COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Reference: Taxation Laws Amendment Bill (No. 5) 1999

THURSDAY, 23 SEPTEMBER 1999

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SENATE

ECONOMICS LEGISLATION COMMITTEE

Thursday, 23 September 1999

Members: Senator Gibson *(Chair)*, Senator Murphy *(Deputy Chair)*, Senators Campbell, Chapman, Murray and Watson

Participating members: Senators Abetz, Boswell, Brown, Brownhill, Calvert, Conroy, Coonan, Crane, Eggleston, Faulkner, Ferguson, Ferris, Harradine, Knowles, Lightfoot, Lundy, Mason, McGauran, Parer, Payne, Quirke, Ridgeway, Schacht, Sherry, Tchen and Tierney

Senators in attendance: Senators George Campbell, Chapman, Gibson, Murphy, Murray, and Watson

Terms of reference for the inquiry: Taxation Laws Amendment Bill (No. 5) 1999

WITNESSES

Committee met at 3.36 p.m.

CHAIR—Today the committee is considering the Taxation Laws Amendment Bill (No. 5) 1999. The committee's scheduled reporting date is 29 September 1999. This a public hearing and, as such, all members of the public are welcome to attend. Today we will be taking evidence from witnesses who have made submissions concerning certain provisions of the bill. We will also receive a response from government officials on comments made during the hearing. To assist all parties involved with the inquiry, I propose the committee agree to publicly release all submissions received during the inquiry except those to which confidentiality applies. There being no objection, it is so ordered.

Before we commence taking evidence, I wish to state for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members, and others, necessary for the discharge of the parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the Senate or any of its committees is treated as a breach of privilege.

[3.37 p.m.]

O'NEILL, Mr Dennis, Chief Executive Officer, Australian Council for Infrastructure Development

CHAIR—Welcome. We have received your submission. Do you wish to make an opening statement to the committee?

Mr O'Neill—Firstly, if I may, I will just give some background as I note there are some new members on the committee since this issue was last addressed in perhaps July last year as part of TLAB4 of that year. The issue of greatest concern to my organisation is that of division 243, which addresses limited recourse debt.

Just by way of explanation, I would like to point out that limited recourse debt is a form of financing which, in many respects, had its origins in Australia in the 1960s with the advent of many of the large mineral sector developments of that time, such that with the growth, both of the resources sector and, more recently, of the private infrastructure sector, we now see that in world rankings of countries that use this form of debt, Australia is frequently listed in the top three to six countries in terms of the quantification of dollars used for this form of financing. From recollection, I believe that in 1997-98 something like $US6 billion of limited recourse debt was the subject of investment activity in this country.

Limited recourse debt became very important in this country for the development of the stand-alone projects for the simple reason that—and by the nature of even the terminology used to describe it—the lending institutions that advanced the money sought as security only the assets of the project or the cash flows from that project. To give a concrete example, if BHP, in developing its large iron ore mines in the Pilbara, for example, sought to use this form of financing to debt fund those projects, then the banks that lent the money would not have recourse to, for example, BHP's assets at Newcastle or Port Kembla. They would only have recourse to the assets and the cash flows from that new iron ore project.

Suffice to say therefore that, because of the expansion of this form of finance, it would be appropriate to suggest that much of Australia's economic development over the last 30 years in the resource sector—and, more recently, in the last seven to eight years, in private infrastructure—has rested very much on the efficiencies that have been available to investors by using this form of debt. Consequently, when the government sought in its original version of division 243 to circumscribe the use of this finance by effectively executing a depreciation clawback on the refinancing mechanisms that were available to borrowers, it put at risk a great many projects in the country which had already been financed in this fashion.

In fairness, I have to say—and I have indicated in our written submission to the committee—that the redrafting that has been undertaken by the government and which now appears in TLAB5 does go a long way towards addressing the concerns which we first put to the government—that is, in terms of the technical day-to-day use of that particular piece of legislation. However, I wish to record that, in view of the parallel analysis of many aspects of business taxation by the Ralph Review of Business Taxation, we remain of the view that it is inappropriate and, indeed, a clumsy way to deal with the issues of concern that the government has raised about certain aspects of the structured non-repayment of this form of debt to proceed with division 243.

Indeed, if I could point you to page 252 of the Review of Business Taxation report, commentary in that report indicates that this proposed division 243 is just one of a patchwork of measures which the government has in the current taxation legislation and it goes on to propose a more generalised regime for the taxation of extinguishment gains to resolve this problem of structured non-payment. For that reason, we are concerned that, while the redrafting

makes the legislation more workable, it is nevertheless clumsy and inelegant in its form. It is difficult to interpret and we suspect that, because of the recommendations being made by the Ralph review, it will have a limited life because, if the government does proceed to implement the recommendations of the Ralph review within the next 18 months or thereabouts, we really wonder what the government is trying to achieve with division 243.

I have a reply from the office of the Assistant Treasurer as of last Friday on the technical points we have raised. I have to say that the response we received, while plausible in terms of its explanations about the interpretations of the proposed division 243, nevertheless leaves us feeling concerned that there will be compliance costs associated with seeking legal or accounting advice in terms of either refinancing existing limited recourse debt or in structuring the use of the new application of limited recourse debt.

I thank you for this opportunity to make those points and I am certainly available to answer any questions to the best of my ability.

CHAIR—Thanks, Mr O'Neill. Perhaps you could assist the committee, because we are not aware of the correspondence that you referred to from the Assistant Treasurer of recent date. Could we have a copy to table?

Mr O'Neill—Most certainly.

Senator GEORGE CAMPBELL—Is that in response to the technical proposals that were developed by Minter Ellison?

Mr O'Neill—That is correct.

Senator WATSON—You have suggested, or hinted, that perhaps the way out of this difficulty is to proceed immediately with the suggested improvements to division 243 made by Ralph. If we went down that line, what sort of delays would there be and what would be the implications of such a recommendation?

Mr O'Neill—With respect, Senator Watson, from a private sector perspective, I do not believe that there would be many implications, provided the government backed away from its policy announcement of February last year. There may well be implications from an Australian Taxation Office perspective, but my recollection of the evidence put to this committee last year was that, when asked for evidence of mischief or rorts associated with the use of this form of finance, no such evidence was put forward. Rather, the whole rationale for division 243 was represented as an integrity measure. We still to this day do not have, at least at the level of large projects—the resource sector projects, the infrastructure projects and, increasingly, tourism-hotel projects—evidence presented to us of mischief in relation to this issue of structured non-repayment of limited recourse debt.

Senator WATSON—Could you explain to the committee how the Ralph proposals would work in this instance?

Mr O'Neill—Unfortunately, I am not able to simply because, other than the few paragraphs contained on page 252, which make reference to a beefing up of the consolidated anti-avoidance section of the act, there is no more detail offered that is able to elucidate further for us what Ralph intends. So I am assuming at this point that it will be up to Treasury officials to put forward suggestions.

Senator WATSON—We will have to ask the Treasury officials when they come in.

CHAIR—On the other hand, it seems to me that, as the Ralph committee report has only just come out, we are not here to examine that, we are here to examine this particular bill.

Mr O'Neill—I understand.

CHAIR—You did say earlier in your evidence that you thought with the bill that is before us there have been certain improvements relative to a year ago.

Mr O'Neill—That is correct. In fairness, I would say that what appears to have been the major problem a year ago, namely that existing major projects would suffer a termination event on refinancing their debt and thereby trigger a clawback depreciation, enough changes have now been placed in the proposed legislation to ensure that, provided such refinancing occurs on an arm's length basis, that refinancing will not be a termination event. That is our understanding. There are, however, a number of other issues which are the subject of those technical points raised in the Minter Ellison analysis which still remain a problem for us.

CHAIR—We have only just received this response, which you have kindly given to us, to those technical issues. Are there any particular ones there that you want to bring to our attention?

Mr O'Neill—There are not at this particular point in the sense that, when I look through that response from the minister's office, as I said earlier, I can understand it. They are very plausible replies, but it is almost a situation that the lawyers on one side and the lawyers on the other side will have an argument at the time in relation to a particular refinancing or extinguishment event as to what is the interpretation.

I suspect one aspect that I would be keen to discover from Treasury officials and from the Assistant Treasurer is whether elements of that further explanation as contained in that letter would be written into a revised explanatory memorandum to assist in the interpretation of the new bill.

