonuses.

Senator CONROY—That is fine. As I said, the figure you just quoted is much less than the figure I thought I had seen attributed to Dr Carmichael. I am sure that you are right and I was wrong.

Mr Thompson—I am not vouching for that number precisely, but I think that it is of that order.

Senator CONROY—If it is substantially different from that, you can take it on notice and let us know, or do not worry about it.

Senator JACINTA COLLINS—While we are on general agency resources, there is one element here that I would like you to explain to me from the PBS. Going to page 123, this additional \$12 million that has been allocated is over three years, is it?

Mr Thompson—I believe that it is over four.

Senator JACINTA COLLINS—It is \$3 million over four years—is that right?

Mr Thompson—Yes, I believe so.

Senator JACINTA COLLINS—What is this reduction in prudential advice between 2001-02 and 2002-03? If you look at the total resources, outcome 1, you are dropping from 8,052 to 4,156.

Mr Thompson—I am not sure why this is the case, but I believe that prudential advice number has a special allocation of \$4 million we receive for costs associated with the HIH royal commission.

Senator JACINTA COLLINS—So that is removing that factor?

Mr Thompson—If you take that out, then the comparable numbers are four and 4.1.

Senator JACINTA COLLINS—Okay. So if I go back to the previous PBS, that should represent that additional \$4 million added to that area with respect to HIH?

Mr Thompson—Sorry, if you go back to the—

Senator JACINTA COLLINS—The previous PBS, it should indicate an additional \$4 million allocated in output 1.1.3 with respect to prudential advice related to HIH.

Mr Thompson—It is slightly odd to me that it is in that item, but I believe that is the explanation.

Senator JACINTA COLLINS—Okay. But can you confirm for me—and you might need to do this on notice—that the previous PBS, when that allocation was made, put that \$4 million into 1.1.3 and that that is the explanation for that drop?

Mr Thompson—I believe it is, but we will confirm it.

Senator JACINTA COLLINS—Thank you.

Senator CONROY—On a very similar matter, in last year's budget you were provided with additional funding of \$4 million to cover costs associated with your activities relating to the royal commission. How much and what costs have you incurred in relation to your activities at the royal commission and will you expend more or less than the \$4 million this year?

Mr Thompson—The factual question I would have to take on notice. Some of our costs associated with the royal commission are covered under an insurance policy through Comcover and others are coming from that \$4 million appropriation. I do not have in my head the amounts under each heading. Whether we will need to expend the full \$4 million or not depends very much on how long the royal commission runs and—

Senator CONROY—That is a piece of string really, isn't it?

Mr Thompson—how extensive the time our legal team spends in preparation of witness statements and other submissions by APRA. This time next year we will know the answer to that question.

Senator CONROY—In the APRA *Insight* for the first quarter 2002, you state:

The HIH Royal Commission will also necessarily absorb a significant amount of management time and effort.

Mr Thompson—Yes.

Senator CONROY—Has your involvement been more than you anticipated? Are you glued to the TV or glued to the transcripts?

Mr Thompson—No, I have not been following—

Senator CONROY—They are making great reading, you've got to admit!

Mr Thompson—I have not been following it closely because of other pressures. In the next two or three months, though, myself and other senior members of staff will be engaged in the preparation of witness statements.

Senator CONROY—You will actually be a witness at that point?

Mr Thompson—That is correct. So the main diversion of time and effort into the royal commission for myself and others—

Senator CONROY—Will be actually prepping.

Mr Thompson—is in the next three or four months.

Senator CONROY—Who has been called? Who is the rogues gallery?

Mr Thompson—Nobody has been formally called, but we have indications from counsel assisting that the chairman of the board, myself, Mr Karp and Mr Thorburn will be giving evidence.

Senator CONROY—Mr Thorburn is overseas now, isn't he?

Mr Thompson—He has taken a position with the World Bank, yes.

Senator CONROY—Lucky bloke! Now that the royal commission has been extended, are you to be provided with extra funds from the government, or do you think that you will be able to absorb these costs from funds which would otherwise be used for supervision work? It is a little bit of a similar question.

Mr Thompson—We have not needed to ask for additional funds yet. If we do, and if the \$4 million is insufficient, then we would request additional funding.

Senator CONROY—Turning to some of the evidence discussed at the HIH royal commission—and I appreciate that there are constraints, but I think this we can safely discuss. I have run it past my lawyer and I do not think that we fall into an area of specifics, though if you do feel that, please just say. It was revealed that the APRA officer asked to examine HIH had received no formal training in the area of financial reinsurance. Can you just take me through how that arose? As I said, if you think that does fall within things that may be part of your evidence, or questions, I am happy for you to—

Mr Thompson—I have got general advice that it is really not appropriate for us to be commenting on evidence that has been led at the royal commission, ahead—

Senator CONROY—No, particularly ahead of your own testimony.

Mr Thompson—of APRA officers giving evidence.

Senator CONROY—I completely understand. I might discuss this from a slightly different angle. I think you have already mentioned this: what training do the new graduates at APRA get now in relation to insurance and what ongoing training is provided? I think you mentioned you are getting in some specific staff.

Mr Thompson—We have a very extensive training program. The particular training that individuals get will depend on which part of the organisation they are going to. There are

general training courses in prudential regulation and there are more specialised courses in aspects of insurance, banking and superannuation, depending on the particular job that an individual will be undertaking.

Senator CONROY—I am thinking more specifically in terms of insurance. I think the structure Mr Karp now looks after is a sort of multi—

Mr Thompson—That is correct.

Senator CONROY—No-one who works out in the field is an insurance person per se. I will come to some jobs that you have advertised in the papers. Given the complexities of reinsurance, is there anything specific you are doing in that area, other than hiring somebody, perhaps? You may say, 'We've got this one person or these new seven people that will be there.'

Mr Thompson—I will ask Mr Karp to say something about our general training program for graduates. We are building this new insurance risk team. We have recruited to senior positions in the last couple of months two actuaries, including the lady who is the President of the Institute of Actuaries of Australia. So we are very much addressing the need to have in-depth expertise in insurance issues, as in the other sectors. In terms of a general training program for people coming into the organisation, I will ask Tom to say a word.

Mr Karp—We do have a small area which is actually now dedicated to establishing training programs. We do have general training about APRA—how it works and how we go about doing things within APRA. We have specific training modules about each of the different pieces of legislation and the requirements on companies that we supervise. We have training about each of the sectors so that people gain knowledge about the sector and the practices within the sector. It goes into different aspects of banking, life insurance, general insurance and so on. These are a mixture of training modules that range from two days to up to a week in length. Depending on what area the person is coming into, they may do an initial week of induction type training and then, over the first two or three months that they are employed, go back and do extra weeks in the different areas they are working on.

Your earlier questions were more towards insurance and reinsurance issues and training there. We do have some specific training on reinsurance, but it does not get right down to the detailed bowels of all different sorts of reinsurance contracts. Mr Thompson mentioned earlier setting up an insurance risk group. That is in the process of being established now. The person who will head that group has in fact been appointed. This person has actually worked for a reinsurer for a number of years. We also have within the organisation someone else who has worked in the reinsurance business. Where we do now need to look at reinsurance arrangements in a complex and detailed way, we call on that person and will clearly be calling on some of these other people who are going to be coming into this new area.

Senator CONROY—In early April I noticed a rather large advertisement for seven senior positions within APRA. How many of those positions have now been filled?

Mr Karp—Within my area I think we have filled about five. We are in the middle of filling about another six. There are some others. I just mentioned one, which is the head of this new insurance risk group. That is not actually in my area so I cannot tell you the exact numbers off the top of my head.

Senator CONROY—You have filled the position for the head of insurance risk?

Mr Karp—That one has been filled, yes.

Senator CONROY—What sort of staff turnover do you have at the moment?

Mr Thompson—In Sydney, where it is highest, I think it has been of the order of 16 or 17 per cent.

Senator CONROY—It is a most competitive market.

Mr Thompson—Very much so, yes. Our experience has been that we are able to attract good graduates into the organisation.

Senator CONROY—But holding them is tough.

Mr Thompson—They tend to stay for two or three years and become very attractive as compliance officers or analysts with commercial banks, insurers or accounting firms.

Senator CONROY—On average, how many jobs are vacant at any point in time?

Mr Thompson—We work on the assumption that we will have about five per cent of our jobs vacant. That is the working assumption we feed into our budgetary process.

Senator CONROY—Have you ever considered the American model where people are seconded into their various agencies for fixed periods? I am just trying to address that issue of a very competitive market, particularly in Sydney, and holding on to your staff—building up that external experience.

