1934.

COMMONWEALTH OF AUSTRALIA.

SECOND REPORT

OF THE

ROYAL COMMISSION ON TAXATION.

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SECOND REPORT OF THE COMMISSIONERS.

To His Excellency, the Right Honorable SIR ISAAC ALFRED ISAACS, *a Member of His Majesty's Most Honorable Privy Council, Knight Grand Cross of the Most Distinguished Order of Saint Michael and Saint George, Governor-General and Commander in Chief in and over the Commonwealth of Australia.*

MAY IT PLEASE YOUR EXCELLENCY :

We, the Commissioners appointed by Royal Letters Patent, dated 6th October, 1932 :—

> " To inquire into and report upon the simplification and standardization of the taxation laws of the Commonwealth and of the States in so far as they relate to substantially the same subject matters of taxation, as, for instance, income tax, land tax, and death duties ; and, in particular, to make recommendations for the purpose of obtaining uniformity in legislative provisions, including provisions relating to procedure and forms of returns,"

have the honour in continuation of our First Report of the 28th August, 1933, to report further upon the simplification and standardization of the taxation laws of the Commonwealth and of the States in so far as they relate to Income Tax.

THE SCOPE OF THIS REPORT.

276. In this part of our Report we examine the conditions that have been instrumental in bringing about the existing complexity in the taxation laws of Australia and the extent to which the difficulties that exist are due to the lack of harmony between the relevant legislation of the Commonwealth and States, and summarize the previous attempts which have been made to overcome the difficulties arising from these causes. We also discuss at length the problem of double taxation of income in the Commonwealth and other countries and between the States, and in particular the double taxation of income derived by the resident of a State from sources in another State. In each case we submit recommendations designed to alleviate or overcome the difficulties to which we refer.

SECTION XV.

THE IMPORTANCE OF INCOME TAX.

277. During the year ended the 30th June, 1933, the Governments of the Commonwealth and the States collected in taxes upon income (including under this heading Unemployment Relief Taxes) approximately £31,000,000. **The magnitude of this amount, and its effect both on national finance and the taxpayer, warrant careful consideration of the principles underlying the method of assessment and collection.**

278. Sir Josiah Stamp in his *Fundamental Principles of Taxation*, published in 1921, attributed the importance of Income Tax to three causes :—

(1) New problems arising merely through the increasing complexity of modern economic life ;

(2) The growing field of State activity, and the enlarged communal consciousness necessitating demands for increased individual contributions towards common spending, and

(3) The financial legacy of a gigantic war.

The first two of these causes alone would suffice to call for a re-examination of principles, but the addition of the third causes the most supine taxpayer to be interested and critical.

To these may be added two others which particularly affect conditions in Australia :—

(4) The introduction of a Federal Income Tax superimposed upon the State Taxes and based on substantially the same income ;

(5) The progressive increase in the rates of tax imposed by both the Commonwealth and States, accentuated in recent years by the financial depression and the necessity to raise still more revenue for the relief of unemployment. This has increased the difficulties which previously existed, because the basis adopted for the assessment of Unemployment Relief Tax differs in some respects from that used for the assessment of normal Income Tax.

279. If the Commonwealth had not entered the field of income tax, and if the rates of tax imposed by the States prior to the War had been maintained, there would probably have been little dissatisfaction. But the increasing demands of two Governments upon the same taxpayer have brought about the position described in another quotation from the same author :—

> " It is not merely that the existing structure of taxation methods is stretched to its utmost limits and shows every crack and every patch ; but the search for new methods and untapped resources also leads men to ask for statements of the principles upon which taxation can properly be based."

280. The cumulative effect of increased rates and new forms of taxation has been to exaggerate the defects in the original systems of taxation. This is well expressed in a further quotation from the same source :—

> " The defects in a photographic negative are often negligible, or, at any rate, tolerable, until we enlarge the picture, when they become clear to all. . . . Taxation is now rapidly developing from a merely unpleasant incident into a dominating feature of daily life, and those features which hitherto have been of little interest, because they have been too small to matter, now become of great importance ; the blemishes which were insignificant may now be intolerable simply because in the magnitude of the burden they have become sufficiently magnified or intensified to be within the range of ordinary human feeling."

Because of this, public opinion in recent years has brought into prominence the necessity for simplicity, and for rules enabling the liability of the taxpayer to be easily understood, calculated and checked.

SECTION XVI.

INCOME TAX LEGISLATION IN AUSTRALIA AND A SUMMARY OF PREVIOUS ATTEMPTS TO OVERCOME THE DIFFICULTIES ARISING OUT OF THE IMPOSITION OF INCOME TAX BY THE COMMONWEALTH AND EACH STATE.

281. To appreciate in proper perspective the reasons for the differences between the Income Tax legislation of the Commonwealth and States, it is necessary to survey briefly the development of this form of taxation in Australia.

282. In the latter part of the last century the Governments of the different colonies of Australia found themselves obliged to raise additional revenues. The existing sources were not considered capable, without undue strain, of providing the necessary amounts, so new sources had to be tapped. Income Tax was one of them. Tasmania was the first to make a beginning in 1880, by imposing a tax on the dividends of companies, and the enabling Act in that case was the forerunner of one of wider scope, applying to all incomes. Queensland and Western Australia in like manner taxed dividends at the source some years before they levied tax on incomes generally. South Australia appears to have been the first colony to impose tax on incomes in the hands of individuals.

283. The following table shows the chronological order in which a tax on incomes was first levied in the various colonies and in the Commonwealth :—

	Dividend Tax.	Income Tax.
South Australia	.. ..	1884
New South Wales	.. ..	1895
Victoria	.. ..	1895
Queensland	1897 ..	1902
Tasmania	1880 ..	1902
Western Australia	1899 ..	1907
Commonwealth	.. ..	1915

284. Australian Income Tax legislation generally followed British lines, but beyond the fact that the general principles of the parent Act were maintained in each there was no uniformity in the Statutes. This might well be expected, since they were framed by different designers, who had primarily in view the needs of their respective Treasuries rather than uniformity.

285. Prior to the War Income Tax was not a very heavy burden. Rates were low, and as each State Act was based on broad and simple principles much income that is now taxable then escaped tax. Interstate trade, though increasing, had not attained its present volume, so that differences between the various Acts and over-lapping taxation did not cause much inconvenience. With the War the position changed, and the subject of taxation assumed a new importance. The Commonwealth, which was solely responsible for War expenditure, was forced to enter the field of direct taxation in competition with the States, and the Commonwealth Income Tax Assessment Act of 1915 introduced into Australian Income Tax new problems of taxation.

286. In his book *Taxes and their Incidence*, Mr. R. Ewing, Federal Commissioner of Taxation, states that when the draft of the first Commonwealth Income Tax Assessment Bill was prepared consideration was given to the Income Tax Acts of all the States, as " it was desired at that time to have an Act which conformed as closely as possible to all the State laws, in order that taxpayers should not be confused more than could be helped by the introduction of a new taxing measure." It would appear, however, that this very desirable object was ultimately regarded as of secondary importance, for Mr. Ewing adds that the draft was materially amended in order to express fully the policy of the Government of the day. The measure as enacted bore but slight resemblance to the Act of any State, and enunciated principles not then to be found in any of them.

287. Very shortly after the enactment of the first Commonwealth Income Tax Assessment Act it was recognized by the respective Governments that it was desirable that the taxation laws of the Commonwealth and States should be brought into agreement as far as that is possible. With this object several conferences of Ministers and officials representing the Commonwealth and the States were held between 1916 and 1921. As these are referred to in the Report of the previous Royal Commission on Taxation at pages 69 *et seq.*, we need only briefly summarize the proceedings.

December 1916.—Conference of Premiers, when it was resolved that the Commonwealth Government and the Governments of the several States should direct their leading taxation officers to prepare a uniform scheme for Income Tax, Land Tax and Probate Duty (rates excepted in each case).

March 1917.—Conference of Taxation officers, which framed and submitted an Income Tax Bill. This was not adopted by any of the States and only partially by the Commonwealth.

May 1918.—Conference of Premiers, when the subject was referred to the taxation officers present who submitted a report which was " received ".

July 1918.—Conference of State Treasurers, which appointed a sub-committee to consider and report upon the proposal to create one collecting authority for the direct taxes of the Commonwealth and the States.

January 1919.—Conference of Ministers, which considered the report of the Committee appointed in July 1918. The report showed that the two members constituting the sub-committee were in agreement on the following matters :—

(1) The assessment and collection of Income Tax and Land Tax for the Commonwealth and States should be undertaken by an amalgamated Department ;
(2) The formation of such a Department need in no way restrict the right of any Government to rescind or amend the taxation laws ;
(3) Legislation should be enacted by all Parliaments to obtain the necessary additional measure of uniformity.

But as the members of the sub-committee could not agree on the constitution of the Bureau to control the amalgamated Department no action was taken and this report was also " received ". At this conference also the Commonwealth Treasurer offered to collect the whole direct taxation of the States at one-third of the cost to the States.

July 1920.—Conference of Ministers, at which the Commonwealth Treasurer repeated this offer which was not accepted. The Conference resolved that there should be one collecting authority and a uniform schedule, and appointed a Board of Inquiry to consider the best means of giving effect to this decision. The Board consisted of the Hon. James Ashton, Mr. R. Ewing (Commonwealth Commissioner of Taxation) and Mr. R. M. Weldon (State Commissioner of Taxes, Victoria). Mr. Weldon also represented all the States except Western Australia.

288. Before this Board could report, an Agreement was entered into between the Governments of the Commonwealth and the State of Western Australia. This Agreement provided for an amalgamation of staffs by transfer of permanent taxation officers in Western Australia to the Commonwealth under the Commonwealth Public Service Act, except in the case of the State Commissioner of Taxes. The latter was to remain an officer of the State Service and be free to administer the State law without interference from any Commonwealth authority. On the other hand the Commonwealth Commissioner of Taxation was to have the free administration of the Commonwealth law without interference from the State of Western Australia.

289. The Board of Inquiry presented its report in February 1921. It stated that two proposals has been considered—one made by the Commonwealth Commissioner of Taxation and the other by Mr. Weldon. As it had been unable to arrive at a unanimous decision it was arranged that separate reports should be submitted.

290. The Majority Report recommended, in effect, that agreements similar to that made between the Commonwealth and Western Australia should be made between the Commonwealth and the remaining States, and condemned as expensive and impracticable the proposal made by Mr. Weldon.

291. In the Minority Report, which was signed by Mr. Weldon alone, strong exception was taken to the Western Australian agreement on the ground that it would practically place the control of the assessment and collection of the State taxes in the hands of the Commonwealth authorities, notwithstanding the fact that the States had indicated at various times that they were not prepared to entrust these duties to the Commonwealth. The opinion was also expressed that, although the States and the Commonwealth have equal rights in this matter, the Agreement subordinated the sovereign rights of the States and did not properly safeguard and maintain their existing rights and interests. It was recommended that the assessment and collection of Commonwealth and State taxation should be controlled by a Board consisting of five members. Four members should be selected from existing taxation officials, two by the Commonwealth and two by the States. The fifth member, who would be Chairman, would, it was proposed, be selected from outside the Commonwealth and State Services. The advantages claimed by Mr. Weldon for his scheme were—

(1) That all the authorities would have representation in accordance with their respective interests ;

(2) That neither Government would subordinate itself to the other ;

(3) That the difficult problems arising out of the taxation of businesses carried on in more than one State could be more effectively dealt with than under the arrangements which then existed ;

(4) That the scheme would reduce the cost of administration, improve efficiency, and make for smoother working.

292. The Board unanimously came to the conclusion that in the circumstances then existing no practical advantage would accrue to taxpayers by the use of a combined form of return.

293. The conclusion arrived at by the previous Royal Commission on Taxation (1920) was that " only by a delimitation of spheres, or allocation of subjects of taxation between the Commonwealth and States, can an ordered and satisfactory system of taxation be brought into being in Australia ". One Commissioner dissented from this conclusion.

294. Proposals for the abolition of dual income taxation by the Commonwealth and States were again discussed at a Conference of Premiers held during the early part of 1923 and later in the Federal Parliament. In addressing the House of Representatives thereon the Prime Minister (Mr. Bruce) said on 14th June, 1923 :—

" The position in regard to this matter has to be considered very closely. There are a number of ways in which we could achieve what we are attempting, and the simplest is that the Commonwealth should take over the whole work of collecting income taxation and that the Commonwealth Act should be the only taxation Act. The objection to that proposal is that we cannot do it under the Constitution, and the States would never agree to it in any circumstances. Another proposal is that the Commonwealth should completely discontinue collecting income taxation and hand over the responsibility to the States. We are not going to do that and we could not consider it for a moment from a financial point of view. Another is that both the Commonwealth and States should continue to function in the field in which we are operating to-day but that the Commonwealth should be the only collecting authority. That would mean a certain advance, but we have to remember that if we had only one collecting authority the problem would not be solved unless we had uniform taxation laws for the Commonwealth and the States.

Another method would be for the States to collect for the Commonwealth. That has been suggested ; but, unfortunately, even if the Commonwealth agreed there would be insuperable difficulties in the way, and no economy could be effected even if the proposal were adopted. The Commonwealth Government have to levy taxation on individuals in Australia, a great number of whom are deriving incomes in more than one State, which means that we have to aggregate such incomes in the Central Office. The States could collect for the Commonwealth only on taxable incomes derived in one State, and could not help us to collect taxes from those whose incomes are derived in more than one State. All these schemes have been tried and have failed.

The duplication of taxation is, of course, costing a very large sum in administration and is also causing a great deal of difficulty and embarrassment to taxpayers throughout the Commonwealth, and also expense, particularly to the taxpayers who have to secure paid assistance in preparing their returns. We were faced with the problem of ascertaining some way out of the difficulty. We tried all the methods I have mentioned and saw that it was impossible to get results from any.

We, therefore, submitted certain proposals to the Conference which I will briefly indicate, but which need not be stressed.

We suggested that the Commonwealth should discontinue taxing incomes under £2,000, and, having allowed the States a larger arena in which to collect taxation, should discontinue the per capita payments. That proposal the States would not entertain. The States' representatives then suggested that we should relinquish taxation on incomes altogether, but they realized that in such circumstances we would not be able to raise sufficient revenue to meet our obligations. They were, however, prepared to enter into an arrangement under which the States would subsidize the Commonwealth. As soon as that proposal was put forward—notwithstanding that we met to come to an amicable arrangement in conference if possible—I clearly stated that it was useless for us to go further with it. The Commonwealth could not entertain such a proposal because had it been adopted the whole Federal spirit would have been destroyed. There are times, too, when some of the States would not be in a position to make an annual contribution to the Commonwealth in consequence of drought and general depression. There are many reasons which might make it difficult for certain States to pay a subsidy to the Commonwealth, particularly when there might be direct antagonism between the Commonwealth and an individual State. Such a proposal I am sure the Commonwealth Parliament would not consider for a moment.

Eventually another proposition was submitted by the Commonwealth which has the advantage that it completely disposes of any duplication as far as individual taxpayers are concerned. The original scheme was that we should not collect on incomes under £2,000, which would dispense with the duplication of taxation on individuals receiving less than that amount ; but it was subsequently proposed that the Commonwealth should vacate the whole field of individual income taxation and should levy income taxation only upon companies, allowing the widest possible interpretation of the word ' companies '. In exchange for the Commonwealth vacating that field of taxation, we pointed out that the States would no longer receive the per capita payments, and must forego the interest payments on transferred properties."

295. On 6th July, 1923, the Prime Minister informed the House of Representatives that although the proposals referred to had been accepted by five of the States (New South Wales dissenting), they could not be completed until accurate statistics were available. He said :—

> " Consequently the Government has very reluctantly decided that it will be necessary to postpone any arrangements of this character for the present financial year. At the same time we are making an earnest endeavour to give in another way that relief which the taxpayers so earnestly desire. We propose to arrange, if possible, for one collecting authority for the Commonwealth and the States. In regard to all incomes derived only from one State the collection will be carried out by the State on behalf of the Commonwealth. Where the income is derived from more than one State the Commonwealth will collect through its own Central agency. Those proposals are embodied in an agreement which has been submitted to all the States for consideration, and the Government hope that the various States will come into line and have one collecting authority throughout Australia for all income taxes—Commonwealth or State. In that way we shall avoid the harassing duplication of returns and also bring about very substantial administrative economies.
>
> We are also endeavouring to place the laws of the Commonwealth and the States on a uniform basis, and with that object we have consulted some of the States. We are asking those States who have not already done so to send their taxation officers here, so that before it is necessary to present the Budget statements to the respective Houses we may be able to arrive at some basis for a greater measure of uniformity in the taxation measures of the Commonwealth and the States. That proposal, of course, only refers to the incidence of taxation and in no way affects the right of every Parliament, whether State or Federal, to impose its own rate of taxation upon its own taxpayers.
>
> By the adoption of our suggestions 98 per cent. of the taxpayers of Australia would be relieved of the necessity of making two returns of their incomes each year. The only persons who will have to make two returns are those fortunate individuals who have incomes derived from more than one State in the Commonwealth. There will be no necessity to maintain two staffs, and as a result of the abolition of superfluous staffs great economy throughout Australia will be effected. These proposals are designed to give immediate relief. The proposals which were submitted at the Conference with State Ministers are still under consideration, and the Government are not abandoning their original project for defining the areas of taxation over which the Commonwealth and States, respectively, would operate, and thus preventing duplication of income taxation."

