

1934.

COMMONWEALTH OF AUSTRALIA.

THIRD REPORT

OF THE

ROYAL COMMISSION ON TAXATION.

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COMMONWEALTH OF AUSTRALIA.

THIRD 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 previous Reports to report finally 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.

512. In this part of our Report we discuss the scope and incidence of income taxation in the Commonwealth and States, and the discrimination made by some States against the residents of other States. We set out in detail the differences between the Acts of the Commonwealth and each State in regard to specific classes of income and deductions, and also in regard to the taxation of certain classes of taxpayers. We also consider the practice relating to objections and appeals and certain other matters concerning administration. Where it appears advisable to do so we submit recommendations designed to produce a greater measure of uniformity in assessment and practice. We forward separately draft provisions of that part of the Assessment Acts dealing with the liability to taxation as we suggest they should appear if our recommendations be approved.

SECTION XXVIII.

THE SCOPE AND INCIDENCE OF INCOME TAX IN THE COMMONWEALTH AND STATES.

513. The intention of the Acts of the various Governments is to impose a tax on “ income ” as distinct from capital receipts. The meaning assigned to income in the various Acts is, generally speaking, its plain and ordinary meaning, subject to certain reservations which will be dealt with in the proper place. But it must be made clear that the income subject to tax is the statutory income measured in a particular way, and not either income or profits in the sense that those terms are used by the business man. It should be noted, however, that none of the Acts contain a complete and satisfactory definition of income, but that the procedure adopted in all cases is merely to state that the expression “ income ” includes certain specific receipts, in order that there may be no doubt that such receipts are taxable.

514. In that section of our Report dealing with double taxation, we have explained that the Commonwealth taxes income wherever derived, subject to the provision that if such income has paid tax elsewhere it is exempt from Commonwealth tax. The States, however, as a general rule impose normal Income Tax only upon income derived from sources within the State. The exceptions to this general rule have been set out in detail in Section XXII. of our Report.

515. Other important differences between the Commonwealth and State Acts arise in regard to the treatment of dividends and casual profits. The Commonwealth Act requires dividends to be included as income of a shareholder. The practice of the States varies, but as a general rule dividends are not subject to normal Income Tax in the hands of the shareholder. The provisions of the various State Acts in regard to dividends are set out in paragraphs 487 and 488 of our Report. Casual profits are taxable in some States but exempt in others. They will be considered subsequently.

516. The incidence of Income Tax on the individual is governed by two factors, namely, differentiation, and graduation or progression.

517. Differentiation is based on the economic distinction between earned income which depends upon the personal effort of the individual for its continuance, and investment income which is derived from capital resources that may continue after his death. It may be regarded as an accepted principle of taxation, and we are satisfied that within reasonable limits it is desirable and just.

518. The practical application of differentiation begins with the statutory allocation of each kind of income to a specific class. Hence every Act, except that of Western Australia, classifies income either as income from personal exertion or income from property. The terms used to express this differentiation are similar, but not identical. The general practice is to specify in more or less detail the nature of the income which is classed as income from personal exertion, and to treat all other income as income from property. In South Australia the reverse method is adopted, and income derived from property is specified, other income being classed as income from personal exertion.

519. Notwithstanding the differences in the language of the relevant Sections of the various Acts it may be said, generally, that most classes of income fall within the same category both for Commonwealth and State purposes, except in Western Australia where no distinction is made. Exceptions which are not important are interest received in connexion with a business and the income derived by beneficiaries from a trust.

520. Subject to reservations in regard to items such as dividends, casual profits and ex-Australian income, we recommend that common form clauses relating to income and the various classes of income be adopted by all Governments.

The extent of Differentiation.

521. Although the Acts draw an arbitrary distinction between income derived from personal exertion and income derived from property, it is not easy in some cases to distinguish between certain types of income that are so classified. In practice, the expression "personal exertion" covers a very wide and divergent range of activities and inactivities, including those of an employee on a salary, a professional man or tradesman doing all his own work, an employer actively engaged in the conduct of his business, one who leaves it chiefly or entirely to his manager, and a sleeping partner who takes no part in the business beyond contributing to its capital. It is difficult to find the point at which a satisfactory line could be drawn between these cases, but the practice of grouping them under one heading and opposing them indiscriminately to the case of the taxpayer who derives his income from property does not constitute such a well balanced and symmetrical scheme as to make one hesitate at taking the risk of disturbing it by considering the question of its modification.

522. In considering the practical application of differentiation two points must be considered—

- (a) the relation between the tax charged on income from personal exertion and on income from property of the same amount, and
- (b) whether differentiation should be unlimited or whether it should cease at a certain point.

523. There is no ideal relation between the rates of tax that should be charged on income from either source, nor is it possible to fix a point at which differentiation should cease by reference to any economic or scientific principles. Both these are matters of opinion, and as they materially affect the yield of tax, in practice they must be decided by every Government in accordance with its requirements. The absence of uniformity in regard to each of these matters is shown in the following summary of the practice of the various Governments. In every case differentiation is effected by imposing a higher rate of tax on income from property than on income from personal exertion :

Commonwealth.—In the case of income from property every pound up to £3,700 is taxed at a gradually increasing rate, but every pound in excess of that amount is taxed at a flat rate of 90 pence. In the case of income from personal exertion every pound up to £6,900 is taxed at a gradually increasing rate, but every pound in excess of that amount is taxed at a flat rate of 76.5 pence. The effect is that although the rates on each class of income commence at almost identical points they diverge until at about £1,200 the rate on property is double that on personal exertion. This relation is generally maintained upon incomes up to £5,000. Thereafter the differentiation against property income begins to diminish, and on an income of £20,000 it is about 30 per cent. higher than on an income of the same amount from personal exertion.

New South Wales.—The tax on income from personal exertion not exceeding £7,000 and on income from property not exceeding £5,000 increases gradually, but every pound in excess of these amounts is taxable at the same rate, viz., 51 pence in the pound. This produces an effect somewhat similar to that of the Commonwealth rates, and results in a gradual diminution in the differentiation on the higher grades of income from property.

Victoria.—The rate on income from property is double that on income from personal exertion, irrespective of the amount of the income.

Queensland.—Commencing with a property rate double that of personal exertion these gradually converge until they meet at £3,000.

South Australia.—There is a differentiation of 50 per cent. on the smallest income from property, which diminishes as the income increases. An income of £7,000 derived either from personal exertion or from property is in each case taxable at a flat rate on each pound of the income (but not at the same flat rate), and the differentiation is then reduced to $12\frac{1}{2}$ per cent. in the case of married taxpayers, and approximately 8 per cent. in the case of unmarried taxpayers.

Western Australia.—There is no differentiation in rates.

Tasmania.—The rates commence at almost identical points. On an income of £1,000 the differentiation against property income is approximately 50 per cent., diminishing to approximately 20 per cent. on incomes in excess of £5,000.

524. The tax on an income which consists partly of income from personal exertion and partly of income from property is not calculated in the same manner in all cases. In Victoria the rate applied to each class of income is the rate that would be applicable to that income if it were the only income of the taxpayer, subject to a reservation of minor importance in the case of small composite incomes. In the Commonwealth and all other States (except Western Australia) the rate of tax on each part of a composite income is the rate that would be payable if the total taxable income were of that class.

525. A perusal of this statement of practice shows a wide diversity both in the extent and range of differentiation. In most cases it extends indefinitely, subject to the important qualification that when the total income exceeds a certain amount the tendency is towards regression, that is to say that when the income exceeds a certain specified amount differentiation diminishes with each additional pound of income. This is a recognition of the principle that as the income increases differentiation becomes less important, for even if the income is derived from those sources which are classified as personal exertion other considerations are not entirely absent. For example in the larger earned incomes derived from business there is considered to be usually an element of the reward of capital, but practical difficulties prohibit any attempt to segregate this. When considering the professional income of a leading surgeon or barrister it may seem hard to discover any property element, but even in this case the fact that he commands higher fees than one of his colleagues of perhaps equal skill but shorter experience is, to some extent, due to the prestige arising from his standing in the profession, which may be said to have an analogy not altogether fanciful to the accumulated capital of the investor. There is good ground, therefore, for holding that a stage may be reached at which the necessity for the distinction ceases and that differentiation should progressively diminish as that point is approached.

526. This is the principle applied in the Queensland State Act. The differentiation is greatest on the first pound of income and it progressively diminishes until the rate of tax on an income of £3,000 from either source is the same. Thereafter one scale of rates is applied to all income in excess of £3,000, irrespective of its nature. While we disclaim any desire to make any recommendation that might seem to infringe on the right of any Government to determine both the extent and range of the differentiation which it will apply, we think that in any revision of rates careful consideration should be given to the principle adopted by Queensland. We recognize, however, that the time may not be opportune to make any general revision in rates, and that a proposal to do so would involve an intricate statistical study which is beyond our

province. We think that the adoption of this principle would simplify the calculation of tax, both by the taxpayer and the Departments. We may also add that the indefinite application of differentiation encourages taxpayers to adopt legal expedients which will transform income otherwise taxable as income from property into income from personal exertion, in order to obtain the benefit of the lower rate. The limitation of an amount which would be taxed at the lower rate would, to some extent at least, restrict the efficacy of these schemes.

Graduation.

527. Graduation or progression of tax is based on the principle that the ability of an individual to pay tax increases in a greater ratio than his income, and that in consequence the rate of tax should increase progressively. Usually differentiation and graduation operate concurrently, though in some instances there is graduation without differentiation, as in Western Australia.

The extent of Graduation.

528. Every Australian Government imposes tax at a graduated rate which increases with the amount of the total income. The degree of graduation is no doubt mainly determined by Revenue requirements, and varies in each case. In every case, except that of Victoria, the rate increases by a straight line progression between minimum and maximum points, each successive pound of income in this range being subject to tax at a slightly increased rate. When the income exceeds the minimum, the excess and in some instances the whole income is taxed at a flat rate. In Victoria a rather complicated calculation is necessary to ascertain the amount of normal Income Tax. The first part of the tax increases by steps, and to the amount so ascertained a percentage is added which ranges from 10 per cent. of the tax on an income which exceeds £800, but not £1,000, and increases to 25 per cent. of the tax on an income which exceeds £5,000. To the sum of both these calculations a further tax at a flat rate is added. This method of calculation is complicated, and we suggest that consideration might be given by the Government of Victoria to the adoption of a straight line progression as used by the other Governments. This method is more scientific and not more difficult either to understand or to apply.

Exempt Incomes.

529. The Acts of all the Governments exempt certain revenues, funds, institutions and persons from liability to Income Tax. The income of certain classes of persons and institutions is exempt in all cases, but there is a lack of uniformity in regard to other exemptions, due probably to local conditions and the varying requirements of Revenue. Almost complete uniformity as between the Commonwealth and all the States is already present in regard to many matters, although there are differences in the language in which the exemptions are expressed. The question of exempting ex-Australian income and dividends in the hands of shareholders involves special considerations which have previously been discussed. Apart from these matters, the exemptions do not produce any serious complexity. It is felt, however, that conditions throughout the Commonwealth are such that there should be no real difficulty in standardizing them. Where it is proper to allow an exemption for Commonwealth purposes it is difficult to imagine circumstances in which a similar exemption is not proper for State purposes, and vice versa.

SECTION XXIX.

DISCRIMINATION ON THE BASES OF RESIDENCE AND DOMICILE.

(1) The Commonwealth.

530. It has already been indicated in the Second Report that discrimination in some respects between resident and non-resident taxpayers is a well-known and justifiable principle of taxation. In the Commonwealth Act it appears in three main ways.

- (a) Firstly, the field of taxable income is more limited in the case of a non-resident than of a resident. It would for instance be constitutionally invalid for the Commonwealth to tax a person who is neither resident nor domiciled in Australia on income which is not derived in Australia. The resident may be taxed on his income wherever derived, and this principle has been recommended in paragraph 379 of this Report. A non-resident, however, can be taxed only on the income he derives in Australia.

- (b) Secondly, it is found that the allowance of many of the concessional deductions is more pertinent to the resident taxpayer than to the non-resident. Thus the allowances in respect of wife and children, life insurance and medical expenses, and the statutory exemption are of such a nature that the taxpayer should receive them only once, and it is apparent that the benefit should be given in the place of residence rather than elsewhere. So it is found that these allowances are restricted by the Commonwealth Act to resident taxpayers. The non-resident will in general have income in the place of residence where his income from all sources can be aggregated, and be entitled to such corresponding deductions as are permitted there. Discrimination on the basis of residence in these matters is the simplest and most effective way of preventing double deductions, and it is recommended that for Commonwealth purposes it be continued.
- (c) Thirdly, the difficulty of collecting tax from a non-resident makes it expedient to introduce a discrimination against him in regard to the method of collecting the tax on some types of income. The Commonwealth Act for instance provides for collecting at the source tax at a flat rate on interest payable to non-residents by companies. This discrimination is dealt with later. A similar system of collection existed in regard to dividends before the method of company taxation assumed its present form, under which it is considered to be unnecessary.

(2) *The States.*

531. The factors which give rise to the discriminations between residents and non-residents in the Commonwealth Act also occur in the States, and give rise there to the three main considerations which have been discussed from the Commonwealth point of view.

- (a) There is a corresponding limitation on the right to tax the non-resident. If the States desire to tax the income derived by their residents from outside sources the method by which this should be done has already been recommended. On the other hand they cannot tax the income derived by a non-resident from sources outside the State.
- (b) So far as concessional deductions are concerned, the Acts of most of the States indicate a desire on the part of their Governments to restrict the allowance of them to residents of the State. Where a person deriving income in the State does not reside in the Commonwealth the family concessional deductions and statutory exemption should not be allowed to him.

Where, however, he resides in the Commonwealth but not in the State from which the income is derived, a new consideration is imported into the problem by the provisions of Section 117 of the Commonwealth Constitution Act:

“A subject of the Queen resident in any State shall not be subject in any other State, to any disability or discrimination which would not be equally applicable to him if he were a subject of the Queen resident in such other State.”

The provisions of that Section have rendered nugatory most of the attempts on the part of State Governments to limit the allowance of the deductions mentioned to their residents. Thus although the Acts of New South Wales and Victoria purport to limit certain concessional deductions to residents, those limiting provisions are not applied in assessing a resident of some other State of the Commonwealth, because it is felt that in the case of such a resident the provisions in question are not constitutionally valid. The contention that they are invalid is supported by the decision in *Parks v. Commissioner of Taxes* (Queensland) (10th October, 1933). In that case the Supreme Court of Queensland held that the provision of the Queensland Act (prior to the 1932 Amendments) which purported to diminish the statutory exemption applicable to the income of a person “not ordinarily resident” in Queensland by reference to the period spent by such person in Queensland was invalid, as being based on a discrimination forbidden by the Commonwealth Constitution Act, Section 117. The result is that a taxpayer who derives income from both New South Wales and Victoria is entitled in each of those States, in the assessment of his income derived there, to deductions of the same allowances for wife and children, and the same statutory exemption, as a taxpayer resident in one State, and deriving from that State only income equal to the income derived there by the first taxpayer.

- (c) The principle of taxing at the source interest on debentures of and money lent to a company has been adopted in some States. Here again the provisions of Section 117 of the Constitution Act must be considered. In New South Wales the interest is so taxed when payable to a person who does not reside in the State. This provision is of doubtful validity where the payee resides in the Commonwealth, because it would appear to impose a disability on a resident of any other State to which residents of New South Wales are not subject. In South Australia a similar provision occurs, but its operation is expressly limited to the cases in which the interest is payable to persons who do not reside in Australia. Interest payable to persons who reside in other States of the Commonwealth is not taxed by these means in that State. The relevant provisions of the Victorian and Tasmanian Acts are apparently inoperative; but in terms they draw no distinction between the payment of interest to a resident and a non-resident. The Western Australian Act provides that the company is deemed to be the agent of debenture holders, and that Income Tax is payable by an agent in respect of the income of a person resident out of Western Australia. This provision therefore corresponds to that in force in New South Wales, but a flat rate tax at the source is not imposed.

532. To overcome the constitutional objection to discrimination on the basis of residence, various expedients have been adopted in some States in regard to the allowance of the concessional deductions and the statutory exemption and in the method of taxing interest and dividends paid to non-residents.

533. The most important and far-reaching of those expedients is the introduction of the principle of discrimination on the basis of domicile in place of that of residence. This method of discrimination first appeared in the Queensland Act, where it was introduced by the Amending Act of 1932. It has since been adopted in one particular in New South Wales. Under the Queensland Act certain concessional deductions (wife, children, dependants, life insurance, superannuation payments, and medical and funeral expenses) are restricted to taxpayers domiciled in Queensland. In addition, interest payable to persons not domiciled in Queensland is taxed at the source at a flat rate. In New South Wales the *Special Income and Wages Tax (Management) Act* 1933 has applied the same principle for the purpose of collecting the special Income Tax on dividends and interest paid by companies. Where dividends are paid to shareholders not domiciled in the State, or interest is paid to a person not domiciled there, the company is required to retain the tax and pay it to the Commissioner.

534. No doubt other States are now considering the legal and practical effect of this innovation with a view to its adoption. The High Court has held that discrimination on the basis of domicile is not invalidated by the provisions of the Constitution Act (*Davies and Jones v. State of Western Australia* 2 C.L.R. 29). Normally the place of the domicile is that of the residence, and consequently at first sight this may appear to be an attractive way out of the difficulties arising from the inability of the States to discriminate on the basis of residence. There are, however, many objections to this solution, and the following considerations render it undesirable.

535. In its legal meaning domicile does not necessarily involve residence, and consequently a person who resides in a State is not necessarily domiciled there, and one domiciled there does not necessarily reside there. So far as income taxation is concerned, a person who resides throughout the full income year in one State should not be subjected in that State to a higher tax than any other resident of it merely because he is not domiciled there. Nor should a person who derives income from a State while residing in another be entitled to advantages as against other persons residing out of, or even in some cases residing in, the State from which the income is derived, merely because he is domiciled there.

536. Two examples may be taken of positions which must arise under the provisions of the Queensland Act to illustrate the inequity of their operations. A person deriving investment income throughout the year from Queensland may spend the whole of his time and income in Europe and yet by reason of being domiciled in Queensland be entitled to the full family concessional deductions referred to. On the other hand a person employed in Queensland may spend the whole of his time and income there and yet be deprived of those deductions because he is not domiciled there.

537. Where the places of residence and domicile are not the same, it is obvious that the test of domicile is improper. If, however, the real merit of the test rests in the identity of the places of domicile and residence in the great majority of cases, then it is a mere subterfuge to evade the provisions of the Constitution Act. Its application might be extended by a State to levy a special

rate of tax on the income derived from that State by persons not domiciled there, and so to effectuate some of the very discriminations which the framers of the Constitution sought to avoid. The considerations which operated to have Section 117 inserted in the Constitution Act apply with as much force to discriminations on the ground of domicile as to those on the grounds of residence, and it is significant that the Royal Commission on the Constitution recommended that the Constitution Act be amended so as to prevent discrimination on either ground. (Report of the Royal Commission on the Constitution page 260.)

538. Further, the average layman, who is expected to some extent to know and understand the laws which impose his taxes, will have considerable difficulty in appreciating the true meaning of domicile. He might fairly consider that he is domiciled, as he understands it, in the place where he resides, when, though this is normally the case, it may be clearly demonstrable in a particular case that it is not so. The determination of domicile will be found in many cases to rest on the intention of the person in respect of whom the inquiry is made. His own assertion of that intention (which may frequently be the only evidence of it) cannot be regarded as a satisfactory means of determining his taxation liability.

539. The determination of domicile will be a matter in many cases of great difficulty to the Department, and must inevitably cause confusion to and arouse the resentment of taxpayers. Where the onus of determining the domicile of its shareholders or of persons to whom it pays interest is thrown on a company, litigation is certain ultimately to arise as between the company and the Department, or as between the company and its shareholders or the persons to whom it pays interest. It cannot be regarded as reasonable that companies should be subjected to the burden of making the appropriate inquiries and drawing the appropriate conclusions to enable them to determine the domiciles of all their shareholders and debenture-holders.

540. Whatever considerations may be involved in other forms of taxation, it is considered that discrimination on the basis of domicile is not proper in income taxation and should be abandoned.

541. Another method of overcoming the constitutional difficulty is used to some extent under the provisions of the Acts of Queensland and South Australia. Where income is earned or derived during part only of a year, the total deduction is proportionately reduced. This principle is applied in Queensland to the allowances for wife, children and dependants, superannuation payments and life insurance. In respect of these allowances, it is additional to the requirement that the taxpayer be domiciled in Queensland. It is also applied in that State to the allowance of the statutory exemption, and in South Australia to the allowances for wife, children, dependants, and the statutory exemption.

542. This method of discrimination is subject to two objections. In the first place, it is inequitable to the local resident who by reason of unemployment, or for any other cause, earns or derives his income during part only of the year. He should not be deprived of his full allowances. In the second place, it is applied and apparently applicable only to incomes from personal exertion. Incomes from property or composite incomes may be and generally are earned or derived throughout the full period of twelve months, and, consequently, the deductions in question would be allowed in full in respect of such incomes.

543. To overcome the difficulty arising from the inability of the States to discriminate on the grounds of residence, we recommend, with regard to the statutory exemption and family concessional deductions, that where a taxpayer residing in the Commonwealth derives income from more than one State he should be allowed in each State a proportion of the appropriate deductions, arrived at by taking the ratio which his net income from that State bears to his total net income derived from all States. Net income for this purpose would be the amount of assessable income remaining after making all the deductions allowable except the family concessional deductions and the statutory exemption. This principle should be applied irrespectively of where the taxpayer resides, provided, of course, he resides in the Commonwealth.