Mr Thompson—One way we are attacking that is to hire people from industry. We have had some success in some of the very senior positions in the last few months. Secondments have certainly been considered. They are not as easy to make work in a small market like the Australian market as they are in a large market like the American market.

Senator CONROY—There are conflict of interest issues?

Mr Thompson—There is conflict of interest but there is also the question of access to confidential information in relation to companies that may be competitors of the company that the secondee comes from. I would draw on experience both from the Reserve Bank and from the Insurance and Superannuation Commission, as well as in APRA. Secondment has not been a terribly fruitful way of bringing industry people into the organisation. At the moment we are having more success in actually hiring people out of industry who are perhaps looking for a change or who are getting towards the end of their career and looking for something with a bit more challenge.

Senator CONROY—A former FAI executive has not applied—one who was up in Queensland, with Metway? He has not put in an application?

CHAIR—We might take a short break for 10 minutes. Before doing so, as I understand it, there is an arrangement that the Australian Office of Financial Management will be dealt with tomorrow.

Senator CONROY—Senator Sherry had indicated that he had quite a few more questions for APRA. He has now indicated that he will put them on notice. That means, I suspect, that I could finish my questions to APRA by 10 p.m.

CHAIR—I believe Senators Schacht and Collins also have questions for APRA. If we deal with the Australian Accounting Standards Board and the Financial Reporting Council some time after 10 p.m., we will still be likely to be finished by 11 p.m. So the Australian Office of Financial Management will not be required until tomorrow.

Proceedings suspended from 9.32 p.m. to 9.45 p.m.

CHAIR—I call the committee to order.

Senator CONROY—I was asking about jobs and vacancies. Are there currently any significant and senior positions which are vacant and that you are looking for people to fill?

Mr Thompson—There is one new position heading up the Quality Assurance and Consistency Unit which I have recently established. We have not filled the position of head of that role yet. Apart from that there are no other senior positions vacant at present.

Senator CONROY—You mentioned there might be some about to become vacant?

Mr Thompson—A couple of senior people will be going.

Senator CONROY—Anyone here? Should we farewell them?

Mr Thompson—Mr Phelps will be leaving us in a couple of months.

Senator CONROY—This might be your last estimates.

Senator SCHACHT—‘Thank God for that,’ he says.

Mr Phelps—It could well be, yes.

Senator CONROY—Good luck. Are you moving on to something else or having a well-earned rest?

Senator Abetz—This is not necessarily a matter for—

Senator CONROY—I am just saying, ‘Are you having a well-earned rest?’ I was just going to wish him luck if he was going to retire or—

Senator Abetz—Yes; but it is going to be on the public record.

Senator CONROY—I am not trying to embarrass him; I am just wanting to wish him well.

Senator Abetz—I am sure we all do.

Senator CONROY—I will have a chat afterwards.

Senator SCHACHT—Minister, at the hearings in February I asked a series of questions to APRA about the issue of the declaration of fees on super funds et cetera, and about what people are charged. I got a response—they took it on notice—from APRA. Mr Thompson, you gave me a response that in one sense was okay but it was not quite to the point of what I was trying to get at. Maybe I misphrased the question. The response stated that the statistical election information from superannuation entities is currently under review by APRA, and that the new draft reporting requirements are undergoing internal review within APRA to ensure that any information to be collected enables APRA to effectively regulate superannuation. The proposed collection will then be open to the public for comment. It states also that in determining the final content of the collection, APRA will assess the need for specific data against the burden to entities in providing the information. Then there is a dot point with a whole series of little hyphens. I do not know whether you have the answer.

Mr Thompson—Yes, I do.

Senator SCHACHT—It is on pages 109 and 110. What I was trying to get to is this. Does this review look at the issue I feel strongly about? The entity should have to tell their client each year in their annual information report on how the investments have gone—in actual dollars and cents terms—how much money has been taken out to cover the charges by the entity. At the moment, it is in a convoluted percentage figure, often split into two and so on.

You would have to be reasonably numerate and literate and have a lot of other information to work out what it meant each year. What I am after is: why can't it be an absolute requirement that they not only put in the percentage figure but that they also say, 'And this means for the year ended 30 June we took out \$347.59 to cover all our expenses'? Why can't that be a mandatory requirement?

Senator CONROY—Would you like me to answer it? Because the government will not make them!

Mr Thompson—A technical answer is that APRA does not have the power to mandate disclosure by superannuation funds.

Senator SCHACHT—If you do not have the mandatory power, who does?

Mr Thompson—ASIC is the disclosure regulator.

Senator SCHACHT—How can you be a regulator if you cannot have the power to do this, even if you wanted to do it?

Senator CONROY—Because the industry is passionately opposed to it?

Senator SCHACHT—You are a regulator, aren't you?

Mr Thompson—We are the prudential regulator. We are concerned with the financial condition of the institutions we regulate—

Senator SCHACHT—But when I went to ASIC they said that it was your—

CHAIR—Senator Schacht, let the witnesses finish their answers. Mr Thompson, you were saying?

Mr Thompson—When you asked ASIC about this last time, they interpreted your question in the same way that we did in responding to you, as being a question about collection of information from funds for calculation of aggregates and assessment of industry trends et cetera. We do have the power to collect that information, and that is what our response to you referred to.

Senator SCHACHT—The power to collect what information?

Mr Thompson—Under the Collection of Data Act we can collect almost any information—

Senator SCHACHT—Why can't you collect that information?

Mr Thompson—What we cannot do is mandate disclosure standards by superannuation funds or other regulated funds. That is an ASIC matter.

Senator CONROY—To assist you, Mr Thompson, I will say that we are actually currently involved in debate on a bill that is about mandating disclosure in dollar terms. It is fair to say that the government and the industry are not keen, but we are pressing on.

Senator SCHACHT—Is that a bill to regulate for ASIC or for you?

Senator CONROY—It is the Financial Services Reform Act—

Mr Thompson—Which is an ASIC act.

Senator CONROY—Which is an ASIC act, but—

Senator SCHACHT—When do ASIC turn up?

Senator CONROY—Tomorrow?

Mr Thompson—Thursday.

Senator CONROY—Thursday. Thank you. But to be fair to APRA, they are correct; they do not have the power to mandate this. Equally, ASIC do not have the power to mandate it. Notwithstanding the legislation's intent, it appears that the government has done a deal with the industry to frustrate the will of parliament. You may get a chance to have a vote on this in the Senate, Senator Schacht.

Senator SCHACHT—Next week? Or the week after next?

Senator CONROY—In a week or two's time.

Senator SCHACHT—I will speak on it as well. Don't you think, Mr Thompson—whether it is you or ASIC—that in terms of good governance of super funds and information to consumers this is not an unreasonable thing to provide?

Mr Thompson—My personal view is that it is not an unreasonable thing to provide, but I cannot help you beyond that, I am afraid.

Senator CONROY—I can only suggest to Senator Schacht that an officer from ASIC is in the room, and he might want to have a chat with him before he leaves.

Senator SCHACHT—Who is that?

Senator Abetz—But not on the record.

Senator CONROY—But not on the record, right.

Senator SCHACHT—Have we got that secretary at the table as well?

Senator CONROY—No, there is an officer in the room.

Senator SCHACHT—Down the back? Do you want to come to the table?

Senator Abetz—No, he does not.

CHAIR—No. That is irregular, Senator Schacht; ASIC is not being called this evening.

Senator SCHACHT—In terms of the answer you gave me, with all these details about how you are looking at what disclosure is required, when you get all this information, I presume, per investment fund, what are you going to do with it? Are you going to publish it to say, 'This fund has had all of these charges, totalling the investment management fees; the custodian fees; the asset consultant fees; the valuation fees, for example, for property; exit fees, rates on withdrawal of investment; other direct investment, for example, brokerage; charges under the heading of 'Other operating expenses', which is really another way of separating them; management fees other than investment management'? It goes on and on. You can see the list there.

Dr Roberts—We only publish aggregates.

Senator SCHACHT—What is the point of collecting it all in individual lines if you only publish it as an aggregate?

Dr Roberts—We use it for information as to the condition of the fund, but we collect it on a commercial-in-confidence basis, and the secrecy provisions in the APRA Act—

Senator SCHACHT—The what provisions?

Dr Roberts—The secrecy provisions, which require us to protect—

Senator SCHACHT—You are not ASIO, are you? You are not ASIS, are you?