296. These quotations are made in order to show that the various alternatives were fully considered by the respective Governments, and it may be presumed that the arrangements then made represented the best compromise that was practicable at that time.

297. During November and December, 1923, the Agreements with the States (other than Western Australia) referred to in the Prime Minister's Speech were completed. These provided that the State Taxation Departments in those States would collect both Commonwealth and State taxes, except where incomes subject to Commonwealth tax are derived from two or more States. In order to give effect to this arrangement the Commissioner of Taxes of each State was made the Deputy Federal Commissioner of Taxation for the Commonwealth. The Commonwealth staff previously engaged in assessing and collecting Income Tax in those States was merged with the State staff after the Commonwealth staff had been reduced by resignations of some officers and transfers of others to other Commonwealth Departments. The officers transferred to the State Taxation Departments became State officers, subject to the provisions of the respective State Public Service Acts and Regulations.

298. The Commonwealth Government, desiring to make further progress towards reconciling the financial relations of the Commonwealth and the States, submitted far-reaching proposals to this effect early in 1926. Speaking on the 4th June, 1926, on the second reading of the State Grants Bill to give effect to these proposals, the Commonwealth Treasurer (Dr. Earle Page) said :—

> " Three years ago this Government was able to effect a great administrative reform by amalgamating the Commonwealth and State Income Tax collecting agencies. This resulted in a saving to the Commonwealth of about £200,000 annually, and rendered [illegible] officers who were practically duplicating work that State

officers were doing. The reform also involved the adoption of a uniform assessment form in practically all the States, and so was a great convenience to the general taxpayer. It is now proposed to effect another reform. Since the one collecting agency has been operating, we have had the burlesque of the Commonwealth Government levying taxes which the State Governments have solemnly collected, the State Governments paying them over to the Commonwealth, and the Commonwealth giving them back to the States. It is now proposed to end this burlesque. It is also proposed that the Commonwealth shall evacuate the field of Land Taxation, Estate Duties, and Entertainments Tax. This also will result in a considerable saving in the administration and will be of convenience to the taxpayer. At the same time the Government will cease the per capita payments to the States and make certain reductions in the rate of Income Tax on both companies and individuals. It is proposed to recoup the States for the loss of the capitation payments by making certain grants to them. The Government proposes to evacuate entirely the field of taxation in regard to Land, Estate Duties and Entertainments, and at the same time to remit taxation on companies and individuals to the extent of 40 per cent."

299. The proposals, however, were not favorably received by the States, and nine months later, on the 2nd March, 1927, the Prime Minister (Mr. Bruce) said, in the course of the resumed debate on the second reading :—

> " This bill has created intense feeling in the country, and many persons appear to believe that it has been introduced to deprive the States of certain rights, to place them in a position of financial embarrassment and to render it impossible for them to carry on their legitimate functions. . . . . For this reason the Government asks the House not to go forward with the whole of the proposals outlined last year, and with regard to which necessary measures were brought down. We propose that Parliament should pass the measure amended in such a way as to provide for the cessation of the per capita payment, that is, the payment to each State of 25s. per head of its population. We ask that that payment shall be terminated on the 30th June next, and that the States shall be invited to a conference to consider methods by which the new financial position can be adjusted without detriment to their interests, and to prevent their financial embarrassment. At that conference the whole question can be looked at from every angle, and every possible method considered."

300. The Financial Agreement of 1927 gave effect to the revised arrangements entered into between the Commonwealth and the States, but this did not in any way affect either the imposition or the collection of Commonwealth and State Income Tax, and the Agreements between the respective Governments previously referred to are still operative. While it may be admitted that they have been of some value in reducing the cost of administration, it is to be regretted that they have had very little influence in bringing about closer agreement between the taxation laws of the various Governments. **Many of the differences in the Acts then existing still exist, and in the meantime many more have been created.** These will form the subject of the next section.

SECTION XVII.

THE CAUSES OF COMPLEXITY AND THE MEANS SUGGESTED FOR ITS REMOVAL OR REDUCTION.

301. The lack of uniformity between the taxation laws of the Commonwealth and the States imposes upon the community unnecessary expense, both direct and indirect, which in the aggregate must be very large. In the first place it increases the cost of administration, but that is not the only additional burden borne by the taxpayer. It includes the cost of his personal inconvenience and in many cases of expert assistance. It is not suggested that either of these can be entirely obviated, but there is no reason why they should not be reduced, for the taxpayer derives no direct benefit for the time that he devotes and the money that he expends in complying with the requirements of the various Acts. Any modification, therefore, which will make it easier for him to comply with his obligations or reduce the cost of doing so will be equivalent, in effect, to a reduction in the real cost of taxation which is now borne directly or indirectly by him.

302. It is obvious that many of the difficulties experienced by the taxpayer arise because separate Governments are exercising their powers directly in the same field and at the same time, demanding revenue from the same people by the same modes of taxation. While in theory this

may be open to objection, in practice it need not create serious inconvenience to taxpayers, provided that the respective Governments can agree upon a uniform method of determining the income subject to tax. It is because they have not been able to agree upon that point that complexities arise.

303. In order to ascertain the nature of the remedies to be applied to remove or reduce these complexities it is necessary to ascertain the nature of the differences which exist.

304. The more important differences between the Taxation Acts of the Commonwealth and the States may be broadly classified under the following headings :—

(1) *Differences which affect the calculation of the income—*

(*a*) The income subject to tax ;

(*b*) Deductions allowed for expenses incurred in gaining or producing the assessable income ;

(*c*) The concessional deductions ;

(*d*) Allowance for losses incurred during a period prior to the year of income.

These more directly concern the taxpayer. Many of these differences are relatively unimportant, and it should be possible by reasonable compromise to reconcile them without a serious loss of revenue to any Government.

(2) *Differences which affect the preparation and checking of the assessment—*

(*a*) The rate and progression of tax ;

(*b*) The statutory exemption allowed.

Uniformity in the rate and progression of tax and in the differentiation between the rate on income from personal exertion and property, respectively, cannot be expected. Each Government must fix rates which will produce the revenue it requires, and in so doing can have regard only to its own requirements and not to the rates fixed by any other Government. To some extent the same considerations apply to the statutory exemption, because an increase or decrease in this allowance directly affects revenue. If it be possible for the various Governments to agree upon the other elements of the taxable income, differences in the rate and progression of tax and the statutory exemption will cause little inconvenience to the taxpayer.

(3) *Differences in procedure, as, for example, that relating to objections and appeals, the time allowed for taking certain steps, amendment of assessments and the like—*

There is no sound reason why these differences should continue. Most of them can be simply reconciled without loss of revenue.

(4) *Diversity in the form of the Acts, in the sequence of their provisions, and in the words used in the relevant sections to express the same intention—*

This will be dealt with in our proposals for a uniform Income Tax Assessment Act.

305. The analysis and classification of the existing differences between the respective Acts enables us to indicate the essential requirements of any scheme designed to remove or minimize them. These are :—

(1) Reconciliation, by agreement between the Governments concerned, of all the provisions of their respective Income Tax Assessment Acts which now differ, but in respect of which uniformity may be achieved without surrender of any essential principle or serious loss of revenue.

(2) The preparation of a uniform Assessment Act to give effect to such agreement.

(3) The adoption of the uniform Assessment Act by the Commonwealth. The Commonwealth Act would also include provisions relating to certain matters which do not concern the States, and to those matters in respect of which agreement is not attained.

(4) **Similarly, the adoption of the uniform Assessment Act by each State Government. Each State Act would also include provisions relating to local requirements, or matters which do not concern the Commonwealth or all other State Governments, or in respect of which agreement is not attained.**

(5) **Agreement between the respective Governments in regard to the manner in which amendments to the uniform Act are to be effected.**

(6) **The rate and progression of tax must be decided by each Parliament in accordance with its financial requirements, without reference to any other Government.**

(7) **The administration of the uniform Act and of the separate State Acts must be designed to assess and collect the taxes imposed by all of the Governments, with efficiency, economy, and convenience to the taxpayer.**

We shall discuss these requirements in detail.

SECTION XVIII.

THE UNIFORM ACT.

306. Those who have had occasion to compare relevant provisions of the various Acts, and who have experienced the difficulty of finding the appropriate Section and reconciling the different language in which the same idea is expressed, will appreciate the need for uniformity.

307. The Acts of the various authorities are not constructed in accordance with any common plan. There is no uniformity of the order in which the Sections appear, and in many cases those which purport to have the same intention and which are interpreted in the same manner are expressed in different language.

308. Nor is there agreement between the Acts in regard to their subject matters. In South Australia, Western Australia and Tasmania the Acts cover the assessment of Land Tax as well as Income Tax. In Western Australia individuals are assessed under the Land and Income Tax Act, but companies are assessed under the Dividend Duties Act. The convenience of a standard form of Act dealing with one subject of taxation only will be apparent.

309. At this stage we should remark that a number of witnesses in one State were entirely opposed to the adoption of a uniform Act. Numerically these represented but a very small proportion of the total number examined. They desired, however, that any provisions of the Commonwealth Act which conferred concessions should be incorporated in the Taxation Act of their State, but they were opposed to any agreement which would prevent amendment of their State Act without the concurrence of the other States. In their opinion a uniform Act would be an infringement of State rights. If these views were to prevail it would be useless to persevere with the attempt to achieve or maintain standardization of Income Tax legislation.

310. In theory the adoption and maintenance of a uniform Act may imply some suspension or surrender of State rights. **But the rights which any Government would be asked to suspend or surrender as the result of agreeing to the adoption of a uniform Act are not of real importance.** An agreement to this effect would not limit the power of any Parliament to raise the Revenue it requires from its taxpayer, but would involve only the adoption by all the Parliaments concerned of a common basis for determining the income to be taxed and the deductions to be made in order to arrive at the net taxable amount. Agreement in regard to other matters, such as those which relate to procedure, can have virtually no effect upon revenue. The experience acquired during the past eighteen years should enable the Governments concerned to arrive at conclusions in regard to many of these matters, and to embody them in an Act which should not require continual amendment. **If the respective Governments are not prepared to approach the subject in this spirit it is futile to hope that standardization can ever be achieved.**

311. In devising a Taxation Act, regard must be had to three basic principles, viz., the requirements of the revenue, equity and simplicity. The primary purpose of a taxation law is, of course, to obtain revenue, and that must be borne in mind when considering the amendments or concessions that should be recommended. Theoretical equity is unattainable, and the attempt to attain it involves a sacrifice of simplicity and convenience out of all proportion to the value of the results achieved. Equity as applied to taxation is, therefore, a relative term and, for practical purposes, is attained if the burden of taxation is fairly distributed over all classes of taxpayers in such a manner as not to confer an undue advantage upon a particular class or number of classes.

312. While it should be the object of the draftsman to express the intention of the Act in clear language and without ambiguity, the complexities of modern trade and commerce are so great that a "**simple**" **Income Tax Act is not practicable.**

313. A comparison of the Acts of the various Governments shows that certain basic principles have been generally accepted. In all cases expenditure incurred in gaining or producing the assessable income is allowed. Concessional deductions and a statutory exemption are also allowed, but the amount of each of these varies. The principle of a graduated rate is also recognized, though there is no agreement in regard to the manner in which this is determined. In some cases, for example, dividends are included and in others excluded for that purpose. In all States except Western Australia income from personal exertion is taxed at a lower rate than income from property.

314. In considering the draft of a uniform Act, the first step is to consider the existing Acts. **We find that none of the State Acts could be adopted in its present form as a basis for the uniform Act. Each contains provisions which relate to its particular requirements and which do not necessarily concern other Governments. After careful consideration we are of the opinion that the Commonwealth Act provides a more satisfactory basis.** There are several reasons for this conclusion. Despite complaints that have been made about the difficulty of interpreting this Act, it appears to be based upon sounder principles than any other Act, and its provisions are known to taxpayers in every State, while the provisions of a State Act are not widely known outside that State. The uniform Act should deal generally with those matters which affect the preparation of the Income Tax return and procedure. These are set out in detail in paragraph 304. It should deal only with Income Tax, and it should not include any references to rates of tax. The Rates Act should be distinct. This would facilitate the variation of rates, without the necessity for amending the Assessment Act.

315. A uniform Act cannot meet all the requirements of all the Governments concerned. It is obvious that each will require special provisions which are not necessarily adapted for general application. For example, the Commonwealth and States may not be able to adopt similar methods for the taxation of companies, of dividends, and of profits withheld from distribution. There are other provisions which will fall in this category. Again, the States will require special provisions, not necessary in Commonwealth legislation, to deal with the apportionment of profits derived from a business carried on in more than one State, and with certain local conditions. There are other matters of minor importance in respect of which agreement may not be possible, and these will necessarily have to be dealt with separately in the Assessment Act of the Government concerned. It should be stressed, however, that even in those cases where the Governments accept a principle but cannot agree upon the extent of its application, as, for example, the amount of a concessional deduction, or where some Governments, but not all, agree in regard to any matter, it is desirable that the corresponding provisions in their respective Acts should as far as possible be expressed in the same words.

316. The advantages of a uniform Act are obvious. They may be summarized thus :—

- **(a) The simplification of Commonwealth and State returns ;**
- **(b) The facilitation of reference ;**
- **(c) The harmonization of the practice under Commonwealth and State law ;**
- **(d) The more uniform application of legal decisions ;**
- **(e) The reduction of the cost of administration.**

317. We have used the expression " uniform Act " as a matter of convenience to describe, not necessarily a single separate enactment of each Parliament, but a body of uniform provisions constituting either such a single Act or a distinct Part of the Assessment Act of the Commonwealth and of each State.

SECTION XIX.

AMENDMENT OF THE UNIFORM ACT.

318. If it be found possible to arrive at agreement in regard to the provisions of the uniform Act it will next be necessary to determine the manner in which amendments are to be effected.

319. Taxpayers, generally, resent the frequent amendments of the taxation laws of the various Governments, and we received many forcible complaints from witnesses in respect to this matter. One witness expressed his views in these words :—

> " Our laws, of course, are not condemned to that immunity from development and improvement which was attributed to the laws of the Medes and the Persians, but they are expected to conform to a certain standard of stability and continuity and freedom from constant tinkering."

320. Before the War the provisions of the Taxation Acts of the States were simple and the rates were low. Dual taxation by the Commonwealth and a State did not exist, and overlapping taxation between States was not considerable. The effect of any State Act was, therefore, largely restricted to the residents of that State.

321. The entry of the Commonwealth into this field, and the imposition by it of severely graduated rates, created a field for the taxation adviser, who was able in many cases to devise expedients which enabled the taxpayer with a large income to avoid the full incidence of taxation. To defeat these avoidances, it was necessary frequently to amend the Commonwealth Assessment Act, and between its introduction in 1915 and 1922 six amending Acts were passed. These amendments resulted in the Commonwealth Acts assuming a patchwork character, and, largely with the object of curing this defect, they were all repealed and an entirely new Act passed in 1922. Finality was not thereby reached, however, for between 1922 and December, 1933, eleven further amendments of the Commonwealth Assessment Act were passed, in addition to special Acts relating to live stock, bonus shares, and financial relief.

322. The extended incidence of State taxation, and increases in the rates of tax imposed, produced similar conditions in the States and necessitated frequent amendments of State Acts. We have made no attempt to ascertain the number of such amendments, but in some States at least the craze for alteration appears to be almost as urgent as in the Commonwealth. Had these amendments been part of a scheme to bring about a greater measure of uniformity between the taxation laws of the Commonwealth and the States they might have been justified and endured, but there is no evidence that any of the Governments were consistently working towards agreement. At one period some of the States amended their Acts to bring them into closer agreement with that of the Commonwealth, but as the latter continued to amend its Act little real advance towards uniformity was made, and the States appear to have abandoned the attempt to follow the frequent amendments of the Commonwealth Act.

323. It might have been expected that the agreements for the collection of Commonwealth Income Tax would have influenced a trend towards uniformity, but this is not the case, for within two years after the execution of the agreement between the Commonwealth and Western Australia the State Commissioner of Taxation, Western Australia, in his Annual Report dated the 7th October, 1922, said :—

> Many amendments were made to both the Federal and State taxation laws last financial year, and instead of these bringing both Acts more into harmony with each other they have widened and increased the differences between them and created additional work in the Department as well as adding further confusion and irritation to taxpayers generally."