544. With regard to interest paid by companies, we recommend that there be no discrimination between residents of Australia. Where the recipient of the interest is liable to tax in his individual capacity and defaults in payment, the company may be assessed as agent under the general provisions relating to agents. Interest paid by companies to absentees should be assessed in the manner described in Section XLIII.

545. With regard to dividends, the recommendation contained in paragraph 509 of this Report makes it unnecessary to insert in the Acts any special provisions with regard to the collection of tax on dividends paid to non-residents, as if that recommendation is adopted no such tax will be payable.

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SECTION XXX.
BUSINESS DEDUCTIONS.
GENERAL CONSIDERATIONS.

546. The provisions of all the Acts, so far as they relate to the deductions allowed from assessable income, are similar, though not identical. In every case certain deductions are specifically allowed and others are specifically disallowed. But as it is impracticable to specify every item of expense which is either deductible or disallowed, each Act contains a Section indicating generally the nature of the expenses which fall under either of those headings.

547. We shall, therefore, consider briefly the relevant general Sections relating to deductions contained in each Act. As the allowance and prohibitory Sections are complementary to one another, it is advisable to consider them together and to express in general terms their combined effect.

Commonwealth.

Allowed.—Losses and outgoings actually incurred in gaining or producing the assessable income.

Disallowed.—Money not wholly and exclusively laid out or expended for the production of assessable income.

New South Wales.

Similar to the provisions of the Commonwealth Act.

Victoria.

Allowed.—Losses and outgoings actually incurred in gaining or producing the assessable income.

Disallowed.—Any loss not connected with or arising out of the trade carried on, or any disbursements or expenses whatever not being money wholly and exclusively laid out or expended for the purposes of such trade.

Queensland.

Allowed.—Losses and outgoings actually incurred in Queensland in earning or deriving the assessable income.

Disallowed.—Any loss not connected with or arising out of the production of assessable income, or money not wholly and exclusively laid out or expended in earning or deriving the assessable income.

South Australia.

Allowed.—Losses and outgoings actually incurred by the taxpayer in the production of the income.

Disallowed.—Any loss or expense not proved to the satisfaction of the Commissioner or which, in the opinion of the Commissioner, ought not to be considered a loss, outgoing or expense incurred by the taxpayer in the production of the income, and also any moneys not wholly and exclusively laid out or expended for the purposes of the trade.

Western Australia.

Allowed.—Losses and outgoings actually incurred in Western Australia by the taxpayer in the production or protection of assessable income.

Disallowed.—Disbursements not wholly and exclusively incurred in the production of the assessable income of any trade, &c.

Tasmania.

Allowed.—Losses and outgoings actually incurred by the taxpayer in the production of his income.

Disallowed.—Disbursements or expenses of any kind not wholly and exclusively incurred in the production of the assessable income.

548. The extraordinary diversity in language is worthy of comment. The expression "losses and outgoings" is common to the allowance Section of each of the Acts, but the phrases "gaining or producing," "earning or deriving," "production of the income" are all to be found in Sections having a similar import. But when we consider the prohibitory Sections the variety of expressions used is much greater. According to the particular Act, the disallowance applies to expenses incurred in the "production of assessable income," "purposes of the trade," "purposes of the business," "production of the income" or "carrying on or conduct of the business."

549. But notwithstanding this difference in language, we find that there is a considerable degree of uniformity in the manner in which these deductions are allowed in practice in the Commonwealth and States. If, therefore, all administrations substantially reach the same end, there is no good reason why the Sections of the respective Acts should not be expressed in identical terms. The advantages of uniformity in this respect both to the Department and to the taxpayer are obvious.

550. At this stage it is important to point out the significance of the difference between the Income Tax legislation of Great Britain and that of the Commonwealth and of the States. The British Act does not deal with the assessable income of a trade or business, but only with "the full amount of the profits or gains," and, generally speaking, does not specify allowable deductions but only those which are prohibited. The relevant words are to be found in rule 3 (cases I. and II.) of Schedule D, and are as follow :—

"In computing the amount of the profits or gains to be charged no sum shall be deducted in respect of—

(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation ;

(c) any loss not connected with or arising out of the trade, profession, employment or vocation."

But the Acts of the Commonwealth and the States in every case bring into account the assessable income, and, as we have already said, indicate generally, and to some extent specifically, what deductions therefrom either may be allowed or are disallowed. When an Act contains Sections which both allow and disallow, there is always a risk that their scope may either fail exactly to meet or may overlap, and, in our opinion, that is undoubtedly the case in the Acts of some of the States. This is another reason why the provisions of the various Acts which relate to deductions should be identical.

551. We received a great deal of evidence in regard to the deductions allowed in respect of a trade or business. Broadly speaking, witnesses representing commercial interests considered that the scope of the Act in regard to these should be enlarged. The most extreme view expressed was that the admissibility of a deduction should be determined by the custom of accountants. The witness who expressed this opinion apparently shut his eyes to the fact that accountants have not yet been able to agree on the ascertainment of net profit, and that profits are therefore not capable of being determined by the application of a rigid rule. That test is impracticable. Other witnesses took a more reasonable view, and asked that all business expenses should be allowed as deductions, having in mind expenses which, while not increasing the assessable income, reduce the expense of earning it, and, therefore, add to the "taxable" income. On the other hand, official witnesses were unanimously of the opinion that the provisions of the Act should not be widened.

552. In the majority of cases it is not difficult to decide whether a deduction is allowable. But there are border line cases where it is not easy for the taxpayer to prove that the deduction complies exactly with the test imposed by the relevant Act. For example, it may be difficult, or even impossible, to prove that the expenditure was incurred for the purpose of "gaining or producing" assessable income, though it may be clear that it was incurred for the purposes of the business, or that it will reduce losses and outgoings in future years and thereby result in an increase in the taxable or net income. It is in connexion with expenses of this nature that most of the difficulties arise.

553. It is obvious that no Act can specify all the deductions that ought to be allowed. "No degree of ingenuity can frame a formula so precise and comprehensive as to solve at sight all cases that may arise." "What is allowed in one business could not be allowed in another ; what is wholly extraneous in one business may be germane to another." It follows, therefore, that the allowance or disallowance of the specific expenditure must be decided as a matter of fact in each case, in the first place by the administrator, but in the last resort by the Courts, and it may be noted that several decisions recently given by the High Court have had the effect of extending the departmental interpretation of the expression "incurred in gaining or producing the assessable income." (See *Gordon v. Federal Commissioner of Taxation* 43 C.L.R. 456 ; also *The Herald and Weekly Times v. Federal Commissioner of Taxation* 48 C.L.R. 113.) The decision in the former case established the principle that money expended, not of necessity but voluntarily, and to secure an expedient aid to the business operations which produce the assessable income, may yet be expended wholly and exclusively for the production of assessable income and, therefore, be allowable as a deduction. To quote Rich, J., in the judgment in this case—"It

is a very narrow and unworkable view of Section 25 (e) of the (Commonwealth) Income Tax Assessment Act which disqualifies an expenditure which produces or aids in the production of assessable income, i.e., revenue, because incidentally and accidentally it may aid in the curtailment of expenditure."

554. The problem, therefore, is to draft Sections relating both to the allowance and disallowance of deductions which will make it clear that the taxpayer is entitled to claim any expenditure properly incurred by him in the production of his income, whether derived from a trade or otherwise, without at the same time opening the door so wide as to permit the allowance of deductions for which there is no justification. This might, perhaps, be accomplished by means of a Section under which the taxpayer would be allowed as deductions all losses and outgoings incurred in gaining or producing the assessable income, or in carrying on a business for the purpose of gaining or producing such income; with a proviso or limiting Section excluding the right to deduct any losses or outgoings of capital, or losses or outgoings incurred in relation to the gaining or production of income exempt from tax.

555. In some of the Acts we find that certain expenditure is allowed as a deduction which is neither a concessional deduction in the accepted meaning of that term nor an expense incurred in gaining or producing the income. Deductions of this nature are not numerous, nor do they result (except, perhaps, in one or two instances) in much benefit to the taxpayer, or involve much cost to the Revenue. Some of them are intended to benefit certain industries which are subject to natural disabilities, necessitating expenditure of a capital nature. Others appear to have been conceded to certain classes of taxpayers without any logical justification. In our opinion deductions which fall into either of these categories should not find a place in an Income Tax Act. As none of these deductions is allowed by all Governments, and some of them are allowed by one Government only, we are not prepared to advocate or recommend their general adoption by all.

DEPRECIATION.

Basis of Allowance.

556. Under the Commonwealth Act the depreciation allowance is either on the prime cost or diminishing cost method, at the option of the taxpayer. In all States, except Western Australia and Tasmania, both methods are allowed. In Western Australia the prime cost method only is permitted, whilst in Tasmania the basis is diminishing cost. The diminishing cost basis is easy to apply, and is applied in the majority of cases. There are, however, certain types of plant where the prime cost method is more suitable, and the method is sufficiently availed of to warrant its continuance.

557. We recommend that in the Commonwealth and all States taxpayers be permitted to adopt either the prime cost or diminishing cost basis of depreciation.

Rates of Depreciation.

558. The evidence in regard to the adequacy of the rates allowed was fairly equally divided. Some witnesses considered that the rates allowed under the Commonwealth Act were satisfactory, whilst others considered that they were too low. We may point out, however, that the rates are fixed by the Commissioner and not prescribed in the Act, and that any adjustment found to be necessary can be made by an Administrative Order without an amendment of the Act.

559. The Commonwealth and some of the States allow the taxpayer to claim any loss made by him when an asset subject to depreciation is sold or scrapped. The measure of that loss is the difference between the depreciated value of the asset and the amount obtained for it; conversely, if an asset is sold for an amount which exceeds its depreciated value the surplus or profit, to an extent not exceeding the depreciation previously allowed, is taxable. In these circumstances it is clear that the annual allowance for depreciation is not of so great importance. If it is too high it will merely reduce the loss which results when the asset is sold or scrapped, or, conversely, increase the profit arising when it is sold.

560. The effect of the allowance of loss on disposal of plant is therefore to provide to some extent for the allowance of a deduction for obsolescence so far as that course is practicable in an Income Tax Assessment Act, and as the taxpayer is entitled to the allowance of the full cost of the asset it is considered that the restriction to "wear and tear" should be eliminated from the Section, and that the rates should be adjusted so as fairly to spread the depreciation allowance over the estimated life of the plant, and to include depreciation of plant held in reserve if such plant has been used.

561. Witnesses commended the practice of the Commonwealth Department in publishing schedules of the rates of depreciation fixed by the Commissioner. It was suggested, however, that these schedules might be simplified and summarized in a smaller number of groups or classes, and that, where possible, a flat rate of depreciation be fixed on the whole of the plant and machinery in a business, in place of differing rates for the various portions of the plant.

562. Witnesses were definite in their views that a uniform schedule of depreciation should be used by the Commonwealth and all the State Income Tax authorities. Whilst there is at present a certain measure of agreement between Commonwealth and State rates, many instances exist in which differing rates are allowed. This variation is confusing and a source of vexation to taxpayers.

563. It should not be difficult for the Commonwealth and States to arrange to use identical rates of depreciation in all cases, but this will not for the time being result in a uniform deduction from the profits of each year, because capital values upon which depreciation is computed frequently differ for Commonwealth and State purposes. If complete uniformity is to be obtained these values must be reconciled. We suggest that this might be done in a manner similar to that adopted by the South Australian Income Tax Department a few years ago, on the occasion of the introduction of a new basis for the allowance of depreciation. Any difference which may exist in the depreciated value of plant upon which depreciation is calculated for Commonwealth and State purposes should be adjusted over a period of ten years by equal annual allowances. The result of this adjustment would be to reduce plant values to the lower amount.

564. We recommend—

- (1) That uniform rates of depreciation be adopted by the Commonwealth and all the States ;
- (2) That the schedule of rates at present used by the Commonwealth be simplified ;
- (3) That any difference in plant values for Commonwealth and State purposes be adjusted by equal allowances over a period of ten years, in the manner described.

Depreciation of Buildings.

565. The Commonwealth Act allows depreciation on fences, dams and other structural improvements on land owned and used by a person carrying on agricultural or pastoral pursuits, and also (although not expressed specifically in the Act) on buildings which form integral parts of manufacturing plant and machinery. Queensland allows depreciation on any buildings used for the purpose of earning income, and depreciation is also allowed on bores, wells, dams or fences. None of the other States allow depreciation on buildings.

566. We received many requests that depreciation on buildings should be allowed in all cases. There are many buildings, however, which with repairs and maintenance, all of which are of course allowed as deductions, will last for hundreds of years. There is the further consideration that many substantial buildings in good localities have not depreciated in value—on the contrary the property as a whole has appreciated owing to an increase in values of the sites on which the buildings stand.

567. If depreciation on buildings were allowed it would be necessary to make it very clear that a loss arising on the sale or demolition of a building could not be claimed as a deduction. The reason is that it would be difficult, if not impossible, to ascertain how much of that loss related to the cost of the building, and how much was due to an alteration in capital values due to other circumstances which are not covered by an allowance for depreciation.

568. If depreciation is to be allowed, we consider that it should be restricted to buildings used to house plant employed in the production of income, and then only when it can be shown that the use of the plant affects the life of the building. In effect this brings us back to the present Federal practice of the allowance for depreciation in respect of buildings forming an integral part of plant.

569. We recommend that depreciation on buildings be restricted to buildings forming an integral part of the plant, and that it be allowed by the Commonwealth and all States.

Wasting Assets.

570. The Income Tax Acts of all the Governments prohibit the allowance of deductions in respect of capital expenditure. To some extent this principle is departed from in the Acts of the Commonwealth and some of the States, which allow expenditure upon mining operations. The premium paid for a lease may also be regarded as a wasting asset, but the Acts of the Commonwealth and of some of the States permit this expenditure to be recouped by deductions from income.

571. It was suggested by many witnesses that a deduction from income should be allowed in respect of the diminution in value of other wasting assets, particularly those which decrease in value by exhaustion. After careful consideration of those suggestions we find ourselves unable to recommend that they be accepted. We do not think that the allowance granted in respect of depreciation should be enlarged to such an extent as to allow an annual deduction that will provide in due course for the eventual recoupment of capital expenditure incurred in the acquisition of a wasting asset.

572. We recommend, therefore, that the existing provisions of the Commonwealth Act in regard to the allowance made in respect of capital expended in the acquisition of a wasting asset be not enlarged and that a similar principle be followed in each State.

BAD DEBTS.

573. Allowance in respect of bad debts is granted in the Act of the Commonwealth by Section 23 (1) (r), which allows as a deduction debts actually written off as bad debts during the year in which the income was derived to the extent that it is proved to the satisfaction of the Commissioner that such debts are bad debts and are in respect of (i) amounts which have been brought to account as assessable income by the taxpayer in his return for any year; or (ii) money lent in the ordinary course of the business of the lending of money by a person who carries on that business, provided that any amount received at any time in respect of any such bad debt shall be brought into account as income in the year in which that amount is received.

574. The provisions of the State Acts are similar, though not identical, except that in New South Wales a bad debt is not allowed as a deduction if the transaction in respect of which it arises occurred more than six years previously. Subject to this exception, we think that the practice of the Commonwealth and States is, generally speaking, uniform.

575. We recommend that the provisions of Section 23 (1) (r) of the Commonwealth Income Tax Assessment Act be retained and that a similar Section be inserted in the Act of each State.

RATES AND TAXES.

Municipal and Water Rates.

576. Some of the Acts allow all such rates annually assessed, irrespective of whether the land was used for the production of income or otherwise. In other States the allowance is made only if the property in respect of which the rates were paid produced income.

Land Tax.

577. Commonwealth Land Tax is allowed as a deduction by the Commonwealth and all States, and State Land Tax is also allowed by all Governments, excepting South Australia. The same distinction is made as in respect of Municipal and Water rates, namely, that in some cases the allowance is restricted to tax paid on land used for the production of income or in respect of income derived from it.

578. We recommend that the deductions allowed in respect of Municipal and Water Rates and Land Tax should be granted only when they are paid in respect of property used for the production of income and in accordance with the general test recommended in paragraph 554.

State Income Tax.

579. State Income Tax is allowed as a deduction for Commonwealth purposes, and we recommend that this allowance should be continued.

Commonwealth Income Tax.

580. We received many requests that Commonwealth Income Tax should be allowed for the purposes of both Commonwealth and State Income Tax. Commonwealth Income Tax is not allowed as a deduction by the Commonwealth, and is allowed as a deduction for State purposes in one State only (Western Australia). In this State the deduction is allowed to individuals but not to companies.

581. We are not prepared to recommend that Commonwealth Income Tax should be allowed as a deduction either for Commonwealth or State purposes. If this concession were allowed by the Commonwealth it would merely mean that an increased rate of tax would have to be imposed upon the residue of income, so that in the long run the taxpayer would probably not benefit. If it were allowed for State purposes the yield of State Income Tax would be so materially diminished as to compel the States to completely revise their existing rates. For that reason alone we consider the proposal to be impracticable. Further, as uniformity is sought the concession should be discontinued by the only State which now allows it.

TRADE SUBSCRIPTIONS.

582. The Commonwealth Act provides for the deduction of subscriptions to trade or professional associations if the carrying on of a calling from which assessable income is derived is conditional upon membership of the association, or if the association carries out activities the expense of which would be an allowable deduction if carried out by the member on his own behalf. In the latter event the member is entitled to a deduction of only so much of his subscription as bears to the whole subscription the same proportion as the outgoings incurred by the association in carrying out that activity bear to the total outgoings.

583. There are no provisions in the Acts of Victoria, Western Australia and Tasmania which specifically allow subscriptions paid to trade or professional associations, but each case is considered on its merits, and to some extent the Commonwealth practice is followed. The New South Wales Act provides for the deduction of amounts paid to any bona fide industrial union of employers and employees, trade or professional association or agricultural society approved by the Commissioner, but not exceeding £50 to each respectively. The Queensland Act provides for a similar allowance, deduction being limited, however, to £10 10s. to each association respectively. In South Australia a deduction is not permitted unless the carrying on of a calling is conditional upon membership of the association.

584. A number of witnesses considered that the dissection of subscriptions referred to in paragraph 582 could be dispensed with if a more liberal view were taken of expenditure under this heading. A view generally expressed was that the whole of the subscription paid to an association having objects which suggested that membership was of value to the taxpayer should be regarded as an expense of his business and allowed in full as a deduction.

585. To some extent this request might be met by allowing as a deduction subscriptions not exceeding a certain maximum amount in each case as provided in the Acts of New South Wales and Queensland. The adoption of this suggestion would make it unnecessary to allocate subscriptions in the manner previously described, and it would be simple and certain in its application. It is, however, open to two objections, the first being that a deduction might be obtained which would not be granted if the services performed by the Association were performed by the member, and the next that the allowance of an arbitrary amount might in some cases be wholly inadequate. For these reasons we do not think that the allowance for subscriptions should be limited to a fixed maximum amount. In our opinion a preferable solution would be to allow to the taxpayer as a deduction in full any subscription made by him to a Trade Association in those cases where the principal activities of the Association during the year of income are of such a nature that, if carried out by the taxpayer on his own behalf, the expense would be an allowable deduction to him. Where the principal activities of the Association are not of that nature no portion of the subscription should be allowed as a deduction.

586. We recommend that subscriptions by a taxpayer in the year of income in respect of the membership of an Association should be allowable deductions—

- (1) where the carrying on of a business or the exercise of a vocation from which assessable income is derived is contingent upon such membership, or
- (2) where the principal activities of the Association during the year of income are of such a nature that if carried out by the taxpayer on his own behalf the expense of those activities would be an allowable deduction to him.

PREMIUMS PAID ON A FIDELITY GUARANTEE OR BOND.

587. Premiums paid in respect of any Fidelity Guarantee or Bond which the taxpayer is required to provide in the exercise of his business are undoubtedly an expense incurred in gaining or producing the income. These premiums are specifically allowed as a deduction in the Acts of the Commonwealth and all the States except South Australia and Tasmania but there is a limitation of the amount allowed.

588. We recommend that a deduction be allowed for premiums paid in respect of any Fidelity Guarantee or Bond which a taxpayer is required to provide in the exercise of his business, without limitation of the amount paid.

CONTRIBUTIONS BY AN EMPLOYER TO FUNDS FOR THE BENEFIT OF EMPLOYEES.

589. Sums paid by an employer to provide benefits for employees are allowed as a deduction under the Acts of the Commonwealth, New South Wales, Victoria and Queensland. The conditions are not exactly the same. Under the Commonwealth Act the contributions are allowed only if they are for the benefit of resident employees. Except in the case of Victoria the payments must be out of assessable income.

590. We recommend that sums paid by an employer to funds for the benefit of employees who are residents be allowed as a deduction up to the amount of the net income of the year.

WIRE OR WIRE-NETTING.

591. The Commonwealth Act permits the taxpayer carrying on agricultural or pastoral pursuits in a district subject to the ravages of animal pests to deduct the cost of erecting or altering fencing to prevent animal pests entering upon the land used by him in the production of assessable income. Queensland allows the cost of erecting, but not of altering, fencing for this purpose. A like concession is not allowed under any of the other State Acts, though in Western Australia the cost of fencing of this nature is allowed, because of the inclusion of the word "protection" in the Section relating to deductions.

592. The value of the concession is not as great as it would appear to be. In effect, it means that the taxpayer in question is relieved from tax upon the difference between the cost of an ordinary fence and the cost of a vermin proof fence. This requires intricate dissection of such expenditure.