Senator GEORGE CAMPBELL—You said earlier in your opening statement that—if I understand you correctly—in light of the commentary in the Ralph report on this issue, you thought the best course of action would be to put this on hold until we see the outcome—the government's response to that. In the letter from the Assistant Treasurer, in the last dot point it says:

Proposed Division 243 is compatible with and produces substantially similar outcomes to the options outlined by the Review of Business taxation.

Have you had the opportunity to look at that statement and to make that assessment?

Mr O'Neill—I considered that statement on the aeroplane coming down here this morning, Senator Campbell. It caused me some difficulty because, for a start, while it may produce similar outcomes, it is doing so in an unwieldy fashion. It is introducing, if you like, interim legislation for a problem that has not yet been adequately defined, if I go back to the evidence of Treasury officers at the last time this matter went before a hearing.

Secondly, I am not clear as to what the options are laid out by Ralph, other than the comment about establishing a generalised regime. So I suspect, in fairness, there just is not sufficient detail in that part of the Ralph report—although there are specific recommendations that precede the page that I referred to. But I think, in fairness, we would like to see how that transforms into a legislative package before we could really say what is intended.

Senator GEORGE CAMPBELL—In your view, will the proposed new legislation that we are currently discussing actually impede the financing or refinancing of private infrastructure projects?

Mr O'Neill—We suspect not. We suspect they have got it to a point where it is workable. But the advice that the members of my council have given me is that, until they have a

specific proposal in front of them for a project or for a refinancing and the legislation in their other hand, with lawyers and accountants on either side working through it line by line, they will not be able to identify all the hurdles and, of course, they will invest money in that advice. This, in our view, defeats many of the objectives which were set out for the Ralph review in the first place—namely, simplification, lower cost of compliance and certainty. It is for basically those reasons we believe it would be more appropriate, unless the government can clearly demonstrate that there are mischiefs out there that have to be stopped immediately, that this legislation be set aside and the whole matter be dealt with collectively as part of the response to the Ralph report.

Senator GEORGE CAMPBELL—I understand that what you are saying is that you are not aware of any projects at the moment that are likely to be impacted by this new legislation as proposed. The converse of that is that you are not aware of any projects where the operation was such that it would have necessitated the introduction of this type of legislation.

Mr O'Neill—I am not aware of new projects, certainly. In relation to existing projects, I am unable to answer your question definitively because one would need to look at the specifics of the financing packages for each of those projects and, indeed, if they are to be rolled over and refinanced, to see that the refinancing arrangements comply with the terms of the proposed legislation.

Senator GEORGE CAMPBELL—Are you aware of any projects around the country that the financing or refinancing of was of such a character that it would have stimulated the Taxation Office to have introduced this legislation?

Mr O'Neill—I am not aware of any.

Senator GEORGE CAMPBELL—Do you think the new legislation is too accommodating of tax planning and that maybe the government has gone too far in watering down the proposed legislation?

Mr O'Neill—On the contrary, I think the government widened the ambit of what is defined as limited recourse debt. I have been advised that there are now definitional issues within this proposed bill which would result in what previously had been termed corporate debt now being considered as limited recourse debt—and that is a matter of concern for a number of companies who have put this view to me. Again, it remains to be seen to what extent that broadening of the definition does impact on their project activities. But, as per the Minter Ellison analysis and the response from the Assistant Treasurer's office, I suspect resolving that concern will only happen when practical examples are put forward.

CHAIR—Thank you very much, Mr O'Neill, for presenting before us.

[3.55 p.m.]

LAWRENCE, Mr Phillip Arthur, Manager, Indirect Tax, Fallon Group, on behalf of Walter Construction Group

NESBITT, Ms Pamela Dawn, GST Manager, Fallon Group, on behalf of Walter Construction Group

CHAIR—Welcome. Could you tell the committee in what capacity you are appearing today.

Ms Nesbitt—Mr Lawrence and I are from the Fallon Group and we are appearing on behalf of one of our clients, Walter Construction Group, in relation to the amendments to Item 192 of the Sales Tax (Exemptions and Classifications) Act 1992.

CHAIR—We have received your submission, do you wish to make an opening statement to the committee?

Mr Lawrence—Our client has a number of projects involving contracts with government bodies that were going on before 2 April 1998 and which have continued to go on. In the process of those projects, various contractors would have bought goods free of sales tax. We accept that the government might have found some problem with item 192 and that possibly it should be changed to prevent some loss of revenue that the government considers should not be missed out on for particular causes, but we do object to the retrospective nature of it. This matter has dragged on. The original amendment died with the old parliament but it is now back on the drawing board. Sales tax is going to be all over on 30 June next year, so the whole complexion of this change is now called into question.

There was an estimate of some $60 million to be gathered in by this amendment. At this stage, by the time the amendment becomes law it looks like the Taxation Office will have to go back and find the $60 million, and presumably harass a lot of subcontractors, small business people who are now gearing up for GST and PAYG and the various tax reform issues. We accept that maybe a change is necessary, but it should be prospective. We also understand that this change was brought about because of the understanding that some of these sales tax exemptions flowed through to casino buildings. We are not representing anybody who built a casino and we believe that it was established law for almost 15 years that subcontractors could buy goods free of sales tax to go into buildings on government land. More than anything, we object to the retrospective nature of it.

CHAIR—Could you give us some order of the value of contracts that are at risk with regard to this sales tax item for your particular client?

Mr Lawrence—We did have an appendix there of about $780 million worth of work. We represent a fairly large builder, so a lot of that $60 million would presumably have to be paid by him to the subcontractors but he would not be able to get the money from the government because of the set price contracts that he has already entered into. He would be facing the state and federal governments and asking for money that they probably do not have or do not know how to get.

Ms Nesbitt—Our concern also is the fact that these contracts are fixed price contracts. We have looked at them from a legal perspective and they are very difficult to break because the government departments involved have been allocated an amount under a budget that they have to function within. If you take it back through the chain, it starts off with the government department developing something. They have received funding from the government, a budget. They then hire a builder who then employs a subcontractor for each of the different types of

areas—electrical, mechanical et cetera. They then also have subcontractors under them. It flows down to their suppliers.

It is going to be asked of the subcontractor, not of the builder, to try to identify this sales tax, and they will have to go back and try to identify where the sales tax is and go back and get it. It is also commercially unrealistic to expect a subcontractor to face up to a builder who they may be tendering to at the moment to say, 'Look, 12 or 18 months ago I did this job and there should have been sales tax on it. I am out of pocket now. You have got to give it to me.' I am sure the builder is not going to. I am sure if the builder turns to the government department who employed them for the job, they are not going to do it either. It is just unrealistic because it is now 18 months old. It is too long.

The change in the law should be happening right from now. Regarding the Ralph changes in the paper at the moment, we are not expecting people to change what they are doing to start paying less tax on the basis of that. It has to become law before a change can come in. The fact that it may have been advertised in a couple of papers—little subcontractors who are out there, they do not read the *Financial Review* or the *Australian*, most of them, they are not aware of it, and yet it is the subcontractors who are going to be conscious of it.

Our clients are larger subcontractors but they employ smaller ones and so it is going to filter all the way down. I think it could be a problem to the building industry if you confront them with the fact that they are owing sales tax totals from 18 months ago. They have got to contend with the changes of the GST, the PAYG, the Ralph changes, all within the next nine months. It is a pretty big burden the government would be asking of a small business under those conditions.

CHAIR—Is what you are saying, in other words, that the procedures under section 128 of the Sales Tax Assessment Act are very difficult to implement?

Ms Nesbitt—Yes. They are. They are both commercially and legally unrealistic. It is very hard, if at all possible, to break a fixed price contract and commercially it is unrealistic because you have got to go back through this chain of supply to when the sales tax was paid. That brings up the other issue that there is actually an inbuilt penalty. Would you like to cover that, Phil?

Mr Lawrence—Yes. Because of the nature of the sales tax law, if these small business people are now asked to pay the tax, they pay more tax than they would have if they bought the goods tax-paid up front. They pay more tax because they would have been able—

CHAIR—You had better explain that in detail. Perhaps you could go through an example so that the committee understands what you are talking about.