324. The Commonwealth Commissioner of Taxation in his Eighth Report, dated the 30th June, 1924, also referred to this as follows :—

> " The taxation legislation of the two Governments (Commonwealth and Western Australia) has not progressed along converging lines but rather the contrary. Local interests have been reflected in the attitude of the State Parliament in apparently small matters of principle, with the result that a number of concessions to taxpayers has recently been granted by the State Parliament."

325. Amendments in recent years appear to have been made to meet particular requirements of the Governments concerned, usually to produce additional revenue or confer additional powers upon the Commissioner. No regard appears to have been paid to the action of any other Government, and even where it has been agreed to adopt a certain course the words used to effect that purpose have not been identical. For instance, South Australia and Victoria have each given practical effect to the Resolutions of the Conference of Taxation Officials in 1929, but the amendments to their Acts for that purpose are expressed in very different language.

326. In consequence of these numerous and divergent amendments it is extremely difficult for persons who are subject to Income Tax in the Commonwealth and in one or more of the States to understand the exact nature of the tax they are called upon to pay, or to ascertain the state of the law, without the expenditure of a great deal of time and laborious research.

327. It is not suggested that any uniform Act that may be adopted by the respective Governments should not be amended ; but means should be devised to control those amendments and ensure that as far as possible they should be adopted only with the approval of all concerned. The need for some control must be admitted. But if the arguments in favour of amendment be sound, or the need be great, there is no reason to doubt that all the Governments concerned, or at least a majority of them, will agree.

328. It was suggested by several representative witnesses that a Central Taxation Standing Committee should be established, consisting of representatives of the Commonwealth and each State Government. That Committee should be required to examine and report upon all proposed amendments of the uniform Assessment Act, whether submitted by the Taxation Department or on behalf of taxpayers. It was considered that a Committee of this nature would also impose a check upon hasty legislation; for it is another source of complaint that in too many cases amendments to the taxation laws are rushed through Parliament in circumstances that preclude consideration by the taxpayer, who in the last resort is most vitally concerned. This complaint is not directed by taxpayers at any particular Government, for with some justification it may be made against all of them. An instance referred to in evidence may be quoted :—

> "During the last few years there has been a tendency, also in other parts of Australia, but particularly in Queensland, for the amending Act to be brought down to Parliament at the last minute, and without time for consideration of its provisions, or to make suggestions for the amendment of particular clauses. The last case, which happened in December last (1932), is one of the worst in that respect, if I may mention it, because it is important. It was in regard to the 1932 Amending Act. We knew that there was an Amending Act coming along. The Bill itself was presented to Parliament at 4 p.m. on 2nd December. It comprised 49 foolscap pages of amendments, many of them of great importance, and altering the previous legislation in some important respects. The Bill was passed through all its stages in the House in less than three hours, and not one member of the Opposition had seen it before 4.10 p.m. The Bill passed through all its stages without amendment. On the motion for the second reading four members of the Opposition protested against the Bill being rushed through in this way, and the Premier and Treasurer replied. No other members of Parliament took part in the debate. We should have had an opportunity to have got hold of this Bill in order to discuss its provisions, but we all woke up the next morning and found that it was law. It was put through without a single amendment, although it contained some most important clauses. This is not a satisfactory state of affiairs."

329. It will, of course, again be argued that any agreement by a State Government to refrain from making amendments to the uniform Act will be a surrender of State rights. Again, this may be admitted to be theoretically correct, but if it be possible for the States to agree upon the provisions of a uniform Act, it is not asking much more to expect them to agree not to amend the provisions of that Act except after due inquiry and by mutual agreement. The taxpayer is not so keenly interested in the preservation of abstract constitutional rights as in the adoption of an arrangement which will obviate the difficulties which now cause him inconvenience and expense, and if that end can be attained by the suspension of unessential powers in regard to the details of taxation he is not likely to object. It is obvious, however, that the unrestricted exercise by each Government of its power to make amendments to any uniform Act that may be adopted will merely lead to a recurrence of the conditions which the uniform Act is intended to remedy.

SECTION XX.

THE ADMINISTRATION OF THE UNIFORM ACT.

330. We have previously stated that the amount collected in Commonwealth and State Income Tax and State Unemployment Relief Taxes is so large as to compel careful consideration of the present methods of assessment and collection in order to determine whether these are capable of improvement.

331. While separate Governments continue to assess and collect Income Tax, some duplication in administration is unavoidable. The agreements between the Commonwealth and the States to which previous reference has been made are intended to minimize this, and it may be admitted that the existing arrangements are better than those which they replaced.

332. Three methods of assessment and collection of tax may be considered :—

(*a*) *That the States should collect all Income Tax, acting as agents for the Commonwealth—*

333. This is, in effect, the existing arrangement, except in Western Australia, where the Commonwealth collects on behalf of the State, and in the Commonwealth Central Office, Melbourne, which collects Commonwealth tax upon incomes derived in more than one State.

334. The collection of all Income Tax by the States does not appear to be the most efficient method that might be adopted. The principal objection that may be taken to it is that **each State Department is separately controlled** and, except for the general control exercised over the collection of Commonwealth Income Tax by the Commonwealth Commissioner of Taxation, acts independently of every other State Taxation Department. This necessarily results in some lack of uniformity in administration and procedure. This conclusion is confirmed by an opinion expressed by the Commonwealth Commissioner of Taxation in his Ninth Annual Report, dated the 16th January, 1926, in which he says :—

> "In this connexion it is necessary to keep in mind that Federal Income Tax is being collected in the various States by the State Taxation Departments and that the systems of assessment and collection adopted by the various State Commissioners are not uniform, as they were when the Commonwealth collected its own Income Tax."

It should be noted that the agreements for the assessment and collection of Commonwealth Income Tax by the States had then been in force for approximately three years. We are not aware that the Commissioner has since had occasion to modify the opinion which he then expressed.

335. Other material objections may be taken to the existing arrangements. The first is that **each State Department will in time tend to develop along different lines.** Hitherto each has benefited by the experience of officers who were trained by the Commonwealth before the amalgamation. But as time passes this influence will become less by the retirement of these officers, and it is not difficult to imagine a time in the near future when a State Department will contain very few officers who have received training, and who have had personal experience, in the Commonwealth Income Tax Department. This is a serious disadvantage from the point of view of the Commonwealth. The second is that **the arrangements fail to meet the convenience of a taxpayer who derives income subject to State tax in two or more States.** He must negotiate separately with the State Commissioner in each State in which he derives income. If either of the other alternatives were adopted this inconvenience could be minimized.

336. Finally the collection of Commonwealth Income Tax by the States is open to objection on the ground that **the refusal of a State to carry out its obligations under the agreement may temporarily paralyse the collection of Commonwealth Income Tax in that State.**

(b) That the Commonwealth should collect all Income Tax, acting as agent for the States—

337. In our opinion this arrangement would be more efficient than that which now exists, mainly because there would be unity of control and a wider field from which to select officers required for the more important positions. The Commonwealth should also be in a position to deal more efficiently with the apportionment between States of income derived from more than one State. We recognize, however, that it is improbable that the States would agree to transfer the collection of their Income Tax to the Commonwealth, and we need not therefore, further discuss this alternative.

(c) That a joint authority should be created to collect all Income Tax—

338. A number of witnesses, each representing an important body of taxpayers, suggested that the administration of the Commonwealth and State Acts and the collection of all Income Tax should be vested in a joint authority.

339. If it be possible for the Commonwealth and the States to agree to adopt a uniform Act, it would appear to be a logical consequence for them also to agree to create a joint authority to administer that Act. It is reasonable to believe that the duties now carried out by the various Departments which assess and collect tax could be performed more efficiently and with greater convenience to the taxpayer by a joint authority operating in all States under uniform control.

340. During the year ended the 30th June, 1933, taxes collected by the Commonwealth and State Taxation Departments were as under :—

—	Commonwealth.	States.	Total.
	£	£	£
Income Tax (including Dividend Duty, Western Australia)	10,878,718	9,607,200	..
Unemployment Relief Tax	..	10,528,333	31,014,251
Land Tax	1,650,311	1,478,288	3,128,599
Probate and Succession Duty	1,126,996	3,766,259	4,893,255
Sales Tax	9,369,276	..	9,369,276
Entertainments Tax	134,042	411,649	545,691
	23,159,343	25,791,729	48,951,072

341. The following statement shows the manner in which these revenues are now assessed and collected :—

Commonwealth Central Office, Melbourne—

Federal Deputy Commissioner assesses and collects Commonwealth Income Tax on income derived from more than one State, Commonwealth Land Tax on land owned in more than one State, and Commonwealth Estate Duty on estates which have assets in more than one State. Also Commonwealth Land Tax, Commonwealth Estate Duty and Sales Tax payable by taxpayers whose interests are confined to Victoria. Also Commonwealth and State Entertainments Tax.

New South Wales—

State Commissioner of Taxation assesses and collects Commonwealth and State Income Tax and State Land Tax.

Federal Deputy Commissioner assesses and collects Commonwealth Land Tax, Commonwealth Estate Duty and Sales Tax ; also Commonwealth and State Entertainments Tax.

Commissioner of Stamps assesses and collects State Duty on the Estates of deceased persons.

Victoria—

State Commissioner of Taxes assesses and collects Commonwealth and State Income Tax, State Land Tax, and State Duty on the estates of deceased persons.

Queensland—

State Commissioner of Taxes assesses and collects Commonwealth and State Income Tax and State Land Tax.

Federal Deputy Commissioner assesses and collects Commonwealth Land Tax, Commonwealth Estate Duty, Sales Tax and Commonwealth Entertainments Tax.

Commissioner of Stamps assesses and collects State Duty on the Estates of deceased persons.

South Australia—

State Commissioner of Taxes assesses and collects Commonwealth and State Income Tax, State Land Tax, State Duty on the estates of deceased persons, and State Entertainments Tax.

Federal Deputy Commissioner assesses and collects Commonwealth Land Tax, Commonwealth Estate Duty, Sales Tax and Commonwealth Entertainments Tax.

Western Australia—

Federal Deputy Commissioner assesses and collects Commonwealth and State Income Tax, Commonwealth and State Land Tax, Commonwealth Estate Duty, Sales Tax and Commonwealth and State Entertainments Tax.

Commissioner of Stamps assesses and collects State Duty on estates of deceased persons.

Tasmania—

State Commissioner of Taxes assesses and collects Commonwealth and State Income Tax, State Land Tax, and State Duty on the estates of deceased persons.

Federal Deputy Commissioner assesses and collects Commonwealth Land Tax, Commonwealth Estate Duty, Sales Tax and Commonwealth and State Entertainments Tax.

The machinery which is employed for the collection of State Income Tax is also used for the collection of State Unemployment Relief Tax. Commonwealth Entertainments Tax was repealed in 1933.

342. It may be claimed that even if the present arrangements for the collection of Income Tax are capable of improvement they are more efficient than those which exist for the collection of the other taxes mentioned previously. The absence of co-ordination in regard to the collection of these other taxes strengthens the argument for the creation of a joint authority to assess and collect all of them.

343. We recommend, therefore, that a joint authority be constituted by agreement between the various Governments for the purpose of assessing and collecting all direct taxation imposed by any of them and also Sales Tax. An agreement of this importance should be for a definite period, and ten years would seem to be reasonable. Thereafter the agreement might be continued unless terminated as regards any Government by withdrawal. The joint authority should represent all the contracting parties, but should be independent of them and free to carry out the duties entrusted to it without interference.

344. It is desirable, but not essential, that all the Governments should agree to the constitution of the joint authority, but the refusal of any State to do so would not necessarily prevent the scheme from being carried into effect. In that event, however, it would be necessary to review existing arrangements for the collection of Income Tax in that State.

345. The witnesses who recommended the creation of a joint authority suggested that it should be constituted and administered in the manner described in the Minority Report of the Board of 1920. As mentioned in paragraph 291, that Report advocated a Board to consist of five members. Four of these were to be selected from present taxation officials and the fifth was to be an outsider with wide business experience. The Board was apparently expected to exercise a number of administrative functions, and it was not to be permanently located in any one State. It was also to act as a Board of Appeal to decide cases where a taxpayer objected to the decision of a chief taxation officer.

346. While we favour the suggestion that the joint authority proposed should be administered by a Board, we do not agree that this should be constituted in the manner advocated. In our opinion the magnitude and importance of direct taxation justify the appointment of a Board constituted in a manner somewhat similar to that of the Commonwealth Bank.

347. We recommend the appointment of a Board constituted as follows :—

(1) **A Chairman to be nominated by the Commonwealth and all the State Governments. The Chairman should not be an official.**

(2) **Two non-official representatives—one to be nominated by the Commonwealth and one by the States. Each of these should be, or have been, actively engaged in commerce, finance or primary or secondary industry.**

(3) **Two official representatives—one to be appointed by the Commonwealth and one by the States. These might be officers of the Treasury or Taxation Departments of any Government.**

All representatives should be appointed for a fixed term during which they should not be removable if of good behaviour.

348. The Board should be responsible for the administration of such Acts relating to taxation as may be assigned to it by the respective Governments and for assessing and collecting the tax imposed by such Acts. It should not consider individual cases except such as might involve questions of principle referred by the administrative officers, or in any manner perform or encroach upon the functions of any appellate tribunal that now exists or may be created. The Board should take over such members of the staffs of the existing Taxation Departments as it may require, and thereafter should control appointments, promotions, transfers and dismissals. The classification and salaries of such officers should be determined by agreement between the respective Governments.

349. The Board should also be required to examine and report upon amendments proposed to be made in any Act under which it collects tax, and to supply any information required from time to time by any Government in respect of such Acts and the taxes collected thereunder. In this event the Central Taxation Standing Committee suggested by witnesses and referred to in paragraph 328 would be unnecessary.

350. The cost of the joint authority should be apportioned between the Governments concerned on a basis to be arranged, and for this purpose the present method of apportioning the cost between the Commonwealth and State Governments under the amalgamation agreements might be taken as a precedent. Any basis arrived at must be elastic to provide for contingencies which may arise.

351. The advantages which might be expected to result from the creation of a joint authority to administer the taxation laws of the Commonwealth and States are not entirely dependent upon the adoption of a uniform Act. It is obvious, of course, that the maximum benefit will be attained if the adoption of a uniform Act precedes the creation of a joint authority. In either event the following arguments may be advanced to support our recommendation :—

(1) It overcomes the objections that have been taken to other proposals for collection by one authority, because it does not require any Government to surrender or transfer its functions to another.

(2) It would provide a more efficient method of assessing and collecting all direct taxes imposed by any of the Governments, including under this heading Commonwealth and State Income Tax, State Unemployment Relief Tax, Commonwealth and State Land Tax, Commonwealth and State Taxes on the estates of deceased persons, and in addition Commonwealth Sales Tax, and State Entertainments Tax.

(3) It would facilitate the assessment and collection in the taxpayer's own State of Commonwealth Income Tax, Land Tax or Estate Duty payable in respect of interests in more than one State. A Commonwealth Central Office would not then be required.

(4) It would provide an impartial body not under the control of any State Government to apportion the profits of a trade or business carried on in more than one State.

(5) It would provide an advisory body to which any Government concerned could refer suggested amendments of taxation legislation. The need for a body of this nature has been repeatedly stressed by witnesses.

(6) It would co-ordinate the administration of the taxation laws of the Commonwealth and the States, and as a result of the uniform training of officers would provide a wider field from which to select those required to perform the more important duties.

352. Objection may be taken to this proposal also on the grounds that it will involve the surrender by the respective Governments of their right to administer and control their own taxation legislation. But there is little real merit in that objection, which might be used with equal force in regard to any of the numerous Commissions that have been created by the various Governments to exercise administrative functions. **The real power of Parliament is the power to impose tax at rates which it considers necessary to produce the revenue it requires, and each Parliament would still retain that right.** The delegation of authority to assess and collect tax so imposed infringes no constitutional rights. A quotation from the Report of the Royal Commission on Taxation, 1920, is pertinent :—

> " The main consideration which should govern reasoning on the subject and to which all other considerations must be adjusted . . . . is the sovereign right of Australian taxpayers to have the mechanism of taxation so designed and controlled as to impose the minimum of inconvenience and involve the minimum of cost."

The joint authority appears to be more likely to produce that result than any other scheme that has yet been suggested.