593. In our opinion, expenditure of this nature is capital expenditure, and, as such, is not a proper deduction for the purposes of Income Tax, and we do not recommend that a Section similar to that contained in the Commonwealth and Queensland Acts should be included in the Uniform Act.

ERADICATION OR EXTERMINATION OF ANIMAL OR VEGETABLE PESTS, ETC.

594. The Commonwealth Act allows as a deduction from income the cost of eradicating or exterminating animal or vegetable pests from land, also the cost of clearing, grassing, or draining land, when that operation improves the agricultural or grazing value of the land. None of the State Acts, except that of Queensland, contain provisions which specifically allow this expenditure, but in most of them such expenditure is allowed as a deduction when it is of an annual or recurring nature. The provisions of the Commonwealth Section quoted appear to be too wide, and we see no reason for allowing as a deduction from income expenditure which improves the value of the land. Obviously, that can only be regarded as capital expenditure.

595. In our opinion, the correct test is that applied by the States, other than Queensland. We recommend that where the expense is of an annual or recurring nature it be allowed as a deduction as an expense incurred in gaining or producing assessable income.

MISCELLANEOUS DEDUCTIONS.

596. We received many requests that more liberal allowances should be made in respect of certain other expenditure, as, for example, legal expenses and interest. It is impossible to specify all the items of expenditure that are allowable as a deduction, and we think, therefore, that the admissibility of any amounts expended under these headings should be decided by the application of the principle laid down in paragraph 554 and that if they comply with that test they should be allowed as a deduction from income, and not in any other circumstances.

SECTION XXXI.

CONCESSIONAL DEDUCTIONS.

GENERAL CONSIDERATIONS.

597. The concessional deductions allowed by the various Acts may be divided into two groups—

- (a) Those which are granted in recognition of the domestic responsibilities of the taxpayer, as, for example, for the maintenance of wife and children or dependants; the education of children; life assurance premiums or deferred annuities; contributions to superannuation funds, and medical and funeral expenses.
- (b) Others, as, for example, gifts and donations to charities; donations to research funds; and calls on shares.

598. The relevant provisions of the various Acts in respect of concessional deductions included in the first group vary in three respects, namely :—

- (a) The nature of the concession.
- (b) The conditions which entitle taxpayers to a deduction of the same nature.
- (c) The amount allowed.

These differences are set out in detail in Appendix 7.

599. The differences in the *nature* of the concession are probably due in part at least to the requirements of the Revenue, particularly in the less wealthy States, though in some cases they may be attributed to the exercise of political or sectional influence. It should, however, be possible to arrive at agreement by reasonable compromise.

600. The differences in the *conditions* which entitle taxpayers to a specific deduction are the least important, and it should be possible to bring these into agreement without difficulty.

601. The differences in the *amounts* allowed for each deduction are also due in part at least to Revenue considerations. While it is hoped that uniformity in this respect may be attained, the practical difficulties are recognized.

602. Social conditions throughout Australia do not differ greatly. It is difficult, therefore, to justify logically the allowance of varying concessional deductions by the Commonwealth and State to the same taxpayer.

603. The influence of these concessional deductions upon complexity is probably out of proportion to their effect upon Revenue. It should not be forgotten that the measure of relief to the taxpayer and, of course, the cost to the Revenue in each case is not the amount of the deduction, but only the tax upon that amount, which is usually not considerable. These deductions affect the great majority of taxpayers, and absence of uniformity in regard to them accounts for many of the differences which occur in the joint returns used in each of the States, and for many of the complexities which confuse the taxpayer. For that reason we suggest that it is desirable that all Governments should agree upon the nature, conditions, and amount of each concessional deduction, even if that results either in some loss of Revenue, or, alternatively, compels a slight revision of rates. The adoption of this suggestion would also result in a more equitable distribution of the incidence of taxation.

604. In our opinion there are certain general considerations which should apply to all concessional deductions. They are—

- (1) The deduction should be allowed irrespective of the amount of the income. In some cases both in the Commonwealth and States the allowance is limited to taxpayers whose income does not exceed a stated amount. If the allowance is justified we consider that it should be granted in all cases. In this connexion we quote from paragraph 270 of the Report of the Royal Commission on the Income Tax, Great Britain (1920):—

“The amount of tax on the allowances may be a negligible quantity in the budget of a very rich man, but it is certain that it is an item worth consideration to taxpayers with incomes far higher than those to which the allowances now apply, and we think that the recognition of these family obligations should have a place in the Income Tax scheme in regard to all incomes of whatever amount. It seems to us evident that the bachelor with £5,000 or even £10,000 a year should be taxed more than a married man with a family who has the same income, and we recommend that family allowances should apply to all incomes of whatever amount.”

- (2) Each allowance should be limited to a maximum amount. This principle is recognized in the case of all concessional deductions other than medical expenses, and contributions to certain Superannuation Funds in the State of Queensland. It is difficult, therefore, to justify an exception in the cases mentioned.
- (3) For Commonwealth purposes the deduction should be allowed only to individual resident taxpayers. The concessional deduction allowed by a State should be allowed in full only to an individual taxpayer residing in Australia who derives the whole of his income from sources within that State. Where the taxpayer derives income in more than one State, he should be allowed in each State that proportion of the deduction which his net income from that State bears to his aggregate income subject to State Income Tax. The reasons for this condition are set out in Section XXIX.
- (4) It should not be a condition that a wife, child or dependant should reside within the jurisdiction of the taxing authority to entitle the taxpayer to a deduction for their maintenance.
- (5) A deduction allowed to a husband in recognition of his domestic responsibilities should be allowed to a widow or wife who has the responsibilities of the husband, due provision being made to prevent a deduction both to the husband and the wife in respect of the same expenditure.

605. We set out hereunder our recommendations in regard to each of the concessional deductions allowed under the various Acts. We recognize that agreement on each of them can be arrived at only as the result of compromise and with due regard to existing practice and the requirements of the Revenue. We consider that we are not called upon to recommend specific amounts to be allowed under each heading, but rather that that is a matter for the Governments to decide. Subject to the general considerations set out in the preceding paragraph we suggest the following conditions for each of the concessional deductions :—

WIFE.

606. The allowance should be made when the wife is wholly maintained by the taxpayer. A wife should be deemed to be wholly maintained by her husband if her private income does not exceed £100 per annum.

CHILDREN.

607. The allowance should be made in respect of each child under the age of sixteen years wholly maintained by the taxpayer.

THE EDUCATION OF CHILDREN.

608. This is allowed only in New South Wales and Queensland, and then only when there are no suitable facilities provided by the State within reasonable daily travelling distance. We appreciate and sympathize with the motive underlying this allowance, but we suggest that the Income Tax Act is not the place in which to give effect to it. We consider that any concession that is made to a taxpayer for whose children the State does not provide suitable educational facilities should be given through the Education Department of the State, and not indirectly as a concession of tax. This would be of more value to the individual who has no taxable income.

DEPENDANTS.

609. Concessions in respect of dependants are not allowed by the Commonwealth, Victoria and Tasmania. In the other States, the conditions vary and in some cases are more liberal than in others. We are not prepared to recommend that the expression "dependant" should be too liberally construed, but think rather that it should be limited. It is not possible in any scheme to adjust taxation so closely as to take into consideration the purely personal obligations of each taxpayer. We suggest, therefore, that a concession should be allowed only in respect of a female relative wholly maintained by a widower, for the purpose of caring for his child or children under sixteen years of age.

LIFE ASSURANCE PREMIUMS, CONTRIBUTIONS TO SUPERANNUATION FUNDS, AND THE LIKE.

610. In some cases a separate allowance is made for each of these contributions. In others only one is recognized. All these payments should be aggregated and treated as one allowance, with a fixed maximum, which should cover—

- (a) premiums paid on a policy of assurance on the life of a taxpayer or that of his wife or children effected with a company carrying on business in Australia ;
- (b) payments to a Superannuation Fund, established in Australia, for the benefit of the taxpayer or his wife or children ;
- (c) contributions to a Friendly Society registered in any State of the Commonwealth.

MEDICAL EXPENSES.

611. The deduction should cover sums paid, not exceeding a fixed maximum, to a legally qualified medical practitioner, hospital, nurse or chemist, in respect of the taxpayer, his wife, or children under the age of 21 years. We are not prepared to recommend that the concession should be extended to include sums paid to a dentist, as this deduction is allowed only by one Government.

FUNERAL EXPENSES.

612. It is questionable whether expenses of this nature should be allowed as a deduction, but, having regard to the fact that they are allowed by the Commonwealth and the three largest States, we do not feel justified in recommending the discontinuance of this deduction. If allowed, the deduction should cover sums paid, not exceeding a fixed maximum, for funeral, burial and cremation expenses of the taxpayer, his wife, or children under the age of 21 years.

613. There remain for consideration the concessional deductions included in the second group of paragraph 597.

GIFTS AND DONATIONS TO CHARITABLE INSTITUTIONS.

614. Some witnesses asked that all gifts and donations *up to the amount of* the income of the year should be allowed and not merely those made *out of* the assessable income. It was claimed that a gift to charity is not usually decided upon with any immediate reference to the question whether assessable income, exempt income, or capital funds are to be used for that purpose. It may be more convenient at the moment for the donor to dispose of part of a capital asset in order to make the actual donation. We think that the donor to whose mind the question of a deduction for income tax purposes did not occur until after the gift was made should not be penalized on that account.

615. The effect of the majority decision of the High Court in the recent case of *Symon v. Federal Commissioner of Taxation* (47 C.L.R. 538) is that where a payment is made out of a mixed fund a taxpayer is entitled to regard payment as coming out of that part of the fund which produces the most beneficial results to him in the matter of taxation, so that a donation from a fund consisting partly of *assessable* and partly of *exempt* income would be allowable in full up to the extent of the *assessable* income. The decision would not cover a gift of capital, however, even if the assessable income of the year exceeded the amount of the gift, so that the gift could have been appropriated by the taxpayer out of such income. To meet such cases we consider that gifts made to charitable institutions as defined should be allowed as a deduction up to the amount of the net income of the year.

616. At the present time the Acts of those Governments which permit the deduction of gifts in kind stipulate that the gift shall have been purchased out of assessable income of the year in which it is made. We think this principle should still be observed to this extent, that a gift in kind should be allowed only if it can be shown that it was purchased during the year of income, for in that case the expenditure, irrespective of the source from which it is taken, has, in fact, reduced the spendable income of that year.

617. We think it not unreasonable that a deduction for gifts and donations should be allowed only in those cases where the charitable institution carries on its functions within the jurisdiction of the taxing authority. In that event the Commonwealth would allow deductions to a charitable institution (as defined) in Australia, and each State would allow donations to similar institutions within the State.

618. We recommend—

- (1) That a deduction be allowed for gifts of £1 and upwards made during the year of income (but not exceeding the net income of the year) to charitable institutions (as defined) which carry on their functions within the jurisdiction of the taxing authority.
- (2) That, subject to the preceding paragraph, gifts in kind be allowed as a deduction only if purchased during the year of income.

DONATIONS TO RESEARCH.

619. The Commonwealth Act allows as a deduction donations out of assessable income made to a public authority engaged in research into the causes, prevention, or cure of disease in human beings, animals, or plants. None of the States, except Western Australia, specifically allow deduction of such contributions, and no general request was made by witnesses for the concession in those States in which it is not at present allowed. **However, having regard to the social value of such contributions, we recommend that they be allowed as a deduction by all Governments.**

CALLS ON SHARES.

620. The Commonwealth, Victoria and Queensland allow a deduction of amounts paid out of the assessable income, in the form of calls to companies carrying on certain mining operations. The Commonwealth and Queensland also allow similar payments to companies which carry on the work of afforestation. Victoria also allows calls paid to companies in liquidation. **In our opinion none of these payments should be allowed as a deduction in arriving at the taxable income.**

THE APPORTIONMENT OF CONCESSIONAL DEDUCTIONS.

621. In Section XII. of our Report we recommended that the concessional deductions allowed under the Commonwealth Act should be deducted in the first place from income from personal exertion, any excess over that income being deducted from income from property. Generally speaking, this is the practice adopted by the States. **To obtain uniformity we recommend that the method of apportionment which we have recommended for the Commonwealth in paragraph 188 be adopted by each State.** For the reasons stated, the adoption of this recommendation would cause very little alteration in the present practice of the States.

SECTION XXXII.

THE STATUTORY EXEMPTION.

622. The Act of every Australian Government allows to an individual resident taxpayer, and in some instances to an absentee, whose income does not exceed a specified amount, a deduction which is known as the statutory exemption. If the income exceeds the amount specified, the allowance diminishes progressively until it vanishes. In our opinion the principle of progressive diminution is just, and we do not recommend any change in the common practice in that respect.

623. As the maximum allowance and the rate at which it diminishes materially affect the yield of tax, both these factors must be taken into consideration by a Government when fixing its Revenue requirements. It is probably for that reason that there is no uniformity in regard to either of them, nor do we think that uniformity is possible. Nor is it essential, for the calculations required to determine the allowance are made during assessment, and not by the taxpayer when preparing his return. While, therefore, each Government should retain the right to fix the maximum statutory exemption and the rate at which it shall diminish, we think that uniformity might be reached on the following matters :—

- (1) That there should be no difference in the statutory exemption allowed on incomes of the same amount, whether that income is derived from personal exertion or from property, or in part from either of these sources.
- (2) That abatement should be effected in the same manner in all cases.
- (3) That there should be no differentiation in the amount allowed on account of the domestic obligations of the taxpayer as these should be recognized in the allowance for concessional deductions.
- (4) That the deduction should be made in the first place from income from property, as recommended for the Commonwealth in paragraph 181.
- (5) For Commonwealth purposes the deduction should be allowed only to individual resident taxpayers. The statutory exemption allowed by a State should be allowed in full only to an individual taxpayer residing in Australia who derives the whole of his income from sources within that State. Where the taxpayer derives income in more than one State, he should be allowed in each State that proportion of the deduction which his net income from that State bears to his aggregate income subject to State Income Tax. The reasons for this condition are set out in Section XXIX.

SECTION XXXIII.

THE CARRYING FORWARD OF LOSSES.

624. There is a variance in the practice of the Commonwealth and States in regard to the allowance of losses incurred in a prior year. We summarize the relevant provisions of the various Acts. It should be noted that these differ not only in regard to the nature of the loss which may be recouped and the time allowed for its recoupment, but also in regard to the form of the words used to give effect to the intention.

The Commonwealth allows the deduction of a loss sustained by a taxpayer in carrying on a business in any of the four years next preceding the year in which the income was derived.

New South Wales allows the deduction of a business loss from the income of the two succeeding years.

Queensland allows the deduction only of a loss sustained by a taxpayer from agricultural, dairying or grazing pursuits out of the income of the five succeeding years, but in the case of a grazier the allowance is limited to £1,000.

South Australia has recently amended its Act to allow a loss sustained by a taxpayer deriving income from agricultural or pastoral pursuits during the taxation year 1932 to be carried forward as a deduction from the income derived from the same pursuits during the succeeding year.

Western Australia allows an individual taxpayer to deduct a net trading, prospecting or business loss incurred during the two years preceding the year of income, and also net losses arising over a like period from a loss of stock-in-trade, crops and live-stock due to droughts or other circumstances or conditions over which the taxpayer had no control or against which he was unable to protect or insure himself. This concession is not allowed to companies.

Victoria and Tasmania do not allow the deduction of losses incurred in any year preceding the year of income.

The proposals we received on this item may be summarized under three headings :—
That the Concession should be extended to cover the allowance of any losses which if they were profits would be taxable.

625. It was claimed that a taxpayer who invests his money in real estate for the purpose of producing income should not be in a worse position than one who invests his money in a business in which a loss is incurred. We think that this claim is reasonable, and that taxpayers in this category should be allowed the excess of expenditure incurred in the production of assessable income over the amount of such income.

That in calculating the amount of the loss to be carried forward exempt income should not be taken into account.

626. Witnesses, generally, took strong exception to the practice of recouping losses first from exempt income, and claimed that this materially reduces the value of the concession. To follow the suggestion to its conclusion no exempt income should bear any loss, which was the original position under the Commonwealth Act. But cases were discovered where there was substantial ability to recoup losses or part of them from exempt income, and it was considered that the concession, while not perhaps being abused, was being given too wide an application, and that the exempt income should at least bear a portion of the loss. The concession was, therefore, limited. In all modern systems of taxation much importance is placed upon ability to pay. The allowance of losses is a recognition of this principle, inasmuch as a person who has had to use his income to recoup losses of previous years is not in as good a position to pay tax as the person who has not sustained a loss or who has received exempt income which recoups his loss. Persons in receipt of exempt income have already had the benefit of not being taxed on it, and in our opinion it is not unreasonable to stipulate that they should not receive a further concession at the expense of the general taxpayer by ignoring this exempt income when considering the deduction to be allowed for losses they have sustained.

627. In one respect, however, it appears to us that the taxpayer is not treated quite fairly. The present practice of the Commonwealth is to regard the full amount of exempt income derived from ex-Australian sources as available to recoup allowable losses. Now it is clear that all that is available is the net income after deduction of the tax paid abroad, and we think, therefore, that only the net income derived from ex-Australian sources should be taken into consideration for this purpose.

That there should be no time limit within which a loss should be recouped.

628. We are not prepared to recommend this. In our opinion the concession should be limited. The period allowed in the Commonwealth Act is reasonable, and should meet all but exceptional cases.

629. We recommend—

- (1) That the taxpayer be permitted to deduct from the income of any year a loss sustained by him in any of the four years next preceding the year in which the income was derived.
- (2) That a loss so allowed should be the excess of expenditure incurred in the production of assessable income over the amount of such income.
- (3) That the deduction should be made in the first place from the net exempt income derived by the taxpayer.
- (4) That a similar concession be allowed by each State.

SECTION XXXIV.

AVERAGING OF INCOME.

630. Averaging may be applied in either of two ways—to determine either an average amount to be taxed as the income of a year or a rate at which the actual income is to be taxed. The difference may be illustrated by a simple example showing the annual income for two taxpayers over a period of five years.

					A. £		B. £
First Year	..	..	..	..	500	..	600
Second Year	800	..	1,200
Third Year	1,200	..	800
Fourth Year	1,600	..	900
Fifth Year..	900	..	1,500
					<hr/> 5,000	..	<hr/> 5,000

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If the first method be used both A. and B. will be taxed in respect of the fifth year on their average income of £1,000 although A. actually received £900 and B. £1,500. If the second method be used A. will be taxed on an income of £900 and B. on an income of £1,500 in each case at the rate of tax applicable to an average income of £1,000.

631. Great Britain formerly taxed the incomes of certain classes of taxpayers by the first method, on an average period of three, five, or seven years as provided by the Statute. But the *Finance Act* 1926 virtually abolished the use of averaging as a measure of assessability, and substituted the profits of the year preceding the year of assessment except as regards a limited number of unusual types of income. Commonwealth tax is based on the second method, and the income of the year preceding the year of assessment is taxed at an average rate based on the incomes of the five years preceding the year of assessment.

632. Wherever the expression "averaging" is used by us, it must be understood to mean the averaging of income for the purpose of determining the rate of tax. This method of determining the rate of tax was introduced in the Commonwealth Act of 1921, which provided that so much of the taxable income of a primary producer as was derived from primary production should be assessed at an average rate. Before any assessments were made in accordance with this provision, the Act of 1922 extended averaging to all taxpayers including companies, but the Amendments of 1923 excluded companies, and these are now taxed for Commonwealth purposes at a flat rate. Any suggestions that we may make in regard to averaging will, therefore, not apply to companies.

633. New South Wales is the only State which has adopted the principle of averaging, and it is applied in that State only to income derived from agricultural, dairying, or pastoral pursuits.

634. **The necessity to average incomes and to keep special records for this purpose, retards and complicates the work of assessment in many ways. It adds materially to the cost of calculating tax on incomes which include dividends and rebates, and increases the possibilities of error.** The amendment of the assessment of any year necessitates the amendment of that of every succeeding year within the average period. If incomes were not averaged the majority of taxes could be ascertained by reference to the rate book and checked by the taxpayer without difficulty. This would be advantageous both to the Department and the taxpayer.

635. In theory, the assessment of tax at an average rate appears to be attractive, but it is not entirely satisfactory in its incidence. The taxpayer whose income is increasing pays less and he whose income is decreasing pays more than he would if he were assessed at the rate applicable to his income of the year preceding the year of assessment. **Assessment at an average rate therefore benefits the taxpayer who is in the better position to pay, and penalizes the taxpayer whose means to do so have been impaired.**

636. Witnesses representing primary producers were unanimous in expressing the opinion that averaging should be continued at least for the benefit of primary producers. A decisive majority of witnesses representing other classes of taxpayers were of the opinion that it should be abolished, though some admitted that it might be applied to the income of primary producers only. All the witnesses representing the Commonwealth and State Taxation Departments were emphatic and unanimous in advocating its total abolition, and none of them viewed with favour the proposal to retain it for the benefit of any class or classes of taxpayers. The State Commissioners also made it clear that they were not prepared to recommend their Governments to adopt averaging for State purposes.

637. Several years after the introduction of averaging, the Commonwealth Act was further amended to allow the recoupment of business losses out of the profits of the four succeeding years. Many witnesses considered that this concession has to some extent at least removed the justification for averaging, and that the allowance of losses is a more effective protection to the general taxpayer.

638. **Our conclusion is that averaging of income for the purpose of determining the rate of tax should be materially restricted.** We are satisfied that it is unnecessary to average the income of a taxpayer in regular receipt of salary or wages or income from investments. Arguments may be advanced to justify its retention for the benefit of taxpayers carrying on a trade or business, but the evidence indicates that the majority of business incomes do not fluctuate sufficiently in normal times to justify its continuance. We think that taxpayers in this class are adequately protected by the right to carry forward losses.