Mr Lawrence—I will do my best. Sales tax is payable on the wholesale value so it is payable at the wholesale level of the chain. But a lot of the people who sell these types of goods are selling them to users, the subcontractors. So they are selling them at a discounted retail price and tax is only payable on the wholesale value of that price. Say the tax is 22 per cent, the effective rate might be 18 per cent or something like that, but if the tax office does audits to find this money and goes back to these people, the law requires them to pay tax on their full purchase price.

Ms Nesbitt—If we substituted the purchase price for $10, the tax at 22 per cent would be another $2.20. However, if they had said that it was taxable before, it would have been on the notional wholesale value and, assuming a 50 per cent mark-up, that would have been $5

and 22 per cent on that would be $1.10, so it is almost 50 per cent in that instance. So there is that inbuilt penalty.

Senator GEORGE CAMPBELL—Could I ask both of you, in your experience with the contracts that are out there at the moment, where will the responsibility for the payment of this tax be—with the subcontractor or with the prime contractor?

Ms Nesbitt—It will fall with the subcontractor.

Senator GEORGE CAMPBELL—So it will be the subcontractor who will bear the burden of the tax?

Ms Nesbitt—Yes.

Senator GEORGE CAMPBELL—In the main, in the building industry, these will be small businesses—

Ms Nesbitt—Yes, predominantly.

Senator GEORGE CAMPBELL—Individuals, in the main. Most of them would fall under the $1 million a year turnover threshold?

Ms Nesbitt—Yes.

Senator GEORGE CAMPBELL—Most of them, I assume, have fairly scant business records, some of them kept on the back of a cigarette packet, to use that term. So going back and dealing with the issue of recovery might actually be much more difficult than is anticipated for the Tax Office?

Mr Lawrence—Yes. I referred to this in the submission and it would be a very big audit task for the tax office to go looking for their $60 million.

Senator GEORGE CAMPBELL—The consequences could be, of course, that some of these individuals could finish up paying more than their actual liability as a result of that process.

Ms Nesbitt—Yes.

Senator WATSON—Wouldn't they have escape clauses in relation to this?

Ms Nesbitt—No, the contracts do not. They are definitely termed 'fixed price contracts'. The only escape clause, if we can refer to it, would be section 128. It really is very difficult to apply that to a fixed price contract, and commercially—because you have to look at the commercial perspective of it as well—it is also unrealistic. It is very difficult. If you get a builder and say, 'Okay, you owe me something for a job two years ago' it is very hard to get the money out of that. The fact is that it was not the law. It still is not the law.

Senator WATSON—It is a tax. I thought you might have been able to get it under—

Ms Nesbitt—But it is not a tax on it as at the moment.

Senator WATSON—Once it is passed, it will be a tax.

Ms Nesbitt—It will be.

Senator WATSON—So then you will be able to collect it at that stage?

Ms Nesbitt—In the future, yes from then on.

Senator MURPHY—It is supposed to be retrospective.

Ms Nesbitt—But I am concerned about the retrospectivity.

Senator GEORGE CAMPBELL—It is the retrospectivity that is the issue at stake.

Ms Nesbitt—That is all we have problems with.

Senator GEORGE CAMPBELL—Can I just draw your attention to the statement on page 3 of the letter signed by Tony Grant to the secretary of this group where it says, 'Reasons for lack of prior action'. In that context it talks about a meeting of the National Sales Tax Liaison Committee, with John McCarthy, Assistant Commissioner. Can you enlighten us a bit more on that?

Mr Lawrence—There is a forum for liaison between people in our profession and the tax office. That is the National Sales Tax Liaison Committee which meets twice a year, I think. The people who represent our profession are people appointed by the accounting bodies and the law bodies. Tony Grant attended a particular meeting representing the National Institute of Accountants. He happens to be a director of our company as well. Because of a particular client we are representing to date, he raised the issue of what had happened to that amendment to the law at that stage—I think that was before the election, was it?

Ms Nesbitt—That was before parliament was prorogued but there had been a Senate economics committee hearing such as this which we appeared at in August and we were waiting for a report from that. I think that that was the reason that Mr McCarthy was asked what progress was being made on it at that stage. Finally, the parliament was prorogued and so the report never came out from the other hearing. Since that time I have rung up the parliament—the people that write the legislation—and asked them and I have been told on two occasions that they did not know what was going to happen to that bill. It was only by following on the computer what acts were going through parliament that I noticed that the bill was going through then.

Senator GEORGE CAMPBELL—The point I am getting is that you were not given any definitive advice from the tax office as to how you were to treat this issue?

Ms Nesbitt—We were not.

Senator GEORGE CAMPBELL—Are you aware of any moneys that have actually been collected in anticipation of this legislation?

Mr Lawrence—The tax office would have to be in that position because it was not law, and there is no way that they could collect money at this stage because it still is not law. It is obviously a problem and in a retrospective issue like this it is messy.

Senator GEORGE CAMPBELL—There are estimates for the 1997-98 year and for the 1998-99 year, so presumably that is based on anticipation that those moneys will be collected. What about the situation where, presumably, there have been contracts that have been completed and there would be some contractors who have carried out work on those contracts who may no longer be in the industry? They may have gone bankrupt, they might have disappeared.

Ms Nesbitt—It is a real problem.

Mr Lawrence—The problem there is, the tax office could probably go back to the fellow who bought the stuff originally, who gave the exemption declaration, and ask him for the money and he has got no hope of pursuing anybody further up the line to get the money back.

Senator GEORGE CAMPBELL—In those circumstances, would there be any liability fall on the prime contractor?

Mr Lawrence—The only possibility is that section 128, and that has not been tested. It replaced some sections under the old pre-1992 sales tax legislation which were a little bit more specific and actually referred to the construction industry. Section 128 is written as a catch-all

reference to contracts generally, but has not been tested. We have doubts about how effective it would be for people to recover money using section 128.

Senator GEORGE CAMPBELL—For the record, can I restate what your position is that you are putting to this committee. Is it that any contracts entered into prior to that date of 3 April 1998 should be exempt from the provisions of this legislation?

Mr Lawrence—We do not like the retrospective nature of it at all because the way exemptions work in business is that people go to a supplier, generally a wholesale supplier, and they are used to filling out—

Senator GEORGE CAMPBELL—I understand that. I am trying to get at what the remedy is that you are seeking.

Ms Nesbitt—I believe that any contracts entered into before it becomes law, before it is actually law and it can be applied, should be—

Senator GEORGE CAMPBELL—So you are talking about contracts between 3 April 1998 and the present day?

Ms Nesbitt—And when the law passes. I believe that should be the case. I do not think you should make retrospective law.

CHAIR—But it has been standard practice for many years. The government makes an announcement that it is going to change tax law from a specific date, normally from the day of announcement, and then warns the community that that is going to take place, just as happened this week with the Ralph announcements. The law will follow on, but the changes will take place from the day of announcement. Now that has been standard practice for a long time.

Senator MURRAY—But not for years and years. The Senate normally is concerned if it is longer than six months.

CHAIR—Are there any further questions?

Senator MURRAY—I have a question. The chair has made the right remark, namely that this is standard practice, particularly for anti-avoidance or measures which affect contractual obligations, that people are pre-advised that once the legislation is passed it will be backdated. It is possible, isn't it, that some contractors might have taken note of that, if they had professional advice, and some fixed contracts might have already had a component of that expected taxation regime in them? If it was not made retrospective, you are left with a situation where somebody has got a bit more out of the contract than they otherwise might—

Ms Nesbitt—I have heard the argument from the other side.

Senator MURRAY—My question to you really is not the ifs, buts and maybes, but are you aware of any contracts which exist, or do you think it is likely that any contracts exist, which have taken this taxation situation into consideration and would have accounted for them?

Ms Nesbitt—No, I am not.

Senator MURPHY—Not even government contracts?

Ms Nesbitt—No. You are saying whether they have known that it was to have a tax applied to them?

Senator MURRAY—You see, the point the chair is making is that this is standard practice, which it is. The point Senator Murphy makes is, not only might it be standard practice, but you expect government departments entering into fixed price contracts to be aware of it. The

fact that you are not aware of it does not mean to say it does not exist, but it would seem surprising that nobody has made provision for this.

Ms Nesbitt—No, as I said, I am not aware of it with our client, it has not been brought to my attention.