353. Even if our recommendation for the appointment of a Board to administer the taxation laws of the Commonwealth and States is not accepted to the full extent, **we still think that a Board constituted in the manner suggested in paragraph 347 should be appointed as a consultative body** with the functions of keeping under continuous review the taxation laws of the Commonwealth and the States, of considering and reporting upon all proposed amendments, and of itself bringing forward proposals for such amendments as from time to time seem to be desirable. This Board would perform the duties of the suggested Central Taxation Standing Committee referred to in paragraph 328.

SECTION XXI.

DOUBLE TAXATION.

354. Before the depression which commenced in Australia early in 1930 the incidence of double taxation did not materially affect resident taxpayers in Australia. Neither the Commonwealth nor the States sought to tax income derived by residents from sources outside their territorial jurisdictions. Some double taxation between States occurred, usually in respect of the profits of a branch of a business carried on in another State, but this was due to the absence of agreement for the apportionment of those profits between the States concerned.

355. In 1930 the Commonwealth Act was amended to bring into the field of taxation income wherever derived, which had not borne tax in its place of origin. About the same time all the States imposed additional or special taxation, not only on income derived from sources within the State, but on income derived by their residents from sources in other States. The result is that **the effect of double taxation is now felt by a much larger proportion of taxpayers, who demand that steps be taken to abolish it or to minimize its influence.**

356. The problem of international double taxation has been exhaustively considered by the Technical and Financial Section of the League of Nations, which has issued a number of reports upon this subject. The most important of these are a Memorandum submitted by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, and the comments thereon of a Committee of Technical Experts who considered the practical application of the theoretical principles enunciated by the Professors. We have drawn largely upon the information contained in these documents in preparing the statement which follows.

357. Every State has an unrestricted right to adopt its own methods of taxation within the sphere of its jurisdiction. The obligation or duty to pay taxes may be determined by reference to various tests, as, for example, political allegiance, temporary residence, domicile or origin. But, broadly speaking, income tax can be levied effectively only—

(*a*) where the income arises, or
(*b*) where the recipient of the income resides.

358. If income arises in a State which levies tax upon it because it arises there, and is received by a person resident in another State which levies tax upon this income because he resides there, double taxation at once arises.

359. States with great natural resources requiring outside capital for their development are likely to favour the principle of taxing income where it arises, whether it remains in the State or goes to some person abroad. Conversely, States whose residents provide capital for investment elsewhere will prefer to tax on the principle of residence, for some part of the income received by their residents will be derived from sources outside the State.

360. Practically, therefore, the choice lies between the principle of residence and that of location or origin. Taking the field of taxation as a whole, the reason why taxing authorities waver between these two principles is that each may be considered as a part of the still broader principle of economic interest or economic allegiance. The individual has certain economic interests in the place of his permanent residence as well as in the place or places where his property is situated or from which his income is derived. If these coincide no problem arises. If they differ, a part of the total sum paid according to his ability ought to reach the competing authorities according to his economic interest under each authority. The ideal solution is that the individual's income should be taxed only once, and that the tax should be divided between the Governments concerned according to his relative obligation to each.

361. On the assumption, therefore, that economic allegiance is the basis on which the total tax paid by the individual should reach the competing authorities, we have to ask what is the true meaning of economic allegiance and how can it be divided. In what manner and to what extent can a man be served by two or more Governments that he should owe them any duty? It is only after an analysis of the constituent elements of economic allegiance that we shall be able to determine where a person ought to be taxed, or how the division ought to be made between the various Governments that impose the tax.

362. There are four main questions which have to be asked when the question of economic obligation is under consideration. They are, broadly—

(1) Where is the income physically or economically produced?
(2) Where are the final results of the process as a complete production of wealth actually to be found?
(3) Where can the right to the handing over of these results be enforced?
(4) Where is the wealth spent or consumed or otherwise disposed of?

363. It is not suggested that every function falls easily into one of these four classes. For example, the origin of the wealth may have to be considered from various points of view, viz., the place of its original physical appearance and of its subsequent physical adaptations, its transport, the residence of the controlling power that directs and co-ordinates the whole enterprise, and, finally, the place or places where it is sold. None of these has any necessary relation to the place where the final owner enjoys his income. A typical illustration of the difficulty of analysis would be the allocation of the profits derived by a mining company incorporated in Victoria, operating a property in Queensland and distributing dividends to shareholders in every State.

364. The most important factors in economic allegiance are the origin of the wealth and the residence of the owner who consumes it. Most of the discussion on double taxation has centred around these two points, and for the purpose of our inquiry it does not seem necessary to go beyond them.

365. The relief of double taxation involves the surrender of revenue by Governments. The question, therefore, at once arises : Which Governments should give up revenue and to what extent ?

366. It must be recognized that the surrender of revenue will, in practice, be influenced by financial considerations. It may be impracticable for a Government to agree to an allocation of income based wholly on theoretical principles. **A practicable compromise between principles and expediency must, therefore, be sought.**

367. It is clear that States with different economic interests will have a different outlook. Each State will attach special importance to its own circumstances, and insist upon the particular form of compromise which will best suit its own interests. But it cannot be conceded that any State which taxes the residents of another State should be entitled, because it has done so, to expect that the other State shall surrender its right to tax those residents.

368. Four alternative methods for the relief of double taxation have been suggested :—

(*a*) *The method of deduction for income from abroad*—

The State of residence may assess the total income at the appropriate rate and then deduct from the tax the amount of the tax paid elsewhere on income derived from sources outside the State, provided that the deduction does not exceed the amount which would have been levied on that part of the income if it had been derived in the State of residence.

(*b*) *The method of exemption for income going abroad*—

The State of origin may exempt all non-residents from taxation on income derived from sources within its borders. The possibility that this proposal will be acceptable is so remote that it need not be further considered.

(*c*) *The method of division of the tax*—

It may be possible by convention to divide specific taxes so that a portion should be taken by the State of origin and the remainder by the State of residence. This method is now employed for relief of double taxation by Great Britain and the Commonwealth. We may add that neither the economists nor the technical experts think that this method can be brought into general use for international purposes.

(*d*) *The method of classification and assignment of sources*—

By convention, it may be determined to attach origin taxation specifically and wholly to particular classes of income, but to exempt the non-resident in respect of income derived from business securities, e.g., shares in companies. The State of residence would tax only the income received by its residents not specifically exempted, or, alternatively, tax its residents on their total income less a rebate of tax paid elsewhere as in the method first described. The State of origin would retain its specific origin taxes in full.

369. After exhaustive consideration of the report of the economists the technical experts arrived at the conclusion that **the solution was not to be found by applying any one of these methods to all classes of income. They suggested, therefore, that various types of income should be treated in different ways ; that some should be taxed on the basis of origin, others on the basis**

of residence, and that, in respect to some, tax in full should be imposed in the country of residence, subject to rebate. In support of this recommendation they drew attention to the fact that most of the International Conventions for the relief of double income tax are based upon this principle.

370. We shall consider how these principles can be applied to relieve double taxation arising in respect of ex-Australian income and between the States.

SECTION XXII.

THE TAXATION OF INCOME DERIVED BY AUSTRALIAN RESIDENTS FROM EX-AUSTRALIAN SOURCES.

371. Generally speaking, ex-Australian income is derived from the profits of a trade or business carried on by an Australian trader outside Australia, from investments abroad, and to a limited extent in the form of remuneration received by a resident of Australia for services performed by him outside Australia.

372. Some witnesses expressed doubt as to the wisdom of taxing ex-Australian income derived from the profits of a trade or business carried on by an Australian trader outside Australia, or from exports made by an Australian trader, on the grounds that such taxation hinders trade, discourages exports and hampers the development of our secondary industries. There is, however, strong reason to believe that a considerable portion of the profits derived from exports from Australia formerly escaped tax both in Australia and in the country to which the exports were sold. To some extent this position has been corrected by the amendments to the Commonwealth Act effected in 1930.

373. Other witnesses expressed the opinion that income derived from investments outside Australia, which mainly consist of interest and dividends on money invested abroad, should not be taxed in Australia, as it was to the advantage of Australia to encourage people who derive income from abroad to reside here. There are, however, several reasons why we cannot support that argument. A resident owes something to the Government of the country in which he lives, where he enjoys the protection of the laws, and obtains the advantage of national institutions, whether he derives his income there or elsewhere. If those who come to live here are to be exempt from tax here because their income comes to them from abroad, it would be difficult to justify the taxation of the Australian resident who invests his capital outside Australia. We were informed that it is the practice of some residents to invest surplus capital in tax-free securities wherever possible, and, as the opportunities for so doing in Australia are limited, to acquire securities of this nature in other countries. In some cases residents of Australia have purchased Australian Loans issued in London with the intention of escaping Commonwealth tax thereon. In the absence of some provision to tax ex-Australian income, income derived from investments of this nature would escape tax both in Australia and in the country in which the investment is made. Residents of Australia who make such investments would, therefore, derive an advantage over other Australian residents who cannot or do not avail themselves of these means of investment.

374. Prior to 1930 income derived from ex-Australian sources was not subject to Commonwealth Income Tax, but the amendments made in that year established the principle of taxing such income. Subject to the provisions of the Act, Commonwealth Income Tax is now levied upon the total taxable income (wherever derived) of a resident, but if any part of such income is, in the opinion of the Commissioner, (1) not exempt from Income Tax in the country in which the income was derived, or (2) derived from the sale of any produce which is chargeable in the hands of the person deriving that income with royalty or export duty by the Government of any country outside Australia, it is specifically exempted by the Act. It follows, therefore, that if, in the opinion of the Commissioner, ex-Australian income is exempt from tax in the country of origin, it is subject to Commonwealth Income Tax, and, conversely, if it is subject to any tax, however small, in the country of origin it is not subject to Commonwealth Income Tax.

375. The practice of the States is not uniform. The provisions of the Acts which relate to ex-Australian income are as follows :—

New South Wales.—Not liable to normal Income Tax.

Liable to Special Income Tax if derived otherwise than from a trade or business not being an investment business.

Victoria.—Where the business of a Victorian taxpayer extends to places outside Australia, the profits derived outside Australia are liable to normal Income Tax, and in addition the income of an individual is liable to Special Income Tax and Unemployment Relief Tax, subject to rebate with certain reservations.

Dividends and interest received by a resident of Victoria from any company incorporated outside Australia are subject to both Special Income Tax and Unemployment Relief Tax.

If the employee of a Victorian employer earns any portion of his remuneration while absent from Australia, that amount is liable to normal Income Tax, subject to an allowance for tax actually paid abroad, and, in addition, to Special Income Tax and Unemployment Relief Tax without allowance for any tax paid elsewhere.

Queensland.—Ex-Australian income is not liable to any tax.

South Australia.—Profits on exports, and dividends received by a resident of South Australia from a company incorporated outside Australia, are liable to normal Income Tax.

There is no Special Income Tax or Unemployment Relief Tax in South Australia.

Western Australia.—Profit on exports from Western Australia is liable to normal Income Tax, also to Hospital Fund Tax and Financial Emergency Tax.

Tasmania.—Income derived by a resident of Tasmania from sources outside Australia is liable to normal Income Tax if such income is brought into Tasmania. Profit on the sale of goods exported from Tasmania is also subject to normal Income Tax. In both these cases a rebate is allowed in respect of tax paid elsewhere, with certain limitations in regard to the allowance for tax paid on exports. Income of the same classes is subject to Special Income Tax, without rebate.

376. Perusal of the preceding paragraph shows that **the Commonwealth and all States, except Queensland, impose tax upon some ex-Australian income, but that there is no uniformity in the provisions of the various Acts.**

377. The provisions of the Commonwealth Act so far as they relate to the taxation of ex-Australian income should be made effective. At present no Commonwealth tax is paid upon ex-Australian income if it has paid tax elsewhere, although the tax so paid may be merely nominal. The Act therefore operates unevenly, and confers the maximum advantage upon the taxpayer who has paid the least tax in another country. The difference between the tax which he has paid elsewhere and that which he would pay in Australia if the whole of his income had been derived from sources in Australia is lost to Australia. If the whole of his income were taxed at the rate applicable to it if it were derived in Australia, subject to rebate for tax paid elsewhere, all taxpayers would be treated in the same manner, and there would be less inducement to make investments abroad to avoid Australian tax.

378. Whether the provisions of the State Acts should be extended to include all classes of ex-Australian income is, of course, a matter of policy to be decided by the Parliament of each State. But if a State decides to tax ex-Australian income we suggest that the whole amount should be taxed in the manner described in the preceding paragraph.

379. We recommend—

(1) That the Commonwealth Income Tax Assessment Act be amended to provide that income derived by a resident of Australia from ex-Australian sources shall be included with his other income and taxed at the appropriate rate subject to a rebate for tax paid elsewhere at the rate paid abroad, or at the Commonwealth rate applicable to his total income, whichever is the lesser.

(2) That States which now impose tax on income derived from ex-Australian sources or which may in the future do so should assess such income subject to rebate by the method recommended for the Commonwealth.

SECTION XXIII.

THE TAXATION OF INCOME DERIVED BY AN ABSENTEE FROM SOURCES IN AUSTRALIA.

380. The individual has certain obligations to the Government of the place from which his income is derived. In the past it seems to have been clearly instinctive to regard the origin of the income as of first importance, and to assume that the country of origin has the prime right to tax income arising therein, although it goes to some person abroad. But in recent years considerable progress has been made in the conception of personal tax based on the principle of residence. The preponderating importance of this conception in taxation first became manifest in Great Britain and in the United States in the nineteenth century. Most of the other nations of Europe and America seem to be moving slowly but definitely in the same direction. In 1930 the Commonwealth, which previously taxed only income originating in Australia, adopted the basis of residence, and now taxes the income of its residents wherever derived, subject to certain reservations. On the other hand, we think that no one will contend that a person resident in another country who derives income from sources in Australia should not pay some tax in Australia. The problem is to arrive at a fair basis for the computation of that tax.

381. The popular conception of an absentee is that he is one who, having made his wealth in a country, has gone elsewhere to spend the income which it produces. The country which produces his income therefore derives no benefit from his personal expenditure, and this is held to justify some discrimination in taxation. But the word "absentee" as defined in the Commonwealth Act and in the Acts of Queensland and South Australia also embraces persons who may never have been in Australia but who have been induced to invest their money here. There may be some justification for discrimination against the Australian resident who has gone elsewhere to live, but it may be argued that the non-resident investor, whose money assists in developing either public or private resources in this country, should not be penalized by the imposition of tax on a basis which may unfairly discriminate against him.

382. It may be impossible to draw a distinction between absentees of these two classes in a taxation law, but it is probable that the treatment of the non-resident investor is to some extent influenced by the popular meaning usually attached to the word "absentee" to which we have referred. It might be advisable, therefore, to adopt the practice of other countries and some of the States and refer to the absentee as a "non-resident person". If that were done we think that the taxation of the non-resident investor would not be affected to such an extent by the popular prejudice against absentees. It is in the national interest that non-resident persons should be encouraged to invest capital in Australia. They will do this if they are assured of fair treatment under the taxation laws. A system of taxation which penalizes them will eventually injure Australia by discouraging future investment, and will provoke the present non-resident investor to withdraw his money from the Commonwealth, particularly if the rates of exchange return to normal.

383. Now, as the Australian Government affords the absentee no personal protection, it may be argued that the tax which he should pay in Australia should be less than the tax which would be paid by a resident deriving the same income from sources in Australia. But it appears to us to be very improbable that any Australian Government would agree to tax the absentee on a lower basis than the resident, and in practice it will probably be considered that it has treated him fairly if it taxes him at the rate which would be applicable to the same income if derived by a resident taxpayer, without allowance for the statutory exemption or concessional deductions to which the resident taxpayer is entitled.

384. If the country in which the absentee resides imposes tax upon the same income double taxation occurs, and as the sum of both taxes will in most cases exceed the amount which the taxpayer would pay in either country if he derived the whole of his income from sources in that country, a demand at once arises for relief.

385. Under the scheme for the avoidance of double taxation within the Empire which was adopted in 1920 as the result of a conference between representatives of Great Britain and the Dominions, any person who had suffered double taxation in Great Britain and the Dominions could apply for relief. Great Britain and some of the Dominions (including Australia) passed laws to give effect to the agreement arrived at by their representatives. The British authorities undertook to give relief on the income subject to double taxation to the extent of the Dominion rate or half the British rate of tax, whichever was the less. The Australian Government amended its Act in 1921 to give relief to the extent of the remainder of the Dominion rate or half the British rate, whichever was the less. The effect of the two reliefs was to eliminate the lesser of the two rates of tax, British or Australian. The relevant Sections are Section 27 of the *Finance Act* 1920, Great Britain, and Section 18 of the Commonwealth Act. None of the Australian States have amended their Acts to give relief in respect of tax paid on income subject to tax in a State and in Great Britain. In order to provide for the circumstances created by the failure of the Australian States to give relief, the claimant is required to add the rate of tax suffered under the Commonwealth and State Acts for the purpose of calculating the rate of relief, and then to take the ratio which the Commonwealth rate bears to the total and to apply the resultant rate to the amount of income subject to treble tax.