639. The primary producer, however, is in a different position. His income is affected by seasonal conditions that cannot be predicted or controlled. If he sustains a loss he will, of course, have the right to carry it forward in common with other taxpayers. But if his income fluctuates considerably without resulting in a loss he would, if averaging were abolished, pay considerably more tax than a taxpayer who received the same aggregate income during the same period in reasonably even instalments. This case is not met by the right to carry forward losses, and for that reason we think that the income of the primary producer should be assessed at an average rate as it is at present.

640. Having arrived at this conclusion, it is necessary to determine what is meant by the income of the primary producer. Is this expression to mean only income derived by him from primary production, or is it to include his total income from all sources? After careful consideration, we are satisfied that the attempt to segregate the primary production income and to average it only, without regard to other income derived by the primary producer, would result in many complexities. Intricate dissection of the allowable deductions would be required, and many arbitrary assumptions would have to be made. Difficulties would also arise if it were necessary to provide for a carry forward of losses. For these reasons, we think that it would be preferable to average the total income of a primary producer who ordinarily carries on primary production as his sole or main business, although this may involve the averaging of some income derived by him from other sources.

641. We recommend—

- (1) That the averaging of incomes for the purpose of determining the rate of tax to be applied to the income of the year preceding the year of assessment be abolished in respect of all taxpayers other than primary producers who ordinarily carry on primary production as their sole or main business.
- (2) That the same basis of assessment of primary producers be adopted by the States.

SECTION XXXV.

REBATES IN RESPECT OF BUSINESS INCOME.

642. Section 30 of the Commonwealth Act was introduced in 1922 to provide for the allowance of a rebate to an individual who carries on a business by himself or in partnership, if his rate of tax on the resulting income exceeds the company rate. In that event he is entitled to a rebate of a sum equal to the amount by which the tax on 15 per cent. of such income exceeds the tax that would be payable on that part at the company rate. "Business" is defined to mean a business which from its nature and character requires for its efficient working the retention of some part of the income of each year.

643. Representations were made that the necessity to prove that some part of the income of each year must be retained in the business severely limited the application of the Section. The Section does not specify or even indicate the percentage of income which has to be retained in the business. If it can be shown that retention is necessary, the business which requires the minimum of income to be so retained is treated in the same manner as that which requires the retention of a much larger proportion of the profit of the year.

644. The object of the Section was to give to the individual or partner a concession of a similar nature to that allowed to a company by Section 21 of the Commonwealth Act. But it does not appear to have been recognized that a concession has already been allowed to the individual in other ways. Certain concessional deductions have been allowed, and the income derived by him from his business will be assessed at personal exertion rates. Had he received the same income as dividends from a company he would have been taxed at the higher property rate. We would also point out that the profit retained by a company is subject to taxation if it is subsequently distributed. The Revenue, however, can never recoup the rebate allowed to an individual or partner in accordance with the Section.

645. We are unable to advance any arguments which justify the allowance of this concession to a limited number of taxpayers. Such taxpayers are placed in a privileged position as compared with individuals and partners who cannot prove the necessity for the retention of some part of their income. As none of the State Acts contain a provision of similar import, we are not prepared to recommend that one should be included in the Uniform Act, and we recommend that the section be deleted from the Commonwealth Act.

SECTION XXXVI. PRIVATE COMPANIES.

646. From a comparatively early date in the development of the limited liability company some individuals have found it, for one reason or another, advantageous to form a limited liability company, and to transfer to it certain of their assets (particularly business assets), retaining for themselves a controlling interest in the shares of the company. That is how what is known as the "one man company" came into being. Without pursuing that indirect method it was impossible for an individual to participate in the benefit of limited liability which the Statutes conferred upon incorporated companies alone.

647. For many years the Companies Acts of some of the States have permitted the incorporation of certain companies as private companies. In others there is no difference in law between public and private companies. A private company frequently comes into existence by the incorporation of a partnership, and the whole of the shares are held by the former partners. The principal reason for incorporation is the limitation of the liability of the members. In no other respect is it intended that there shall be any difference in the conduct of the business or in the division of its profits. Other private companies are created by persons who prefer to carry on a new business in that form rather than as a partnership. In either case the incorporators derive the same benefits, and, in effect, enjoy some of the advantages both of a partnership and a company.

648. Prior to the imposition of Commonwealth Income Tax, consideration of taxation did not materially influence the formation of private companies. The practice of all the States was to tax the profits of a company in the hands of the company at a rate higher than that which would be payable on the income of the majority of individual taxpayers, and to exempt dividends in the hands of shareholders. The Commonwealth Income Tax Assessment Act of 1915 introduced a new method of taxing companies and shareholders;—it taxed the company only on its *undistributed* profits, and taxed the shareholder on the dividends he received at the rate applicable to his total income. This at first appeared to be advantageous to shareholders, and no doubt provided the first inducement to form private companies to reduce taxation. But the effect of the provision of the Act which empowered the Commissioner to impose additional tax on companies which failed to make a reasonable distribution was not fully realized, and when the Commissioner began to exercise this power much dissatisfaction was created and a strong agitation for its repeal or modification was instituted. A compromise was finally arrived at, and the Act of 1922 allowed a company to retain not more than one-third of its taxable income without being liable to additional tax. In 1923 the Commonwealth altered its method of taxing the profits of companies, and imposed tax on the total profits of the company at a flat rate, and also on the dividends received by the shareholders, subject to rebate. Meanwhile the incidence of State taxation has been increasing and altering, and for some years the rate of tax payable by an individual in receipt of a substantial income has been higher than that payable by a company. The influence of these considerations has no doubt resulted in the creation of many private companies for the purpose of reducing the taxes that would have been payable by their principals if they had carried on business in any other manner.

649. The desire to reduce the liability to tax is not in itself reprehensible. But the expedients adopted by some taxpayers to obtain possession of the profits of private companies, without exposing themselves to liability to tax on such profits, have created many problems. Some of the complications in the sections of the Commonwealth Act which relate to the taxation of private companies and their shareholders are due to the attempts made by the Department to cope with these expedients. The Explanatory Notes on the amendments of the Income Tax Assessment Act of 1930 contain some examples of the methods that have been adopted by some taxpayers to obtain possession of these profits by means which avoid or reduce their individual taxes. These may be summarized as follow:—

- (1) The failure to make a reasonable distribution of profits.
- (2) The formation of a number of separate private companies or chain of private companies each of which holds shares in that preceding it in the chain. (This will be considered in Section XXXVII.)
- (3) The allotment of shares for the purpose of reducing the holding and thereby the dividends of the principal shareholder, in order to reduce the rate of tax which would otherwise be payable by him.
- (4) The distribution of profits as salaries or bonus to directors or shareholders.
- (5) Distribution of profits in the form of loans to shareholders, instead of by way of dividends.

The failure to make a reasonable distribution of profits.

650. Section 21 of the Commonwealth Act is designed to prevent the loss of tax which results from failure to make reasonable distributions. The necessity for the inclusion in a taxing Act of a Section of similar import depends entirely upon the scheme of the Act. If the scheme is to tax the company and exclude dividends from the taxable income of the shareholder, this power is not required. But if the object is to impose tax at a graduated rate upon the total taxable income of an individual from all sources, power must be taken to impose additional tax on companies that fail to distribute a reasonable proportion of their profits, otherwise persons controlling companies may refrain from distribution if it suits them to do so. For this reason we have recommended in Section XIII. of our Report that Section 21 of the Commonwealth Act be retained subject to certain modifications which we have suggested.

651. New South Wales is the only State which requires a shareholder to include dividends in his taxable income for all purposes. Hence a similar Section is embodied in the Act of that State. The other States do not require this power, as they are either not interested or only indirectly interested in dividends received by shareholders.

652. In our opinion, however, a State cannot effectively impose additional tax on companies that fail to make a reasonable distribution. A perusal of Section XXVII. of our Report, in which we deal with the problems arising out of the taxation of dividends of companies by States, will indicate the difficulties that would result if the States attempted to do so. For these reasons, we consider that while a Section similar to Section 21 of the Commonwealth Act is necessary to effectuate the scheme of that Act, we do not think it is required for State purposes.

The allotment of shares for the purpose of reducing the holding and thereby the dividends of the principal shareholder, in order to reduce the rate of tax which would otherwise be payable by him.

653. Section 21A was inserted in the Commonwealth Act in 1930 to deal with these cases. Its provisions may be summarized as follows :—

Where the Commissioner is of the opinion that any company formed after the commencement of the *Commonwealth Income Tax Assessment Act 1915*, being a company where not less than 90 per cent. of the paid up capital is represented by shares held by or on behalf of not more than ten individuals, or a company having such a company as the principal shareholder, has been formed for the purpose, *inter alia*, of relieving any person specified by the Commissioner from any liability to which he would have been subject under the Act if the company had not been formed, and that purpose is, in the opinion of the Commissioner, effective in the year in which the income was derived, the income of that company shall be subject to tax at a special rate. The rate is designed to produce the amount which, together with the tax payable by the individual, will represent approximately the same amount of revenue as would have been derived from that individual if the company had not been formed. For the purposes of the Section shares are deemed to be held by or on behalf of an individual if they are held in the name of any nominee; of any person who is a relative by blood, marriage or adoption of a shareholder if that relative has acquired the share by gift from that shareholder or by means of money received from that shareholder; or of any *cestui que* trust to whom the trustee is required to pay the income resulting from the ownership of the shares. The Section also provides for the disallowance as a deduction to the company of remuneration paid to any of the holders of the 90 per cent. of the shares.

654. The obvious intention of the Section is to give the Commissioner power to deal with the promoters of bogus companies by authorizing him to refuse to recognize for the purposes of taxation the effect of the dispositions of shares which they have made. Our chief criticism is that the Section goes too far, and that it places too much emphasis on the purpose for which the company was formed and not enough upon the means adopted by the promoter.

655. The formation of a company, even for the purpose of reducing the tax otherwise payable by the promoter, is not in itself unlawful. "It is trite law that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the taxing Acts. They incur no legal penalties and, strictly speaking, no moral censure if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside them." (Viscount Sumner.) "No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business

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or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow—and quite rightly—to take every advantage which is open to it under the taxing Statutes for the purposes of depleting the taxpayer's pocket. And the taxpayer is in a like manner entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue." (The Lord President Clyde.)

656. It should be noted that under the Section the desire of the individual to relieve himself of tax need not be the only purpose, or even the principal purpose, for which the company has been formed; it may be only one of them. The incidence of tax is invariably taken into consideration when the formation of a company is being considered, and it would be difficult, if not impossible, for the most honest taxpayer to prove that the formation of the company has not relieved him of some liability to which he would have been subject under the Act if the company had not been formed. It follows also as a consequence that the "purpose," i.e., the relief from taxation, must have been effective, because in the absence of other considerations the distribution of the share interests of one person among several must inevitably reduce the tax that would have been payable by the transferor had he retained the shares transferred. There appears to us to be a danger that the "purpose" for which the company was formed and the "consequence" of its formation may be confused, and that the Section may be applied in cases to which it was not intended to apply.

657. That the Commissioner should have power to deal with the promoters of bogus companies may be admitted without hesitation. But we think that the most dangerous manner in which that power can be conferred upon him is to give him the right to impeach a lawful distribution of assets, merely because it reduces the tax otherwise payable by the person who disposes of them. If he be entitled to do this in the case of a bona fide transfer of shares it is but a step further to authorize him to treat as invalid a gift in money or kind, as, for example, of investments or real estate, for in every case the effect is the same, namely, to relieve the taxpayer from tax which he would have paid if the gift had not been made. If this argument be carried to its logical conclusion power should be given to disregard a voluntary disposition of any income-producing asset by a taxpayer and to tax him on the income he would have received if he had not made the disposition.

658. There are other aspects of Section 21A which might be criticized. We shall not refer to these in detail, but merely point out that the powers conferred by the Section are too great, and the language employed to give effect to them too wide. If the Section be strictly interpreted, we think that many private companies formed for legitimate purposes and not for the purpose of evading tax would be subject to penal assessment.

659. It may be argued that these powers are necessary in order to enable the Commissioner to deal with cases where it is difficult to obtain proof, and that he may be trusted to exercise them with discretion. But it is a well established principle that the language of taxing Acts must be strictly construed, even if the letter of the law leads to a result which seems unjust and oppressive. If, therefore, a specific case comes within the terms of the Section the Commissioner has no discretion. In our opinion, liability should depend upon the means employed by the promoter to reduce the tax which he would otherwise pay. If the persons who purport to be shareholders are nominees or dummies, the Commissioner should be empowered not only to assess and collect the tax properly payable, but also to take such other steps as he may consider the circumstances require. If the company is a real company and not a sham; if the shareholders are the real owners of the shares which are registered in their name, and if they have the receipt and control of the dividends on these shares, the Commissioner should have no power to impose additional tax. The relationship of the shareholders to the promoter, and the consideration (or lack of it) for the allotment or transfer of the shares which they hold, are matters which should not concern the Commissioner, except in so far as they bear on the question whether the ostensible transaction disguises the real facts.

660. The evidence we have received from official sources indicates that the section has been applied in very few cases. Other evidence suggests that it is almost impossible of application because of its intrinsic defects. It appears to us, therefore, that Section 21A should be deleted from the Commonwealth Act and reliance placed upon other provisions which invalidate the consequence of fictitious transactions, as, for example, the allotment of shares to nominees or persons who are not the real owners of the shares and in receipt and control of the income derived therefrom.

The distribution of the profits of a company as salaries or bonus to Directors.

661. If the amount paid to Directors as salary or bonus be regarded as an expense incurred in gaining or producing the assessable income, and in consequence allowed as a deduction from the profits of the company, the company and/or its shareholders benefit in three respects :—

- (a) It reduces or eliminates the income of the company upon which it would otherwise be liable to pay tax ;
- (b) In certain circumstances it may reduce the rate of tax payable by the company, as, for example, when that rate is based upon the amount of the profits or upon the ratio which they bear to the capital employed ;
- (c) It reduces the tax payable by the members, as the salary or bonus is taxed as income from personal exertion, while a dividend would be taxable as income from property at a higher rate.

662. For many years it was looked upon as a legitimate practice for the Directors of a private company, in which they were the principal or only shareholders, to divide the whole of the profits among themselves as salary or bonus. The resulting loss of tax led some of the States to enact provisions empowering the Commissioner to review remuneration paid to Directors and shareholders. In 1918 the Western Australian Act was amended to give the Commissioner power to disallow as expenditure any remuneration paid by a company to any of its Directors, officers or employees, if, in his opinion, such payment was not made bona fide as remuneration for services but as a means of avoiding taxation. In 1921 the Queensland Act was amended to empower the Commissioner to disallow any remuneration paid or credited to a Director of a company or to a member of his family in excess of what he considers a reasonable amount, and to treat such excess as dividend. In 1928 a Section to the like effect was embodied in the New South Wales Act, but its application was restricted to private companies. The Acts of Victoria, South Australia and Tasmania do not contain any similar provision. The Commonwealth Act is also devoid of a specific provision in regard to this matter, except to a limited extent in regard to remuneration paid to the shareholders of certain private companies which fall within the scope of Section 21A.

663. The right of Directors to allocate the profits of the company to themselves as salary or bonus has been recognized by the practice of the Commonwealth Income Tax Department, and under the express terms of a departmental Order issued on the 12th November, 1923, the assessment both of the company and of the Directors was based on such allocation in cases where it was made. The Order (No. 1111) was in these terms :—

" Payments to Directors.—There is no provision in the Act to prevent the profits of a company being absorbed as Directors' fees or commission to Directors. The amount so absorbed is a deduction to the company under Section 18 (1) (a) of the 1915-1921 Act or Section 23 (1) (a) of the 1922-1923 Act."

664. This Order continued to be acted upon till 1932, when the Aspro case on appeal from New Zealand was decided by the Privy Council, and the Sennitt case came before the High Court of Australia. In the Aspro case the remuneration of two Directors, who were also the sole shareholders of the company, was fixed each year by a resolution of the company, passed at a time when the results of the year's operations could be fairly estimated, and absorbed about two-thirds of the profits. In the year in question the sum so divided amounted to £10,000. The Commissioner disallowed the deduction as to £8,000 of this amount. This decision was upheld by a Stipendiary Magistrate on appeal. The Judicial Committee in July, 1932, held that there was evidence to support the decision, and that the appellant company had failed to establish that the assessment based on the reduced deduction was excessive.

665. J. P. Sennitt and Son Pty. Ltd. was a Victorian proprietary company consisting of two members, who had been drawing salaries of £520 each as Directors. In one year they divided between themselves in the form of a bonus profits amounting to £13,000, and the company claimed to be entitled to this amount as a deduction. It was disallowed by the Commissioner, whose action was sustained by the Board of Review. An appeal to the High Court was dismissed by Starke, J., on 1st June, 1932, on the ground that no question of law was involved, and that the appeal was therefore incompetent, but he expressed the opinion that the Commissioner and the Board were right, and that the colourable description of the amount in question as remuneration for the Directors' services did not take it out of its real category as a distribution of profits.

666. There is nothing in either of the cases cited to fix any limit either by way of maximum or minimum, to the amount which may be allowed in a company's accounts as a deduction for directors' salaries ; nor do they lay down any general rule as to the principles to be applied in determining what proportion of the amount received by a Director is to be treated as his remuneration, and what proportion as a dividend to him as a shareholder. They merely decide that the allocation by the directors themselves is not conclusive—in other words, that it does not rest with them to decide how the company and they themselves are to be taxed. It remains a question of fact in each case what amount was really paid to the Director as remuneration for his services ; and this, like every other question upon which the assessment of a taxpayer's income depends, must be decided in the first instance by the Commissioner, subject to the ordinary process of review.

667. No hard and fast rule can be laid down as to the amount which should be allowed. A salary that would be grossly excessive in the case of a company doing a very small business might equally be grossly inadequate in the case of a company of another kind. A very little consideration, too, will show that it would be absurd to measure the value of a Director's services by the time that he spends in his office, or by the record of his daily work. In the practical business of commercial life values are not measured in that way.

668. The legitimate scope of inquiry seems to be whether the payments to directors are in fact salary or in fact a distribution of profits. In cases where they are clearly payment for services rendered, the question whether they are more or less than the services are worth is irrelevant. If the Commissioner is to have the right—stating the case baldly—to say whether a taxpayer is giving larger salaries than the Commissioner thinks reasonable, it is hard to see why he should not be empowered to criticize the amount of the taxpayer's rent or the prices he pays for his stock-in-trade. This, no doubt, was the ground of the contention put forward by more than one witness, that it was no part of the Commissioner's duty to manage the taxpayer's business for him.

669. But it is easy to carry this contention too far, or to misapply it. It does not follow that the Commissioner is called upon to shut his eyes to the amount allotted to directors as their remuneration. As in the case of every other deduction claimed by the company, he is entitled to satisfy himself that the payment was in fact what it is claimed to be. A person cannot call a thing by a wrong name and thereby disentitle the Commissioner from calling it by its right name. The amount of so-called salary paid to the directors, taken in connexion with other circumstances, may be very material as a guide in determining whether or not it is in whole or in part really a dividend in disguise.

670. It should be apparent that the Commissioner must make the decision in each case upon a consideration of all the circumstances of that case. The first matter that must be considered is the constitution of the company. If the director or employee does not either alone or with others exercise a controlling interest which enables him to fix his own salary, any remuneration which he receives should be allowed as a deduction without question. In that case it is obviously payment for services, like the salary paid to any employee. If he is not a shareholder, directly or indirectly, or has a very small share interest, the conclusion that the payment is really salary and not a disguised dividend is strengthened. If, however, he holds a controlling interest in the company and is in a position to determine his own remuneration, the solution becomes more difficult. Possibly the most helpful line of approach, as a general rule, would be to look into the accounts of other companies doing a reasonably comparable business, see what salaries are paid to persons occupying corresponding positions in those companies, and so obtain something in the nature of a standard to be applied with such modifications as any special circumstances in the case might seem to require. The same principle would apply to the consideration of cases where the salaries paid to members of a Director's family come into question.

671. The taxpayer will no doubt interpret the discretion of the Commissioner in regard to this matter as an implied power to determine his remuneration. In the States where the Commissioners have this power the taxpayers resent it, firstly because they think it should not be conferred upon the Commissioner, and secondly because they are of the opinion that an official is not fitted by training or experience to estimate the true value of their services to the business. **The real matter for determination, however, is not what amount the directors should receive, but how it should be treated for taxation purposes.** It must be admitted that if the directors are permitted to distribute the whole of the profits of the company as remuneration and not as dividends, and to have that distribution accepted without question as the basis of taxation, the power may be used in such a manner as to gain concessions at the expense of other taxpayers who do not avail themselves of this expedient.

672. This is one of the specific avoidances with which Section 21A was intended to deal. Since that Section was enacted the decisions in the Aspro and Sennitt cases have to some extent removed the necessity for those of its provisions which relate to this matter.

673. We may add that some of the difficulties which arise in regard to directors' salaries and bonuses would be minimized if differentiation between income derived from personal exertion and from property respectively were limited in the manner described in paragraph 526 of our Report.

674. One aspect of the question of the allowance of Directors' remuneration as a deduction in the assessment of the company that has recently come into prominence is the right of the Commissioner to re-open the assessment and retrospectively disallow or reduce the deduction. This matter is dealt with in Section L of our Report.

Distribution of profits in the form of loans to shareholders instead of by way of dividend.