Mr Lawrence—The people at the government department level and the builder level are probably relying on people down below to make the right decisions on tax. Tax would not be something that they expect—

Senator MURRAY—Who are the people down below? You mean the subcontractors?

Mr Lawrence—Starting at the suppliers of the goods and working up through the different levels of subcontractors. They will endeavour to keep their price down. This law might have been announced on 2 April last year, but most of the contracts we are concerned with had already started. The issue is with the subcontractors. They have continued to buy the goods free of tax, unless they knew about this. We do not think the government departments would be too fussed to go into some sort of publicity distribution process and tell everybody. Because of its nature as a self-assessing tax, these things seem to go on; people keep doing things until an actual ruling comes out from the tax office and says this has happened type of thing.

Senator MURPHY—I understand the concern about the retrospect aspect of it, but the announcement would have been made in May, wouldn't it?

CHAIR—No, 2 April.

Ms Nesbitt—1998.

Senator MURPHY—With effect from that date?

CHAIR—Yes.

Senator MURPHY—And you say that the concern is for the contracts that were in place prior to that date?

Ms Nesbitt—I have been concerned about ones even since, because I do not think it was publicised enough. I have spoken to the subcontractors who are my clients, and they are very large clients—as I said, they have sub-subcontractors under them—and until I have made them aware of it, they were unaware of it because there was not a great amount of publicity. I have been told there were two advertisements placed in the paper. Yet the building industry is very big, perhaps it should have been published through the building industry press, I don't know.

Senator MURPHY—I can understand the comment that has been made with regard to the fact that departments, when they get their fixed price quote in, are not going to say, 'That doesn't include this tax'—honest as they might be.

Ms Nesbitt—It is a bit unrealistic.

Senator MURRAY—But there is a greater danger, isn't there, that the price was in?

Senator MURPHY—That is right. That is the point I think Senator Murray is making—what happens where there has been a price built into the contract in light of? What is your view with regard to the contracts that have been entered into after 2 April?

Ms Nesbitt—Again, as I said, I think that they were retrospective in that there was not that knowledge. When you were saying that there may have been built into that head contract between the developer, if it is a government department, and the builder, that would have been very, very clear, and that would have been part of the builders' final fixed price amount. The way the tendering process works is that they tell them that they must quote when they are

tendering for the job on a sales tax inclusive or exclusive basis, and that would have been very obvious.

Senator MURPHY—Can I just ask again, what is your view about contracts that were entered after 2 April?

Ms Nesbitt—I think that, again, the retrospective law is going to mean that those subcontracts or contracts are unaware of their tax liability, and it is unfair to go back to them now to ask them for that tax that they did not know they had to pay.

Senator MURRAY—You might have heard the interchange between the chair and me. As a rule of thumb, the Senate accepts retrospectivity in these matters around about the six-month level, because that is a reasonable period between an announcement generating the legislation and getting it through the parliament. They start to get a bit nervous thereafter. Would you accept retrospectivity of six months, or do you regard any retrospectivity as bad?

Ms Nesbitt—Knowing the people in the building industry, they are going to be caught out-of-pocket with any retrospectivity. As I said, they have already got a tremendous burden with all the tax changes coming in that are going on at the moment, with GST, PAYG and the Ralph changes coming through. It is a tremendous burden for them to face over the next nine months and then have to confront this additional tax that they are going to have to find, which they absolutely will not be able to go back to the builders or the government departments and obtain. Can I just put one other point there please?

CHAIR—Yes.

Ms Nesbitt—I have spoken with government bodies, not being departments as such, but authorities, and they believe that they actually do get the benefit of this sales tax exemption, because it comes back to them in the lease. They will let something for a 100-year lease et cetera but, therefore, it has a price, it is a notional sale. They believe that they get the benefit of that in that price that they have settled. I have spoken to two of those such authorities, which I have been asked, particularly by one, not to name, and out of the respect for the other, I won't. It is on the marketplace. If it costs something less in the construction, it is then reflected in the price that they are paying.

CHAIR—I think there is a problem between different levels of government. That is where the concern is.

Ms Nesbitt—Yes.

CHAIR—Thank you very much for your submission and thanks for coming along today.

[4.21 p.m.]

ANDERSON, Mr Phillip John, General Manager, Lend Lease Development

TAFFT, Mr Mark, Partner, Arthur Andersen

CHAIR—Welcome Mr Andersen and Mr Tafft. We have received your submissions. Do you wish to start with an opening statement? Mr Andersen first.

Mr Anderson—Lend Lease is here to speak this afternoon in relation to the changes flagged last year in respect of sales tax. We are here because we have a problem. We have a fairly simple problem, but nonetheless we have a problem. Lend Lease is involved in many long-term construction contracts involving government, in particular in a head contract situation. These contracts in all cases that we are here to talk about were entered into prior to April 1998. Flowing from those contracts, because of the long-term nature of them, will be many hundreds of subcontracts over the life of the project. As an example, the contract in particular that we are talking about relates to the Olympic athletes' village in Sydney. That contract was entered into in December 1996 and has a duration of 3½ years requiring Lend Lease to deliver an Olympic village to the Olympic Coordination Authority by June of next year. The contract was bid and priced on the basis of the law as it pertained at that time, which enabled an exemption for sales tax for that project. We had senior counsel's opinion at the time, before we entered into the contract: we locked that sales tax risk away in our mind, we were complying with the law and we priced our bid accordingly. We have now moved forward and are implementing the delivery of that head contract through leasing or letting a number of subcontracts and we find that, half way through the project with another year to run, the price of that contract will go up substantially to us if this legislation goes through.

The nature of the contract that we have with the Olympic Coordination Authority in this case does not allow us to vary the contract in the manner that section 128 enables in the act. We have had senior counsel advice to that effect so we are unable to recover this increasing tax from the Olympic Coordination Authority under that contract. We have had many exchanges of correspondence with the Treasurer's office over the last year or so. In fact, the Treasurer's office appears to have conceded to us that we do have a problem in this regard.

I think you have copies of some of those letters. As recently as starting on 11 March, the Treasurer's office indicates that if we have a problem that we should take action under section 128 and, if that was deficient in dealing with our concern, then the Treasurer's office would be willing to propose an amendment to section 128 to ensure that it achieves the intended purpose. Recently on 3 September, in a letter to David Baffsky at Accor Pacific about the Olympic village, the Treasurer repeated that recommendation—

CHAIR—That is a new letter which we do not have.

Mr Anderson—That is a new letter which I am happy to leave here for you.

CHAIR—Yes, if we could have copies of that later and if the committee agrees that letter will be tabled.

Mr Anderson—Again, suggesting that if we were not successful under section 128 in obtaining a remedy that that would be amended. We have a simple view that the tax, if it were changed would, in effect, be retrospective in regards to these long term head contracts that we are involved in with government. We feel that, rather than go down a process of trying to get remedy out of section 128 and then perhaps putting amendments through to that law, maybe a more simple amendment to schedule 1, paragraph 2 might be more appropriate simply

for the purposes of performing a contract entered into prior to April 1998, that the exemption that pertained at that time remained for the delivery of those long term contracts.

CHAIR—Do you have a written version of what you have suggested?

Mr Anderson—Yes, I have written it on a piece of paper.

CHAIR—Perhaps we might take a copy of that, if you do not mind.

Mr Anderson—Certainly.

CHAIR—The committee will table that.

Senator MURPHY—When did the Lend Lease become aware of the changed taxation?

Mr Anderson—At the time it was announced.

CHAIR—Can I follow that through? You are not arguing for an adjustment between 2 April 1998 and whenever this bill goes through?

Mr Anderson—No.

CHAIR—But you are arguing that any contracts entered into prior to then should not be caught by this latest legislation?

Mr Anderson—That is right, because the pricing of that contract was done at a time, as I say, in the Olympic village case, in 1996. When the exemption allowed, it was a 3½ to four-year contract and would run for that time.

Senator GEORGE CAMPBELL—Could I follow that up? Would a remedy be acceptable to you that provided for—and I am not suggesting this is the outcome—contracts entered into prior to 3 April 1998 that were fixed and not capable of being varied to accommodate the new provisions to be exempt and those contracts that were capable of being varied not to be exempt from the provisions of the act?