386. It should be noted that when this Section was first incorporated in the Commonwealth Act, the Commonwealth imposed tax only on income derived in Australia, and hence the effect of this Section was to benefit only absentees who derived income from sources in Australia, and not residents of Australia who derived income from Great Britain. It was probably for that reason that many witnesses expressed the opinion that the Section should be repealed, as they considered that Australia received no compensation for the relief which it gave. We think, however, that these witnesses did not fully appreciate the alteration in the conditions which had

been brought about by the adoption of residence as the test of taxation in Australia. We are, therefore, unable to support the contention that Section 18 of the Commonwealth Act should be repealed. If the Section was considered to be necessary when Australia taxed income only on the basis of origin, it is clearly more necessary when the taxation is based on residence.

387. The evidence indicates, however, that the administration of the Section by the Commonwealth Department is not satisfactory to taxpayers. The Department is said meticulously to insist upon the exact identification of the specific income which has suffered double taxation. This is at times difficult, as the accounting periods in Great Britain and Australia do not coincide, and other differences in assessment occur. It was thought by witnesses that approximately the same result could be arrived at in an easier manner. We were informed by a witness conversant with English practice that in Great Britain the adjustments are made on broader lines and with less delay.

388. As we have recommended that the Australian resident shall be granted rebate of tax paid abroad, with certain reservations, we do not consider that any further relief should be given to him by the Commonwealth under Section 18. If the rate of tax paid by him abroad exceeds the rate payable by him in Australia on his total income he should seek relief in Great Britain under the relevant provisions of the taxation laws of that country

389. The resident of Great Britain who derives income from sources in Australia is, however, in a different position, and Section 18 should be retained in the Commonwealth Act for his benefit.

390. We recommend—

(1) That Section 18 be retained in the Commonwealth Income Tax Assessment Act to give relief to persons resident in Great Britain who derive income from sources in Australia ;

(2) That the administration of the Section be simplified ;

(3) That each State should consider the adoption of a similar Section in its Act.

SECTION XXIV.

THE TAXATION OF PROFITS OF A TRADE OR BUSINESS CARRIED ON PARTLY IN AND PARTLY BEYOND AUSTRALIA.

391. This subject may be considered under two heads :—

(*a*) The taxation of profits arising from sales in Australia by a non-resident trader.

(*b*) The taxation of profits arising from sales abroad of exports from Australia.

We shall consider them in that order.

The taxation of profits arising from sales in Australia by a non-resident trader.

392. No attempt has yet been made by any Australian Government to tax profits made by a non-resident trader, except where he is carrying on his trade in Australia. The constitutional right of any Government to tax the profits of a trade carried on in its territory is undoubted. But two questions arise : (*a*) What circumstances constitute the carrying on of a trade ? and (*b*) What profit is derived from the trade so carried on ?

393. A non-resident trader is not taxed merely because he sells goods to a resident of Australia. There is a broad distinction between trading *with* a country and carrying on trade *within* a country. " Many merchants and manufacturers export their goods to all parts of the world, yet I do not suppose that any one would dream of saying that they carried on trade in every country in which their goods found customers." (*Grainger and Son* v. *Gough* 1896 A.C. 325, per Lord Herschell.) The liability of a non-resident to tax in Australia depends entirely upon the facts of the case. This may be illustrated by two simple examples.

394. The first is that in which the non-resident trader makes no direct effort to obtain business in Australia, but merely executes orders sent to him. He may receive these orders because his business is well known, or as the result of advertisements in trade journals of wide circulation. He may even carry on the business of selling entirely through advertisements, as in the case of the mail order house. Where income is derived from sales made by a non-resident trader in these circumstances we are not aware that any Australian Government seeks to tax it.

395. In the second case the non-resident trader, desirous of establishing a regular connexion with buyers in Australia, establishes either an agency or a branch here. That Branch carries stocks, and sales are made either for immediate delivery or to arrive. Now, in these

circumstances, it is clear that the non resident trader is carrying on a business in Australia and that the profits of the business are properly taxable here. Every witness who gave evidence on the subject admitted this.

396. The difficulty of deciding whether the profits derived from the sale of goods in Australia by a non-resident trader should be taxable in Australia arises in the intermediate field between these extremes, as, for example, where the trader, not being content to wait for unsolicited orders, nor willing to take the risks incidental to the establishment of an agency or branch carrying stocks, employs an agent to offer for sale in Australia goods which, at the time of offer, are not in Australia.

397. The authority given by a non-resident trader to his representative in Australia may vary in extent. For example the agent may—

(*a*) hold stocks, make sales, and collect (this case is covered by paragraph 395) ;

(*b*) hold no stock, but be authorized to accept firm orders, and may or may not be authorized to receive payment ;

(*c*) be authorized only to show samples, quote prices and accept orders subject to confirmation by his principal ;

(*d*) be authorized only to show samples and quote prices but not to receive orders, which must be sent to his principal direct for acceptance, or to an overseas office of the buyer for execution.

398. It will be obvious, therefore, that the liability of a non-resident trader for tax in Australia depends upon the view taken of the activities of his agent. Does he thereby " carry on a business " in Australia ?

399. The Report of the Royal Commission on the Income Tax (Great Britain) 1920 contains a reference to this subject which has been of considerable assistance to us. When the Income Tax Act of 1842 (Great Britain) was enacted, provision was made for the assessment, in the name of his agent, of any non-resident trading within the United Kingdom. If the notices could not be served on the non-resident person it was provided that they should be served on any agent or other person who was actually in receipt of any of his trading profits. No definition of what constituted trading within the United Kingdom was given, but by a series of cases decided in the Courts it was determined that the essential features were (*a*) whether the contract of sale was made in the United Kingdom, and (*b*) whether delivery of the goods took place there. The question as to whether the agent could be properly assessed turned upon whether he was or was not in lawful receipt of the profits of the trade.

400. From these decisions emerged what, for convenience, we may describe as the " three point test " of contract, delivery, and payment. But, in the opinion of the British Royal Commission, the position of the law with regard to the non-resident trader, as determined by reference to this test, was very unsatisfactory, and its report states—

> " From these decisions the anomalous result followed that two non-residents might through their agents occupy adjoining offices in the United Kingdom, sell the same class of goods, take equal advantage of the home market, and yet, owing to technical differences in their trading methods, the one would be held to be trading within the United Kingdom, while the other would not."

401. The Report refers to the amendments effected by Section 31 of the *Finance (No. 2) Act* 1915, enacted in order to prevent avoidance of Income Tax by non-residents, who, while in effect trading within the United Kingdom through resident agents, were enabled to escape payment of Income Tax owing to technicalities. These amendments provided that a non-resident trader should be liable for tax in the United Kingdom in respect of any profits or gains arising, whether directly or indirectly, through or from any agency or branch, and should be so assessable in the name of the agent or branch whether the agent or branch had the receipt of the profits or gains or not, in the manner and to the like amount as he would be assessed if he were a resident of the United Kingdom and in receipt of those profits or gains.

402. The liability of agents representing non-resident traders under the original Commonwealth Income Tax Assessment Act is set out in the following extract from the Sixth Annual Report of the Federal Commissioner of Taxation :—

> " The *Income Tax Assessment Act* 1915–16 provided that agents who represented non-resident merchants for the purpose of selling the goods of the latter in Australia should be liable to be assessed in their representative capacity on 5 per cent. of the

total sales made by them in Australia. Agents who merely advertised their principals' goods, or who received a commission on direct sales by the principals, were included in this field of taxpayers. The Act made the agents personally liable for the tax for the second and subsequent assessments. Great objection was raised by the agents to the operation of these provisions of the law, and Parliament repealed them at the end of the first assessment year."

403. In determining whether a non-resident trader is carrying on a trade or business in Australia, the Commonwealth practice now follows, to some extent, the decisions given in the English Courts to which we have referred. The three points to be decided are—

(*a*) Place of contract, i.e., location of the person who accepts the contract;

(*b*) Place of delivery, i.e., the location of the goods when the seller loses all right to them;

(*c*) Place of payment, i.e., whether made to the agent in the country of delivery or to the principal abroad.

404. If any two of these factors occur in Australia the non-resident trader is deemed to carry on a business here. It follows, therefore, that if the agent of a non-resident trader merely takes orders and has nothing to do with delivery of, or payment for, the goods, there will be no Commonwealth Income Tax payable in respect of the profit made on such sales.

405. If this be the only test to be applied, the anomalous position referred to in the Report of the Royal Commission (Great Britain) must also occur in Australia. **Every one of the three specified factors, i.e., contract, delivery and payment, can be varied at the will of the contracting parties without any alteration in the practical effect of the transaction. The non-resident trader can, therefore, please himself whether he makes himself liable for tax or not.**

406. When we consider the practice of the States, we find that a different test is applied. Formerly liability was determined by reference to the place of contract, delivery and payment, but the ease with which these factors could be varied compelled the States to adopt in their place the test of " instrumentality ".

407. In all the States the non-resident trader is held liable for tax on all sales made through the instrumentality of his agent. It is not material whether the agent makes the sale in any of the circumstances referred to in paragraph 397 or whether the business comes to him as representative of the non-resident trader, or because of the goodwill enjoyed by him or his principal. It is held in all these cases that the agent has played some part in bringing about the sale, and perhaps the best proof that the principal recognizes that this is so is that he has paid or will pay the agent remuneration for so doing, either by way of salary or commission, or both.

408. The expressions used to define " instrumentality " differ in the relevant Sections of the various State Acts. For example, in Queensland, Western Australia and Tasmania, the sales in question must be made " by means of an agent ". In New South Wales and Victoria the agent must be " instrumental in selling ". The South Australian Act refers to goods sold " on behalf of " a non-resident trader. But, in practice, all these expressions are interpreted in the same manner, viz., that where the agent takes any part in the sale, the profits of the non-resident trader are subject to tax.

409. In *Hughes* v. *Munro* 9 C.L.R. 289, Isaacs, J., interpreting the language of the Queensland Act, said :—

> " Plenary power in the agent to make a binding contract was not a condition, the only condition in respect to him is that the sale is to be made ' by means of him ', not that he is to be the only means, that he is to be an instrument—not the sole instrument—of securing the business. Provided the person in Queensland really holds the character of ' agent ' the extent of his agency is immaterial so long as it extends far enough to make his exertions a means of obtaining the business for his principal."

410. We recognize, of course, the practical difficulties that are experienced in assessing and collecting tax on sales made by non-resident traders in certain circumstances. It is difficult to obtain particulars of sales made by transient agents. Even resident agents do not always know the total volume of business obtained by their principals from Australia, as direct orders

may be placed with the latter through the overseas office of the Australian buyer. But these difficulties must be experienced by the States, and we are, therefore, forced to conclude either that the provisions of the State Acts cannot be enforced, or, alternatively, that the Commonwealth is losing tax to which it is equitably entitled on sales made by non-resident traders.

411. Some witnesses consider that the practice of the Commonwealth is more fair and reasonable than that of the States. They are of opinion that the principle of " instrumentality " should not be adopted by the Commonwealth for the following reasons :—

(1) That it amounts, in effect, to a tax on the employment of agents.

(2) That as British manufacturers employ agents to a greater extent than, say, Continental manufacturers, it will confer an advantage on the latter and thus nullify to some extent the preference given to British manufacturers by the fiscal policy.

(3) That it will cause non-resident traders who are at present represented by agents to dismiss them but to continue to trade direct with Australian buyers. In that event the revenue would lose tax on the remuneration of the agents.

412. These objections cannot be ignored or treated as fanciful, but it seems to be impossible to devise any scheme which would completely meet them and at the same time be itself free from serious anomalies.

413. If the line be drawn between non-resident traders who are carrying on business in Australia and those who are not, it is no doubt easy to choose examples in each class and show the difficulty of making a satisfactory logical distinction between them. For example, a foreign trader may derive a considerable income by selling in Australia goods brought under the notice of Australian buyers simply by advertisements in the local newspapers, and yet be free from tax because he is not " carrying on business " here in the sense in which that term has been interpreted. It might be urged with great force that if he goes free from taxation it is unfair to tax one of his non-resident competitors who carries on business in substantially the same way, except that his advertising is done through a resident representative by word of mouth.

414. The answer to this contention—possibly not an entirely satisfactory answer—is that one is trading in Australia and the other is not, and that all non-residents trading in Australia must be treated on the same footing, unless a ground of discrimination between them can be found, based on some well-defined principle. If some non-resident traders escape taxation simply because they conduct their business in a particular manner, they will undoubtedly be able to compete unfairly with other non-residents and with Australian taxpayers conducting substantially the same class of business, who cannot adapt their business methods to the conditions which enable their competitors to obtain exemption. There seems to be no escape from this position, except by the adoption of expedients which have not yet been tried in Australia, and which it might not be considered desirable to adopt.

415. In the case of a non-resident trader doing business in Australia by means of a local branch or a fully authorized resident agent, there is always some person representing the trader and subject to the jurisdiction, who can be required to make a return of the income of the business and to pay any tax imposed in respect of it. But in dealing with cases where the authority of the representative is less and less complete, it becomes more and more difficult either to assess or to enforce the liability of the trader, until the point is reached where if any tax is received from him at all it is really in the nature of a voluntary contribution by him to the Australian revenue.

416. The position in these cases is exceedingly unsatisfactory, and there seem to be only two alternative methods of dealing with it. One is the adoption of an inquisitorial system of following imported goods from the point of their entry into Australia, and so acquiring the information necessary to ascertain the extent of the business done by each individual trader, and then charging each consignment with a proportionate instalment of tax in the hands of the purchasers. Even disregarding the practical and constitutional difficulties in the way of such a system, it is unlikely that any Government would willingly impose upon the import trade of the country the hampering restrictions which the system would involve.

417. The other alternative is to enter into a series of conventions with the countries in which the ex-Australian traders have their head-quarters, providing for reciprocal interchange of information and assistance. This is the method which is being increasingly employed by countries in other parts of the world. It is a question for each Government concerned to decide

whether the amount of tax involved and other considerations of policy make it advisable to enter into such conventions. **We feel bound to point out that under present conditions a considerable amount of tax that should be borne by income derived by oversea traders is lost to the Commonwealth and the States, and so long as those conditions prevail we cannot recommend any scheme which will obviate this loss. The recommendations we make must be read subject to these observations.**

418. Adapting the language employed by the British Royal Commission on Income Tax in 1920, in expressing their conclusions in regard to the taxation of non-residents trading in the United Kingdom, **we feel strongly that if a non-resident is trading within the Commonwealth he should pay a contribution to the Revenue equivalent to that borne by an Australian trader making the same profits. The test whether trading is actually being carried on within Australia should depend, in our opinion, not upon small technicalities, but upon a broad consideration of the question whether the non-resident, either in person or by his agent, is in substance conducting a profit-making business in this country.**

419. We recommend that a non-resident trader shall be deemed to carry on business in Australia—

(1) If he is represented in the Commonwealth by an agent either resident or transient ;

(2) If sales of goods belonging to the non-resident principal are made " by means of " or " through the intervention of " or " by the instrumentality of " the agent ;

(3) If it is a condition of sale, either express or implied, that the goods sold by or through the agent are to be brought into the Commonwealth ;

and that the same test be applied by the Commonwealth and all the States.

420. When it has been determined that a non-resident trader carries on business in Australia, the next matter to be decided is what profit he has derived from the business. It has been submitted by some witnesses that up to the time the goods are in the hands of the actual buyer in Australia the profit arises wholly from their production abroad, and not from any operation performed in Australia, with the exception of the agent's services in so far as he has contributed towards the sale of the goods. These witnesses argue that the only profit that should be taxed is that made by the re-seller or user of the imported goods, and, in addition, the commission earned by the agent for selling them, and that a tax on these amounts is all that the Australian revenue is morally entitled to receive out of the transaction. But, in our opinion, this contention is untenable.

421. It has been held in a number of decided cases that the income derived from a business comprising a number of operations may result in part from each operation and not from any one of them. Therefore, when a non-resident manufacturer sells in Australia, some part of his total profit may be said to arise from manufacture and some from selling. An apportionment of profits thus becomes necessary. In our opinion, no part of the manufacturing profit should, in such a case, be taxed in Australia, but only that profit which arises as a result of sale in this country.