675. Some of the examples quoted in the Explanatory Notes already referred to show that in some cases the principal shareholders of a company obtain possession of the profits of the company not as dividends, but as loans, often without interest. Although Section 21 of the Commonwealth Act permits a company to retain one-third of its profits without liability to pay additional tax, shareholders are liable to pay tax on profits distributed to them which have not previously borne tax under Section 21, without regard to the time when the actual distribution takes place. If, therefore, shareholders in control of a company can obtain by way of loan sums equivalent to that which they would otherwise receive as dividends, they escape payment of tax on these amounts.

676. The Queensland Act contains a provision intended to deal with distributions of profits effected in this matter. Section 15 (4) (c) of that Act provides that if any amounts are advanced or assets are distributed by any company (not in liquidation) to any of its shareholders by way of advances or loans to such shareholders, and such advances or assets represent, in the opinion of the Commissioner, a distribution of income, the amounts advanced or distributed shall be deemed to be and treated as dividends in the hands of the recipient. **We think that a Section of like effect might be included in the Commonwealth Act to prevent the avoidance of tax by shareholders of private companies who avail themselves of this method of obtaining possession of their profits.**

The taxation of private companies as partnerships.

677. Many witnesses suggested that some of the difficulties which arise in regard to the taxation of private companies and their shareholders would not occur if private companies were regarded as partnerships and their members were taxed as partners. We cannot support this suggestion for the following reasons :—

- (1) If the members of a company were assessed on their notional shares of the profits of a company many of them would be unable to pay their taxes without a distribution from the company.
- (2) Some shareholders of a company are not in a position to exercise any influence in the control of a company. They would be called upon to pay tax on a notional share of income which they may never receive.
- (3) Many of the problems which arise are common to private companies and partnerships, and these the treatment of private companies as partnerships would not remove.
- (4) It would be difficult to draw a distinction between those companies which should be assessed as companies and those which should be assessed as partnerships.

678. A further consideration is that taxpayers are free to elect to carry on business either as partnerships or companies. If they choose to form a company in order to obtain the advantages of incorporation, we see no reason why they should be relieved of the obligations incidental thereto. If these are found to be irksome, we suggest that the remedy lies in their own hands. In support of this view we submit the following quotation from the evidence of a representative witness :—

“Existing companies of small capital might well consider the advisability of liquidation and a return to individual ownership or partnership. The business community would welcome the development. The small one man companies have proved a fruitful source of bad debts during the depression, and in cases within my own knowledge business credit has been so curtailed that the company has been abandoned or wound up.”

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SECTION XXXVII.

HOLDING, SUBSIDIARY AND INTERLOCKING COMPANIES.

679. The development of the holding company, and the increase in the number of such companies during recent years, make it necessary to consider the manner in which they should be treated for the purpose of taxation. The term "holding company" is sometimes used without a clear understanding of its real meaning. For the purposes of this Section we regard as a holding company one which holds shares in other companies, called subsidiaries, for the purpose of controlling their operations. A company which merely holds shares in other companies as investments, without control, is not a holding company in the proper sense of the term.

680. As a general rule the only income of a holding company consists of the dividends which it receives from its subsidiaries. The holding company is in effect the medium through which the profits of the operating companies (i.e., the subsidiaries) reach the real owners of the latter in the form of dividends. For this reason a number of witnesses suggested that the Act should be amended to provide that a holding company and all its subsidiaries should be assessed as a single entity; or, alternatively, that the holding company should be given the right to elect to be so assessed. We have given this suggestion careful consideration, because it seemed to provide a solution for some of the problems which arise in connexion with the taxation of holding companies.

681. If it were not for the incidence of the special property tax, holding companies would neither gain nor lose to any material extent by the aggregation of profits. If each subsidiary made a profit, the same amount of tax would be payable by all of them whether they were assessed separately or as an aggregation. If one of them made a loss, the holding company would benefit in that year, because it would be allowed to deduct the loss from the profits of the other subsidiaries. But in the long run the holding company would probably be no better off, because the subsidiary which made the loss is allowed to carry it forward and recoup it out of the profits of the four succeeding years. The only case in which a holding company would be liable to pay more tax because of the separate assessment of each of the companies included in the group would be the case where the subsequent profits of a subsidiary making a loss were insufficient to recoup that loss in the four subsequent years.

682. But holding companies would benefit materially under present conditions if the profits of all the companies comprised in the group were regarded as one fund, for this would relieve them of their present liability to pay special property tax on the dividends they receive from their subsidiaries, out of which they subsequently pay dividends to their shareholders. To this extent holding companies have a legitimate grievance, for if these dividends were paid to shareholders, otherwise than through the medium of the holding company, each shareholder would be entitled to an exemption of £250 in respect of his income liable to special property tax.

683. The following figures supplied by a representative witness give the position in regard to one holding company, and are doubtless indicative of the position which exists in many other cases :—

Total number of shareholders	.. .. .	1,183
Total annual dividend .. .. .	.. .. .	£36,000
Total number of shareholders whose dividends do not exceed £250		
per annum .. .. .	.. .. .	1,174
Dividends paid to those shareholders	.. .. .	£28,768

684. The effect of the present practice is that special property tax is collected from the holding company on dividends amounting to £28,768, although if these dividends had been received by the shareholders from the companies which earned the profits, and not through the medium of the holding company, no special property tax would have been payable by the individual shareholders, assuming, of course, that each had no other income from property.

685. Disregarding, however, the incidence of special property tax, holding companies have little to gain or lose by aggregation. We have discussed the special property tax in Section XIV. of our Report, and have referred to the complications which it creates. As there is reason to hope that this tax will be progressively reduced and eventually abolished, or merged into the normal tax, its existence does not appear to call for a special amendment of the Act to provide for the assessment of holding and subsidiary companies in a particular manner.

686. The manner in which a holding company should be regarded for the purposes of taxation depends not so much upon the fact that it is a "holding" company as upon its constitution, that is whether it is a "public" or a "private" company. The more important holding companies are public companies registered on the Stock Exchange, whose shares are widely distributed and freely dealt in by the public. It is obvious that a holding company of

this type has not been formed for the purpose of avoiding tax or reducing the tax that would otherwise be payable by its shareholders. For that reason it should be regarded and taxed in the same manner as any other public company. A private holding company, however, is in a different position. The number of its shareholders is limited. Its shares are not quoted on the Stock Exchange and there are restrictions on transfer or sale. The dividend policy of all the companies comprised in the group may be, and doubtless often is, framed with a view to the amount of tax payable by the principal shareholders on the distributions to be made to them by the holding company.

687. There is reason to believe that some private holding companies have been formed solely to reduce the tax which would otherwise be payable by their shareholders, and particularly to avoid the imposition of additional tax under Section 21 on profits which should properly be subject to that tax. The following example, based upon an actual case which came under our notice, we think more than justifies this opinion.

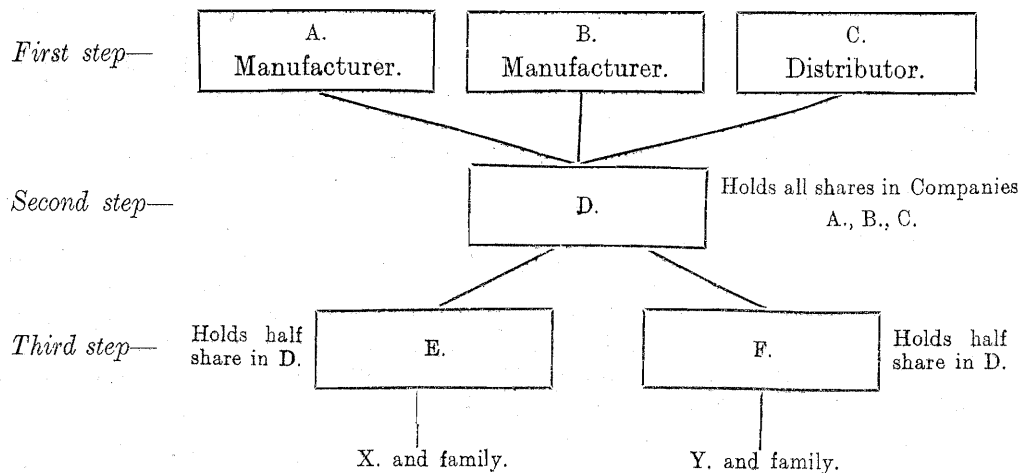
688. X. and Y. are equal partners in a business which manufactures and distributes two distinct products. Desiring to reduce the tax for which they would be liable if they continue to trade as a partnership they proceed as follow :—

First step.—They incorporate three private companies. Company A. purchases one factory. Company B. purchases the other factory. Company C. purchases the finished stock and book debts, and controls distribution of the products of companies A. and B. The consideration for sale is in each case the allotment of shares in each company equally to X. and Y.

Second step.—They next incorporate company D., to which they sell the shares they have received from companies A., B. and C., the consideration being the allotment equally to X. and Y. of shares in company D.

Third step.—X. now incorporates company E., consisting of himself and the members of his family. He sells to it his shares in company D., the consideration being again paid in shares. Some of these shares are allotted or transferred by X. to the members of his family. Y. incorporates company F. with the same capital as company E., and follows exactly the same procedure as X.

The following diagram will make it easier to understand the procedure adopted :—



689. The profits of companies A., B. and C. for the first year are as follow. In each case two-thirds is distributed as dividend to company D.

				Profit.		Dividend.
				£		£
Company A.	..	..	..	30,000	..	20,000
Company B.	..	..	..	7,500	..	5,000
Company C.	..	..	..	4,500	..	3,000
				42,000	..	28,000

Commonwealth tax is paid by each company on its total profits at 1s. in the pound. Company D. has no income other than the dividends amounting to £28,000 which it has received from companies A., B. and C. These are free of tax in its hands by reason of the rebates to which it is entitled in its capacity as a shareholder. It distributes two-thirds of this amount as

dividends equally between companies E. and F. Companies E. and F. each receive £9,333 as dividend from company D. free of tax. Each distributes two-thirds of this amount as dividends to its shareholders.

690. It should be noted that none of the companies is liable to additional tax under Section 21, as each has distributed two-thirds of its taxable income. To avoid a confusion of the real issue special property tax is ignored in the example.

691. The net result of this complex scheme is that the profits still remain the property of the former partners in the same proportion as they did before the companies were formed. They have avoided payment of tax on profits which they have not withdrawn (except to the extent of 1s. in the pound which was paid by the companies). The advantage of the arrangement is shown by the following table of the taxable income of each partner in the circumstances stated :—

	Taxable Income. £
(a) As a partner—as income from personal exertion	21,000
(b) If only one company had been formed—dividends—as income from property	14,000
(c) As a result of the scheme described—dividends—as income from property	6,222

Tax on dividends under (b) and (c) would depend upon the manner in which each partner has distributed the shares he received from company D.

692. In the examples given the taxpayers concerned have been content to form only three successive companies or groups of companies, but the only practical limitation to the number of successive companies that might be formed is that the distributable income of the last company must be sufficient to provide for the dividends required by the promoters for their individual use.

693. It is not suggested that Income Tax legislation should interfere with the right of the taxpayer to form a private holding company with as many subsidiaries as he may consider he requires for the purpose of his business. But if he does so he should not be placed in a better position for the purposes of taxation than he would have been if the whole of his interests were represented by one company. The acceptance of this principle is essential to preserve equity between shareholders of private holding companies and other private companies.

694. In order to prevent avoidance of tax by the formation of private holding companies, we recommend that dividends received by one private company from another shall, to the extent to which such dividends form portion of the distributable income, be deemed to be distributable in full for the purposes of the calculation of additional tax under Section 21.

SEPARATE COMPANIES.

695. The additional tax payable by a company that fails to distribute two-thirds of its taxable income is calculated by adding to the other income of each shareholder the proportion of the notional distribution of that company which he would receive if it were distributed. No regard is had to the fact that the shareholder may have shares in other private companies, which have also failed to distribute the statutory proportion of their income and which may, therefore, be liable to pay additional tax under Section 21.

696. It has been suggested that taxpayers might derive some advantage from this method of assessment by forming a number of separate private companies. Upon investigation, however, we find that in those cases where the taxable income of each separate company would be large enough to justify its formation the promoters would derive little benefit. **An amendment of the Act intended to aggregate the taxable income of companies of this type to prevent a possible avoidance of tax would result in many complications, and is not recommended.**

PRIVATE INVESTMENT AND PROPERTY COMPANIES.

697. A taxpayer who is in receipt of substantial income from property, as, for example, rent, interest and dividends, may find it to his advantage to incorporate a private company to take over the assets which produce this income, if the rate of tax payable on his income exceeds the company rate, which at the present time under the Commonwealth Act is 1s. in the pound.

698. An example will make this clear. Let it be assumed that a taxpayer has a net income from property amounting to £5,000. Commonwealth Income Tax payable on this amount (excluding special property tax) would amount to £1,216 14s. 2d. He incorporates a private

company which derives the same income. If two-thirds of this income is distributed as dividends no additional tax under Section 21 is payable by the company. The tax payable by the company and the individual shareholder would in that event be as follows :—

	£	s.	d.	£	s.	d.
The company pays 1s. in the £ on £5,000				250	0	0
The shareholder pays on the dividends received by him amounting to £3,333	598	5	4			
But he receives a rebate on account of the tax paid by the company—						
1s. in the £ on £3,333	166	13	0			
				<hr/>	<hr/>	<hr/>
				431	12	4
The total tax payable is				681	12	4

which is £535 1s. 10d. less than he would have paid if the company had not been formed.

A further saving could have been effected if the taxpayer as managing director of the company had drawn a substantial salary for managing its business, which is, in effect, still his own.

699. In our opinion there is no reason why a company such as that described should be entitled to retain any portion of its taxable income without incurring liability to additional tax under Section 21. It is not exposed to the risks to which a manufacturer or merchant is subject. It does not require to retain profits for expansion or to protect it against fluctuations in stock-in-trade or possible losses from bad debts. Its assets are in the main liquid, and its income is received in cash and available for distribution.

700. We recommend that Section 21 of the Commonwealth Act be amended to provide that private investment and property companies should not have the privilege of retaining any portion of their distributable income without being liable to additional tax.

SECTION XXXVIII.

FAMILY PARTNERSHIPS (INCLUDING PARTNERSHIPS BETWEEN HUSBAND AND WIFE).

701. Witnesses, generally, admitted that the Commissioner must have power to question, and, if necessary, disallow the allocation of the income of a business between a taxpayer and his wife or members of his family in cases where it appears that an arrangement has been made for the purpose of avoiding or reducing the tax payable by the actual owner of the business. Section 29 (2) of the Commonwealth Act is intended to be applied in such cases. The Section may be summarized as follows :—

Where the Commissioner is of opinion that a partnership between husband and wife or between relatives was formed or varied for the purpose of relieving any person from any liability to which he would have been subject if the partnership had not been formed, and that purpose is effective, or where there is a trust which is a partnership, the partnership shall be assessed and taxed at a rate declared by Parliament as if it were a single person, without regard to the interests therein of any of the partners or to any deductions to which any of them should be entitled under the Act.

702. The similarity between the words of this Section and Section 21A of the Commonwealth Act is intentional, as both these Sections are intended to deal with the same type of arrangement, carried out in the one case by a partnership and in the other by the formation of a private company.

703. The Acts of New South Wales, Queensland and South Australia contain clauses which confer similar powers upon the State Commissioners, with the essential differences, however, that in each case payments made by the taxpayer to his wife and relatives of such amounts as the Commissioner considers reasonable and are actually paid for services performed in the business are allowed as a deduction from the partnership income. Under the Act of Victoria, when the State Commissioner is of opinion that a partnership has been entered into for the purpose of relieving the husband or wife of any liability, he may jointly assess the partners as if the income had been the income of a single person, without regard to the respective interests of the partners or to any deductions to which either of them individually may be entitled under the Act. The Acts of Western Australia and Tasmania do not contain special provisions relating to family partnerships.

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704. We are informed that all of these Sections are designed not to produce more Revenue but to preserve equity as between taxpayers, and to ensure that a husband or father who enters into a partnership arrangement with the members of his family, which is merely formal and which does not deprive him of his control of the income, should not be allowed to derive an advantage in the form of a reduction in the tax which he would otherwise have paid.

705. The provisions in the Queensland Act are mandatory, and it is not necessary to establish intention to relieve any person from taxation. If the partnership is constituted in any one of several ways specified in the Act, the liability to tax attaches automatically. In all the other Acts mentioned, "intention" is an essential consideration, and we have been assured by the Commonwealth Commissioner and the Commissioners in all the States in which this is the test that the provisions are never applied to bona fide partnerships. If an individual has legally and definitely transferred portion of his assets to any other person, whether a member of his family or a relative or connexion by marriage, and that person is in receipt and control of the income resulting therefrom, no objection is taken by the Department to the arrangement, and each partner is separately assessed.

706. In our opinion this interpretation of the law should not be left to departmental practice, but should be embodied in the specific provisions of the Act. Taxation officials should not be concerned with the purpose for which a partnership is formed or with the relationship of the partners. The only test that should be applied is whether the partnership is bona fide or fictitious. The partnership should be regarded as bona fide if each partner is the real owner of his share of the capital and profits of the partnership.

707. If the Commissioner is satisfied that the partnership is not bona fide and that it has relieved any member specified by him from any liability to which he would have been subject under the Act if the partnership had not been formed, he should have power to assess the partnership as an individually owned or severally owned partnership (as the case may require) in the manner provided in Section 29 (2) of the Commonwealth Act.

SECTION XXXIX.

TRUSTEES AND BENEFICIARIES.

708. The taxation of trustees and beneficiaries is a matter in which there is substantial uniformity in practice as between the Commonwealth and the States. The provisions of the Acts of New South Wales and Queensland are, with minor qualifications, in identical terms with those of the Commonwealth. The provisions of the Acts of the other States are quite different in terms, although in practice their administration is substantially similar.

709. Criticism has been directed to the drafting of the Section of the Commonwealth Act, and the interpretation which the Courts have in some cases been forced to adopt probably runs counter to the intention of the draftsman. In administration, however, the Section has not led to undue complexity.

710. The income of the trust estate may fall into any of four distinct categories, namely :—

- (a) It may be held wholly or in part for beneficiaries who are under the terms of the trust presently entitled to it, and are not under any legal disability.
- (b) It may be held wholly or in part for beneficiaries who are under the terms of the trust presently entitled to it, but are under a legal disability.
- (c) There may be no person presently entitled to the whole or to some part of the income.
- (d) The trustees may have a discretion exercisable from time to time as to which beneficiaries are to receive the whole or part of the income.

711. Where a beneficiary is presently entitled to income of a trust estate and is not subject to any disability he should be taxed in respect of that income whether he has actually received it or not. The income is properly treated as income of the beneficiary and should be aggregated with any other income which he may have and be taxed accordingly. Conversely, the trustee should be under no liability in respect of the assessment or payment of tax on such income, except in his representative capacity under the provisions dealing with the collection of tax.

712. Where the beneficiary is presently entitled but subject to a legal disability, e.g., infancy, a different consideration arises, in that he is not generally in a position to receive the income or to compel the trustee to pay it to him. His share of the income should therefore be taxed in the hands of the trustee; but as the amount of his share is definitely ascertainable, it should be taxed at the rate appropriate to the share, so that if there is other income of the estate held in trust for other beneficiaries, or to which no one is presently entitled, the share in question should, for the purpose of assessment, be treated as severed from that other income. This appears

to have been the Commonwealth practice under the present Section till recently, and appears to be the State practice; but expressions in the judgment of two Judges of the High Court in Howey's case (44 C.L.R. 289) would indicate that the separation of such a share for the purposes of assessment is not justified under the Section as at present framed. **We recommend that it should be clearly provided that such interests be separated, and the tax on each such interest assessed to the trustee. Where the beneficiary has income from other sources he should be assessed, as at present under the Commonwealth Act, on the aggregate of his trust and other income, with a rebate of the amount assessed to the trustee.**

713. Where income of the trust estate is held for persons who are not presently entitled, the trustee is taxed in respect of that income as though it were the income of an individual. Evidence was received that this method of taxation resulted in a rate of tax which was inequitable, and that the income to which no persons are presently entitled should for the purpose of assessment, be regarded as being divisible among all the persons in existence who are contingently entitled to it. For example, if income were held in trust for such of the children of A. as attain the age of 21 years, and A. has three children (all under 21 years of age), the suggestion is that the trustee be assessed on three individual incomes each of one-third of the trust income. The benefit which would follow from the reduction in rate, and the allowance of the statutory exemption and concessional deductions (if any), is immediately apparent. Two methods were suggested of meeting the possibility that the number of contingent beneficiaries may be subject to alteration. On the one hand it was suggested that, in the event of a change occurring in the number of presumptive beneficiaries, the trustee should be reassessed from time to time as changes occur, so that ultimately the tax paid would be based on the actual number of beneficiaries who participate in the income. The impossibility of obtaining finality in the assessments of beneficiaries until the whole income is distributable, and the extra work involved, are sufficient to justify the rejection of this proposal.

714. On the other hand it was suggested that the tax should be levied on the possible number of participants in each income year without regard to the number in past or future years, i.e., without any readjustment to meet any increase or decrease of the class of possible beneficiaries. The assessments under this scheme would be final, and the income would be taxed as a single income only in those years in which there is no person contingently entitled, or only one such person. The amount of tax paid in respect of the income throughout the years in which the interests are contingent would bear no necessary relation to that which would have been payable had those beneficiaries who actually participate in the income been at all times entitled to it.