Mr Anderson—The head contract that we have entered into, on advice that we have from senior counsel, cannot be varied. Yes, that is correct.

Senator GEORGE CAMPBELL—I understand that. That is clear.

Mr Anderson—What flows from that are a myriad of subcontracts over the life of that contract. We have assumed that they would be one and the same with the head contract at delivering those long term projects. What we are saying is that they ought to remain exempt as well.

Senator GEORGE CAMPBELL—What I am really asking is: would it be acceptable to you if the distinction was drawn between contracts that were incapable of being varied and contracts that were capable of being varied?

Mr Anderson—If a contract was capable of being varied then that would be an acceptable situation. The advice we have from senior counsel is that the nature of the contracts that we are involved in here representing are not capable of being varied.

Senator MURRAY—There is a follow-on point, if I may. The logic of that is probably unarguable, but the previous witness made the point that even where contracts were capable of being varied, it might be almost administratively or logistically impossible to reach or interact with contractors and subcontractors on that basis. If that is so, you then have issues of natural justice and of simplicity of administrative feasibility with all of this. How do you view that aspect of varying contracts?

Mr Anderson—I will answer first and then pass to Tafft, who is a practitioner in this area. We would concur with that general thrust of what you have said—that it would be

administratively very difficult to do. However, if we were speaking as Lend Lease Development being involved in tendering for a major government project post the announcement of the change in the tax laws, then we would have factored into tender with the government the impact of that tax law. We would have framed our bid on that basis. What we saying is that prior to April 1998, we framed our bids on a different basis with them being exempt.

Senator MURRAY—Before we move to Mr Tafft, is it the fact or is it the case that you have entered into contracts since then and you, therefore, would be sitting on tax which, once the law is passed, you would pay across?

Mr Anderson—I cannot speak for the construction part of Lend Lease, I am speaking for Lend Lease Development. We have not entered into contracts of that nature since the tax came out.

Mr Tafft—If I might try to assist, Senator: I suspect that it is the case that post 2 April last year, organisations with sufficient resources to stay on top of tax developments would have taken into account the possibility that these bills would be reintroduced, so I think you see a real issue. But, equally I think, there are a variety of players out there who do not necessarily focus on it to that degree who may be caught out.

If I can come back to the contracts with which we are concerned here today, and the ones that are of primary concern to us: these were contracts entered into based on the laws as they were before 2 April and where we are stuck with fixed price arrangements. The specific contract that I am representing Accor in relation to relates to the Olympic Hotel which is, again, at the Homebush site. That contract was effectively locked in from 14 November 1997 and from that date forward the bid prices could not be varied.

CHAIR—Could you explain to us the magnitude of these contracts that you are talking about, please?

Mr Tafft—Yes, the Olympic Hotel has a construction cost of $61.8 million. It will be a 318-room hotel. It will involve 200 construction jobs and another 250 jobs on a permanent basis to keep it running. It is an unusual facility; it has lots and lots of state initiatives built into it, in that it is ecologically sound. It has reduced water and power usage and, I am sure Phillip will also note, the degree of state involvement in the Olympic Village site and what an unusual construction exercise that has been, involving all sorts of other risks.

Mr Anderson—Perhaps, Mark, I could just do that for you now. Many of you probably are not aware of the Olympic Village site to the west of the new Sydney Olympic Stadium, but it was formerly the Newington army munitions land owned by the federal government that was given to the state government under arrangements in order to house the Olympic Village. It is a 90 hectare site. The Olympic Village is required to be given to government early next year. It will house 15,300 athletes during the games. It is a fully master planned community. It will have during the games mode over 500 permanent houses and nearly 400 permanent home units. It will have, what is called, an international zone of permanent buildings to house Olympic facilities. It is done under contractual arrangements with the Olympic Coordination Authority, SOCOG, back to back with the Olympic agreement. Currently, we have over 2,000 workers every day on the project. It is due for completion, as I say, early next year, and it is in the range of around $450 million to $500 million.

CHAIR—Any further questions?

Mr Tafft—I would like to come back to a point that I think Senator Murphy made in the earlier session. It is true that this sort of announcement where the government says, 'We would like to narrow the range of an exemption with effect from a given day,' is a fairly standard event. That works reasonably well in a transaction tax context most of the time, particularly when we are talking about fast moving goods such as televisions or cameras, which could readily be shifted across a taxing point and thus perpetuate whatever the evil is that the government is trying to avoid. Then, that sort of announcement makes sense.

But as infrastructure development gets more and more complex and has longer and longer time frames around it, this sort of announcement does create a very real retrospective impact. As organisations like the ones we are representing today do commit, they are locked in well in advance. From that point on, they are stuck. They have been there in a competitive tender situation and they have nowhere else to go with this.

I am hesitant to lecture the senators about previous exercises with retrospectivity, and I struggle at times to find a clear picture as to those cases where something will be addressed and cases where it will not. But one that I have found that seemed to me to be pretty much on all fours was relatively recent and dealt with the Shipping Grants Legislation Bill 1996, which related to shipbuilding grants. In that case, the government was looking to cancel out those grants before the previously announced date of closure of that scheme. The end result was that the Senate looked at that and said, 'This is simply not fair because it is impacting large organisations which have committed to contracts in good faith based on the law as it was at that time.' So, our central submission is that we would like the law to operate insofar as it relates to contracts entered into before that date.

I understand that the submissions earlier on are coming at it from a slightly longer time period—and there is a real issue there about procedural fairness for builders who do not have access to information. But at least that point is the point that we seek.

CHAIR—This amendment you have proposed, you are both agreeing with?

Mr Tafft—Yes.

Mr Anderson—Yes.

CHAIR—And you have had legal advice to that effect?

Mr Anderson—We have had legal advice to that effect and senior counsel advice that that amendment would redress the issues that we have raised here with this committee.

CHAIR—For the committee's benefit, could I find out the scope—because I do not know enough about the building industry—for $400 million or $500 million worth of project. How much sales tax are we talking about, roughly?

Mr Anderson—On the Olympic Village, the sales tax has been estimated at somewhere between $5 million and $10 million. You must bear in mind that the Olympic Village, which is a new suburb being delivered in one hit—which is very unusual—has a lot of things in it such as landscaping and so on that are not normally subject to these things.

CHAIR—I understand.

Mr Tafft—There have been various studies done over the years on the sales tax content of construction and it can vary anywhere from around one per cent through to about four per cent, depending on what it is. If it is something that has a lot of rooms, kitchens and bathrooms, there is a bit more in it.

CHAIR—I understand.

Senator GEORGE CAMPBELL—In both of your submissions you raised the question of constitutionality of the proposed legislation. Can you just briefly outline where you are concerned about that?

Mr Tafft—The concerns relate to two points, if I recall. There have been a number of cases in the past where sales tax has been found to offend constitutionally. The one that comes to mind is the swimming pools case. Under the constitution, you can only address one subject of taxation and by attempting to tax both goods, like this water glass and, at the same time, tax in-ground swimming pools, the law was found to offend that part of the constitution, which ultimately resulted in a separate act to deal with in-ground swimming pools.

There is a concern that if this law goes through, given that a lot of goods will have been incorporated into buildings by the time it is made effective, that it is then taxing not only goods but real property, which it cannot do under the constitution.

The second constitutional concern is that the Commonwealth cannot tax the property of the state, so if a project is built on Crown land and this law is now brought in and purports to tax goods which have been built into that, then it may well be taxing the property of the state. But those are not concerns which we wish to pursue here particularly.

Senator GEORGE CAMPBELL—I am just trying to understand and get on the record what the constitutional concerns were.

Senator WATSON—Why don't you wish to pursue them—because they could successfully challenge the legislation?

Senator MURPHY—They might if we do not get this amendment through!

Mr Tafft—Our proposition is very simple. These arrangements were started on one set of rules. Our client would like to finish them on the same set of rules. Yes, we are interested in constitutional concerns but the particular problems for these very large, very high profile projects are solved by that amendment which we have tabled today.

CHAIR—That ends the questioning. Thank you for your submissions and thank you for appearing before us, Mr Anderson and Mr Tafft.

Mr Anderson—Chairman, if you like I will leave with your secretary some coloured aerial photographs just recently taken of the Olympic village which the senators may find interesting.

CHAIR—Thank you.