Mr Thompson—We are operating under legislation passed by parliament. I am sorry—

Senator CONROY—You probably voted for it, Schachtie. I know you are a great civil libertarian on privacy.

Senator SCHACHT—I know; I am all in favour of privacy. But you tell me that if this were adopted you would collect all of these individual pieces of information and then you would put—

Senator CONROY—Then they would keep it secret.

Senator SCHACHT—Then you keep it secret.

Dr Roberts—It is used in two ways.

Senator SCHACHT—But how could my privacy in terms of the fund I am in be affected if you publish that? The fund I am in might have \$100 million invested through 100,000 people. I am not asking you to name each one of us. Why couldn't you publish that the Acme Investment Fund collected investment managers fees charged to the fund of X amount of dollars, and custodian fees of X amount of dollars? How is my privacy being affected?

Dr Roberts—No, it is not personal privacy; it is commercial-in-confidence privacy.

Senator SCHACHT—What? Explain that to me again. How could it be commercial-in-confidence when it is an individual's money?

Dr Roberts—The unit record data we collect from individual entities, whether it is a bank or a superannuation fund or a credit union, is collected on the basis that we protect it as confidential, commercially protected information. That is the understanding that we have with the industry. It is the same as regulators do elsewhere. We publish aggregates to the extent that they do not identify individual regulated entities. It is the same as, for example, the ABS does.

Senator SCHACHT—Hang on! This is not the same as the ABS on individual privacy. The *Financial Review* publishes at the end of the week hundreds of funds with their percentage return. Why don't you publish, and make available in a document for each of those same funds, that the total amount of all these fees—just one line—represented four per cent, which is X amount of dough? What privacy is being broken?

Dr Roberts—It is not personal privacy, which relates to individuals; it is commercial-in-confidence, which relates to commercial entities.

Senator SCHACHT—What is commercial-in-confidence about it? It is about competition and showing people that one fund is charging more than another fund. Then the consumer has some information to say, 'Actually, I will stay with this fund rather than that one, because they are charging me less.'

Dr Roberts—With the research houses in the market that survey industry, where those entities are happy to volunteer that information, it gets published in the *Financial Review*. But that is not our job.

Senator SCHACHT—No. As I said, you might tell me that the legislation does not allow you to do this; that is the fault of parliament. We may have an argument about that. But in terms of transparency for consumers, I am not asking you to name an individual investor, or the general manager or the senior people running the company—that is listed somewhere else. All I am saying is this: why couldn't you produce a list at the end of year and say, 'From the information we have collected, these are the percentages and this is the dollar amount'?

Dr Roberts—It would go beyond our mandate, which is to—

Senator SCHACHT—Sorry; is your mandate in the legislation or is it—

Dr Roberts—Yes.

Mr Thompson—I do not think we have the power to do what you are suggesting.

Senator SCHACHT—That means we have to amend the act?

Senator CONROY—He wants to get a ‘name and shame’ operation going.

Mr Thompson—I honestly do not think we have the power.

Senator SCHACHT—This is what I want to get to: you are telling me that to get that we would have to amend your act?

Mr Thompson—I believe so.

Senator SCHACHT—That is your act, not ASIC’s act?

Dr Roberts—That is the APRA Act.

Mr Thompson—It deals with secrecy of information.

Senator SCHACHT—So apart from Senator Conroy and a couple of others here—even including Senator Watson, who is probably on the same track as this—you are telling us that the whole industry is opposed to this publication?

Senator CONROY—I think it would be fair to say that I said that, rather than—

Senator SCHACHT—I am sorry. Have you sought the views of industry about whether they have any objection to having published each year, for all of the funds, one extra line saying that you have collected this information and that for a certain fund all its total admin fees equal two per cent?

Dr Roberts—That is not our role.

Mr Thompson—I do not think we have. But it is a question we could ask them when we get into this consultation process that we described to you in the response.

Senator CONROY—I am sure that if any of your APRA officers were present at an IFSA function a little while ago in Parliament House that Mr Mohl from AMP spoke at, the chair of IFSA—

Mr Thompson—I do not—

Senator CONROY—A few of you are nodding.

Mr Thompson—We know Mr Mohl.

Mr Karp—We actually did have a person there, but none of us was there.

Senator CONROY—I think he gave a very passionate speech about the question of disclosure of fees on behalf of IFSA. If a copy is available, I am sure you would be entertained and appalled.

Mr Thompson—A better way of attacking this, in my view, would be to mandate that funds provided it. Then it is much more accessible to the members of a particular fund, if it is being provided to them by their fund, rather than in some screed. There are several thousand funds.

Senator SCHACHT—Now that you have raised it, I want two things. Firstly, you are going to get all of this information. I cannot see why you cannot publish it per fund as one figure. I also believe it ought to be mandated that each individual, when they receive their

annual report on how their investment has gone, not only has a convoluted percentage figure but is told what it equates to. I think some people would probably be shocked to find when they actually read it in dollars and cents that it is a heck of a lot more than they expected. One per cent or 0.9 per cent looks a very seductively small figure.

Mr Thompson—I believe you are right. Some people would be surprised.

Senator SCHACHT—You will take it on board now, on notice, that when you consult over the draft in your area about whether it should be mandated you can have it mandated that you will publish, once a year, the management costs of each of the funds when they provide you with all this information?

Mr Thompson—Well—

Senator SCHACHT—They do not have to agree to it; but will you at least ask them?

Dr Roberts—Mr Brunner said earlier—I think you were not here, Senator—that he would be consulting with ASIC as to whether we could collect some information on their behalf. It is ASIC's role, but if it is decided that we would collect some fee and charges information on their behalf because that is efficient, then that could happen. But it is not our core role.

Mr Brunner—That is right. There are two elements to this. One is about aggregate information, and the other is the separate question of individual reporting to fund members. They are quite distinct things. We will examine the legalities of publishing information, but we will also, as part of the consultation process with the superannuation funds for these new returns, flag with them options for publishing data. We already publish individual company data in the insurance sector, because the insurers have agreed to that. They allow us to do that. If the superannuation funds say, 'We have no problem in publishing some aggregate data,' that would be fine.

Senator SCHACHT—I think this will have to be mandated, because you will have to make sure that everyone does it, that everyone suffers equal pain. The next thing I am worried about is that some funds might say, 'Well, we do not mind you publishing six of these dot points, but we don't want you to publish those four.'

Senator CONROY—Can I perhaps help to short-circuit this. There is currently a regulation before parliament that goes to the heart of this issue in terms of mandating, or otherwise, information to be provided by the funds to each individual member. It is subject to Senate disallowance. I suspect you may well get the chance to join this debate soon on this very issue, Senator Schacht.

Senator SCHACHT—So long as you take this on notice and come back. I will not be here at the next estimates, but Senator Conroy will be more than happy to receive the answers and get on with it. I look forward to the debate. I just think it is a very reasonable thing for consumers to have. Thank you.

Senator CONROY—I wanted to have a chat about your policy program for this year, which was released in the *APRA Insight* for the first quarter. That *Insight* there is an article on APRA's policy program for 2000 and beyond. Could you outline broadly what factors have determined APRA's policy program and what those priorities will be?

Mr Thompson—That article described the program.

Senator CONROY—Could you just give us a brief summary?

Mr Thompson—Of the main items?

Senator CONROY—Yes.

Mr Brunner—Obviously, it was outlined in *APRA Insight*. We also report our policy program to the board on a regular basis. At the most recent board meeting, we went to the board to outline the program. I will run through the list, if you like?

Senator CONROY—Just the headings would be fine.

Mr Brunner—The prudential supervision framework for superannuation; prudential supervision of medical defence organisations; ADI—that is, authorised deposit-taking institution—conglomerate proposals; our roll-out of our statistics program, our new statistics systems; APRA's legal framework and powers; ADI liquidity management and crisis management; the Basel capital accord; a scoping study on compensation arrangements; regulation of specialist credit card issuers and acquirers; our improved risk rating system for financial entities; superannuation returns; interest rate risk in the balance sheet; management of IT and security risks; and another proposal in relation to ADI conglomerates, looking at non-operating holding companies and how we bring them into the prudential framework. We are looking also at conglomerate issues for general insurance, because the new general insurance reform proposals do not go to the conglomerate levels, and so we need to consider that. There is the review of life insurance, and eligibility of innovative capital instruments.

Senator CONROY—Comprehensive.

Mr Brunner—It is.