715. The present method of taxing income to which no one is presently entitled has the merit of simplicity, and it does not always result in the imposition of a higher rate than is in strict equity appropriate. If only one person succeeds to the income the rate is correct, but even if more than one succeed there will be cases where a beneficiary contingently entitled has income from other sources, and the rate appropriate to that beneficiary's share, taking this other income into consideration, may well exceed the rate payable under the present method by the trustee. It would not be practicable to aggregate the income to which a beneficiary is only contingently entitled with his actual income, as he may never enjoy the contingent fund.

716. Either of the methods suggested in its stead would lead to complications in assessments and difficulties in application. For example, if the income of a fund were held in trust for such of A.'s children as attain the age of 21 years, and, if no such children attain that age, in trust for the children of B., a difficulty would immediately arise in determining which class of contingent beneficiaries should be taken for the purpose of making the assessment.

717. If any real inequity is involved in taxing as one income in the hands of the trustee, the whole of the income to which no person is presently entitled in our opinion it is not sufficient to justify the replacement of that system by a more complex, and, in many circumstances, equally capricious one.

718. There is one source of inequity, however, which can be simply dealt with. In many cases where no person is presently entitled to the income of a trust estate, the beneficiaries contingently entitled are children, and the trustees have either under the trust instrument or the general law power to expend or advance money for the maintenance, education or advancement in life of the infants. Where this power is exercised, so much of the income as is applied for the purposes referred to in respect of each child should, we consider, be treated as income to which that child is presently entitled, and taxed to the trustee accordingly.

719. Where the trustee has a discretion as to which beneficiaries are to receive the income, and when in any year he exercises that discretion, the income dealt with should be taxed as at present as though the beneficiaries who actually receive it had been presently entitled to it.

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720. In the case of a trust, the question whether income received by a beneficiary is to be taxed as income from property or from personal exertion depends upon the Act which is being applied. The Acts of the Commonwealth and of some States classify the income according to its origin, so that if it is derived from a business carried on by the trustee it is taxed in the hands of the beneficiaries as income from personal exertion, although they may take no part in the business. In Victoria the income of a trust estate is treated in the hands of beneficiaries as income from property whatever its source. The view is taken that if a beneficiary receives income which results from the efforts of some one else, it reaches the beneficiary as income from property and not as income from personal exertion. A similar provision is contained in the Queensland Act, subject, however, to the qualification that if a business is carried on by beneficiaries or trustees who are beneficially entitled to any part of the income derived from such business, that part of the income is treated as being from personal exertion.

721. There is certainly justification for treating the income of beneficiaries as income from property; but it is felt that where a business, as distinct from investments, forms part of a trust estate, the estate and consequently the beneficiaries run the risks incidental to carrying on a business. There is more income in the good years and a greater risk of loss in the bad years than in the case of investments in trustee securities. It is difficult to distinguish the position of the beneficiaries from that of sleeping partners, or even from that of working partners in a business of such a nature that its success is dependent more on the amount of capital invested in it than on the personal efforts of the partners.

722. In the interests of uniformity, having regard to the present practice of the Commonwealth and all the States except Victoria and Queensland, it is recommended that the income of the beneficiary be taxed according to its nature in the hands of the trustees.

723. In some cases, no doubt, the medium of a trust is used for the purpose of lessening the taxation of a settlor. Assets producing income may be transferred to trustees in trust for the settlor's wife and children. The income of the beneficiaries may then be used for their maintenance, and a taxpayer who is in a position to adopt this expedient in effect gets an allowance for the maintenance of his wife and children which is denied to other taxpayers.

724. If the transfer is absolute and the transaction bona fide, we consider that these trusts should not be attacked. If, however, any beneficiary is not in genuine control of his income, or the transaction is otherwise a sham, it is subject to the provisions of the law governing evasion. It is recommended that the only provision to be inserted expressly to meet these cases should follow the lines laid down in the Queensland Act. For Commonwealth purposes, where the settlor has a power of revocation which he could have exercised in respect of the income of any year, the income in question should be taxed to the trustee at a rate ascertained by aggregating that income with the income of the settlor. For State purposes the same system could be used, or alternatively the income could be taxed as income of the settlor, an alternative which on constitutional grounds might possibly be difficult of adoption by the Commonwealth.

SECTION XL.

LEASES.

GENERAL CONSIDERATIONS.

725. What may be called the normal type of lease is that in which the owner of the land lets it to a tenant for a fixed term and receives rent in the form of periodical money payments. This rent is a typical form of income derived from property.

726. Amongst the variations from this type of lease are some which, while perhaps differing in some respects in their legal incidents, are essentially the same from a taxation standpoint. For example, the rent, instead of being paid monthly or yearly, may be paid in one sum, or instead of being paid in money, may be paid wholly or partly in money's worth. It is none the less rent, and income from property.

727. A common form of transaction is that in which the lessee pays a premium for the lease, or, as it is sometimes termed, buys it for a fixed sum. In other words, the landlord purports to sell to him at the price of, say, £500, a lease for five years at the rent of £100 a year. This is indistinguishable in substance from a lease at a rental of £200, half being paid in advance in cash.

728. Still another form of transaction is that in which, in addition to his agreement to pay rent, the lessee covenants to erect buildings or make other improvements of a certain value on the land during the currency of the lease. The cost of these improvements is in substance part of the rent. There is no essential difference between such an arrangement and one under which the lessor himself makes the improvements and recoups himself by fixing a higher rent.

729. In all these cases the owner parts with the possession of his property for a certain term for a consideration which, however described and however paid, is in effect rent. The feature common to them all is that the property continues throughout the term to be his. He has divided his interest into two parts, the term which goes to the tenant, and the reversion which remains with himself. The rent he receives, which in legal phrase is "incident to the reversion", is his consideration for the use of his property during the time for which he has parted with its possession.

730. The various types of leases referred to may be classified in three general cases, viz. :—

Case (1).—Those in which the consideration is paid in regular periodical amounts.

Case (2).—Those in which the consideration is paid wholly by way of a premium, or partly by way of a premium and partly in regular periodical amounts.

Case (3).—Those in which the consideration is paid wholly or partly in money's worth, which is usually represented by a covenant to erect buildings on or to make improvements to the leased property.

It is necessary to consider each of these cases in detail.

Case (1).—Those in which the consideration is paid in regular periodical amounts.

731. This may be termed the more usual form of lease. From the point of view of taxation it presents no difficulty. The lessor is taxed on the rent as and when received by him, and where the premises are used by the lessee for business purposes, he is allowed a deduction of the rent so paid as expenditure incurred in the production of income.

Case (2).—Those in which the consideration is paid wholly or partly by way of a premium.

732. This type of lease is not uncommon, particularly in certain trades. The lessor is taxed on the amount received by him during each year, irrespective of whether that amount includes the premium or any part thereof. The lessee, in the case of business premises, is allowed a deduction over the term of the lease equal to the total amount paid by him in the form of premium and rent.

Case (3).—Those in which the consideration is paid wholly or partly in money's worth, e.g., by a covenant to erect buildings or to make improvements.

733. The Acts of the Commonwealth and all the States make an allowance to the lessee for improvements effected upon leased property used for business purposes. But the lessor is taxable on the benefit he derives from such improvements only in New South Wales and Queensland.

734. The improvements made by a lessee upon the leased property fall into two classes—those covenanted for in the lease and those made in the absence of a covenant. Many witnesses asked that the deduction allowed to the lessee in respect of the improvements to the leased property should not be restricted to the improvements effected under covenant, but should be allowed in all cases where the expenditure is made by the lessee in accordance with a binding agreement in writing between the parties, or, in certain cases in which the lessor is a public authority not prepared to enter into an agreement, with the written consent of that authority.

735. In our opinion, the concession should be granted only where the Act imposes a definite liability upon the lessor (where a taxpayer) to pay tax upon the improvements so effected, as otherwise too great scope would be allowed for an avoidance—possibly collusive—of tax that should be paid.

736. Other witnesses asked that all expenditure by the lessee upon improvements, whether incurred under agreement or not, should be allowed to him as a deduction. It is impossible for us to support this request. It would be unfair to impose upon the lessor in such circumstances liability to pay tax in respect of improvements made without his consent, and possibly against his will.

737. In fairness to other taxpayers, all persons who let property for valuable consideration should be liable to pay tax upon that consideration, irrespective of its form. If the consideration consists wholly or in part of improvements, we think the question upon which the liability of the lessor and the rights of the lessee should depend is whether the improvements made by the lessee are part of the price he pays for the use of the premises. If so, their cost should be treated as being in substance rent paid by the lessee, and their value to the lessor should be treated as rent received by him. This principle would cover every case where the original lease or any modification of it contained a binding covenant or written agreement for the making of the improvements.

738. If the lessor is to be liable to tax on the value of improvements effected upon the leased property, it is necessary to determine the manner in which his liability is to be calculated. Though there may be an immediate benefit to him in the added value of his reversion, the benefit

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is not necessarily the cost of the improvements, but their value to him at the time when they will come into his possession, that is upon the expiration of the lease. Allowance must, therefore, be made for loss of interest and for the depreciation which will occur during the term of the lease.

739. In such cases we think the justice of the case would be met if an estimate were made of the value of the improvements as at the time they will revert to the lessor after allowing for probable depreciation, and if he were required to pay Income Tax in each year during the unexpired term of the lease upon the annual contribution that would have to be set aside to accumulate to an amount equal to that depreciated value.

740. The deduction allowed to the lessee should, however, be calculated on a different basis. He is not concerned with the depreciation of improvements or the loss of interest by the lessor, but only with the amount which he has actually expended. Where the deduction is allowable, it should be allowed to the full extent. **The usual practice, which we think should be continued, is to deduct in each year an amount ascertained by dividing his expenditure on the improvements by the number of years in the unexpired period of the lease at the date the improvements were effected.** This deduction will in practically all cases be in excess of the amount upon which the lessor is taxable.

SALE OR TRANSFER OF LEASES.

741. If during the currency of the lease either party disposes of his interest in the leased property it is necessary to consider how each is affected for the purpose of taxation.

742. We shall first consider the case where the lessor disposes of the freehold. It is obvious that the rights and obligations of the lessee cannot be affected by the sale. Therefore, the deductions to which he is entitled are unaltered. But the lessor having disposed of his interest in the lease will no longer be liable to tax, and the purchaser, in whom the lessor's rights vest, should step into his shoes and become liable to pay the tax which, but for the sale, would have been paid by the lessor.

743. If, however, the lessee disposes of his interest in the lease, other and more difficult questions arise. The taxable liability of the lessor is not affected, as the person to whom the lease has been transferred is, of course, obliged by the conditions of the lease to carry out the obligations of the original lessee. The view taken of the position of the original lessee may depend upon the nature of the transaction by which he parts with his interest. If he merely grants an ordinary sub-lease, at a rental higher than that which he is paying, the position is simple. The rent he receives is clearly assessable as income, subject to a deduction of the rent he pays as an expenditure incurred in the production of income.

744. If he adopts the not unusual expedient of assigning the premises by way of sub-lease for the residue of the term except the last day, he is still in the position of a landlord, as he remains entitled to the reversion, and even if the consideration takes the form of a single payment, it may reasonably be treated as commuted rent.

745. A more controversial position arises where the lessee makes an absolute assignment of the residue of his lease. In regard to this, two opposite points of view were put before the Commission. One was that any profit derived from the transaction was a capital profit which should not be subject to tax unless it came within the scope of the provisions relating to casual profits. The other was that the consideration for the assignment was really in the nature of rent and should be so treated.

746. There seems at first sight to be some weight in the argument that as from the moment of assignment the original lessee has no further interest in the property, and has no reversion to which rent can be incident, it would be improper to treat the consideration as rent; and that the transaction is indistinguishable in its nature from the sale of any other asset. **But in all taxation questions it is essential to keep steadily in view the substance of the matter as distinct from the form.** What the lessee has to dispose of, and does dispose of by an assignment, is the right to occupy the leased premises for a specified time, and, in our opinion, whether the consideration he receives is technically rent or not, it should not be treated for purposes of taxation on a different footing from the consideration which an ordinary landlord receives for disposing of exactly the same right.

747. But while what we may call the ordinary and normal transfer seems to be adequately covered by the principles we have enunciated, there are no doubt exceptional cases in which the leasehold interest does partake so largely of the character of a capital asset as to justify a question whether the sale price should properly be treated as income. The 99 year lease, more common in the early period of Australian settlement than to-day, is an instance in point. Such a leasehold interest, with an unexpired term of 40 or 50 years still to run, and with a present day value bearing no relation to the small ground rent reserved, is so like in its nature to freehold, that the mere fact of its sale being effected by means of an assignment of the lease instead of a conveyance.

seems a rather inadequate reason for treating it differently for taxation purposes. However, if any serious grievance existed in connexion with leases of this kind, we should probably have heard more about it in evidence. In the majority of cases, perhaps, a way of escape is provided by facilities for conversion into freehold.

748. A number of witnesses representing primary producers urged that the profit on the sale of a lease from the Crown should be exempt from tax, either on the ground that it is a capital profit or as a concession to the industry. In our opinion, however, these profits are in no respect distinguishable from those which arise on the sale of any other lease, and there is therefore no justification for making a distinction in the manner in which they should be treated for taxation. If the amount paid for the transfer of a Crown Lease is not to be taxed in the hands of the vendor, it would be illogical to allow the purchaser a deduction for the amount paid. An amendment of the law which exempted the vendor from tax at the expense of the purchaser would create a great deal of dissatisfaction on the part of those who would lose a deduction which is at present allowed to them. It appears to us to be more equitable to tax the recipient of a premium than to deprive the payer of a deduction to which he is properly entitled.

749. After full consideration of the matter in all its aspects, we have arrived at the conclusion that whether a lessee grants a sub-lease or makes an absolute assignment, the consideration, whether it nominally takes the form of rent, premium or purchase money, should be treated as rent and so taxed. If he has paid a premium for the lease, he should be allowed, amongst any other deductions to which he is entitled, the proportion of the premium attributable to the unexpired term of the lease, to the recoupment of which by instalments he would have been entitled had the transfer not been made.

SURRENDERS.

750. In our opinion payments made and received for the surrender of a lease should be treated in the same manner as those made for a transfer.

GOODWILL.

751. In considering the subject of leases it is necessary to have regard to goodwill. It is not uncommon in lease transactions, particularly in connexion with hotel properties, to find a provision under which, in addition to the rent, a fixed sum is payable for goodwill. Some witnesses have claimed that this should not be taxable, but it must be recognized that the value of the property to the purchaser is in some cases materially affected by the goodwill. For example, the value of a hotel lease is due in part to the possession of the licence and in part to the situation of the property. The only real measure of value for taxation purposes in such cases is the value of a leasehold estate in the property taken as a whole with all its advantages and disadvantages. Therefore, where the so-called goodwill is simply an added value given to premises by reason of the fact that they are licensed for the sale of liquor and favorably located for that purpose, there is no more justification for treating the price paid for it as something distinct from the rent than there would be for putting a separate value on any other circumstance that adds to the rental value of the premises. In such cases the price of the goodwill is merely a disguised commutation of rent, and it should be so taxable.

752. Witnesses have called attention to the possibility that Section 16 (d) as it now stands might be applied in such a manner as to tax the goodwill received upon the sale of a professional connexion carried on in leasehold premises. We are officially informed, however, that the Section is not so interpreted, and that no attempt has been made to apply it in such cases. We do not consider that the sale price of the goodwill of a professional man is income, or that it should be subject to Income Tax. In such cases the goodwill is personal and to a large extent independent of the premises upon which the profession is carried on. A common example is the goodwill of a doctor or other professional man, which cannot be acquired merely by the purchase of a lease of his office or consulting rooms. It would be an anomalous proceeding to tax him upon the price received for his goodwill where he carries on his profession in leased premises, and exempt him where the property is freehold. If the goodwill is attached to the premises, then the consideration for it upon a lease is rent and should be taxed as rent. If the goodwill exists independently of the premises, it should be exempt from tax.

TAX ON PREMIUMS RECEIVED BY LESSORS AND TRANSFERORS.

753. If a premium or other consideration for the grant, transfer, or assignment of a lease is to be taxed as income, a question arises how the tax should be calculated. We received much evidence that the present Commonwealth method of taxing the whole amount as income of the year in which it is received, at the rate applicable to the total income of that year, is unduly harsh, and we are inclined to think that there is some justification for that view. The importance of the question arises from the steep graduation of the rate of tax coupled with the fact that every

addition such as the premium makes to the ordinary income of the year involves a higher tax, not only on the amount of the premium, but on the ordinary income itself. To some extent the hardship has hitherto been mitigated by the operation of the averaging system ; but it becomes necessary to review the position in the light of our suggestion that that system should be restricted. Moreover, none of the States adopt the principle of averaging income of this kind.

754. The reason for treating the premium as income is that it is in effect a commutation of several years' rent ; and this is a matter that might properly be taken into consideration in determining the method according to which it should be taxed. **A reasonable solution of the problem would seem to be reached by taxing the whole premium in the year in which it is received, but by using only a proportion of it for the purpose of calculating the year's rate.** For example, if a premium of £5,000 were paid for a five years' term, £5,000 would be added to the other income of the year to ascertain the amount to be taxed, but only £1,000 would be added to determine the rate of tax.

755. If the matter stopped there, however, the taxpayer in question would have received a concession putting him in a better position than the lessor or transferor whose rent was paid periodically and not commuted in a premium. The latter would have the rate on his other income in each of the five years increased by reason of the receipt of the additional £1,000. To meet this difficulty, a taxpayer who gets the benefit of the concession should have £1,000 added, but only for rate purposes, to his other income in each of the four succeeding years. Thus while paying tax on the £5,000 in the year in which he received it, his aggregate tax for the five years would be the same as if he had received £5,000 in rent spread over the five years.

756. We think, however, that this concession should be limited by a provision that where the term of the lease, or the unexpired period in respect of which the premium is received, is more than five years, the divisor to be used should not exceed five. This is the number of years hitherto adopted by the Commonwealth for averaging purposes.

757. We recommend—

- (a) That the premium received for the grant, assignment or surrender of a lease (including any goodwill or licence attached thereto) be taxable in the hands of the recipient as income of the year in which it is received by him.
- (b) That the rate of tax payable by him for that year be determined by adding to his other income an amount ascertained by dividing the premium by the unexpired period of the lease (in years) not exceeding five years.
- (c) That the rate of tax payable by him for each of the remaining years (not exceeding four) of the unexpired period be determined by adding the amount so ascertained to his other income.
- (d) That a lessor who is not exempt from tax under the Act be liable to pay tax upon the estimated value of improvements effected by the lessee in accordance with a covenant or a binding agreement, in writing, made between the lessor and the lessee. That in such cases the amount subject to tax be the annual contribution that would have to be set aside to accumulate during the unexpired period of the lease to an amount equal to the depreciated value of the improvements at the date when the lease expires.
- (e) That the premium paid by a lessee for the grant or transfer of a lease of a property used for the production of income (including any licence or goodwill attached thereto) be allowed as a deduction to him by annual instalments spread over the unexpired period of the lease.
- (f) That the cost of improvements effected by a lessee of such property in accordance with a covenant or a binding agreement in writing made by him with the lessor, or, in the case of a lease granted by a public authority, with the consent in writing of the lessor, be allowed as a deduction to him by annual instalments spread over the unexpired period of the lease.

SECTION XLI.

CASUAL PROFITS.

758. A casual profit may be defined as a profit arising from a transaction that does not form part of the ordinary business of the person who makes it. Profits which are over and above ordinary expectations of the taxpayer are considered in many countries to possess a high degree of ability to pay tax. This is well expressed by Stamp, who says, "As a development of modern times one is almost obliged to lay it down as a principle that irregular or spasmodic receipts, which were not required or essential in order to provoke or sustain any economic effort or sacrifice, possess in the abstract a higher degree of 'ability to pay' than corresponding amounts of regular income or capital."

759. With one possible exception, all Governments seek to tax casual profits to some extent, but the test of taxability varies. In the Commonwealth, Victoria and South Australia such profits are taxable only if it can be shown that they arise from the sale of any property acquired by the taxpayer for the purpose of profit-making by sale or from the carrying on or carrying out of any profit-making undertaking or scheme. These words are specifically used in the definition of income in the Commonwealth Act, but do not appear in the Acts of Victoria or South Australia, where it is considered that the Commissioner has the power to impose tax upon profits of this nature by virtue of the general scheme of the Act. In each of these cases the profit is taxed in the year of receipt at the rate applicable to the total income of the year.

760. New South Wales and Queensland tax casual profits on a different basis. In New South Wales tax is payable on any profit made upon the sale of real property situate in the State, purchased during the year of income or the six years next prior thereto, or of any personal property situate in the State of an aggregate value exceeding £200, purchased during the year of income or the two years next prior thereto, and upon the sale of shares acquired during the like period but without the limitation as to value. The profit is taxed in the year of receipt at a rate ascertained by adding to the other income of the taxpayer a proportion of the casual profit based on the number of years during which the asset sold was owned by the taxpayer, not exceeding seven. In Queensland tax is payable upon any profit realized on real or personal property, without limitation of value, purchased or acquired for sale in the ordinary course of business without regard to the time that has elapsed between purchase and sale. If, however, such property was not purchased or acquired for sale in the ordinary course of business the profit is not taxable unless such property was acquired during the year of income or the six years prior thereto. The profit is taxed in the same manner as in New South Wales.

761. In Tasmania tax is payable on the profit derived from the sale of land, including the goodwill of any business carried on on such land, if acquired by the taxpayer during the year of income or the three years next prior thereto. The profit is taxed in the year of receipt at the rate applicable to the total income of the year.