[4.42 p.m]

FLATTERY, Mr Brendan, Executive Officer, Australian Taxation Office

NOLAN, Mr Darrel Andrew, Assistant Commissioner, Office of Chief Tax Counsel, Australian Taxation Office

CHAIR—We will deal with limited recourse debt, division 243. Can I remind committee members that under the parliamentary privilege resolutions agreed to by the Senate, officers of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy. Officers should also be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister.

Mr Nolan—When this legislation was being prepared I was in another role and that was as assistant commissioner in the legislative services group of the ATO.

Senator MURPHY—Neither does the ATO!

CHAIR—Gentlemen, you have heard the evidence that the committee has had before us this afternoon and the submissions. On that first issue, my first question to you is: do you have evidence of mischief out of the current arrangement?

Mr Nolan—There have been cases of what we might call structured non-payment of limited recourse debt. I have not brought with me details of those cases but an outline of the way that works could be provided.

Mr O'Neill said though that we had not provided evidence of rorts—I think he used that expression—and he pointed out that the provisions have been designed—and these are my words—as a general set of principles and that is true. They have not been designed as a specific anti-avoidance measure although there have been cases that we have come across where taxpayers have utilised the non-payment of limited recourse debt to achieve greater tax benefits than they ought to have.

Just as a reminder to the committee, capital allowances under the law are based on the initial cost of an asset, generally, or the particular capital expenditure, but they do not take into account the fact that, if there have been borrowings and those borrowings are not paid, there is not really a loss by the borrower, or there is not a full loss. If the expenditure or the asset has been financed by limited recourse debt, then the taxpayer can get deductions greater than actual outlays. It is that deficiency in the law that we are trying to remedy.

Mr O'Neill mentioned that in limited recourse debt the borrower's risk is broadly limited to the asset being financed and/or the cash flows that are generated by that asset. If the debtor cannot or does not pay, then the debtor's loss in effect is limited to the initial amount of equity that the debtor puts in, plus any actual debt repayments that have been made along the way.

Division 243 is trying to limit, in effect, the tax deduction to that actual loss of the debtor, and that is the principle. If there is non-payment, some of the real loss is actually borne by the lender who gets the appropriate tax deduction as a bad debt. Under the current structure of the law, where there is no account necessarily of non-payment of debt in relation to capital expenditure financed by limited recourse debt, there is the possibility of a double deduction in effect. In a roundabout way that is probably our broad response to Mr O'Neill, both a restatement of what the proposed law is all about and some of the general mischief that it is trying to remedy.

I notice that Mr O'Neill referred to the major issue of refinancing which was a thorny issue when this legislation first reached the parliament. Technically, limited recourse debt was terminated if there were a refinancing. He acknowledged that that matter has largely been

resolved. On a range of technical issues he said, I think, that no specific issue remains unresolved even though there may be some issues that are still arguable—and I do not suppose there are too many tax laws where there are not issues that are unarguable—but that largely he thought that the response from the Treasurer's office, which the tax office helped in drafting, represented a plausible response.

CHAIR—He asked whether the points in that response letter could be incorporated in the explanatory memorandum.

Mr Nolan—Yes. I have not had a chance to consult with the Assistant Treasurer's office about this but I guess our response is that we will do that to see whether it is feasible to do it. I guess it requires some thought because some of these issues are a bit esoteric and you do not want to beef up an EM perhaps with that level of detail. It may be that the Assistant Treasurer might instead choose to say something about some of these issues in the second reading debate. With that reservation, we have not yet consulted with the Assistant Treasurer.

CHAIR—Thanks, Mr Nolan.

Mr Nolan—Mr O'Neill mentioned the Ralph report. You have given me the perfect let-out in your opening remarks. It really is not for me at this stage to comment on policy issues about which the government has not made decisions, but to defer the measure, which was the implication of Mr O'Neill's submission in connection with Ralph, would certainly be at a cost to the revenue. This measure was first announced in the 1997-98 budget and under current estimates it is going to represent a saving to the revenue of approximately $50 million per annum out to the year 2003-2004. It would open up the prospect of this particular weakness in law remaining there for some time in relation to ongoing debts. The other point I would make—and I do not want to be seen as commenting on Ralph—is that this is an amendment to the existing law. That is the way I think it ought to be viewed.

CHAIR—That is our brief today anyway. That is what we are looking at.

Senator MURRAY—You have heard a few propositions put to the committee by the witnesses for amending the act. The first one—not the first amendment, but probably the first that could be looked at sequentially—was the view that any fixed term contract not capable of variation—

CHAIR—I think you are onto the next item. These two experts from the office are about the limited recourse debt, division 243.

Senator MURRAY—I thought you had dealt with that.

CHAIR—No, we have two others to come forward.

Senator GEORGE CAMPBELL—Mr Nolan, you have said that these proposals were to remedy the deficiency that had been identified in the act in respect to these issues. If that deficiency were not remedied for the next nine months, what would be the potential impact on revenue?

Mr Nolan—Off the top of my head I cannot say exactly but, as I said in answer to the chairman's question, there is approximately $50 million per annum at stake from—if my memory serves me correctly—the 1998-99 income year. That would be the order of the loss. I am just reading now from the explanatory memorandum. The financial impact section says that the gain to revenue from this measure will be approximately $40 million in 1998-99, $50 million in 1999-2000, and then $50 million per annum out as far as the projections are made to 2003-2004. It is of that order in terms of annual cost but we are now in the income year 1999-2000. There would probably be two years of that revenue lost.

Senator GEORGE CAMPBELL—That has already been lost.

Mr Nolan—It has not been lost because of the commencement arrangements. This measure commences from 28 February 1998.

Senator GEORGE CAMPBELL—From the point of commencement?

Mr Nolan—Yes.

Senator MURPHY—So the tax is being paid, in effect?

Mr Nolan—The provisions are in a de facto way operative, yes. Of course they have to run the gauntlet of the parliament.

Senator MURPHY—What revenues come in on the basis of the things being in effect since whatever the date was in February 1998?

CHAIR—Senator Murphy, it is not law yet so there cannot be any revenue coming in yet.

Mr Nolan—I do not think I can answer that question. All I am saying is that the estimates of revenue gained from the implementation of these measures with effect from February 1998, is of the order of $50 million per annum.

Senator GEORGE CAMPBELL—If the proposals in the Ralph report were implemented what would that mean in terms of revenue, as opposed to taking this legislative approach? Has the tax department done an analysis? You have not done this calculation.

Senator MURRAY—We are a little confused by the answer, quite frankly, because it is not revenue which is gained but which would be gained. We are debating between ourselves about where that money is. Has a taxpayer put it in a special account and said, 'This is the amount of money which, if that law were passed, we would pay over.' Do you know where it exists—is it in the ether?

Mr Nolan—No, I cannot say how it exists. If this were a measure that was a new tax, then presumably none of it would have been collected yet because the law is not law, or the proposals are not law. It gets rather more complicated when it is a provision that attempts to clawback, as it were, excessive deductions dating back to a particular time but the law has not yet been implemented. When the law is implemented then I suppose it is a question of taxpayers looking at what actually has occurred to see whether that law actually applies to particular transactions or events. The other complicating factor is, I suppose, that some transactions which might have occurred—and I think this is probably quite important—will not occur because people are, as it were, standing still in relation to particular transactions.

Senator MURRAY—Behind our side discourse here and the questioning of you is really this question: how certain would we be, or could you be, that this amount of money is capable of being recovered given the effluxion of time, because you are seeking to influence us by saying there is a great deal of revenue at stake. In fact, because it is from February 1998 forward and various complications exist that you have outlined, is it a thumb suck? Is it reality? How much of it is potentially available? Would you have to revise your projections? We are concerned with those sorts of questions.

Mr Nolan—I am not sure I can give you a very firm answer because I do not have the basis of the estimates with me. Perhaps we can revisit that and provide some advice.

CHAIR—You can take that on notice, Mr Nolan.

Senator MURPHY—That would be useful if we could be provided with some information.

Mr Nolan—The only point I would make about that is that, by and large, I think people who are financing on a limited recourse debt basis are very well aware and are very well

advised taxpayers. I think their response is likely to be a legitimate response. In other words, they will take note of the potential effect of a bill announced, or in the parliament, from a particular date and the extent there are likely to be revenue effects particularly in respect of transactions or events that do not occur that might otherwise have occurred.