Senator CONROY—Thank you for that. I wanted to focus in particular on one matter in that article under the heading 'Enforcement and failure management'. The article states:

Our objective with this project is to update, strengthen where necessary, and harmonise APRA's enforcement and failure management powers across all the industries that we supervise. APRA is working closely with Treasury on developing policy proposals. It is expected that Treasury will issue a discussion paper in early 2002 with a number of reform options.

Can you provide some further explanation of the goals of that project and details of any areas where you have found that your powers need to be strengthened?

Mr Brunner—In the outline that I just gave you, we are now describing this really as all encompassing APRA's legal framework and powers. We are looking a bit beyond purely enforcement and failure management. So we are looking at all of APRA's powers there.

Really, the aim is in one area to get harmonisation across the different pieces of legislation, because the different acts at the moment allow us to do different things. We are certainly looking to extend some of the powers that have been brought into superannuation in recent times and introduce concepts such as enforceable undertakings and the different liability offences across the various pieces of legislation that we have. It is also looking at the structure of our legislation. At the moment, the model that we have involves high level legislation, prudential standards, and then guidance notes. We wish to introduce that type of structure of legislation and prudential framework across all of our industries. We are there with ADIs, we are getting there on 1 July with general insurance, but we are not there with life insurance or with superannuation in terms of that structure of our legal framework. So they are essentially the aims.

Senator CONROY—The crisis in public liability insurance has focused attention on why insurers were able to engage in such heavy discounting without—'protection' is not quite the right word, because a lot of people were talking particularly about HIH and their aggressive

policies. What powers do you have to assess whether, for premiums, insurance companies are charging actuarially—I will say ‘fair prices’, but I am probably meaning by that prices that are not going to send them bankrupt?

Mr Brunner—I think that we are seeing from the data that we are receiving from insurance companies as part of the reauthorisation process under the new GI reform, particularly in the public liability area, that the companies were not really recognising the risk that existed in that business. We prepared some statistics for the public liability ministerial meeting last week which indicated that for the top seven major insurers in the public liability area the capital needs for that class of business are considerably greater than the capital that was actually being set aside under the previous framework. What this new GI reform model is showing the companies is the amount of capital that they really need to set aside for that line of business. It is making it a lot more transparent for them—the cost of capital that needs to be taken into account. The hope would be that they will use that information when they are putting it through their pricing models. There is no mandating by APRA of pricing decisions. It is not something that we see ourselves wanting to get involved in to any great extent, but we feel that the new GI model will make much clearer to companies exactly the risks involved and give them much better signals when they actually price their products.

Senator CONROY—So all you can really look at then is whether they have got the reserves; is what you are saying? You have got the new formula. They have got to have the reserves. You do not have any powers to look at whether or not if another HIH comes in—

Mr Thompson—We do not have powers over pricing, if that is what you are asking.

Senator CONROY—No, I am probably not asking about powers on pricing, but to go to them and say over a sustained period of time—you do not want to stop discounting and advertising and competition, but do you have a mandate to keep an eye on what is going on? If, over a couple of years, a company is pricing in a manner that you feel would jeopardise the stability of the market, do you have the capacity to have a quiet chat to them and say, ‘Is this position that you are taking sustainable over time?’ I am just trying—

Dr Roberts—Ultimately, if they underprice—which we do not like but we do not regulate it in Australia—

Senator CONROY—No, I am not—

Dr Roberts—If they underprice continually over a period of several years—and it happened in the life insurance industry in the late 1980s and in general insurance in the late 1990s—to chase market share, because they are more focused on growth than profits, then regrettably for us they will start making losses, that will diminish their capital and our controls will come in when their capital is under threat. We would much prefer for them to be profitable. But, apart from drawing their attention to the fact that there might be excessive price cutting in a particular product line, and that we would prefer that they were focused on product line profitability, we are not going to attempt to tell them what prices to set, because price controls are not a part of the Australian system.

Senator CONROY—Understood. Mr Brunner mentioned that you were preparing information for last week’s public liability summit.

Mr Thompson—And Mr Brunner spoke at that summit, yes.

Senator CONROY—You mentioned that. In terms of the argument that is taking place over this issue at the moment, there is a lot of debate backwards and forwards about tort

reform—caps and floors, I call them, but other people call them other things. Do you have a view on that at all—what is needed to help make the industry sustainable?

Mr Thompson—No. Clearly, the things that the government has talked about doing in the summit will ease some of the pressures which are coming through on either the profitability or the pricing that the insurance companies need to contemplate. Exactly how significant and over what time those effects will work through is not something that we are expert in.

Senator CONROY—I am not trying to get you to buy into the argument about what the governments are doing per se. Governments from all political persuasions are going in all different directions, so there is no political context to what I am trying to get to. There are a range of reforms, say, in New South Wales, which propose significant tort law reform. The insurance industry appears to be saying at the moment, ‘We are not able to indicate whether or not this will affect premiums.’ Do you think that is a sustainable position for the insurance industry?

Mr Thompson—I cannot speak for the industry in a sense. I am not sure if they are saying, ‘We really need to see how these things work in practice before we can make an assessment.’

Senator CONROY—How are you saying that?

Mr Thompson—They may be saying that. On the other hand they may be saying, ‘Yes, this will be helpful, but there are all sorts of other factors that are pressing on premiums as well. So we cannot guarantee that, with everything else that is going on, there will actually be a fall in premiums as a result of reform in tort law.’ But I am not—Mr Brunner will—

Senator CONROY—But they have argued for some consistent period that tort law reform is critical. All of a sudden, they get a government that is prepared to put it on the table and say, ‘Right, we are going to do it,’ and they suddenly throw up their hands and say, ‘Well, we are not really sure this is going to make a difference.’ Would they prefer it if everyone just did not do it? It just seems to be a nonsensical position that they have taken at the moment.

Mr Thompson—I have not been following their arguments that closely, but I would be very surprised if they were saying this would not be helpful to them.

Senator CONROY—Are they saying that they cannot guarantee that there will be a cent in premium falls if the sort of tort reform being talked about by New South Wales is put on the table? Does anyone want to comment on that? It is not about this.

Mr Thompson—It is not something that we have done any work on or that we have an official view on. I am not close enough to exactly what the insurance companies have been saying to comment on their view.

Mr Karp—I would just add one particular comment, and that is that part of their argument is that, while some of these things that are being talked about might not necessarily lead to reduced premiums in this area, they might actually lead to a situation where cover can actually be provided, whereas at the moment there are some situations where cover, self-cover—

Senator CONROY—I understand they have withdrawn cover in some areas. I am just intrigued by their argument for most of the last six to eight months that one of the key price drivers is the number of claims and the size of the payouts. To be fair to the government, Senator Coonan has been supportive of the New South Wales position, and all of a sudden the industry is saying that they no longer consider this as one of the key price drivers.

Dr Roberts—To be fair to the industry, they have put some qualifications on it. One is that just having tort law reform in New South Wales will not work if it does not happen in other states because you will find that all the litigation will shift—

Senator CONROY—They have got a national pool all of a sudden, have they?

Dr Roberts—The litigation will shift to another state. I think the insurance industry is waiting to see if this becomes a national uniform kind of tort law reform, because if it is not national and uniform we will just get a result of jurisdiction shopping.

Senator CONROY—I understand that is a potential problem. I am not quite sure how simple it is to shop across industries in some of these instances. I accept that is a theoretical position that they can adopt and Tasmania may suddenly become the home of every single claim. I am not sure how that would actually happen if it is a claim taken up by a company based solely in New South Wales and the injury took place in New South Wales. But it is theoretically possible that you could get that effect. I accept that that is a potential issue. I would have thought it is more likely that the effect would be that if Tasmania held out by itself no company would offer anybody within Tasmania a policy. But I just find it extraordinary that they are not prepared to put up their hands—after demanding tort law reform and after saying it is a key price driver of premium increases, to then turn around and argue, ‘Well, I can’t really offer anything.’

Dr Roberts—I do not think they are arguing that. I think they are saying it would be helpful—

Senator CONROY—They have said it publicly. Mr Mason has now repeatedly been on national television and radio saying that—

Dr Roberts—They cannot guarantee premiums will come down.

Senator CONROY—Yes.

Dr Roberts—Of course they cannot. In some cases, the premiums are still way, way below the costs of those particular policies. They have had five or six years of underpricing in some of these product lines and their reinsurance costs have gone up 25 or 30 per cent because the conditions in the international reinsurancing market—

Senator CONROY—They have tightened up.

Dr Roberts—There is a lot of catch up.