422. When the non-resident trader is not a manufacturer, a different position arises, and the decision of the High Court of Australia in the case of *Commissioner of Taxation* v. *D. and W. Murray Ltd.* (42 C.L.R. 332) enunciated certain principles which should be applied in the case of a non-resident merchant selling in Australia. From the judgment in that case we quote the following :—

> " In our opinion, the place where the whole profit of such a business is made is that where the goods are sold. It does not follow that, in order to determine where the profits were made, it is proper to inquire into all the causes which, in combination, or in succession, operated to produce them. If it were possible to discover and discriminate among the innumerable factors which contribute to the profitable exercise of a trade and to assign locality to each of them, still no light would be thrown upon the place where the profits were made. To attempt to appraise the relative efficacy or potency of these contributory factors, when and if ascertained, and to distribute the profit accordingly among the localities to which the factors have been assigned, is to lose sight of the true nature of the question, which is not why, but where, the profits were earned. The case is not one in which operations in one place have produced the merchantable commodity, or have given or added value to things, marketed in another. In such cases value or wealth have been produced or increased and is contained in disposable assets. In other words, unrealized profits exist in the territory whence they are transported for the purpose of sale.
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> . . . . . .

In the case now to be decided the respondent Company's business operations conducted in England by its Head Office consisted only in buying. They neither gave nor added value to the things which were purchased. There were no unrealized profits brought into existence, and contained in the goods when exported from England. The case is, we think, governed by the principles established by *Sulley* v. *Attorney-General* (1860) 5 H. & N. 711, and the many cases which follow that authority."

423. Applying these cases it is possible to enunciate a principle for the apportionment of the profits of a non-resident trader. In our opinion the quantum of taxable profit should be the difference between the value of the goods in the country of origin and the price for which they are sold in Australia, less any expense incurred in their transportation and sale, the value in the country of origin being taken to be the price actually paid for the goods there by the trader, or, where he has not bought but manufactured them, the price which a wholesale buyer would pay for them there under normal conditions. The application of this principle would exclude that portion of the profit attributable to manufacture if the trader produced the goods, but if he merely purchased them, the whole of the net profit resulting from the transaction would be taxable in Australia. This is in accordance with the decision in Murray's case.

424. If the non-resident trader is prepared to submit accounts showing the actual result of the business carried on by him in Australia, it is usual for the Commonwealth Department to assess him on the result shown therein. In the absence of such accounts, it is usual to assess on the basis of 5 per cent. of sales.

425. The practice in the States is not uniform. Where the agent is in a position to submit accounts showing the actual results of the trading in the State, it appears to be the general practice to accept those accounts and to assess on the basis of the profits which they show. If accounts are not submitted, or if the accounts which are submitted are not satisfactory to the Departments, the profit is assumed to be a percentage of the sales, usually 5 per cent. But in New South Wales 7½ per cent. may be taken in certain circumstances, and in Queensland the Commissioner may assess on the basis of a percentage varying from 2½ per cent. to 20 per cent., as he considers reasonable.

426. The non-resident trader dislikes assessment on a percentage basis, for several reasons. Assessment, even on the basis of 5 per cent., may be too high, for many commodities, particularly those produced by the heavy industries or sold in bulk, carry a smaller rate of profit. This method of assessment also results in payment of tax even when the manufacturer is able to demonstrate that he has made a loss on the sale. **Where it is necessary, therefore, to assess on a percentage basis, the rate should not be fixed in the Act, but it should be determined after consideration, and should be based on the rate of profit usually made by local traders dealing in the same commodities under the same conditions.**

427. We recommend that the profit derived by a non-resident trader from a business carried on by him in Australia shall be deemed to be—

(1) (a) In the case of a manufacturer—the difference between the amount for which the goods are sold in Australia and the amount for which they could be sold to a wholesale buyer, in similar circumstances, in the country of manufacture—less any expenses incurred in transporting the goods to and selling them in Australia, or

(b) In the case of a merchant who is not the manufacturer of the goods sold—the difference between the amount for which the goods are sold in Australia and their purchase price, less the cost of transporting the goods to, and selling the goods in, Australia ;

(2) If accounts showing the actual profit on the transactions are not produced, the profit should be assessed as a percentage on the amount of the sales, to be determined in accordance with the profit that would be made by a resident trader selling similar goods under similar conditions ;

and that the same test be applied by the Commonwealth and all the States.

The Taxation of Profits Arising from Sales Abroad of Exports from Australia.

428. When Australian products are purchased in Australia by or on behalf of a person whose business is controlled outside Australia, and are exported for sale outside Australia in the form in which they were purchased, no part of the profits, if any, resulting from the transaction is taxable in Australia. If, however, such goods have been subjected to processes

akin to the processes of manufacture, or have been substantially altered in condition, a taxable profit is deemed to have arisen in Australia equal to the difference between the price at which the goods would have been sold after treatment and the price paid for them, together with the expense of the processes to which they have been subjected.

429. In apportioning the profit on goods exported from Australia by a resident trader different conditions arise. The total profit derived by the exporter from all sources has been ascertained, but what has to be decided is how much of that profit has been earned outside Australia, because, in certain circumstances, that portion may be exempt from tax, either by the Commonwealth or a State. Reference has already been made to the cases deciding that where a business comprises a series of operations some of which are carried on in Australia and some elsewhere, and where each operation results in a real enlargement or enhancement of value contained in the goods, the profits resulting from sale must be attributed in part to each of these operations. An apportionment of the profits derived by an Australian exporter, therefore, becomes in some cases necessary, but no rule for such apportionment has been laid down by the Income Tax Acts of any of the Governments or by the Courts. It has been the practice both in the Commonwealth and the States to apportion these profits, either by the application of a departmental rule or after consideration of each particular case. Section 16c was inserted in the Commonwealth Act in 1928 to provide a legislative guide, and to sanction the determination of the method of apportionment by Regulation, or in the absence of an appropriate Regulation to empower the Commissioner to make it. No Regulations under the Section have been made.

430. Many of the witnesses who gave evidence upon this subject expressed the view that it was desirable that some definite basis of apportionment should be adopted, and that, if possible, it should be applied both by the Commonwealth and the States in order to obviate the necessity for separate consideration of each case by the respective authorities. Taxpayers who are carrying on business in the same manner would then be treated similarly.

431. Three methods of apportionment were suggested :—

(*a*) The f.o.b. basis.

(*b*) An arbitrary apportionment similar to that recommended by the Conference of Taxation Officials for the apportionment of the profits of a business carried on in more than one State.

(*c*) An apportionment in the ratio of the expenses incurred upon each operation.

The F.O.B. Basis.

432. This may be shortly defined as the ruling Australian market value for home consumption of similar goods of similar quality. The Commonwealth Act, as originally enacted in 1915, prescribed the adoption of this basis, but as the provision was found to be extremely difficult to administer on account of many complications in the export business, it was repealed by the Amending Act of 1918. However, this basis was strongly advocated by witnesses representing certain interests, who claimed that if it were adopted the taxable liability of the exporter could be determined with greater expedition, as it would not be necessary to await the realization of each shipment.

433. The f.o.b. basis can obviously be applied only in those cases where goods have not been sold at the time of shipment, for if they have then been sold their value for the purpose of taxation is the amount realized for them. The adoption of an f.o.b. value interposes an artificial figure, and results in the determination of an artificial profit or loss which may not correspond with actual results.

434. An objection to the adoption of this method is that in many cases it is difficult, if not impossible, to determine an f.o.b. value, because the goods exported are of such a nature that they are not saleable in Australia in the quantity and form in which they are shipped.

435. It may be suggested that if it is possible to arrive at the f.o.b. value of imports in the country of manufacture for the purpose of ascertaining the profits of a non-resident trader, as recommended by us in paragraph 427 (1) (a), it should also be possible to adopt the same method of valuing goods exported from Australia. But the circumstances are not similar. As a general rule goods which are purchased by Australian traders in other countries are purchased in the open market, and, therefore, have a definite market value apart from their value to the Australian trader. This may also occur in regard to some of the goods exported from Australia, but, generally speaking, Australian exports consist of raw material which in some cases at least

cannot be said to have an ascertainable value until it is brought to the place of sale. For these reasons we think that, **while the f.o.b. basis might be adopted to a limited extent, the uncertainties and difficulties associated with it are so great that it cannot be regarded as suitable for general application, and we do not recommend it for that purpose.**

An Arbitrary Apportionment on the Lines of that Recommended by the Conference of Taxation Officials for the Apportionment of the Profits of a Business Carried on in more than One State.

436. The next suggestion to be considered is that the profits derived from goods exported from Australia should be apportioned on the basis of an arbitrary formula similar to, but not identical with, that recommended by the Conference of Taxation Officials for the apportionment of profits derived from a business carried on in more than one State. This is discussed subsequently.

437. This proposal is attractive, but, upon consideration, certain disadvantages are apparent. Because the conditions of interstate and export trade differ so widely, great difficulty would be experienced in determining a basis of apportionment which could be applied generally in order to ascertain the amount of the profit to be attributed to Australian and ex-Australian sources respectively, and a large proportion of the cases arising would require special consideration. It should also be recognized that the reciprocity which it is hoped to establish between the various States would not exist between Australia and foreign countries unless special agreements were made with each of them, and this may not at present be practicable. **For these reasons we do not think that this basis could be generally adopted for the apportionment of the profits derived from the sale of goods exported from Australia.**

An Apportionment in the Ratio of the Expenses Incurred at Each Stage of the Operation.

438. This method of apportionment, as well as that described in the last preceding paragraph, is based on the actual profit or loss resulting from the complete transaction, and not upon an assumed result arrived at by the interposition of an artificial figure as in the case of the f.o.b. basis.

439. An attempt is made to ascertain the cost of each separate operation which enters into the transaction from which as a whole the profits are derived. In practice such an allocation may be said almost to baffle analysis, and it may well be that the precise amount of profit to be allocated to particular operations can never be finally determined. An arbitrary basis must, therefore, be adopted, and this is based on the assumption that the cost of any specific activity is perhaps the best measure of its value. The correctness of the result obtained depends largely upon the meaning to be attributed to the word " activity ". We do not think that it can be maintained that the proportion of profits attributable to Australia on goods exported by a manufacturer is the same as that on goods exported by a merchant who has not produced them. If the principles enunciated in Murray's case are regarded as applicable in those cases in which a merchant exports goods to which his operations have not given or added value, except to the extent that he has directly incurred certain expenditure in preparing them for shipment, it would seem proper to exclude the cost of those goods from the calculation and to base the apportionment on the actual cost of the activities in or out of Australia. But if this principle be carried to its logical conclusion, it would be proper also to exclude the cost of all materials included in manufactured goods exported, and the attempt to analyse the cost of such goods to determine this amount would in many cases be impracticable. Hitherto the Commonwealth Department has treated the cost of the goods as one of the Australian " activities " and has made its apportionment on this basis. The information we have received indicates that no serious objection has been taken by the taxpayers concerned, and, notwithstanding the defects to which we have referred, we think this method is the best of the three we have considered, although we are not prepared to recommend it for use in all cases.

440. Since the Commonwealth Act was amended in 1930 to provide for the taxation of ex-Australian income (subject to certain reservations), there has been less necessity to apportion profits between Australian and ex-Australian sources. If our recommendation set out in paragraph 379 be adopted, all ex-Australian income derived by a resident of Australia will be liable to Commonwealth tax, subject to rebate, and in that event the necessity for the apportionment of profits between Australian and ex-Australian sources will be still further reduced. It would arise only in the few cases where there is a serious and irreconcilable difference between the views of the Australian and the overseas taxation authorities as to the amount of income which should be subject to tax abroad.

441. In our opinion none of the three methods described can be adopted for use in all cases. While, however, the number of instances in which an apportionment of profits between Australian and ex-Australian sources is required may not be considerable, it is necessary to make provision for them.

442. We recommend—

(1) That profits derived from the export of goods for sale outside Australia be taxed in the manner recommended in the first section of paragraph 379 of this Report.

(2) That Section 16c of the Commonwealth Income Tax Assessment Act be retained and that a Section to the like effect be adopted by each State.

(3) That no set formula for the apportionment of profits on exports between Australian and ex-Australian sources be specified in the Income Tax Act or Regulations of the Commonwealth or any State, but that in cases where an apportionment is necessary it should be based on the facts of each case.

(4) That in each case where it is necessary to apportion profits between Australian and ex-Australian sources both the Commonwealth and the State or States concerned should adopt the same basis.

SECTION XXV.

APPORTIONMENT BETWEEN STATES OF PROFITS DERIVED FROM A TRADE OR BUSINESS CARRIED ON IN MORE THAN ONE STATE.

443. Many witnesses who gave evidence on behalf of traders operating in more than one State complained forcibly that the absence of uniformity in the provisions of the Acts of the various States, or of any agreement between them in regard to the apportionment of these profits, resulted in the imposition of tax on the same income in more than one state.

444. The subject is of considerable importance, as many merchants and traders carry on business in more than one State. Many instances have been brought under our notice which show clearly that the complaints are fully justified, and that the amount of additional tax imposed is considerable.

445. In order to devise means of rectifying the anomalies associated with the taxation of these profits, the State Taxation Commissioners met in conference in Melbourne in October, 1929, and submitted certain recommendations. We shall refer to these subsequently, but at this stage it is necessary to say that only the States of South Australia and Victoria have incorporated the principles of these recommendations in their Income Tax legislation. The other States have not yet adopted them, and a disinclination to do so appears to exist in some States.

446. The subject was again considered at a Conference of Commonwealth and State Ministers held in Melbourne during October, 1932. The State of Victoria submitted a Memorandum in respect of this subject, from which we quote the following extract:—

> "It is the duty of the States to adjust the taxes so that citizens will not pay double taxes, and a failure to place this on a proper basis is a reflection on the political capacity of governments. It is suggested that the failure to meet the position by the States may result in such an intervention as will, in effect, be a determination of the existing autonomy."

447. It was admitted, even by the Commissioners of Taxation of those States which have not yet adopted the recommendations referred to, that it is not proper that there should be taxation on more than 100 per cent. of the profits earned by a business carried on in more than one State.

448. In considering this subject two questions arise:—

(1) The nature of the activities carried on by or on behalf of the taxpayer, which render him liable to tax in another State.

(2) The apportionment between the States concerned of the profits derived from a transaction partly carried out in each of two States.

449. To a certain extent the problems associated with the determination of the taxable liability and the apportionment of the profits of a trader who carries on business in more than one State resemble those which arise when determining the taxable liability or profits derived upon the sales of goods imported into, or exported from, Australia. It will be convenient, therefore, to refer at times to our Report on these subjects.

450. We shall consider first the nature of the activities carried on by or on behalf of the taxpayer which render him liable to tax in another State. The test applied by the States is that of "instrumentality". In practice the States claim tax on the profits of any sales made by an agent in any of the categories referred to in paragraph 397. In effect, therefore, the test now applied by the States is that contained in our recommendation in paragraph 419.

451. We have already drawn attention in paragraph 408 to the variations in the expressions used in the relevant Sections of the various State Acts to define "instrumentality". But, in practice, all these expressions are interpreted in the same manner, namely, that where the agent takes any part in the sale, the profits of the principal are subject to tax in the State of sale, and, having regard to the conditions under which interstate trading is carried on, we do not think that any other test should be applied.

452. Provided, however, that the States enter into a reciprocal agreement for the apportionment of profits derived from a trade or business carried on in more than one State, this question of instrumentality is not so important to the interstate trader, for the essence of any agreement on this subject is that he shall not be required to pay State tax on more than 100 per cent. of his profits, and in that event he will be concerned only with the incidence of tax in the States in which he is so assessed. If the basis of such an agreement be fair, the heavier incidence of tax in one State than in another does not constitute a reasonable ground for complaint, for in this respect he is subject only to the disabilities experienced by the trader in that State who does not carry on business elsewhere.

453. It was for this reason, no doubt, that a number of representative witnesses stated that, provided a satisfactory arrangement could be made between the States for the apportionment of profits, the Associations which they represented would be prepared to waive technical considerations, as, for instance, the relation between the principal and agent, and accept liability to pay tax to a State on all sales made to residents of that State which involved delivery of the goods therein. In our opinion, however, this test would be too severe, as it would appear to impose liability on the vendor of goods which were purchased by the residents of a State in which that vendor had no representation—perhaps merely in response to an advertisement which appeared in a newspaper published outside that State. The Commissioner of Taxes, Queensland, who at first also suggested this test, when asked if he considered that the sales of a mail order house should be taxable, replied: "If a mail order house was only dealing with Queensland by mail order we would not tax it. It is only taxable when they put some one here as an instrument or agent. Something must be done here. They must have representation."