Senator MURRAY—I guess we would need a current estimate, so that is what we are asking for.

Senator GEORGE CAMPBELL—The other side of that is that you need to also take into account Mr O'Neill's comments in response to questions that I asked him. He did not seem to be aware of any impact, adverse or otherwise, on any projects that were currently in progress in respect of this law other than the statement he made that it was a very clumsy way of going about addressing the issue.

Mr Nolan—I think that was in relation to his view that the law that is proposed in this bill is an add-on to the existing provisions. He would have preferred, on behalf of his organisation, that there be a comprehensive solution under the banner of the business tax reform measures. He mentioned, I think, that he saw this as an interim measure. That is the way I took it: to be clumsy.

Senator GEORGE CAMPBELL—I think he was making the point that this may well turn out to be an interim measure if it subsequently is addressed as a consequence of the business tax reform package. But I think he was still making the point, distinguishing between what was proposed in the business tax review and saying that he felt that this was a clumsy way of dealing with the issue. But in response to the questions that I asked him, he did not seem to be able to point to any projects or potential projects that were going to be materially affected or impacted by these current provisions.

Mr Nolan—Are you asking us to do that? Are you asking the ATO to do that? I am not sure that we are in a position, any better than industry would be, to identify particular projects that are going to be affected by a rule that comes into operation only if there is limited recourse debt, or if there are capital allowances associated with that limited recourse debt, and if the debt is terminated without being paid. To some degree that is looking into the future.

Senator GEORGE CAMPBELL—How do you make the assessment that those savings are $40 million or $50 million a year?

Mr Nolan—That is a good and difficult question, Senator. I think I will have to take it on notice.

CHAIR—I think that winds up that section. Thank you, Mr Nolan and Mr Flattery.

[5.03 p.m.]

GOODWIN, Mr Nigel Howard, Senior Officer, Australian Taxation Office

McCARTHY, Mr John Maxwell, Assistant Commissioner, Australian Taxation Office

SMITH, Mr Michael Paul, Assistant Commissioner, Australian Taxation Office

CHAIR—Thank you very much, gentlemen. You heard the evidence before us today, and no doubt you have seen the submissions. Would you care to comment on the points that were made?

Mr Smith—It may assist, I think, to get a little bit more background in relation to item 192 and its progress through the parliament. Like a lot of bills that were in force before the calling of the last election, it has gained a new life in the new parliament. It is not exceptional in that regard; there were bills relating to software expenditure which were announced in May 1998 which suffered the same course.

The bill itself went through, and it went through the previous Senate Economics Committee on 5 August 1998. Issues of retrospectivity and section 128 were certainly raised in that context. In reintroducing the bill on 11 March 1999, the government made, not a concession, I suppose, but it listened and it varied the application clause in relation to which goods were affected. In the original bill that was introduced, that related to dealings that occurred on or after 2 April 1998. The application clause in the bill that is currently before the Senate actually excludes any goods that were acquired before 2 April 1998. In other words, in a sales tax context the point of sales tax is when the assessable dealing occurs. In relation to a contractor, that is when it is applied or applied for use. Under the bill as originally introduced, it may have been possible that there were purchases from suppliers before April 1998 which were not, in effect, used until after that point in time. Now the new law introduced simply applies to acquisitions after April 1998.

I have some points about retrospectivity. I concur with the discussion between Senator Murray and the chairman. As regards announcing and introducing laws, that is normal, although I might say that we are in a very fortunate position at the moment in that we do have a lot of laws before the parliament that will not be applying until 1 July 2000. That does give us good lead time to overcome anomalies, et cetera, which are highlighted.

There was some discussion about a meeting with John McCarthy, who fortunately just happens to be here today so I will let John correct some of the evidence given in that regard. In relation to the section 128 issue, and what the sales tax law can do in relation to that, I suppose I was not aware of the recent Treasurer's advice to Lend Lease and I understand from the evidence that there was some sort of commitment form the Treasurer that that would be looked at if it was found to be ineffective. Maybe we should just leave it at that point. I might, if it is okay with you, Mr Chairman, see if Mr McCarthy or Mr Goodwin want to add any more by way of general comment.

CHAIR—Thank you, Mr Smith.

Mr McCarthy—Again, by way of general comment, the Sales Tax Liaison Committee that was referred to was the National Sales Tax Liaison Committee meeting which was held in Sydney on 21 October 1998. I have a copy of the minutes of the meeting with me. Whether the minutes are incorrect or whether that evidence was incorrect, I am not sure, but I do not see Mr Tony Grant appearing as a member of that committee. That is probably irrelevant because the question was asked of me about the status of sales tax amendments to the legislation that had lapsed. I did give the answer that is recorded in the submission from the

Fallon Group, which was that we were awaiting government direction on what amendments would be reintroduced. That evidence is correct.

I would just point out that that meeting was held on 21 October 1998. I would put that in context in that, according to the dates the parliament was dissolved on 31 August, the election was held on 3 October, the ministry was announced on 18 October and the ministry was sworn in on the same day that this meeting was taking place on 21 October, so there was no opportunity to ascertain the government's intention before this meeting. I stand by the advice given at the meeting that we were awaiting government direction. I have no other general comments.

Senator GEORGE CAMPBELL—Can I just clarify the point about Mr Grant. I did not indicate that Mr Grant was at the meeting. I said it was referred to in the letter signed by Mr Grant.

Mr McCarthy—The evidence was from Ms Nesbitt or Mr Lawrence that Mr Grant was at the meeting. That is really irrelevant, the question was asked and the question was answered.

Senator GEORGE CAMPBELL—What is recorded in the correspondence is factual.

Mr McCarthy—Yes.

CHAIR—Mr Smith, back on the general question that Lend Lease put that they entered into a large contract, a fixed price contract, going back several years, well before 2 April last year and that the contract was fixed price, there may not have been much acquisition to complete that project prior to that particular date. There is a problem there, isn't there?

Senator WATSON—There was a deficiency in the framing of the legislation, because it fails to recognise the fact that there are long-term contracts written. It is a very limited application because you are referring to 'dealings' et cetera in terms of the flow of goods. Obviously, your knowledge of the industry would indicate that there are going to be long-term contracts. I would have thought that that should be actually written into the legislation because you are just talking about dealings as goods move across from point A to point B, et cetera, and ignoring commercial reality whereby contracts will be entered into for long periods of times.

Senator MURPHY—And no goods purchased.

Mr Smith—I hear what you say. I can only just say that—

Senator WATSON—It just ignores commercial reality. That is what worries me.

Mr Smith—The sales tax law is all about assessable dealings. I am not sure about the application clause in relation to earlier sales tax amendments. If you like we could possibly get some advice on that. But what is the norm? Is this the first time we have left out contracts entered into in relation to an application clause?

Senator WATSON—Whether or not, it does not matter. There is—

Mr Smith—Yes, I can understand your point.

Senator MURPHY—There is an inequity.

Senator WATSON—There is obviously a commercial omission in terms of commercial reality.

Mr Goodwin—I think part of the rationale is that the government saw that there was a problem with the legislation, that exemption was being allowed in circumstances where they considered it was not appropriate. In that regard—I guess it is the same with any other avoidance measures or problems—they want it to have effect from the date of announcement.

Senator GEORGE CAMPBELL—That is understandable. The other argument is that the impact of it is that people who have entered into contracts are being caught by a provision that they were not aware of that was not in place before they entered into the contract. The evidence we have had this afternoon, I think from Ms Nesbitt, was to the effect that most of these people on whom the burden will fall are small business people, individual contractors—it is your plumber, electrician and so forth. They do not go around and buy a thousand toilets when they enter a contract. They will buy the toilet when the toilet is required to be put in place. As a consequence they are being hit with a law that obviously, at the end of the day, will affect their margin in the market place and that they were not aware of when they entered into the contract.

Mr Smith—Could we pursue this a little more, because to me—and I thought that in the evidence it was touched on a little bit—we have the head contract but underneath that, in a project this size, I would imagine we would have numerous—probably thousands—of cascading contracts entered into during the term of the construction. If you have the head contract, does that mean that there would be a subsequent exemption flowing through to all the cascading contracts? I think there are a few issues here in relation to those cascading subsequent contracts and what the wash-up is at the end of the four-year construction project.