Senator CONROY—The problem here is this question of catch up. Is it fair for consumers who have never made a claim to be paying for the incompetence of HIH and FAI management? Is it fair for consumers to pay for five or six years catch up for an industry that has run itself into the ground?

Mr Brunner—I do not want to necessarily be stepping in and speaking for the insurance industry. That is obviously for them to do.

Senator CONROY—But just look at what you have had so far lining up at the table.

Senator Abetz—That is unfair.

CHAIR—Senator Conroy, hang on. Mr Brunner, what were you going to say?

Mr Brunner—I was going to say that the insurers, as far as I am aware, have made the point that they are not attempting to make up for past losses, particularly in the public liability line of insurance. They are just looking to get it on to a sustainable even keel. In relation to

the APRA data that we publish in relation to the net loss ratio for public and product liability, there is a net loss ratio of 125 per cent. So it is an unprofitable line of business, as Dr Roberts said. These statistics have been along those lines for quite a number of years now. My understanding is that the insurers are arguing that they just want to get that back to an even keel and not actually try to—

Senator CONROY—No, I have not got a problem with them wanting to get this year's premium to reflect a reasonable and sustainable position. I am not trying to verbal you, Dr Roberts, but I think there is an enormous suspicion that there is a catch up taking place.

Dr Roberts—You mean catch up in terms of recouping—

Senator CONROY—Profitability. Recouping past losses.

Dr Roberts—That is not what I meant.

Senator CONROY—As I said, I did not want to verbal you because I want to give you a chance to clarify your definition of catch up. Most of us sitting back think that that is exactly what they are trying to do.

Dr Roberts—I meant by catch up reversing underpricing so that their product lines become profitable here and now, as Greg said. We would not defend the five or six years of underpricing in order to chase market share by the general insurance industry over the late 1990s. That was not commercially sound. The companies were trying to grow at the expense of profits in assuming that their investment returns would enable them to stay in the black. That does not make good commercial sense. We would not defend that. As Greg said, as part of the rigour that they will have to face in the new regime that comes in and with the actuarial advice that they will be getting, hopefully they will be getting a bit more commerciality—

Senator CONROY—We all live in hope.

Dr Roberts—and science into their operations at present.

Senator CONROY—I again want to briefly talk about the preparation of your information in terms of the summit last week and the earlier summit. There has been a debate about the statistics that APRA have provided in terms of the number of claims. There has been an argument about apples and apples in terms of whether the figures are directly comparable and whether they are relevant. I am hoping you understand better than the way I just described that particular debate, because I want to give you the opportunity to put on the record your view on your statistics and whether the criticism of them is fair. One of my colleagues in the Senate has indicated that he believes that there has been a substantial fall in the number of claims; your press release said that the insurance crisis is over and the number of claims fall. I was just wondering if you wanted to give your perspective on the data you have collected and the rigour of the data you have collected.

Mr Thompson—I will ask Dr Roberts to comment, but I think part of the problem is that people have been trying to use our statistics for more than they can bear. They are trying to read more into them than—

Senator CONROY—You should speak to the insurance industry. They started this old fight.

Mr Thompson—Part of the problem is that, in some respects, they are the only statistics available so people will try to use them as far as they can. I think people have tried to read more into them than they can realistically carry.

Mr Brunner—I would make two points. There certainly were some errors in the data. It related to a change in the statistical format about three or four years ago where we moved from asking insurance companies to report to us the total number of claims—as in 7,000—and changed the format of the return into asking them to report to us in thousands. Some people continued to report 7,000, so they ended up reporting to us 7,000 thousands. That boosted the numbers. That was not picked up. It was just a number of companies and it was not picked up. As part of the statistics project and the fact that we have been putting greater resources into that area, those errors have been picked up. In the recent *APRA Insight* we made it very clear that the data had been amended and that we were fairly confident that the numbers that we were reporting now were reasonably accurate, but there still is a problem in that the definition of a claim is not very clear in the current set of prudential returns. However, the new general insurance returns which will be introduced with the new regime provide a much better explanation of what we believe a claim to be. Whilst we have tidied up the information that we have received from companies under the old reporting format, going forward under the new regime the data will be much more consistent. We will be comparing apples with apples.

Senator CONROY—Thanks for that. The problem that I have—and I know some of my colleagues have it too; this goes across all the political perspectives—is that the debate was kicked off because the industry pointed to a big jump. Correct me if I am wrong. I think it was in the two years from 1998 or 1999 to 2000-01. There was a jump from 50,000 to 80,000. If you have got the correct figures, please insert here.

Mr Brunner—No, I do not have them.

Senator CONROY—Therefore, this represented a massive problem in the industry and it needed tort law reform. Again, this is getting to the nub of where people should go at the moment. Can you comment on those figures that have been bandied around—the 50,000 or 60,000 to 80,000?

Mr Brunner—I do not have the exact numbers in front of me. I do know that some people were focusing on data which were not correct and did seem to suggest that the magnitude of the problem was greater than was in fact the case. Nevertheless, our data do indicate at a very aggregate level—because we do not break this information down—that there has been an increase in the level of claims and in the size of claims. But that data—

Senator CONROY—So those figures that I am roughly talking about—I am happy if you are able to correct them or clear them up—of a jump from 50,000, 55,000—

Dr Roberts—You would not want to draw too much on them. We have cautioned people. In particular—apart from the errors that Greg mentioned that we have had in our returns and some anomalies—we have cautioned people against drawing conclusions from two years of data, or one year over the previous year, or one year over two years ago. It is too short an interval to detect their trend. There is too much noise.

Senator CONROY—No, I appreciate that and I think your caution is well founded.

Dr Roberts—I think there are probably three conclusions that we would support. One is that there appears to be some sort of secular rise in claims but in particular claims trends have become very difficult to read—it has become very difficult to separate out the trend from the short-term fluctuations. That would be one conclusion. So it is becoming particularly difficult to get a grasp of a trend that is occurring there. Secondly, I think that we are aware, without wanting to get involved in the debate between lawyers and insurance companies, which is like an adversarial—

Senator CONROY—Vigorous.

Dr Roberts—So without commenting on trends in litigation activity, we do have a feeling that litigation costs are a substantial cost for the industry. Thirdly, we do have a feeling that awards by judges have been rising over time.

Senator CONROY—You have a feeling. The problem is that saying that you have a feeling is not a rigorous way to try to argue the case. As you know, in the High Court there are eminent lawyers and judges saying, ‘Actually, you are just wrong.’ So when you say ‘a feeling’, I am hoping that you give me something a bit more substantive than ‘a feeling’.

Dr Roberts—Yes, I would say that it is a robust feeling.

Mr Brunner—But I do think that this comes to the point that Mr Thompson made. People have been focusing on some data which was collected for prudential purposes and trying to draw conclusions from that for other purposes. We do not break down the components of claim information. So we simply do not know whether it was legal costs or higher awards for loss of income. We do not know the components of claims. The second point I would make is that the number of claims data is not a particularly important prudential measure. We focus on the profitability measures and net loss ratios.

Senator CONROY—Sure, I appreciate that.

Mr Brunner—It is not a piece of information that our analysts would look at and say, ‘I need to focus on that as an important prudential piece of information.’

Senator CONROY—No, I accept the point that you made and Dr Roberts indicated: treat it with caution. It is just that the industry in particular have leapt on these figures to justify things. I am just looking at the wire at the moment and under the headline ‘Business liability premiums skyrocket: survey’, it says that almost one-quarter of New South Wales businesses have had their public liability insurance premiums rise by more than 100 per cent according to a survey released by the New South Wales State Chamber of Commerce. Your data are being used as a justification for withdrawing cover, massive increases of 100 per cent and tort law reform. I appreciate the point that you are making. I am just trying to get to the bottom of the figures that are being championed by the industry as indicating the need for these things. You are saying that the industry has overemphasised the reliability of this data. I know that Senator Cherry, for instance, has challenged the data and Dr Roberts’s point about the cycle. Senator Cherry indicated that it had dropped from \$80,000 back down to \$60,000. The industry then countered by saying that that does not include the HIH claims, because HIH is separate and that accounts for the reason that the claims—help me here.

Dr Roberts—We would not want to build too much into a couple of years data, given all of the qualifications that we have made. But I think we are pretty confident, looking at the other factors and with some sense of the long-term trends, that tort law reform would be helpful.

Senator CONROY—I accept that, but because the industry has championed your statistics as the base need—I do not know; I will not invite you to read one of my speeches, but—

CHAIR—Please do not inflict that upon the officers.