454. It seems to be common ground that, in order to establish liability, the principal must be represented in the State of sale by an agent. The first resolution of the Conference of Taxation Officials clearly contemplates this test, for it refers to the "instrumentality of an agent", but there is nothing in the resolution to indicate how this expression is to be defined. Having regard to the conditions under which interstate trading is carried on, we do not think that any definition of instrumentality which fails to cover every form of representation would be satisfactory, for otherwise certain classes of taxpayers would be able to arrange their business in such a manner as either to avoid tax or to allocate the greater part of their profits to the State in which the rate of tax happens to be lower. **We think, therefore, that the test of instrumentality applied to the non-resident trader from overseas should be applied also to the interstate trader, and we recommend that the principal in another State should be taxable in the State of sale in respect of goods sold by him in that State in the following circumstances :—**

(1) **If he is represented in the State by an agent either resident or transient ;**
(2) **If sales of goods belonging to him are made "by means of" or "through the intervention of" or "by the instrumentality of" the said agent ;**
(3) **If it is a condition of sale, either express or implied, that the goods sold by or through the agent are to be brought into the State.**

455. It is next necessary to consider the apportionment between the States concerned of the profits derived from a transaction partly carried out in each of two States. The following is a summary of the intricate provisions of the State Acts which relate to this subject. We shall classify these under the various cases :—

Case (1).—Where sales are made in one State of goods manufactured by the seller in another State.

Case (2).—Where goods, the property of a principal in one State, not manufactured by him, are sold on his behalf in another State by a branch or agent in that State.

Case (3).—Where primary products (agricultural or orchard produce, wool or live-stock) produced in one State are sold in another State.

We shall consider each of these cases from the point of view of the manufacturer, merchant or producer, as the case may be—first, in the State from which the goods in question emanate, and next in the State in which the sale is made.

Case (1).—*Where Sales are made in one State of Goods Manufactured by the Seller in another State.*

456. (*a*) *The taxable liability of the manufacturer in the State of manufacture—*

New South Wales.—As apportioned by the Commissioner. The facts of each case are considered, and if there are no special features, it is usual to regard 75 per cent. of the profit as being derived in New South Wales.

Victoria.—Two-thirds of the profit arising from the sale.

Queensland.—The whole of the profit arising from the sale, but in law this is effective only to the extent to which the profits in question are earned in, or derived directly or indirectly from sources in Queensland.

South Australia.—Two-thirds of the profit arising from the sale.

Western Australia.—The profit derived in Western Australia, which the Commissioner usually regards as two-thirds of the total profit.

Tasmania.—The whole of the profit arising from the sale, but a rebate, with certain limitations, is made in respect of tax paid in another State.

457. (*b*) *The liability of the manufacturer in the State in which the sale is made—*

New South Wales.—Where is is possible to separate or make a true estimate of the income arising in the State, such account or estimate is accepted. If the Commissioner is not satisfied with the estimate, the profit arising in the State is deemed to be that proportion of the total profits which the sales made in the State bear to the total sales.

The Commissioner states that for the income year ended 30th June, 1932, one-third of the amount so ascertained is taxed in New South Wales.

Victoria.—One-third of the profit arising from the sale.

Queensland.—The Act authorizes the Commissioner to treat the whole of the profit as arising in the State. Since the Courts have decided that the whole of such profits are not taxable in Queensland, it is the practice of the State Commissioner to make an apportionment. Where the manufacturer in another State furnishes accounts showing the actual profit earned in Queensland, or where the Commissioner, in the exercise of his discretion, determines the amount of these profits, 50 per cent. of the amount shown or determined is taxable in Queensland.

South Australia.—One-third of the profit arising from the sale.

Western Australia.—If a company—the profit derived in Western Australia.

If an individual—5 per cent. of the amount of the sale, unless accounts are prepared showing the actual profit.

The Commissioner usually regards one-third of the total profit as being derived in Western Australia.

Tasmania.—The actual profit derived in the State from the sale, and if this cannot be determined to the satisfaction of the Commissioner, that proportion of the total profit which the sales made in the State bear to the total sales, or, alternatively, 5 per cent. of the sales.

Case (2).—*Where Goods the property of a Principal in one State, not manufactured by him, are sold on his behalf in another State by a Branch or Agent therein.*

458. (*a*) *The taxable liability of the principal in the State from which the goods emanate—*

New South Wales.—Where it is possible to separate or make a true estimate of the income arising in the State, such account or estimate is accepted. If the Commissioner is not satisfied with the estimate, the profit arising in the State is deemed to be that proportion of the total profits which the sales made in the State bear to the total sales.

The Commissioner, New South Wales, states that for the income year ended the 30th June, 1932, where the goods are sold in another State through a traveller or agent, 50 per cent. of the profits so ascertained is taxable in New South Wales. Where the goods are sold in another State by a branch no part of the profit is taxable in New South Wales.

Victoria.—Where the goods are sold by an agent or a branch not substantially self-controlled, one-half of the profit arising from the sale.

Where the goods are sold by a branch substantially self-controlled, no part of the profit arising from the sale.

Queensland.—The whole of the net profit arising from the sale, but in law this is effective only to the extent to which the profits in question are earned in or derived directly or indirectly from sources in Queensland.

South Australia.—One-half of the income arising from the sale.

Western Australia.—The profit derived in Western Australia, which the Commissioner usually regards as one-half of the total profit.

Tasmania.—The whole of the profit arising from the sale, but a rebate, with certain limitations, is made in respect of tax paid in another State.

459. (*b*) *The taxable liability of the principal in the State in which the goods are sold—*

New South Wales.—Where the goods are sold by an agent and the profit cannot be satisfactorily determined—5 per cent. of the sales.

Where sold otherwise than by an agent—if it is possible to separate or make a true estimate of the income arising in the State, such account or estimate is accepted. If the Commissioner is not satisfied with the estimate, the profit arising in the State is deemed to be that proportion of the total profits which the sales made in the State bear to the total sales, or, alternatively, 7½ per cent. of the sales.

Victoria.—Where sold by an agent or a branch not substantially self-controlled, one-half of the profit arising from the sale.

Where sold by a branch substantially self-controlled, the whole of the profit arising from the sale.

Queensland.—The Act authorizes the Commissioner to treat the whole of the profit as arising in the State.

If such profit cannot be determined to the satisfaction of the Commissioner he may assess on a percentage of sales varying from 2½ per cent. to 20 per cent.

South Australia.—One-half of the income arising from the sale.

Western Australia.—If a company—the profit derived in Western Australia.

If an individual—5 per cent. of the amount of the sale, unless accounts are prepared showing the actual profit.

The Commissioner usually regards one-half of the profit as being derived in Western Australia.

Tasmania.—The actual profit derived in the State from the sale, and if such profit cannot be determined to the satisfaction of the Commissioner, that proportion of the total profit which the sales made in the State bear to the total sales, or, alternatively, 5 per cent. of the sales.

Case (3).—*Where Primary Products* (*Agricultural or Orchard Produce, Wool or Live-stock*) *produced in one State are sold in another State.*

460. (*a*) *The taxable liability of the producer in the State of production.*—the Commissioner, New South Wales, states that the proceeds of primary produce are treated in the same manner as the proceeds of goods manufactured in the State, i.e., if there are no special features, it is usual to regard 75 per cent. of the profit as being derived in New South Wales. In Queensland the whole profit is taxable, but in law this is effective only to the extent to which the profits in question are earned in or derived directly or indirectly from sources in Queensland. None of the Acts of the other States contain specific provisions, but, apparently, the whole profit arising from such sales is taxable in the State of production.

461. (*b*) *The taxable liability of the producer in the State of sale.*—The Acts of the States of New South Wales, Victoria and South Australia state specifically that such profits are not taxable. The Acts of the other States contain no specific provisions exempting such profits from tax, but we understand that it is not the practice to tax them.

462. At this stage we may draw attention to the absence of uniformity in the provisions of the Acts of the various States. Some refer to "income" and others to "profits". In some the Sections deal with profits arising from sales made both within and out of the State. Some provide for alternative methods of assessment, and others do not. Where the assessment may be made on a percentage basis the rate varies from 2½ per cent. to 20 per cent., but is usually 5 per cent.

463. The first steps that require to be taken to arrive at uniformity are, therefore—

(1) That there should be a definite basis of apportionment.

(2) That the relevant provisions of each Act should be expressed in identical terms.

464. It is difficult to indicate a secure basis upon which the allocation of interstate income can be made with any degree of certainty. In the case of a manufacturer part of his profit is attributable to manufacture and part to sale. There is no accepted criterion for determining the weight to be given to each of these factors, and it is a matter upon which widely divergent views may quite legitimately be held.

465. The first difficulty occurs in reconciling the views of the Commissioners of Taxation in the State of manufacture and in the State of sale, for each will be inclined to give the greater weight to that activity which occurs in his own State.

466. The second difficulty occurs in reconciling the views of the Commissioners with those of the taxpayer, who may hold the opinion that the proportion of profit derived from each activity differs materially from the proportion attributed to it by each Commissioner or by an arbitrary formula.

467. But while we recognize that discrepancies are inevitable, we consider that the question can only be regarded as a whole and that in the aggregate any reasonable method of apportionment will probably be fair not only to the taxpayer but to the respective States.

468. Although witnesses expressed various opinions as to the basis on which such profits should be apportioned between the States, they were unanimous on one point, namely, that they were not so much concerned with the basis adopted as that it should be definite, and that they should not be assessed on more than they earned. In effect, they say to the Commissioners in the various States : " Settle amongst yourselves how you shall assess us, and we will be quite prepared to agree."

469. The following suggestions for the apportionment of profits between States were submitted to us :—

(1) *That each case should be decided on its merits.*—To a large extent, and particularly in certain States, this is the present practice, and the evidence we have received indicates that it is not satisfactory.

(2) *That where the taxpayer keeps correct accounts showing the profit made in each State such accounts should be accepted.*—In effect this suggestion carries us but little farther, as it merely transfers the decision from the Commissioner to the taxpayer. The apportionment made by the latter may perhaps be influenced by the incidence of taxation in a particular State.

(3) *That the profits should be apportioned between the States in the ratio which the sales in each State bear to the total sales.*—This is generally described as the " sales-over-sales " basis. As the whole of the profit arising from the sale would thus fall to be taxed in the State in which the sale was made, and none to the State in which the goods were manufactured or from which they emanated, the adoption of this basis would operate adversely to the State in which much of the capital is invested and where manufacture or management is centred.

(4) *That the profit should be apportioned in accordance with a fixed formula.*—It is acknowledged that an arbitrary formula will not correctly apportion the profits derived from every type of business activity. The proportion of total cost represented by manufacture and selling, respectively, vary considerably. In some cases the cost of manufacture is high and the cost of selling low. In other cases the converse applies. No formula can, therefore, be correct in every case, but, provided that it does not result in the taxation of an amount which exceeds the total profits, the taxpayer will not be materially affected. On the other hand, the Commissioners in those States which have not yet adopted the Resolutions of the Taxation Officers' Conference appear to be quite prepared to accept a fixed formula, although they have not yet been able to agree that the proportions stated in those Resolutions are fair to their States.

470. A suggestion has been made that the application of an arbitrary formula by a State taxing authority is constitutionally inadmissible ; but no difficulty in this connexion seems to have arisen in the States which have adopted the principle.

471. We have also considered another suggestion, put forward in evidence—

(5) *That the apportionment should be entrusted to an independent authority, which should determine as a question of fact in each case what proportion of the profits was attributable to the operations in each State.*—If this plan were adopted, it would be necessary, of course, for the States to concur in the selection and appointment of the person or persons to constitute the authority, and separately to confer upon it statutory jurisdiction. It is a matter that presumably could not be dealt with by Federal legislation. In the absence of some such single authority, then so long as there is no common basis upon which the apportionment is to be made, it seems hopeless to expect that the existing evil of overlapping assessments can ever be cured.

472. But it is quite possible that the taxpayer would view with dismay the addition to the several Taxation Commissioners of still another authority to which he would be required to present his case, even if the change promised a more exact allocation of his taxable income. It is already too often a matter of complaint that the chief result of attempts to arrive at precise accuracy in taxation matters has been an added burden of expense constituting in effect a serious addition to the nominal tax.

473. Moreover, whatever may be the defects of an arbitrary formula, they would not be avoided by the mere substitution of one apportioning authority for several. No tribunal could ever make such an analysis of the innumerable transactions involved in interstate trade as to sort out the exact activities in each State that went to the production of the resulting income. The elements of the problem are far too uncertain, vague and elusive to admit of being accurately weighed. In the end, therefore, the decision in the majority of cases would rest wholly or in part on an arbitrary basis, whether admittedly embodied in a formula or not. The addition of the new proceedings, instead of eliminating the formula, would merely have moved it a step farther along.

474. We think, therefore, that the position should be frankly faced, and a formula based on accumulated experience adopted, if one can be found which will be satisfactory to taxpayers as a body, and will not operate unreasonably to the prejudice of any of the States.

475. There is room, of course, for wide differences of opinion as to the percentage of profit to be allocated to the State in which the goods are manufactured or from which they emanate, and to the State in which they are sold. This more directly concerns the Commissioners in the various States, but we suggest that, in considering such percentages, it should be recognized that the profits derived from interstate trading must be regarded as a whole and not by reference to the profits of a particular type of business.

476. The Conference of Taxation Officers held in 1929, after fully considering the manner in which the profits of a business carried on in more than one State should be apportioned between the States concerned, recommended that the following basis should be adopted :—

"(1) That this Conference agrees to regard as sales within a State all sales effected in that State by the instrumentality of an agent in such State on behalf of a principal outside that State.

(2) That on the submission by the principal of Profit and Loss Account and Balance-sheet to each State Commissioner 50 per cent. of the profits attributable to the sales covered by resolution (1) be taxed in the State of the principal and 50 per cent. of such profit be taxed in the State of the sale.

The understanding is that this will apply to traders other than manufacturers and primary producers.

(3) That as to profits on sales in one State of goods manufactured by the seller in another State 66⅔ per cent. be apportioned to the manufacturing State and 33⅓ per cent. to State of sale.

(4) That the formula laid down in resolutions (2) and (3) be applied with regard to branches, i.e., that where a branch sells goods manufactured by its principal in another State the profit be apportioned on the basis of 66⅔ per cent. to the State of manufacture and 33⅓ per cent. to the State of sale; that where a branch is instrumental in selling goods bought outside the State by its principal and which are delivered to the purchaser direct from outside the State the profit be apportioned on the 50-50 basis adopted for agencies. In the case of other business (i.e., direct imports by the branch or sales from stock—other than stock manufactured by its principal—carried by the branch) the full profit to be taxed in the State of sale."

477. Most of the witnesses who dealt with this question favoured the adoption of these Resolutions by the States which have not already given effect to them. We have already stated that South Australia and Victoria have incorporated the principles in their Acts. Western Australia gives effect to them where possible. The Commissioners in New South Wales and Queensland accept the principle of the resolutions, but consider that the percentages on which the allocation is to be based are not fair to their States. New South Wales claims that 75 per cent. of the profit on goods manufactured in that State but sold in another State should be taxable in New South Wales, but is not satisfied to accept 25 per cent. in the case where the goods are manufactured in another State but sold in New South Wales. Queensland considers that the profit on such sales should be equally divided between the State of manufacture and the State of sale. The Acting Commissioner, Tasmania, does not agree in principle with the resolutions, and prefers to tax the whole profit and allow a rebate in respect of tax paid in other States.

478. Any percentage that may be adopted must necessarily represent a compromise between divergent views. After a careful examination of the position in every aspect, we have not been able to arrive at a more satisfactory solution of the problem than that put forward by the Conference of Taxation Officials. In our opinion the percentages there recommended are fair both to the taxpayer and to the States.

479. We recommend, therefore, that the profits derived from a business carried on in more than one State be apportioned between such States in the following proportions :—

Where sales are made in one State of goods manufactured by the seller in another State—

Two-thirds to the State of manufacture and one-third to the State of sale.

Where goods, the property of a principal in one State, not manufactured by him, are sold on his behalf in another State by a branch or agent therein—

If sold by an agent—

One-half to the State from which the goods emanate and one-half to the State of sale.

If sold by a branch—

The whole to the State of sale.

Where primary products (agricultural or orchard produce, wool or live-stock) produced in one State are sold in another State—

The whole to the State of production.

SECTION XXVI.

TAXATION OF INCOME DERIVED BY THE RESIDENT OF A STATE FROM SOURCES IN ANOTHER STATE (OTHER THAN FROM A TRADE OR BUSINESS).

480. As a broad statement of fact it is correct to say that, prior to the depression which commenced in 1930, the States assessed normal Income Tax principally on income derived from sources in the State, and did not seek to impose tax on a resident in respect of income derived by him from another State. But since 1930 the financial exigencies of the State Governments have compelled them to depart from this principle—to a limited extent for the purposes of normal Income Tax, but to a very much wider extent for the purposes of Special Income Tax and Unemployment Relief Tax. **The problem of double taxation between the States has, therefore, become more acute, and there is a grave danger that the principle, adopted for special taxation, of imposing tax on all income derived by the resident of a State will, if not checked, be extended later to normal Income Tax.** Hence it is desirable to consider the principles which should be observed by State Governments in the exercise of their taxing powers over the persons and properties within their own jurisdiction, in order that double taxation shall not arise. We have made recommendations for the prevention of double taxation of the profits of a trade or business carried on in more than one State, and we shall now consider the means of obviating the double taxation of other income, which consists principally of dividends, interest, rent, and remuneration for personal services.