Senator MURPHY—Does not the head contract, though, as a fixed price contract take account of the other contracts, regardless of whatever time they occur in the process?

Mr Smith—It is not my domain. But I would have thought that there would be estimates of what people would be paying under those particular contracts. But I would also suspect that maybe some of those contracts have not been entered into at the time that head contract is signed.

Senator MURPHY—Yes, but the point made to us in evidence was that in the case of the example given, here is a very large contract and, yes, it will have some rise and fall capacity in it, but the contract was entered into as a fixed price contract under laws of the day. The law gets changed and, as it says in the application, unless the goods were acquired on or before 2 April. What happens when the goods for a contract that has been taken in 1997 are put into a price for that contract on the basis of what was applicable then—and of course they were put in priced as exempt goods in the main—and then this set of laws comes along and changes it all? That is a concern.

Mr Smith—The law itself anticipated that, through section 128 which has also been referred to in evidence. It is all about alteration of contracts if the cost of supplying assessable goods is affected by later changes to the sales tax law. We have talked about section 128 to date and maybe the Treasurer's office has given a commitment in relation to the application of that. The evidence, if I recall, talked about the possibility of amending to ensure some sort of assurance if it did not work out. I do not think I can add any more to that.

Senator GEORGE CAMPBELL—I thought the evidence that Mr Tafft gave was to the effect that in their particular instance, there was not a remedy under 128?

Senator WATSON—There is doubt about 128 and the simple solution is to amend to adjust to commercial reality for the purpose of forming a contract entered into before 2 April 1998. It is just so simple.

Senator MURPHY—It might be simple for one set of circumstances, Senator Watson. Can I ask you, when this decision was taken in respect of this change, how was it advertised, or published in terms of advising the people on whom it might have a potential impact?

Mr Smith—This was the original introduction?

Senator MURPHY—Yes, what was the process?

Mr McCarthy—The normal requirement under the sales tax law is that there be a notice published in the daily press under section 130B of the Sales Tax Assessment Act. Those notices were published on each of the occasions that the bills were introduced. The people affected by this may have been in the building and construction industry and more widely may have been thought to have been notified of it. But, as far as I am aware, the only advertising undertaken was the requirement under section 130B of the act. Advisers and consultants also would have been aware of the changes.

Senator MURPHY—Can you give us a bit more explicit answer as to what actually happened?

Mr McCarthy—To my knowledge, there were only the newspaper advertisements that are required under section 130B of the Sales Tax Assessment Act.

Senator MURPHY—Could you provide the committee with the evidence of which newspapers?

Mr McCarthy—We will provide the evidence.

Senator MURPHY—Because it was also put to us this afternoon that there is a concern about the fact that a lot of people who will be caught by this may not have necessarily even been aware of it, despite that. Some people may not read the public notices. I assume that is where it would have been put.

Mr McCarthy—It is an advertisement, not a public notice, to my knowledge.

Senator MURPHY—It might be useful for us to understand in so far as the concern that has been expressed by some of the witnesses.

Mr Smith—Would it be helpful if I just read out what the requirement on the Commissioner was?

Senator MURPHY—Yes, you can read it out.

Mr Smith—The section says that the Commissioner must, within seven days of the minister making the statement, publish for the information of taxpayers in each state and territory a public notice in plain English in at least two newspapers circulating generally in that state or territory, as the case may be, which shall include the following. Do you want me to go on, Senator?

Senator GEORGE CAMPBELL—I think what Senator Murphy is asking for is the names of the newspapers which carried the advertisement.

Senator MURPHY—And when that was done.

Mr Smith—Yes. For each of the two occasions?

Senator MURPHY—Yes.

CHAIR—Can I give you a question on notice, please, to look at? The previous witnesses gave us a suggestion for amendment to the schedule. Could we ask you to have a look at that and give the committee considered advice about that proposed amendment?

Mr Smith—Certainly, Mr Chairman.

Senator MURPHY—With regard to the evidence that was put to us, can you explain something to me? It was put, I think, if I understood the evidence, that a lot of contractors in the building industry may or may not have been aware of this proposal, or what is proposed

to be law. If it becomes law, how does the tax office intend to deal with that in so far as recovering the monies that would deemed to be owed? How do you track all of this down?

Mr McCarthy—Publishing the notice as required by 130B puts these people on notice that sales tax may be payable. The prudent course for a subcontractor to follow would have been to purchase his goods tax paid. In which case the tax would have been remitted by the supplier. If the purchaser provided an exemption declaration or quoted a sales tax number to purchase the goods tax free, then that person would have a sales tax liability.

We would be expecting that, within 28 days after royal assent, on the appropriate payment date, they would pay us the money that they presumably have been holding for us over this period. If they fail to do that, then we would, through our normal audit and compliance processes, have to check to make sure that we got the appropriate amount of revenue.

Senator MURPHY—What does that involve? I am just curious about it.

Mr McCarthy—We would be looking at the contracts that fall foul of this legislation, whether they may be major contracts like the ones that have been mentioned here today—there will not be very many of them—and looking at the contractors and subcontractors who participated in that, checking their payment records and, if necessary, making appropriate visits.

Senator GEORGE CAMPBELL—But potentially thousands of contractors could be affected by this and presumably a lot of them are no longer in business and have gone into the night.

Mr McCarthy—That may be so.

Senator MURPHY—Was there an estimate on the revenue for this?

Mr McCarthy—Yes.

Senator MURPHY—Excuse my ignorance.

Mr Goodwin—It was estimated at $50 million for a full year. It was $10 million in the period April to 30 June 1998 and $50 million in each year after. That would be taken into account if people were purchasing tax paid and not claiming exemption.

Senator GEORGE CAMPBELL—I have one other question which you may not be able to answer now, but if you cannot, please take it on notice. We are in a position where we are now facing a GST which will be introduced in nine months. How will the GST treat these types of transactions? Will they be all taxable or will that change the name of the game in nine months time again?

Mr Goodwin—Could I clarify your question? Are you asking how the GST would affect these sorts of transactions?

Senator MURPHY—That revenue is based on 22 per cent or whatever the percentages of the sales tax are.

Senator GEORGE CAMPBELL—We are talking about putting in place a law in relation to sales tax. We have a GST which will be coming into force in nine months time. What I am asking you is: what will be the impact of a GST on these types of transactions? Will they be taxable under GST, or are we facing the situation where we are going to put a law in place that will have a life of nine months and then a different set of circumstances will apply at the end of that nine months? Presumably for people out there who are in the process of writing contracts, or may be writing contracts, it will be a very confusing environment.

Mr Goodwin—The GST legislation takes into account contracts that are entered into before the GST legislation was introduced. In terms of goods which might be covered by this

amendment, obviously sales tax is only going to have an application up to 30 June 2000 and after that date those goods would be subject to a GST.

Senator GEORGE CAMPBELL—But will they?

Mr Goodwin—Yes. We are talking about anyone purchasing the goods; they will all be subject to GST.

Senator GEORGE CAMPBELL—Yes, but that may be an input and at the end of the day that may be recoverable.

Mr Goodwin—That is right.

Senator GEORGE CAMPBELL—That is the point. Under this provision, there will be a tax payable on them which will be payable by, presumably, the subcontractor. Under the GST, there will be a tax payable that may be regarded as an input so it will then be refundable. I am asking, essentially, if the treatment of these will be different to what it will be under the sales tax. Are we putting in place a law which will have a life of nine months that will materially be changed again on 1 July 2000?

Mr Goodwin—That is correct.

CHAIR—Did we get an answer?

Mr Smith—Yes. In providing an answer to the chairman in relation to your request about us putting in a reply in relation to—

Senator GEORGE CAMPBELL—Yes, I am happy for you to take it on notice because it needs a bit of thought.

Senator MURPHY—Can I also ask if the outyears assessed revenue takes account of that change?

Mr Goodwin—The revenue estimate?

Senator MURPHY—Yes.

Mr Goodwin—Yes. That would only be under the sales tax legislation.

Senator MURPHY—That is what I thought.

CHAIR—Thank you very much for your evidence and for appearing before us this afternoon. That completes this hearing of this committee.

Committee adjourned at 5.24 p.m.