Senator CONROY—I am a supporter of the New South Wales government position by and large, and I have said so publicly. But it is difficult to convince all of my state colleagues of this case when the insurance industry is quoting figures that are—‘discredited’ is not the

right word, but certainly under question even from yourselves. Even picking those particular years really is not statistically sound and so the whole basis of the debate is under challenge.

Dr Roberts—We have been more cautious in drawing inferences from our short-term statistics, but we still do believe that tort law reform would be of assistance.

Senator CONROY—Sure.

Dr Roberts—Not only in terms of the size of claims or the incidence of claims, but what is quite important for us in this industry is the predictability of a claims trend.

Senator CONROY—No, I understand. I agree. So what would you say to anybody who was wanting to just use those statistics as the sole reason for saying that there is a crisis?

Dr Roberts—We would draw their attention to all the qualifications that we have mentioned.

Mr Brunner—Which have been made very clear in our publications. The amendments to the statistics were pointed out very, very clearly and I suspect some people did not actually pick that up. They were working on old statistics and had not picked up the very clear notice that we made when we revised them to say that we had gone back, we had looked at some of the previous returns, we had made some revisions and we feel that the data that we now publish is of a better quality than was published prior to that.

Senator CONROY—I will draw your comments in *Hansard* to the attention of the minister for small business when I get a chance. Has Treasury—

CHAIR—Before we go on, do you still expect to reach the AASB and the Financial Reporting Council this evening?

Senator CONROY—I regret to say that if we stick to the absolute 11 o'clock deadline, I suspect that we will not complete everything. I appreciate that they are interstate agencies and, if humanly possible, I would like to get them away tonight, but I would have to be a little flexible. I will happily work to any timetable.

CHAIR—I just wonder whether you can give me some indication as to how long you will be with these officers, having regard to the fact that you can put questions on notice.

Senator CONROY—No, no, I appreciate that.

CHAIR—How long do you think you will be?

Senator CONROY—We just have less estimates.

CHAIR—Just tell me how long it is going to take.

Senator CONROY—I suspect I will use up most of the 20 minutes left on APRA. Again, they are also an interstate agency. I am not trying to hold them up or any of the other people. If we are in a position where we can be a little flexible, I am happy to do it as fast as I can.

CHAIR—You carry on.

Senator CONROY—I am just going back to the original discussion of your policy program. Has Treasury released the discussion paper on developing policy proposals?

Mr Thompson—No, not yet.

Senator CONROY—When do you anticipate it will be released? I think you said it would be early 2002?

Mr Thompson—I think it is probably running a bit more slowly than was indicated in that, and we would certainly hope soon.

Senator CONROY—Do you have any idea why that is?

Mr Thompson—Work pressures in both places.

Senator CONROY—I am just looking to see what I can put on notice. The Law Council has described your stats as ‘flawed’. I am sure you have seen that criticism. It was perhaps referring to the earlier statement without realising that you had amended or put out a statement. Would that be fair?

Mr Brunner—I am not sure if the timing is accurate.

Senator CONROY—Probably the minister for small business is drawing attention to those earlier figures?

Dr Roberts—Certainly, as you know, there is a kind of propaganda war going on—

Senator CONROY—I am glad you said that; I certainly would not want to say that.

Dr Roberts—between the insurance companies and the plaintiff lawyers. We are not taking sides in that debate.

Senator CONROY—I have a couple to add; I will put those on notice. From your press releases you appear to have been taking some action recently in relation to mutual aid schemes. You were in discussion with the medical defence organisations and have taken action against some Victorian taxi clubs.

Mr Thompson—Yes.

Senator CONROY—What is a mutual aid scheme and why are they not currently regulated under the insurance act?

Mr Thompson—We probably should deal with the medical ones and the taxis separately.

Senator CONROY—My next question is: you are attempting to bring medical defence organisations under the insurance act. How is that progressing and what issues are there?

Mr Thompson—Dr Roberts could explain why the medical defence ones are currently not under the act and what we are doing to—

Senator CONROY—It is the taxi clubs that I am particularly interested in.

Dr Roberts—In relation to all of them the key point is this: if there is a contract between the policyholder and the entity that specifies a defined benefit when the trigger event occurs, that looks like insurance and it would come under our act. If there is not a contract that specifies a defined benefit, if the understanding is through a membership subscription or arrangement rather than a contract, if the benefit has some discretion to it—it is not predefined—it is probably not insurance in the terms of our insurance act.

Senator CONROY—So that would be like the ambulance subscription in some states? You can pay a dollar amount and they will cover your ambulance costs? That would not necessarily be a defined amount?

Dr Roberts—If they use their best endeavours; but you do not get a guaranteed contractual obligation to pay—

Senator CONROY—It is a fine line. Never tried to rope them in? I would have thought that that would not have stood up much?

Dr Roberts—The boundary issue—the definition of an insurance and what is inside and out—has been an issue for decades.

Senator CONROY—You are finally winning?

Dr Roberts—It has always been there. From time to time we get legal advice in relation to particular schemes and you have to look at the scheme. Even then you can get one lawyer who will tell you it is in and another lawyer who will tell you it is out. But, for example in the medical case, the medical defence organisations are clearly set up with a discretionary product where there is not a contractual defined benefit, so it is pretty clearly out. In the taxi case, they thought it was out. When we looked at it, it did look more and more like an insurance arrangement. Eventually with our legal advice we concluded it was insurance.

Mr Thompson—In both cases our aim is to bring the arrangements under—

Senator CONROY—To bring them in?

Mr Thompson—To bring them in or to have them reshape themselves or amalgamate in some way with other players. But they look to us, notwithstanding the legal niceties, to be areas that should be subject to prudential supervision.

Senator CONROY—I was unaware that this fine line existed, even though it has been around for decades.

Mr Thompson—I think it is fair to say that the medical defence industry generally is also recognising the value of coming under it.

Dr Roberts—The thing about mutual aid societies is that historically they have quite often worked quite well when it has been a relatively small community or coherent group, because quite often the peer pressure between the members has kept the claims down and people have exercised more due care. When they become large enough to become like a retail operation—

Senator CONROY—That breaks down a bit?

Dr Roberts—and the medical defence ones are so big; there are so many members—you do not get the peer pressure, the commonality and communal kind of spirit, and they do not work so well.

Senator CONROY—UMP was not regulated by APRA, but its insurance arm AMIL was; is that right?

Dr Roberts—Correct.

Senator CONROY—When did you first become aware that there were problems with AMIL? Were there problems just with AMIL or with the parent, UMP, as well?

Dr Roberts—In July 2001 there was some public concern expressed about UMP, the group, including by some people from the actuarial profession. APRA has been watching the group closely since then, since July. But the audited accounts at 30 June 2001 showed that AMIL was quite sound. UMP was solvent at June 2001, but in its notes to its account had a \$455 million potential liability for IBNRs for claims incurred but not reported. But the auditor—

Senator CONROY—Were they UMP's claims or were they AMIL's claims?

Dr Roberts—UMP's. But there had for some time been a kind of actuarial accounting/auditing and legal issue as to whether they should be brought on the balance sheet, because they would become claims in the future.

Senator CONROY—They were going to become claims? It was not a question of whether the event occurred. The events had occurred; they just had not paid out yet?

Dr Roberts—The IBNRs are imaginary claims individually incurred but not reported at an individual level; they are imaginary completely. At a collective level they are real in the sense that we know there are going to be some in the future, but you do not know—

Senator CONROY—The forms have not been put in, but you know statistically that you are going to get that many; is that what we are talking about?

Dr Roberts—Correct. The incident has already occurred. There may be a claim materialised over the next 20 years or so or there may not. You do not know which incidents will turn into claims and which will not, but you do know that collectively some time over the next 20 years a certain number of past incidents will turn into claims. There is an issue among the actuarial and accounting and auditing profession and—

Senator CONROY—We have some of the country's top accounting and auditing minds with us tonight.

Dr Roberts—I am sure they will explain it further if you need, as to whether they should be brought on the balance sheet or not. As of last year that was still contentious. As of now I would say it is—

Senator CONROY—It is certainly not anymore.

Dr Roberts—I would say the consensus is that they should be brought on the balance sheet. Just to recap—as at 30 June 2001 AMIL was sound. It had several times our solvency requirement under the old insurance act. UMP was ticked by the auditor—

Senator CONROY—What did UMP do? I am just trying to work that out. It was not an insurance company. You did not regulate UMP. What were they?