481. The following summary shows the various classes of income in respect of which double taxation arises in each State :—

New South Wales.—Special Income Tax is payable by a resident on income derived by him from any source outside New South Wales, otherwise than from the carrying on of any trade or business not being an investment business. Both normal and special Income Tax are payable by any person, whether a resident or not, who receives interest on debentures paid by a company incorporated outside New South Wales, which employs part of the debenture issue in New South Wales.

Victoria.—Normal and special Income Tax and Unemployment Relief Tax are payable on the remuneration of a person ordinarily resident in Victoria but temporarily engaged on duties outside Victoria for a Victorian employer. Rebate for tax paid elsewhere is allowed.

Special Income Tax and Unemployment Relief Tax are payable by a resident on interest and dividends received by him from a company incorporated in another State, and by the resident of another State on interest and dividends paid to him by a company incorporated in Victoria.

Queensland.—Normal Income Tax and Unemployment Relief Tax are payable on debenture interest paid by a company trading in Queensland (whether incorporated there or elsewhere) to a debenture-holder wherever residing.

Income derived by a resident from sources in another State is not liable to normal Income Tax or Unemployment Relief Tax.

South Australia.—Normal Income Tax is payable on dividends received by a resident from a company incorporated in another State.

Western Australia.—No tax is imposed on income derived by a resident from sources in another State.

Tasmania.—Normal and special Income Tax are payable on income derived from sources in another State if brought into Tasmania, subject to rebate for tax paid elsewhere in the case of normal Income Tax.

482. In our opinion double taxation between States can best be obviated by the adoption of the fourth alternative referred to in paragraph 368 (*d*) of this Report, namely, the method of classification and assignment of sources. The States should agree to attach origin taxation specifically and wholly to particular classes of income. The State of origin would retain its specific origin taxes in full. The State of residence would tax only income received by its residents not specifically exempted, or, alternatively, tax its residents on their total income less a rebate of tax elsewhere as described in paragraph 368 (*a*).

483. We recommend the following classification of income (other than the profits of a trade or business) for this purpose :—

Rent—to be taxed in the State where the property is situated ;

Interest on Mortgages—to be taxed in the State where the mortgaged property is situated ;

Interest on Debentures—as for interest on mortgages ;

Interest on Loans—to be taxed in the State in which the borrower resides ;

Interest on Bank Deposits and Current Accounts—to be taxed in the State where the head or branch office which pays the interest is situated ;

Earned Income—to be taxed in the State in which the occupation is normally and habitually carried on. In the case of persons whose occupation requires them to visit other States a rebate to be allowed for tax paid in those States ;

Dividends are considered in the next following paragraphs.

SECTION XXVII.

THE TAXATION OF COMPANIES AND DIVIDENDS BY THE STATES.

484. In Section II. of our First Report we considered the various methods of taxing companies and dividends that have been adopted in Australia. In our opening remarks we pointed out that there is no great difficulty in determining the profits of companies as such, and that the income of a company is arrived at in a similar manner to that of any other taxpayer. What has to be decided, however, is in what manner and at what rate such profits are to be taxed, and whether dividends are to be taxed in the hands of the shareholders, and in that event, in what manner.

485. In all States, except Western Australia, the taxable income of a company is ascertained in accordance with the provisions of the Income Tax Act, generally speaking, in the same manner as that of an individual, subject to the reservation that a company is allowed no deduction in respect of the statutory exemption or concessional deductions. In Western Australia the taxable income of a company is ascertained in accordance with the provisions of the Dividend Duties Act, which differs in some respects from the Income Tax Act of that State.

486. Various methods are employed to determine the rate of tax to be paid by a company.

Victoria, Western Australia and Tasmania tax a company on its total income at a flat rate, without regard to the amount of the income. The rates are :—

Victoria, 1s. 10.575d. in the £.
Western Australia, 1s. 5.25d. in the £.
Tasmania, 1s. 6d. in the £.

New South Wales and South Australia impose tax at a rate graduated by reference to the amount of the income. The rates are :—

New South Wales.—When the income does not exceed £500 the rate is 1s. 9d. in the £. It increases by regular graduations to 2s. 6d. in the £ on an income of £4,500, at which amount it remains constant.

South Australia.—When the income does not exceed £5,000 the rate on the first £ is 1s. 3d., which increases by regular graduations to 3s. 9d. on an income of £5,000, at which amount it remains constant.

Queensland taxes at a graduated rate based on the percentage which the profits bear to the capital employed. This may vary in the case of a trading company from 2s. 1.2d. to 6s. 3.6d. Other classes of companies are taxed at different and higher rates.

487. In some of the States dividends are subject to normal Income Tax in the hands of shareholders. In Victoria they are wholly exempt from normal Income Tax, and in other States they are included in the total income of the shareholder for certain purposes. The following summary shows the manner in which dividends are treated in each State for the purposes of normal Income Tax :—

New South Wales.—The shareholder, wherever residing, is taxed on the proportion of his dividend which is paid out of income derived in New South Wales, subject to rebate at his own rate or at the rate paid by the company, whichever is the lesser. Increased tax cannot be imposed by reason of the inclusion of dividends, except to the extent to which the additional tax due to their inclusion exceeds the tax on the shareholder's income, excluding the dividends, plus the proportion of the company's tax applicable to the dividends.

Victoria.—Dividends are wholly exempt in the hands of the shareholder without regard to the amount.

Queensland.—Dividends are exempt in the hands of the shareholder, but are included in his income for the purpose of determining the rate of tax, the statutory exemption and the right to certain concessional deductions when that is dependent on the amount of the taxpayer's income.

South Australia.—A resident shareholder is liable to tax at a flat rate on dividends received by him from any company wherever incorporated, and whether the income from which the dividends are paid is derived from the State or not. A shareholder not resident in South Australia is not liable to tax on dividends paid to him by a company incorporated in South Australia.

Western Australia.—A shareholder is not liable to pay tax on dividends paid to him by a company in Western Australia which is subject to the Dividend Duties Act, unless the rate applicable to his total income exceeds the company rate, and in that event he is allowed a rebate at the rate of tax paid by the company.

Tasmania.—Tax on dividends paid by a company having its Head Office in Tasmania is paid by the company, and the dividend is not again taxable in the hands of the shareholder, but it is included for the purpose of calculating the rate of tax to be paid on the other income of the shareholder.

Dividends received by a resident of Tasmania from a company incorporated in another State are subject to tax in Tasmania if received in that State, subject to a rebate, with certain limitations, if tax has been paid on those dividends in another State.

488. In recent years the complications existing in regard to the taxation of dividends have been increased by the enactment of special legislation relating to the imposition of taxation for the relief of unemployment or for other special purposes. In accordance with these Acts shareholders are now required to pay additional tax on dividends in the circumstances described in the following summary :—

New South Wales.—A resident shareholder is liable to tax on the whole dividend received by him from a company incorporated in New South Wales, wherever the profits were earned, and on any dividends received by him from a company incorporated outside New South Wales. A shareholder not domiciled in New South Wales is taxed on the whole dividend paid to him in respect of shares registered on a register in the State.

Victoria.—A resident shareholder is liable to tax on all dividends received by him, whether the company is incorporated in Victoria or in another State. A shareholder not resident in Victoria is liable to tax on all dividends paid to him by a company incorporated in Victoria.

Queensland.—Dividends are exempt in the hands of the shareholders.

South Australia.—There is no special Income Tax or Unemployment Relief Tax in this State.

Western Australia.—Dividends are exempt in the hands of the shareholder.

Tasmania.—A shareholder is liable to tax on dividends on the same basis as for normal Income Tax.

489. Consideration of the foregoing summary shows—

(a) That there is no uniformity in regard to the manner in which the rate of normal Income Tax payable on the income of a company is ascertained ;

(b) That at the present time every State is using dividends in some manner for the purpose of assessing normal or special Income Tax or Unemployment Relief Tax payable by the shareholder ;

(c) That there is no uniformity in regard to the manner in which dividends are used for these purposes ;

(d) That double taxation of dividends by the States occurs to some extent in respect of normal Income Tax, and to a much greater extent in respect of special Income Tax and Unemployment Relief Tax.

490. For many years the States have adopted different methods for determining the rate of normal Income Tax payable on the income of a company, but the other conditions referred to are due principally to the enactment of emergency legislation for the imposition of special Income Tax and Unemployment Relief Tax.

491. The provisions of this emergency legislation applied with great severity to dividends The exact effect in each State has been set out in full in paragraph 488 and hence it is sufficient to summarize its general effect in a few words—

(a) It imposed tax on dividends paid by a company incorporated in the State to its shareholders wherever residing ;

(b) Except in Queensland, it imposed tax on dividends received by its residents from a company wherever incorporated.

In either case the fact that the dividends had paid, or would be liable to pay, tax elsewhere was ignored.

492. We shall review various schemes designed to obviate the double taxation of dividends in more than one State. It is necessary, however, first to consider the manner in which companies should be taxed by the States.

493. In paragraph 160 of our Report we stated that the method at present used by the Commonwealth was, in our opinion, more suitable to its requirements than any other considered, but we made it clear that this method might be inapplicable or at least not entirely suitable to the requirements of the States.

494. Under the present Federal system tax is imposed at a flat rate on the total taxable income of a company. No deduction is allowed to the company for dividends distributed by it, but such dividends are taxable to the shareholder at the rate applicable to his total taxable income from all sources, subject to certain rebates. To achieve simplicity we recommended that in the case of a resident, the whole dividend should be taxable and that the rebate allowed should be at a standard rate or at the taxpayer's own rate (whichever is the lesser).

495. It is practicable for the Commonwealth to adopt this scheme for the taxation of companies and dividends, because the greater part of the dividends distributed by Australian companies is paid to residents of Australia. It follows, therefore, that the same Government collects tax both from the company and shareholders and that it may, if it thinks fit, rebate to the shareholders a part of the tax paid by the company.

496. If every company carried on business only in one State, and if all its shareholders resided in that State, a similar method of taxing companies and dividends might be adopted by the States. But except in the case of the smaller private companies, these conditions rarely exist. Most of the larger public companies and many of the larger private companies carry on

business and have shareholders in more than one State. Such companies may derive profits in some States and incur losses in others. It follows, therefore, that **the dividends received by their shareholders in a particular State bear no relation to the profits earned by the company in that State. For this reason it is not practicable for the States to adopt a method of taxing companies and dividends which involves the allowance of rebates to shareholders.**

497. Another reason why a system of rebates by States based on the Commonwealth system would be impracticable is that a State is not entitled to demand information from a non-resident shareholder concerning income derived by him from other sources.

498. The attempt by a State to tax dividends in the hands of shareholders subject to rebate would involve so many assumptions that it would become artificial, and other methods of attaining the desired end must therefore be considered.

499. In our opinion the first step towards a solution is to regard the company as an entity apart from its shareholders and to draw a clear distinction between the taxable obligations of each. In common with the rest of the community, a company enjoys the protection of the State and other advantages which it provides, and it should, therefore, as a company, contribute to the Revenue of the State in which it carries on business. If its business extends over more than one State, the profits earned in each State should be determined in accordance with the recommendations we have made for the apportionment of profits of a trade or business carried on in more than one State.

500. The profits of a company should be taxed in each State at a flat rate, and not at a graduated rate based either on the amount of the profits or their ratio to the total capital involved. Our reasons for this conclusion are set out in paragraphs 29 and 35 of our Report. It would be in the interests of the States to adopt a rate reasonably uniform and not too high. A high rate of tax on companies is a deterrent to investment or the formation of new companies.

501. The next matter to be considered is the taxation of dividends in the hands of shareholders. We have previously explained the practice of the various States, and emphasized the need for the adoption of a consistent basis. Three suggestions may be considered—

(*a*) *That each State should tax the shareholder, wherever residing, on that part of the dividend paid to him out of the profits derived by the company in that State.*

502. This is the principle upon which the taxation of dividends is based in New South Wales. That State seeks to impose normal Income Tax on every shareholder, wherever resident, in respect of that portion of his dividend which is deemed to have been derived from profits earned in New South Wales. In practice the method operates only to a very limited extent, for the effect of the State Act is to impose tax on dividends only in those cases in which the rate of tax payable on the income of the individual shareholder exceeds the rate of tax payable by the company.

503. An objection that may be taken to this method of taxing companies is that the State in which the company derives its profits has done nothing for the non-resident shareholder as an individual. It has received tax on the profits of the company and it may be argued that that is all to which it is entitled. Another objection is that it is difficult for the State of origin to reach the non-resident shareholder, and it is therefore necessary to require the company to deduct tax on the dividend paid to him.

504. In our opinion this method of taxing dividends could not be generally adopted by the States. Carried to its logical conclusion, it would mean that every shareholder in a company which carries on business in more than one State would receive a separate assessment from the Commissioner in each State in which the company carries on business in respect of that portion of his dividend deemed to have been derived from profits earned in that State. **The attempt to allocate and assess dividends received by shareholders in the other States and to collect tax from them would, in time, demoralize any State Income Tax Department, and the effect upon the taxpayer need not be described.**

(*b*) *That the Dividends should be taxed in the hands of the shareholder only in the State in which the Company is incorporated—*

505. In considering this proposal it must be recognized that financial conditions in the various States differ. Those which have attained a higher stage of development provide capital which is used in other States that are not so highly developed. This method of taxing dividends

would therefore operate in favour of the States whose citizens provide capital which is used elsewhere, as in most cases companies would be incorporated in the State where the capital is raised. **The ability to alter the incidence of tax merely by changing the place of incorporation is a strong reason for rejecting this proposal.**

(c) *That the dividends should be taxed in the hands of the shareholder only in the State in which the shareholder resides, without rebate.*

506. We have referred previously to the progress that has been made in the conception of residence as a test of taxable liability. The Commonwealth has adopted this basis for normal Income Tax, and all States except Queensland have adopted it for special Income Tax and/or Unemployment Relief Tax. The economists to whom we have referred in paragraph 356 have accepted the principle that the State of residence of the shareholder has the best right to tax the income arising from his investments. **Provided, therefore, that provision be made to prevent double tax by States, there can be no logical objection to the acceptance of this principle for the taxation of dividends.**

507. Two objections may be advanced against it. The first is that it would benefit those States whose residents incorporate companies which provide capital used to develop public or private resources in other States. But it must be recognized that the residents of States which are not so highly developed experience difficulty in obtaining suitable investments in their own States, and frequently invest in the shares of companies incorporated in the more populous States. At the present time the State of residence does not as a rule impose normal Income Tax on the dividends received by the residents from companies incorporated elsewhere. This results in an anomaly which has been brought under our notice, namely, that by investing in companies incorporated in States where the company itself is subject only to a low flat rate of tax and the dividends are exempt, the resident of another State may now entirely escape normal Income Tax in that State, although he derives all the benefits of the amenities provided by the State at the cost of other taxpayers.

508. The second objection is that it would be unfair to tax shareholders on dividends received by them, without rebate for the amount paid by the Company. But as we have explained in paragraph 119, there may be no inequity in requiring the shareholder to pay tax on his dividend without rebate if companies are taxed at a low rate, and our suggestion is based on the assumption that this condition will be observed by all the States. We have also explained at length the difficulties that would be experienced in practice in attempting to apply a system of rebates to the taxation of dividends by States.

509. We recommend—

(a) That a company should be liable to pay tax in each State on the profits derived by it from sources in that State, at a flat rate, and that, if possible, the States arrive at an agreement that the flat rate shall be uniform in each State ;

(b) That if shareholders are to be taxed on the dividends received by them, tax on such dividends should be imposed only in the State in which the shareholder resides, without rebate.

510. In our opinion this proposal offers the most practicable solution. Its simplicity may be contrasted with the complexities which now surround this subject, or which might be expected to result from an attempt to apply to State purposes the method of taxing companies and dividends which we have recommended for adoption by the Commonwealth, with all the difficulties that would result from an attempt to allow rebates to shareholders by the States.

511. We desire to make it clear that our recommendation in this respect is not to be construed as a suggestion that a State should necessarily impose tax upon the dividends received by its residents, but only that if it desires to tax dividends in any form it should tax only the dividends received by its residents, and not seek to impose tax upon dividends distributed to shareholders in other States out of the profits earned by the company in the State.

The other matters referred to us by Your Excellency will be dealt with in subsequent reports.

DAVID G. FERGUSON (Chairman.)
EDWIN V. NIXON.

J. A. NEALE (Secretary),

Melbourne, 5th February, 1934.

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