762. The essential differences between the methods described are that the Commonwealth, Victoria and South Australia impose tax only on the profits derived from a profit-making scheme; New South Wales taxes the profits derived from the sale of an asset, which has been sold before the expiration of a specified period irrespective of the intention of the owner at the time when he acquired it, and Queensland employs both tests. It follows, therefore, that in Queensland and New South Wales capital profits in some circumstances are subject to tax. It should be noted, however, that the method of determining the rate of tax to be applied to casual profits in the two States last-mentioned to some extent makes a distinction between the speculator and the investor, as in effect it imposes the highest rate of tax on the former and the lowest on the latter.

763. In our opinion casual profits should be taxable only if they are derived from a transaction recognizable as a business transaction, i.e., one in which the subject matter was acquired with a view to profit-making.

764. We recognize, however, that it may not be possible to obtain agreement between the Commonwealth and all the States on this subject, and that the States which now impose tax on casual profits derived from the sale of assets which have been held for less than the period specified may desire to continue to do so. While, therefore, we consider that the principle we have recommended in paragraph 763 should be followed, we think that those States which desire to tax other casual profits should do so by applying the methods now used in New South Wales.

Casual Losses.

765. There remains the question of the treatment of casual losses. Witnesses not unreasonably contended that if casual profits are to be taxed, a deduction should be allowed for casual losses. In theory it is difficult to dispute this proposition, but be that as it may no Government appears to be prepared to allow a deduction for casual losses of a "capital" nature, without limitation.

766. The practice of the various Governments differs. In those which tax casual profits arising only from a profit-making scheme it would appear that a deduction must be allowed for casual losses arising from that class of transaction. In those States which do not allow the carrying forward of losses, this deduction would be limited to the amounts of other income of the year. In the case of the Commonwealth, which allows the carrying forward of losses, it would appear that a taxpayer would be entitled to deduct the unrecovered portion of a casual loss incurred by him in any of the four years next preceding the year in which the income was derived. The Acts of Victoria and South Australia do not permit a casual loss to be carried forward.

767. In New South Wales, Queensland and Tasmania a casual loss sustained during the year of income may be set off against a casual profit derived during the same year, but not against any other income. New South Wales, however, allows a casual loss incurred during the two preceding income years to be set off against any similar profit in the year of income.

768. We recommend—

- (1) That those Governments which tax casual profits arising only from the carrying on or carrying out of any profit-making undertaking or scheme should allow as a deduction a casual loss arising from the same class of operation, and that the provisions of any of the Acts which permit the recoupment of a loss out of the profits of subsequent years should apply also to such casual losses.
- (2) That those Governments which tax all casual profits irrespective of the manner in which they arise should allow casual losses as a deduction to the extent of casual profits of the same nature derived by the taxpayer during the year in which the loss was incurred, and that the taxpayer be entitled to set off any unrecovered balance of such loss out of the income of the same nature derived by the taxpayer during a specified number of subsequent years.

SECTION XLII.

LIVE STOCK.

769. There is probably no other subject in regard to which the provisions of the Income Tax Acts of the Commonwealth and the States differ so greatly as in respect of the valuation of live stock. The absence of agreement in regard to one of the principal primary industries of the Commonwealth is a striking example of the present lack of uniformity in taxation law, though we think that in practice there is a greater measure of agreement between the Commonwealth and the States than the language of the respective Acts would suggest.

770. Most of the differences in the respective Acts relate to the following matters:—

- (1) The omission or inclusion of live stock at the beginning and end of each year ;
- (2) The valuation of live stock ;
- (3) The manner in which profits arising from the sale of breeding stock are to be treated ;
- (4) The valuation of sheep in the wool or in lamb.

THE OMISSION OR INCLUSION OF LIVE STOCK AT THE BEGINNING AND END OF EACH YEAR.

771. This question may be considered in relation to :—

- (a) Working beasts and beasts of burden ;
- (b) Natural increase ;
- (c) Other live stock.

772. *Working beasts and beasts of burden.*—The Acts of the Commonwealth, New South Wales and Tasmania provide that these shall not be included in the value of the live stock at the beginning and end of the income year. The Acts of the other States are silent on the point.

773. We recommend that working beasts and beasts of burden be regarded as plant and so treated for the purposes of taxation. Their value should be excluded from the value of live stock on hand at the beginning and end of each year.

774. *Natural Increase.*—The Acts of the Commonwealth, New South Wales and Tasmania permit the taxpayer to omit the value of natural increase until sold or otherwise disposed of. This concession is not allowed by the other States. It first appeared in the Commonwealth Act in 1923, the reasons assigned for its inclusion being that it would obviate the taxation of unrealized profits and tend to simplify assessment in some of the States where, it was stated, a similar practice had been in vogue for many years.

775. Although both Queensland and Victoria at one time permitted a grazier to omit from his return the value of all live stock on hand, neither of these States permitted him to omit only the natural increase. It is significant that in 1923 (i.e., at the same time that the Commonwealth granted the right to omit natural increase) Queensland repealed the provisions of the Act which permitted a grazier to omit all his live stock until sold or otherwise disposed of, and required him thereafter to bring it into account both at the beginning and end of each year. The Victorian Act still permits a grazier to omit all his live stock, until sold or otherwise disposed of, but this method of computing the taxable income is officially frowned upon in that State.

776. The expectation that the omission of natural increase would tend to simplification has not been realized. The evidence of the Federal Deputy Commissioner in every State showed that the option has been availed of to a very limited extent, and that many of those who have adopted it now regret their decision and would like to change it. The practice is embarrassing both to the Department and to the grazier, and the attempt to separate natural increase that has been omitted creates general confusion, with the result that the return cannot possibly be correct.

777. We have given very careful consideration to the request of the Federated Graziers' and Pastoralists' Associations of Australia, made through their official representative, that we should recommend that this concession be continued, but, in our opinion, the balance of evidence is distinctly against that suggestion, and we consider that it will not promote either simplicity or uniformity.

778. We recommend that the option given to a grazier to omit from his return the value of all natural increase of live stock owned by him and born during the year in which the income is derived be deleted from the Commonwealth Income Tax Assessment Act, and from the Acts of those States which now allow that concession.

779. If this recommendation be adopted, it will be necessary to make provision to cover the case of a grazier who has previously elected to omit natural increase. The value of the natural increase previously omitted must, of course, eventually be brought into his accounts. To permit him to bring this amount in as opening stock in the year of change would place him in an advantageous position in comparison with the grazier who has previously included his natural increase. On the other hand, if he were required to bring it in as part of the value of his live stock on hand at the end of the year of change, it would mean that he would have to pay tax for that year upon the accumulations of natural increase extending over several years.

780. We recommend, therefore, that graziers who have previously omitted natural increase be required to account for the proceeds of such natural increase only when sold or disposed of for value.

781. *Other Live Stock.*—As we have previously stated, Victoria is now the only State which permits graziers to omit *all* live stock on hand at the beginning and end of each year and to submit returns on a cash basis. In our opinion, the right given to graziers to exercise this option should be terminated, equitable arrangements being made to place upon a proper footing the accounts of those taxpayers who have previously availed themselves of it.

VALUATION OF LIVE STOCK.

782. This may be considered under two headings :—

- (a) Valuation of grown stock ;
- (b) Valuation of natural increase.

As the flocks of a grazier may be built up partly by purchases and partly by natural increase, it is difficult, if not impossible, to consider the valuation of grown stock apart from the valuation of the natural increase which will ultimately be included in the total stocks and influence their values. It will be convenient, therefore, to consider the valuation of live stock as a whole.

Commonwealth.—The taxpayer may elect, in writing, whether he will adopt cost price or market value. The election is irrevocable. If he elects cost he must select for natural increase a value within certain prescribed limits which are as follow :—

		Sheep.		Cattle.		Horses.		Pigs.
Minimum	..	.. 2s. 6d.	..	10s.	..	15s.	..	5s.
Maximum	..	.. 10s.	..	£5	..	£3	..	£1

New South Wales.—A taxpayer may adopt such value per head as he desires, with the approval of the Commissioner, or, in default of agreement, then such value as is in the opinion of the Commissioner just and reasonable. The value so fixed must be adopted each year unless and until altered with the consent of the Commissioner.

Victoria.—There is no specific basis prescribed in the Act, but the Commissioner states that market selling value is adopted in most cases. If the values returned are unreasonably low, an average cost price is determined by taking the closing values in the previous return, adding purchases at cost and natural increase at 5s. for sheep and £1 for cattle.

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Queensland.—Live stock must be brought to account at the value or values determined from time to time by the Commissioner. The Commissioner explained his practice as follows :—

“There is no election of values for grown stock, and natural increase is brought in at the end of the first year as follows :—

Lambs.—2s. 6d. per head, or if taxpayer's grown value has never reached 10s., at one-fourth of such grown value.

Calves.—15s. per head, or if taxpayer's grown value has never reached £3, at one-fourth of such grown value.

Foals.—£1 per head, or if taxpayer's grown value has never reached £4, at one-fourth of such grown value.

At the end of the second year the natural increase of the previous year are merged with the grown stock at four times the values at which they were brought in as natural increase. Alternatively, on application, a taxpayer would be permitted to return the natural increase of sheep and cattle, viz :—

Lambs.—First year at 2s. 6d. or one-fourth of grown value if such has never reached 10s.; second year at 5s. or half of grown value if such has never reached 10s.; third year merged with grown stock at 10s., or at four times the first year value, if grown value has never reached 10s.

Calves.—First year at 15s. or one-fourth of grown value if such has never reached £3; second year at 30s. or one-half of grown value if such has never reached £3; third year at 45s. or three-fourths of grown value if such has never reached £3; fourth year, merged with grown stock at £3, or at four times the first year value, if grown value has never reached £3.”

South Australia.—There is no specific basis of valuation prescribed by the Act, but in practice the taxpayer values live stock at either cost price or market value. Where cost is selected most taxpayers include natural increase at the value elected for the purposes of the Commonwealth return.

Western Australia.—Live stock on hand at the end of the accounting period is valued at an average figure obtained by taking the number and value on hand at the beginning of the income year, adding thereto purchases at cost price, and natural increase at the prescribed values, which at the time of our inquiry were as follow :—

					Sheep.	Cattle.		
					s.	£	s.	d.
Kimberley	..	..	..	..	5	..	1	10 0
North-west	..	..	..	..	5	..	1	10 0
Western	..	..	..	..	6	..	2	0 0
South-western (1)	..	..	..	..	8	..	3	0 0
South-western (2)	..	..	..	..	10	..	4	0 0
Eastern	..	..	..	..	6	..	2	0 0
Eucla	..	..	..	..	6	..	2	0 0

Tasmania.—This State adopts the same methods of valuation as the Commonwealth.

783. Consideration of the sections of the respective acts summarized in the foregoing paragraphs shows the diversity in the methods of valuation adopted by the Commonwealth and States, and the difficulty of suggesting a method which will suit all of them.

784. Where the Acts of the Commonwealth and the States prescribe rigid bases for the valuation of live stock, and where these differ from each other, the accounts of a grazier may show three values for his live stock, viz. :—

- (a) The value for Commonwealth Income Tax ;
- (b) The value for State Income Tax, and
- (c) The value adopted for his own accounts.

The result is that the income subject to Commonwealth tax differs from that subject to State tax, and each may be different from the profits of the business as shown by its accounts. Where a business is carried on by trustees, any difference in the taxable profit which is due to the application of an arbitrary method of valuing live stock may represent an amount upon which the beneficiaries are subject to tax but which they may never receive. The problem, therefore, is to indicate a method of valuing live stock which is fair to the Department and to the grazier, and at the same time sufficiently flexible to meet unusual circumstances which are likely to arise.

785. Several methods may be considered. The first is that live stock should be valued at actual cost. But in many cases it would be difficult, if not impossible, to arrive at "actual" cost, particularly of natural increase. In practice an average cost basis is adopted. This may be briefly described as an average figure arrived at by taking the number and value of stock on hand at the beginning of the income year, adding thereto the number and value of stock purchased during the year, and the natural increase of the year at a prescribed value. In normal conditions this method appears to work smoothly.

786. The next is that live stock should be brought to account at market value. The evidence that we have heard leads us to believe that while it might be practicable to determine market values in the more closely settled areas, it would be difficult, if not impossible, to do so in the more remote parts of the Commonwealth. Witnesses representing graziers in Western Australia informed us that sheep in the distant parts of that State had no local market value, and that it would be unprofitable to bring them into the settled areas, as the cost of moving them would exceed the amount they would realize. Other witnesses stated that sheep had recently been sold in more closely-settled districts at a few pence per head. But even if the difficulty of arriving at market value could be overcome, an objection from the point of view of the grazier would be that the adoption of this basis of valuation would bring unrealized profits into account, and in view of the uncertainty inseparable from the industry, he takes strong exception to this.

787. A further alternative is that the grazier should be permitted to value live stock on the same basis as trading stock, i.e., either at its actual cost price, market value, or replacement cost—whichever is the lower, at his option and without regard to the basis adopted by him in a previous year. While the adoption of this suggestion might simplify the preparation of the returns of graziers, it is open to objections, the most important of which is that it would probably be difficult in many cases to satisfy the Department that the values adopted were reasonable or consistent with those used in previous years. This would give rise to queries and correspondence and create irritation. It would also increase the cost of administration. We may add that this suggestion is not favoured by the representatives of the Federated Graziers and Pastoralists' Associations of Australia.

788. It is clear that the greatest difficulty which arises in valuing live stock for the purposes of taxation is to assign a fair value to natural increase. The Commonwealth and some of the States have attempted to overcome this difficulty by fixing prescribed values. The Regulations made under the Commonwealth Income Tax Assessment Act fix minimum and maximum values and permit a grazier to elect irrevocably to adopt any value between these limits. In Queensland alternative but arbitrary values are prescribed. In Western Australia values are prescribed for each pastoral district. In the other States a grazier may adopt values which he considers reasonable.

789. In our opinion the advantages of prescribed values for natural increase outweigh the disadvantages. The range of values prescribed in the Regulations made under the Commonwealth Act appears to be sufficiently wide to cover most cases, but in certain conditions some graziers may be able to prove that even the minimum value prescribed is too high. This may occur when conditions over which the grazier has no control have reduced the true value of his natural increase to a figure which is materially less than that which he elected to adopt some years ago. It may also result from delay in adjusting the values prescribed by certain States to meet altered conditions in the industry. Conversely, some graziers may desire to adopt values which are higher than the maximum values prescribed, as, for example, breeders of stud stock. All these cases could be met in a simple manner by giving the grazier the right to adopt other values for live stock if he can satisfy the Commissioner that the conditions under which he carries on his business justify the adoption of values outside the prescribed range. It should, however, be a condition that the same values are to be adopted both for Commonwealth and State purposes and that once they have been adopted they are not to be altered without the approval of the Commissioner.

790. If the accounts of a grazier are to be brought into agreement for Commonwealth and State purposes, similar options must be available to him under the respective Acts. The first step towards this end would be to give the grazier in Queensland and Western Australia the option to adopt market values, for at present the Acts of those States provide that he must adopt average cost basis. The next step would be for all the Governments to agree upon a uniform method of valuing natural increase. A reference to paragraph 782 will show the existing variations in the values. Thereafter whatever basis of valuation is adopted by the grazier should be used for Commonwealth and State purposes.

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791. We recommend—

- (a) That a grazier be given the option (to be exercised in writing) to value his live stock (including natural increase) at cost price or at market value.
- (b) That a grazier who elects cost price shall value natural increase born during the year of income at a value to be selected by him within the limits to be prescribed.
- (c) That where a grazier can satisfy the Commissioner that the conditions incidental to his business justify the adoption by him of a basis of valuation other than those set out in (a) and (b) above, he may, with the approval of the Commissioner, adopt such other basis of valuation.
- (d) That any basis adopted for the valuation of live stock shall be used for both Commonwealth and State Income Tax purposes. Provided, however, that a grazier who has previously elected cost basis and desires to remain on that basis may be permitted to adopt the same value for live stock on hand at the end of the year of change, for both Commonwealth and State purposes, notwithstanding the fact that such amount may not represent "cost" as determined in accordance with the provisions of the respective Acts.

THE RIGHT TO MAKE FRESH ELECTIONS.

792. Under the Acts of the Commonwealth and Tasmania the grazier, as we have pointed out, in addition to the option which we have already considered of omitting natural increase altogether, is allowed two other options as to the valuation of his live stock. He may elect—

- (a) to value it at cost price or market value, or
- (b) if he adopt cost price, to select for natural increase a value within certain prescribed limits.

Both these options are at present irrevocable.

793. We received requests from witnesses representing Graziers' Associations that graziers should be permitted to make fresh elections. In support of this request it was pointed out that the elections had been made under abnormal conditions which no longer exist. The evidence presented to support this request indicates that the witnesses were more anxious to obtain the right to adopt new and, presumably, lower values for natural increase than to be allowed to adopt another basis for the valuation of their live stock.

794. In our opinion there is some merit in the request for the right to adopt new values for natural increase. We think also that a grazier might be given the right to elect another basis of valuation, for we can contemplate circumstances which justify the variation of the previous option, and as the principal object of our inquiry is to establish uniformity between the Commonwealth and the States it may be necessary in order to do so to permit a grazier to adopt another basis of valuation if his accounts are to be brought into agreement for Commonwealth and State purposes.

795. While we appreciate the necessity for reasonable permanence in regard to any option that may be exercised by a grazier, we do not think that a decision once made should be irrevocable. Future conditions cannot be foreseen, and a choice which is fair and reasonable in certain circumstances may be entirely inequitable when those circumstances alter from causes over which the grazier can have no control. But we think that the right to adopt a fresh election should be exercised not entirely at the option of the grazier, but only when he can show good cause.

796. We recommend that a grazier who has made, or who may make, any election relating to the valuation of live stock (other than the election to omit natural increase) for the purpose of the Commonwealth or any State Income Tax Act be allowed to make a fresh election, subject to the following conditions :—

- (1) That the new election shall be subject to the approval of the Commissioner, and that all subsequent returns shall be prepared on that basis unless and until it is altered with the consent of the Commissioner ;
- (2) That in the year of change the value of live stock on hand at the beginning of the year must be brought into account at the value at which it was assessed by the Department as on the last day of the preceding year ;
- (3) That, in the absence of any material objection, the Commissioner shall favorably consider any application to make a new election if the object of the alteration is to bring the valuation of live stock into agreement for the purposes of the Commonwealth and State returns.

PROFITS ON SALE OF BREEDING STOCK.

797. Section 16 (h) of the Commonwealth Income Tax Assessment Act provides that the assessable income of a taxpayer who has sold assets for the purpose of putting an end to the whole of a business or in consequence of the compulsory acquisition of land shall not include any live stock which, in the opinion of the Commissioner, were ordinarily used for breeding purposes (except that the value of the wool on the sheep's back shall be assessable). Provisions of similar import are contained in the Income Tax Acts of New South Wales and Tasmania. By judicial interpretation the same exemption is allowed in South Australia. The provisions of the Income Tax Acts of the remaining States specifically impose tax on the proceeds of breeding stock sold in these circumstances.

798. Witnesses representing the various Associations of graziers were insistent in their request that we should recommend that this concession should be continued, and that it should be extended to all States. The arguments advanced to justify this request, however, do not appear to us to be convincing.

799. The claim is based upon the argument that live stock used for breeding purposes is equivalent to plant, and that when it is sold the proceeds should be regarded as a realization of capital. But the grazier does not take this view when he buys it, for the cost is debited to his working account, and he is allowed a deduction in full for the amount so expended. If breeding stock is sold otherwise than upon the realization of a business, the proceeds are brought to account as ordinary income, and the grazier is taxed on the profit or allowed for the loss on the transaction. If the argument that breeding stock is capital be sound, it should be treated consistently in all circumstances, and in that event its cost would not be allowed as a deduction, nor would any profit upon its realization be taxable.

800. The truth is that live stock possesses some of the characteristics both of a fixed asset and a trading asset. Although an animal may be acquired primarily for breeding or wool-growing purposes, its ultimate sale is in many cases by no means a minor consideration. The life of any stock is limited to a few years, and it must be eventually realized or replaced.

801. Another aspect of the subject may be commented upon. The offspring of stock acquired for breeding may be omitted from the accounts of the taxpayer or brought in at a low value. In either case the payment of tax on the real profits of the business is delayed. In the event of realization the resulting profit is increased either because of the omission of natural increase or because of the low value at which such natural increase has been brought into the accounts, and in these circumstances the profit does not represent a capital profit which is due to an appreciation in values, but a profit which is due in part at least to the fact that the cost of the breeding stock sold has been reduced by the operation of the Regulations to a sum which is less than its true worth. It is clear, therefore, that a grazier who either omits natural increase or who brings natural increase into his accounts at a low value derives a benefit which is not enjoyed by a grazier who does not avail himself of either of these options.

802. In our opinion there is no real justification for the continuation of this concession. There can be no real grievance, as in almost every case no less than the full cost price of every head of stock purchased or reared has been allowed as a deduction. We should point out that a grazier is not permitted to claim any loss resulting from the sale of breeding stock upon the realization or discontinuance of a business, and that as a matter of fact the concession only operates to his advantage when the values of stock are relatively high.

803. It appears to us that the claim for the exemption of profits in these circumstances is really based upon the fact that the business is to be terminated, and not upon the nature of the stock sold. If this be admitted it is difficult to see why the profit on trading stock realized by a merchant in similar circumstances should not also be exempt from tax. This was, in fact, the position until the Commonwealth Act was amended to make such profits taxable, and there seems to be no reason why an exemption denied to the merchant should be permitted to the grazier.

804. We recommend that the proceeds of breeding stock sold upon the realization or discontinuance of a business from any cause whatever shall be included in the assessable income of the taxpayer.

SHEEP IN THE WOOL.