Dr Roberts—UMP was the membership organisation that not only—it was what we would call the 'road service arm' for the group. But it also provided quasi-insurance for claims that fell outside the AMIL framework. So it was solvent—

Senator CONROY—You were aware of the IBNR contingent liability, if I can call it that?

Dr Roberts—We were aware that this was there as a contentious issue. We did not regulate UMP—

Senator CONROY—What capacity had you to deal with UMP on this issue?

Dr Roberts—Only—

Senator CONROY—Only insofar as it affected the potential solvency of AMIL?

Dr Roberts—Correct.

Senator CONROY—So you still had a pretty strong capacity to look into UMP?

Dr Roberts—We were interested in it as the parent who would need to inject capital if AMIL needed capital.

Senator CONROY—So even though you did not strictly regulate, you were able to get access?

Dr Roberts—Only through AMIL. We have no powers over UMP—

Senator CONROY—I am just trying to work out how you got to it. You merely declared this whole area of membership organisations; it cannot happen again?

Dr Roberts—Yes. As at mid last year we were conscious that this group was an issue but we were not concerned about soundness at that point. In October 2001 we developed serious concerns. We became doubtful as to whether AMIL would be able to meet APRA's new capital adequacy standards by the deadline of June 2004. So that was in October—

Senator CONROY—It is an understatement; they were going to be lucky to be solvent by the end of the year.

Dr Roberts—It was not clear. There were a lot of complicating factors and a very hostile environment that the company sailed into in the 2001—02 year due to some external events as well as history.

Senator CONROY—When did you first brief the minister? Which minister did you brief in this case?

Dr Roberts—We had been briefing, first, Minister Hockey and, secondly, Minister Coonan since July 2001.

Senator CONROY—Did you brief the minister for health at any point, or did you just anticipate that it would be passed on?

Dr Roberts—We were responsible for briefing the Treasury ministers and the Treasury department.

Senator CONROY—When did you first brief Minister Hockey?

Dr Roberts—In relation to the company—July 2001.

Senator CONROY—How regularly did you brief him after that on this particular company?

Dr Roberts—I do not think it is appropriate for us to go chapter and verse through our communications with the minister, but we have been regularly briefing the relevant minister since then.

Senator CONROY—I am actually allowed to ask when. I am allowed to ask about dates. But I am happy to take 'regularly'. Would that be monthly?

Dr Roberts—I can tell you that we have provided 19 ministerial briefings in writing—

Senator CONROY—Less than 12 months now?

Dr Roberts—Since July.

Senator CONROY—Thank you. Sorry, I have interrupted you. Do you want to keep going?

Dr Roberts—I am just giving you the abridged version here. In February we got indications, based on new actuarial work and new monthly estimates that we were getting by this stage for the company, that AMIL was breaching solvency under the old insurance act. It was as a result of that that we—

Senator CONROY—You used your powers to bring in an actuary, or was it internal?

Dr Roberts—This was the result of work done by the company's independent actuary.

Senator CONROY—Did you invoke that? Did you ask them to do that?

Dr Roberts—Yes. They had previously been getting annual actuarial estimates of claims and, as a result of our concerns we expressed to them, they also then got a six-monthly

assessment to update that from their actuary. We also engaged the government actuary to give us our additional technical advice on the numbers we were getting from the company.

Senator CONROY—So on 22 February you then appointed an inspector?

Dr Roberts—Yes.

Senator CONROY—And that required approval from the relevant minister?

Dr Roberts—Yes.

Senator CONROY—When did you seek that approval?

Dr Roberts—Shortly beforehand. I do not have it on this—

Senator CONROY—Sure. Did the inspector suspect that AMIL was likely to collapse when you appointed the inspector? I think you said that in mid-February or earlier in February you came to the conclusion that it was insolvent; is that what you said?

Dr Roberts—They were in regulatory insolvency.

Senator CONROY—About when was that?

Dr Roberts—Mid-February. We were becoming increasingly concerned month by month as each month's figures came out. That resulted in the direction on 27 February, five days after the inspector was appointed, to raise capital by 30 June 2002 to restore themselves to regulatory solvency under the old act as a short-term measure to get them to mid-year or to keep them above water by mid-year. A month later we expressed deeper concern, and that led to some meetings that the Prime Minister convened on 26 March with APRA and representatives from the medical community.

Senator CONROY—The PM convened that one on 26 March, did you say?

Dr Roberts—Yes. Following that, on 28 March the government announced a \$35 million guarantee to stabilise the company until 30 June. By 29 April APRA and the group were concerned that, particularly because of the IBNR issue on top of the AMIL issue—

Senator CONROY—Sorry? I just assumed at this point—and I have not followed this one as closely as I have others—that this problem was purely AMIL's own, even though in their previous accounts you were comfortable with their solvency. This problem that developed in AMIL in this eight to 10-month period was not directly related to the IBNRs. So it became its own problem on top of the 'gorilla' setting off balance sheet?

Dr Roberts—Yes. The IBNRs are an additional problem.

Senator CONROY—I was just assuming as you were going through this that the sort of context of the IBNRs being brought on the balance sheet was what was actually destabilising the balance sheet, but it is a completely separate issue?

Dr Roberts—Correct. If the IBNR issue had not existed we would still be having trouble.

Senator CONROY—They would still have been in trouble? Okay. So what actually happened to AMIL? Was this again poor actuarial work in terms of their tail? I think you said that as at the 30 June accounts 2001 you considered they were solvent under all of your guidelines but by mid-February you had reached the conclusion that they were regulatory insolvent. What actually happened in that eight months?

Dr Roberts—I have eight factors—

Senator CONROY—Eight factors? I apologise. I was not anticipating quite such a comprehensive discussion.

CHAIR—That is fine. But at 11 o'clock I think we need to revisit what is going to happen thereafter.

Senator CONROY—I am happy to.

Dr Roberts—The eight factors refer to some history as well as to what happened from mid last year; but for completeness I mention them. One is the UMP IBNRs which, while they were not directly a cause of AMIL's problems, became a complication later in the year—

Senator CONROY—In trying to solve the problems.

Dr Roberts—Yes. They were a barrier to extracting more money from the doctors to recapitalise.

Senator CONROY—Are you saying it is good money after bad?

Dr Roberts—Yes. So one factor is the legacy of old IBNRs. A second is the collapse of HIH, which was a major reinsurer of the group's \$56 million exposure to HIH. A third is New South Wales tort law reform—ironically, because while that over time promised to curb claims—

Senator CONROY—There was a rush.

Dr Roberts—In the short term there was a rush to—

Senator CONROY—To lodge one under the existing laws.

Dr Roberts—Which caused this big spike in the claims. A fourth factor was September 11, which had two impacts. One was the immediate reduction in capacity in the international reinsurance market, which affected every insurer, not just UMP AMIL. So \$US50 billion were immediately taken out of that market. The relevance of that was that AMIL's reinsurance expired on 31 December. It was a calendar year reinsurance. Right on the time that September 11 happened, their broker in London was engaged in trying to negotiate the next year's reinsurance. In addition, the turmoil in the investment markets which followed that created some investment losses for them. A fifth factor was the Simpson case, which will end up costing them probably \$18 million when all the costs are added in, and for which they have no reinsurance—because, during the late 1970s when that incident actually occurred, I think their reinsurer was FAI. A sixth factor was the withdrawal of commercial capacity in the market which, if you like, put more pressure on them and on the entire market, because the safety valve of having some commercial players in the medical indemnity market went, and they all withdrew.

A seventh factor is the fact that the claims trends—and I imagine this is also in relation to public liability insurance—have become almost impossible to read, and their results throughout the year are based on actuarial estimates, not on the actual claims that come in, which are very uneven and unpredictable. The 2001 calendar year for claims will turn out to be totally different from what went before and what is probably going to go after. So everyone found it difficult to get a grasp on the claims trends—whether there was a flat trend with just a lot of noise, or a spike, or whether we have an upward trend exaggerated by the spike. An eighth factor is the term of the international insurance cycle, which went from soft to hard—which meant that even without September 11 reinsurance supply was going to diminish and reinsurance costs were going to rise. Compounded with September 11, they had a great deal of difficulty negotiating new reinsurance for calendar year 2002. Part of that factor was

historical—the IBNRs and the unregulated parent—but the other factors were just like a ship sailing into a storm: they entered a very hostile environment. If you have capital of \$100 million and you take hits of \$80 million or whatever, suddenly your capital is below regulatory solvency.

We have also become increasingly conscious—and Greg has mentioned the risks associated with long tail insurance generally, which have become apparent under our new laws—that in this business, where there are about \$800 million of assets and \$800 million of liabilities in the whole group, it does not take much shift on either of those sides of the balance sheet for the capital to go from \$100 million to \$20 million or \$10 million. So there is some history there, and it was a hostile environment that they sailed into.

CHAIR—Dr Roberts, I will ask you to pause there. We cannot go for very much longer, Senator Conroy, having regard to Hansard and staff imperatives. I think there is really no prospect, unless you are willing to put all your questions on notice, of dealing with the AASB and the Financial Reporting Council this evening. Do you require them?

Senator CONROY—I do have some questions for them. Certainly I have a couple that I do want to talk to the AASB about.

CHAIR—What about the Financial Reporting Council?

Senator CONROY—I can probably put Mr Lucy's questions on notice, just to save him having to come back in the morning.

CHAIR—This is Mr Lucy from the Financial Reporting Council?

Senator CONROY—Yes, the FRC. So apologies to Mr Lucy for not getting a chance to chat with him directly, but I am sure he would rather go home than come back in the morning.

CHAIR—Can we maybe then excuse the Financial Reporting Council entirely?

Senator CONROY—I can probably do that.

CHAIR—Thank you.

Senator CONROY—Mr Alfredson will have to sit there by himself tomorrow without Mr Lucy to keep him company.

CHAIR—The Financial Reporting Council will expect to receive some questions on notice from Senator Conroy.

Senator CONROY—If Mr Lucy is available and will be hanging around anyway, then I am happy to fit him in. It was merely an opportunity, if he was booked on a plane in the morning, rather than holding him up.

CHAIR—In any event, the Australian Accounting Standards Board and the Financial Reporting Council certainly will not be commenced this evening. I propose to take them as a first item of business at 9 o'clock tomorrow morning.

Senator CONROY—I was going to suggest that, given the congestion we have run into, that I am happy to start a little earlier to try to clear the backlog—at, say, 8 o'clock or 8.30 a.m. If people think that is a reasonable idea, I am happy to do that.

CHAIR—Okay. We will commence at 8.30 in the morning.

Senator CONROY—And they can come on.

CHAIR—Senator Conroy, how much longer do you expect to be with APRA?

Senator CONROY—Not too long—about 10 or 20 minutes. I am happy to knock it over. I am generally happy to push on.

CHAIR—Senator Conroy, if it is 10 or 20 minutes, let us go till 11.15. Can I ask you, gentlemen, to try to contain your answers.

Senator CONROY—Dr Roberts was particularly expansive, which is great.

Dr Roberts—I was just getting started, Mr Chairman.

Senator CONROY—He got on a roll and I did not want to interrupt his roll.

CHAIR—We will adjourn at 11.15 p.m.

Senator CONROY—Thank you for that flexibility there. How long have you been considering reforms to bring MDOs under the Insurance Act? You mentioned that this is an issue that has been around for thirty years. When did you really actively start kicking it around?

Dr Roberts—Last year. A working group representing over 90 per cent of the industry had come to this view of its own accord. They approached Treasury and us.

Senator CONROY—When was that, roughly? I do not need an exact day.

Dr Roberts—That would be around November last year.

Senator CONROY—Do you think that if UMP had been regulated under the Insurance Act that would have provided earlier notice of the potential problems?

Dr Roberts—Yes.

Senator CONROY—In terms of Victorian taxi clubs—and I would actually happily spend another couple of hours on UMP, but I will move on because of time—can you briefly explain what is happening there and incorporate in your answer whether you are attempting to bring all Victorian taxi clubs under the insurance act or only those which are providing insurance? Or is it impossible to distinguish, given their mutual aid structure? Are they all mutual aid structures? If a club continues to operate as a mutual aid structure, will it continue to be unregulated?

Mr Phelps—There are about a dozen of these entities. They all thought they were mutual aid schemes, but our observation of them suggested that some of them were not. We are talking to them all and giving them the option of becoming regulated under the act, or stopping business altogether, or becoming a proper mutual scheme. It is possible to have a small group of people who join together and agree a common interest to share the risk that someone might run into them—but not if somebody is running the show and running a panel beating works and taking the profits and then not being there when the problems arise. So it is to draw this distinction clearly and cleanly: either it is a proper mutual or it is a proper insurance company or it is not, or it is out.

Senator CONROY—So have you any indication if all 12 are going to jump one way or the other? Are they going to fall into different categories?

Mr Phelps—Early indications are that there might be some in each of those groups. Some will leave, some will be mutual, and so on.

Senator CONROY—I had some questions about your new outsourcing draft and final standard. I am quite happy to put them on notice. Can I congratulate you on following that one through as you have. You recently issued a consumer warning urging consumers to

exercise caution before entering into insurance policies with unauthorised foreign insurers. I have a couple of questions that I can put on notice on that—unless you wanted to just briefly say something now?

Mr Thompson—Very briefly, we were concerned that there were brokers offering insurance through overseas companies and, in some cases, those companies were regulated in their home jurisdiction and in other cases they were not.

Senator CONROY—So a few Bahamas companies?

Mr Thompson—A bit closer to home, actually.

Senator CONROY—Vanuatu? Pacific?

Mr Thompson—Getting close, yes—Solomon Islands.

Senator CONROY—Solomon Islands.

Mr Thompson—So they were cleared. Our main purpose there was to draw to consumers' attention—

Senator CONROY—Can you regulate the brokers offering them?

Mr Thompson—No; they come under ASIC.

Senator CONROY—No wonder they always send someone to watch over you guys! You drop them in it all the time.

Mr Thompson—They come under FSR. It might be better to handle it on notice, because there are some subtleties, but basically the brokers were not necessarily in breach of FSR. Our concern was that it seemed to us that there were consumers buying insurance from companies that they may not have appreciated were—

Senator CONROY—There was no backing—

Mr Thompson—That were not regulated here and in some cases not even regulated in their home.

Senator CONROY—Have you had any discussion with ASIC about the best way to try to enforce some standards on the brokers? They have got to declare that it is a \$2 company in the Solomon Islands and has no—

Mr Thompson—We have had extensive discussions with ASIC about this problem, because it is one of those joint issues.

Mr Phelps—Yes; and FSR could well help solve it. But in the meantime the disclosure will work only if it is meaningful and the people understand that they are dealing with a \$2 company.

Senator CONROY—And you are confident that ASIC will be able to get the level of disclosure necessary so that consumers will know the risk?

Mr Phelps—That is what we are working towards; and if we spot any more we will do the same as we did with these two.

Senator CONROY—As you say, they are not yours; they are ASIC's. So the question is that you just get ASIC to make sure that there is sufficient disclosure—something that I can take up with ASIC. I am sure that they will look forward to that. I did actually want to have a chat with you about your new bank branch numbers and points of presence. Are APRA due before the Corporations and Financial Services Committee any time soon to deal with the

annual report or anything like that? That might be a forum where I can do that. Mr Phelps, who will not be with us, may miss that, but—

Mr Thompson—We do not normally appear before that committee.

Senator CONROY—Okay. Do you normally appear before—

Mr Thompson—This is the only committee that we appear before regularly. Last year, we had a number of appearances before the Superannuation and Financial Services Committee.

Senator CONROY—Financial Services has been transferred to Corporations. It is now Corporations and Financial Services. But you do not normally report, in the way that ASIC has a reporting function direct to the committee?

Mr Thompson—We do not.

Dr Roberts—The House committee looks at the annual report.

Senator CONROY—They do not let me on it. What can I say? They have standards!

Dr Roberts—It is an oversight.

Mr Thompson—If you have got a particular interest in that connection, we would be happy to do a briefing offline.

Senator CONROY—Yes. Maybe I can have a briefing. With the perennial ‘fit and proper person’ test for banks, I note that we have now been able to rush through an insurance one, but I still have not seen the banking one.

Mr Thompson—It is in the pipeline. I am not sure exactly where it is, but it is close.

Mr Brunner—It is an amendment to the Banking Act.

Senator CONROY—It is imminent?

Mr Brunner—I believe so, yes.

Senator CONROY—Thank you.

CHAIR—Senator Conroy, you have some questions that you will put on notice?

Senator CONROY—Yes, I will happily put those on notice.

CHAIR—Senator Collins has indicated that she also has some questions which she will put on notice. I thank you, gentlemen, for your cooperation and patience. We will resume at 8.30 a.m. tomorrow with the Australian Accounting Standards Board and the Financial Reporting Council. The committee stands adjourned.

Committee adjourned at 11.13 p.m.