805. Section 17 of the Commonwealth Income Tax Assessment Act permits the purchaser of sheep in the wool to elect, upon lodging his return, to treat the cost as a purchase of sheep and wool as distinct from each other. None of the State Acts contain a similar provision. We are informed that very few graziers take advantage of this Section, and that it may be regarded as virtually inoperative. The opinion was also expressed that the valuation of partly-grown wool is in any case largely a matter of guess work.

806. One witness suggested that the cost of sheep in lamb purchased should be treated in the manner prescribed by the Commonwealth Act for sheep in the wool. In our opinion, however, the reasons which have induced us to take the view that the provisions relating to the latter should be deleted from the Commonwealth Act, preclude us from supporting this suggestion.

807. We recommend that Section 17 of the Commonwealth Income Tax Assessment Act, which permits the purchaser of sheep in the wool to treat the cost as a purchase of sheep and wool as distinct from each other, be deleted from that Act.

SECTION XLIII.

TAXATION AT THE SOURCE.

GENERAL CONSIDERATIONS.

808. The Report of the Royal Commission on the Income Tax (Great Britain) estimated that at least 70 per cent. of the British Income Tax is collected at the point at which the income arises, through persons who are not directly interested in the payment. A few witnesses suggested that similar methods might be adopted in Australia, but the great majority of witnesses were of the opinion that this was impracticable. We have very carefully considered whether any of the desirable features of the British system might be adapted to Australian requirements in the hope of simplifying some of the problems to which we have referred from time to time.

809. It is necessary to appreciate that the taxation systems of Great Britain and Australia are fundamentally different. Taxation by deduction at the source lies at the very root of the British system. It is based upon a flat rate of tax which is deducted by the payer, as, for example, by a company on dividends paid to its shareholders. Incomes not exceeding a certain amount are taxable at half the standard rate, and hence in such cases, and in others where the recipient is not taxable, refunds and adjustments have to be made. But because the deduction is always made at a flat rate such adjustments are easy to make. Australian tax systems, however, are all based upon a graduated rate of tax, commencing from the lowest point. If, therefore, an attempt were made to apply taxation at the source to Australian conditions, it would be necessary to repeal all the Commonwealth and State Acts relating to Income Tax, and completely alter existing methods of administration.

810. Deduction of tax at a flat rate runs counter to the principle of progression, for whatever rate be adopted must be too high for some taxpayers and too low for others. Numerous adjustments would be required, and it would be necessary to establish an elaborate refund department. This would neither simplify procedure nor reduce the cost of administration. For these reasons taxation at the source as applied in Great Britain could not be generally adapted to Australian conditions. There is, however, no reason why limited use should not be made of "collection at the source", which is not open to so many objections. It is an essential of the latter method that the taxable income be assessed in the ordinary manner, and an adjustment be made between the amount found to be due and the amount collected. A taxpayer, therefore, pays only his proper tax. It has been found convenient to collect tax on wages and salaries, bearer securities, and payments to absentees in this manner. We shall deal with each of these subjects separately.

WAGES AND SALARIES.

811. The opinion was expressed by a number of witnesses in every State that tax upon wages and salaries should be collected at the source. The statistics included in the Fifteenth Annual Report of the Commonwealth Commissioner of Taxation show that approximately two-thirds of the total number of taxpayers consist of employees. There are, however, many persons in receipt of wages and salaries who are not subject to Commonwealth Income Tax, and it is probable, therefore, that a larger percentage of the adult population of Australia derives the greater part of its income from these sources. Detailed statistics are not available to us, and it is difficult to make an estimate owing to the difference in the statutory exemptions allowed in the various States.

812. There are distinct advantages to be gained by the collection of tax on wages and salaries at the source. It ensures a regular flow of Revenue; it enables tax to be collected from persons who have hitherto evaded their obligation, and it is of material assistance to the taxpayer who is able to provide for the payment of his tax by small regular instalments instead of being asked to make an inconveniently large single payment. It is essential, however, that the machinery of collection and assessment should be as simple as possible, in order that it should not add to the cost of administration or impose unnecessary inconvenience on the taxpayer.

813. A witness representing the Taxpayers' Association of Victoria proposed that tax payable by persons in receipt of income from salary and wages not exceeding £400 per annum should be collected, without assessment or adjustment, by means of a graduated stamp tax to be

deducted by the employer at the time of payment, and that such persons should not be called upon to lodge returns unless their other income exceeds £25 or their income from salaries and wages exceeds £400. It was suggested that the rate of stamp tax should be graded to be as nearly as possible 50 per cent. of the personal exertion rate, and that no deduction should be allowed for the statutory exemption or the concessional deductions (wife and children, life insurance, medical expenses, and the like).

814. The proposal has the merit of simplicity, and it is possible that it would produce approximately the same aggregate amount of tax as assessment by the customary method. But it is open to various objections. Under this system it would be necessary to provide that only those persons in receipt of an income in excess of a fixed minimum should lodge returns. Such persons would be then assessed in the ordinary manner, i.e., on the income of the *preceding* year. Others whose wages are below this minimum would be assessed on the income of the *current* year. It might happen that a taxpayer who this year pays tax on his income by stamps would become liable next year to lodge a return. The converse position may also arise, namely, that a taxpayer liable to lodge a return this year might, because of a reduction in his income, pay his tax by stamps next year. A system of taxation which classifies the same taxpayers in different groups in successive years must add to the difficulties of administration and increase the risk of evasion.

815. The system is clearly inequitable, for it imposes the same tax on a given amount whether the recipient is a single man without responsibilities or a married man with a family. The latter is not likely to be satisfied with the explanation that the rate is calculated at an average applicable to all workers, for he can reasonably maintain that his domestic responsibilities entitle him to greater consideration than the taxpayer without any. Further, as the tax imposed must, of necessity, be collected at the time of each payment, it does not provide for equitable treatment of the casual worker who may receive wages at a fairly high rate for a few weeks and then suffer a long period of idleness. **Simplicity is not the only consideration, and we are not prepared to recommend any method of collecting tax on wages at the source that does not provide for an eventual adjustment of over or under payments.**

816. Taxation by means of stamps without adjustment has been applied in various States for the collection of Unemployment Relief Tax, but experience has shown that it is not entirely satisfactory, and in our opinion the method which has now been adopted by the States of South Australia and Victoria is preferable. In each of these States an amount determined by reference to the weekly wage is paid each week by stamps, but an annual return is made and the income is assessed in the ordinary manner. When the assessment is due for payment, an adjustment is made between the amount of the assessment and the amounts previously set aside by the purchase of stamps. Under this method the taxpayer is allowed the statutory exemption and any concessional deductions to which he is entitled, and, therefore, pays the correct amount of tax. Although certain difficulties were experienced at its inception, these appear to have been overcome. The system is giving general satisfaction in those States, and is extremely popular with those whose tax is so assessed.

817. We have considered whether Commonwealth Income Tax might not simultaneously be collected from the same class of taxpayers by the same methods. This would involve either the use of State stamps or the issue of special Commonwealth stamps. Objection was made to the use of State stamps, as it was held that this would involve difficult financial adjustments with the States. But, in our opinion, this difficulty could be easily overcome. The issue of separate Commonwealth stamps for this purpose would create confusion, and it cannot be recommended. We think, however, that the scheme would be of less value for Commonwealth purposes because many employees would be exempt from Commonwealth tax owing to the statutory exemption and the concessional deductions to which they are entitled.

818. The various schemes to which we have referred relate entirely to the collection of tax and not to its assessment. For this reason it is not essential that they should be included in the Uniform Act and adopted by the States. **It is for each Government to choose the particular machinery which it will employ for the collection of tax on wages and salaries, and we do not desire to make any recommendation on this subject.**

INTEREST ON BEARER SECURITIES.

819. This is another class of income upon which tax might be conveniently collected at the source. Bearer securities are a convenience which meet a public demand for an investment which is easily negotiable, and it need not be assumed that they are invariably acquired to facilitate the evasion of Income Tax or death duties. There is, however, reason to believe that some evasion occurs, but in attempting to detect this it is essential that the larger question of public policy be not overlooked. **It would be unwise to adopt any measures designed to detect the omission of interest on bearer securities, which would seriously interfere with their popularity as an investment.**

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820. Bearer securities fall into two classes—(1) those issued by public authorities and companies, and (2) those issued by the Commonwealth Government. The Acts of the Commonwealth, New South Wales, Queensland, South Australia and Western Australia contain provisions designed to collect tax from companies on interest paid by them on bearer securities which they have issued. The provisions of the Acts of Victoria and Tasmania appear to be ineffective. Except in the case of Queensland, none of the Acts appear to contain effective provisions for the collection of tax on interest on bearer securities issued by a public authority.

821. Bearer securities issued by the Commonwealth Government exceed all others in number and amount. A substantial proportion of them is held by corporations that are not taxable, as, for example, State Savings Banks, Friendly Societies and public authorities. Further considerable amounts are held by Banks, Investment and Insurance Companies, and others who, though taxable, are not likely to attempt to evade tax on the interest which they receive from this source. The residue is held by other companies and individuals, and many of these include the interest in their returns. **It is clear, therefore, that the amount of interest paid on these securities in respect of which there may be some evasion of tax is relatively small in comparison with the total amount paid.**

822. Three methods for the prevention of evasion have been suggested :—

- (1) That tax should be deducted on the interest at a flat rate, but refunded on the production of evidence that such interest has been included in the assessable income of the claimant.

The objections to this proposal are that deduction would have to be made at a fairly high rate to meet the case of the individual in receipt of a substantial income, and that persons who are not taxable, or whose rate of tax is less than the rate at which the deduction is made, would be put to a considerable amount of inconvenience in obtaining refunds. The administrative cost of checking and making refunds must also be taken into consideration.

- (2) That the actual recipient of interest on bearer securities should be required to sign an acknowledgment showing the name of the beneficial owner, the name of the collector, and the amounts received, and that these acknowledgements should be forwarded to the Commonwealth Bank for transmission to the Commonwealth Income Tax Department.

The adoption of this suggestion would impose some responsibility on the Bank paying the interest, and further responsibility and a considerable amount of work upon the Commonwealth Bank. It is doubtful whether the remedy would be effective, for the signature on the receipt might be that of a nominee or agent, and not necessarily evidence of ownership of the bonds in respect of which the interest was collected. We think that a person who is at present evading tax on these securities would not hesitate to make use of other persons, or even to sign a fictitious name, when receiving his interest.

- (3) That every person making a return should be required to include therein a statement showing the face value of the Commonwealth Government bonds held by him at a specified date, say, the 30th June, or alternatively that he has none.

This course would probably disclose ownership of bonds by persons who are not known to hold them, as such persons would not care to make a declaration denying possession or control of the bonds for the fear of the penalties attaching to a false statement.

823. Whether any of these methods should be adopted appears to be a matter for the Commonwealth Treasury to decide, having regard to the probable effect upon investors. We are not prepared to recommend that either the first or second proposal should be adopted, but merely indicate them as possible solutions. Less friction with investors should occur if the third alternative were adopted, and this would not prevent the application of one of the other methods if it were subsequently thought expedient.

ABSENTEES.

824. The Commonwealth Act provides that a company shall pay normal Income Tax, at the company rate, on interest paid or credited by the company to an absentee on money raised by debentures and used in Australia, or on money lodged at interest in Australia with the company. In certain circumstances the company is exempted from this liability, and these will be discussed later. The absentee is also personally liable to pay both normal Income Tax and special property tax, not only on such interest, but on any other income that he may derive from sources in Australia, as, for example, rent, dividends, and interest other than that previously specified, but with this liability the company is not directly concerned.

825. Prior to the imposition of special property tax the majority of absentees in receipt of interest on debentures or deposits were taxable at a rate less than that deducted by the company. If they made a return in Australia the amount paid by the company was allowed as a rebate of tax up to the amount of the total tax assessed, but if the deduction exceeded this amount any excess paid by the company was not refunded either to the company or the absentee. In effect, therefore, the absentee receiving interest on debentures or deposits, who made a return in Australia, was taxed on the same basis as the shareholder of a company, i.e., at the rate applicable to his own income or to the income of the company, whichever was the greater. But if he made no return he was assessed, through his agent, at the rate applicable to his known income derived from sources in Australia without allowance for the tax deducted by the company on his interest.

826. The imposition of special property tax created new conditions. When this was first imposed the rate was 1s. 6d. in the pound; in the two years following this was increased to 2s. in the pound, but for the current year the rate is 1s. 2·4d. Many absentees who previously paid by deduction through the company more than they would have paid on their actual incomes became liable to additional tax. In the case of those who did not make returns the position was aggravated by the non-allowance of the tax deducted by the company. The position was met, to some extent, by an amendment of the Act in 1932, which allowed as a deduction from the tax assessed the amount deducted by the company, irrespective of whether a return had been lodged. But as an absentee is not entitled to the statutory exemption or the concessional allowance, there was in the majority of cases some additional tax due by him. **It is clear, we think, that the present disability of the absentee is due, not to the fact that he has to pay special property tax—for in this respect he is in the same position as a resident, but rather to the fact that he is not allowed the exemption of £250 given to the resident who derives income subject to special property tax. When this tax is no longer imposed this disability will disappear, and the absentee will then be taxed in the manner previously described, i.e., at his own rate or that of the company, whichever is the greater.**

827. *New South Wales.*—In New South Wales the company is taxable at a flat rate of 1s. 6d. on the interest paid or credited by it to a non-resident person or a foreign company on money raised by debentures and used in the State, or on money lodged at interest in the State with the company. If a return is lodged by or on behalf of the absentee the amount deducted by the company is set off against the tax payable, but no refund is made.

828. *Queensland.*—In Queensland every corporate body (however described) is taxable at 2s. 9·6d. in the pound on interest payable to a person who is not domiciled in Queensland. When a return is made by or on behalf of an absentee and such interest is included in the return, the tax deducted by the company is credited to the absentee and any excess is refunded.

829. *South Australia.*—In South Australia the company is taxable at 2s. in the pound on interest paid or credited by the company to any party who is an absentee on money raised by debentures and used in South Australia, or on money lodged at interest in South Australia with the company. The amount deducted by the company is credited against tax payable by the absentee, and any excess is refunded. If the absentee is non-taxable, the amount deducted by the company is refunded in full.

830. Interest payable to absentees by a company on debentures and deposits is not collected at the source in Victoria, Western Australia, or Tasmania.

831. It should be noted that the complications arising out of special property tax do not occur in the States, although others arise in regard to the collection of Unemployment Relief and special Income Taxes. To some extent, however, the remarks relative to the collection of special property tax by the Commonwealth apply to the special taxes imposed by the States.

832. We have previously expressed the opinion that the absentee should pay some tax in the country from which he derives income. In practice, this tax can be most effectively collected at the source, but it would be impracticable to require every individual who pays interest to an absentee to deduct it, and therefore the method is, we think, properly restricted to those cases where the borrower is a limited company or a corporation. If tax be imposed at a reasonable flat rate, we think the absentee is fairly treated if the amount paid on his behalf be set off against any tax for which he may be personally liable up to the amount of that tax. We are, however, not prepared to recommend that any excess should be paid or credited to him. If this were done it would be difficult to refuse to extend the principle to dividends, and any attempt to carry a proposal of that nature into force would necessitate the creation of a refund department. Where tax is at a high rate, as in Queensland and South Australia, equity demands that some adjustment should be made, and it is probably for that reason that the Acts of those States provide for refunds, but we think the absentee would be fairly treated if the principle we have enunciated were adopted.

833. We recommend—

- (1) That a company should be liable to pay tax at a relatively low flat rate on interest paid or credited by it to any absentee on moneys raised by debentures of the company and used within the jurisdiction of the taxing authority, or on moneys deposited at interest with the company within the same jurisdiction.
- (2) That where an absentee is assessed on such interest in his personal capacity he should be entitled to be credited with the amount of tax deducted by the company not exceeding the amount of tax for which he is personally liable.

The Obligation of a Company to Pay Tax on Behalf of Absentees.

834. A number of witnesses expressed the opinion that a company should not be liable to pay tax on interest paid by it to absentee debenture-holders or depositors, which it was not legally entitled to recover from them in view of the decision given on 30th July, 1926, in the case of *The London and South American Investment Trust v. The British Tobacco Company (Australia) Limited* (1927 1 Ch. 127). During the currency of our Commission the Commonwealth Act was amended to relieve a company "if the contract under which the money is raised by debentures is one the interpretation of which is not governed by the laws of the Commonwealth or a State". It may seem equitable that a company should not be required to pay on behalf of others tax which it cannot recover from them; but, upon examination, further considerations arise.

835. The effect of exempting a company from liability to pay tax on interest paid to absentee debenture-holders will be clearly seen from the following comparison. Assume that two foreign companies each carry on business in Australia and that each employs here an amount of £100,000. Company A. has raised this amount by the issue of shares, but company B. has obtained it by the issue of 6 per cent. debentures. Assume further that the trading profits of each are £6,000. In the case of company A. these profits are liable to tax and are available for dividends; but in the case of company B. the trading profit disappears, because the interest on debentures is allowed as a deduction to the company, which, therefore, has no taxable income. If the debenture-holders of company B. are to be exempt from tax upon the interest they receive, no tax will be payable in Australia, either directly or indirectly, on the income derived from the employment of their capital in Australia.

836. A foreign company contemplating investment in Australia may in certain cases choose whether it will raise the capital it intends to employ by the issue of shares or debentures. The instance we have just given will show that if the capital is provided by the issue of shares Australian tax will be payable on the profits of the business, whereas if it is provided by the issue of debentures no tax will be payable under Commonwealth law upon that portion of the profits which is used to pay interest on such debentures. If interest paid to absentee debenture-holders is to be free of tax, it will rest with the promoters of a foreign company created to carry on a business in Australia to determine by the form in which they choose to make their financial arrangements whether they are or are not to pay tax in Australia.

837. In our opinion, therefore, the amendment to the Commonwealth Act effected in 1933, which substitutes as the test of taxability the question whether the interpretation of the contract is governed by the laws of the Commonwealth or of a State, goes too far and opens the door wide to the avoidance of tax by persons who desire to carry on business in Australia without paying any tax for the privilege. We cannot conceive that an amendment of this nature would be agreed to by any of the States.

838. There can be no hardship in requiring a company, which has raised capital by debentures since the decision in the case of *The British Tobacco Company*, to pay tax. The inability of such companies to recoup themselves had then been determined, and it was for them to take other steps to protect themselves. If they failed to take these precautions, their case for exemption is weak. A company which borrows upon debentures in future has no right to exemption from this liability. It can always protect itself by issuing its debentures on terms which make Commonwealth and State taxes a first charge on the interest, and we do not see why a company which in future deliberately abstains from adopting this course, or its debenture-holders, should be relieved from the obligation to pay tax in Australia.

839. We recommend that a company be not relieved of its obligation to pay tax on interest paid to absentee debenture-holders, except in those cases where the debentures were issued prior to the date when the decision in the case of *The London and South American Investment Trust v. The British Tobacco Company (Australia) Limited* would become generally known, or say prior to 1st January, 1927.

Liability of an Agent to Pay Tax on Behalf of an Absentee.

840. A few witnesses took exception to the powers contained in the various Acts which make the agent for an absentee liable to pay tax due by the latter. We think, however, that some of those who made these complaints did not fully understand the position. Except under certain very special provisions relating to insurance, in respect of which no complaint has been made, it is clear that an agent is not personally liable to pay tax on behalf of an absentee, unless he holds moneys belonging to that absentee or has disposed of such moneys after he has received the notice of assessment, and that, in any event, he is not liable for more than the amount which he holds on behalf of the absentee at or after the time when the assessment was received. In these circumstances, we do not think that any legitimate objection can be taken to those provisions of the Act which impose liability on agents for absentees.

SECTION XLIV.

SHIPPING, INSURANCE AND BANKING COMPANIES.

841. There are certain businesses which employ a considerable amount of capital, but which by reason of their nature are concentrated in the hands of a relatively small number of taxpayers. From the Fifteenth Annual Report of the Commissioner of Taxation we take the following statistics of such businesses :—

	Number of Taxpayers.	Percentage to Total Number of Taxpayers.
Shipping	232	·07
Insurance Companies, including Fire, Accident, Fidelity, Guarantee, Marine and Life ..	164	·05
Banks and Financial Institutions	199	·06
	595	·18

842. This table shows that the businesses included in this group represent less than one-fifth of 1 per cent. of the total number of taxpayers. Many of these confine their operations to one taxing jurisdiction, i.e., either the Commonwealth or a State, as the case may be, and in such cases the determination of the taxable income presents no serious difficulties. In the case of the remainder, operations are carried on in more than one country or State, and in these cases complications may arise through the necessity for apportioning the aggregate profits between the countries or States interested. The nature of all of these businesses is such that apportionment is difficult, and hence in the majority of instances it has been necessary to adopt arbitrary methods.

843. The general principles upon which such companies should be taxed on profits derived from ex-Australian sources have already been discussed in Section XXIV. of this Report, and need not be again referred to. There remains, however, the problem of apportioning profits between the various States in which they carry on their operations. In the absence of any uniform arrangements between the States there is always the possibility that taxation will overlap, and that a company will pay tax on more than its aggregate profits. The considerations that justify an arrangement for the apportionment of the profits of a merchant between the States in which he carries on his business apply equally to the apportionment of the profits of businesses such as those under consideration. But it is more important to adopt a uniform method than to strive for one which is theoretically perfect, for as we have already pointed out, the conditions of each of these businesses are such that probably no method of apportionment that is not to some extent at least arbitrary will be practicable. It is probable that an agreement between the States in regard to the apportionment of the profits of any of these businesses can only be arrived at as the result of a compromise.

844. In practice, however, uniformity in regard to the taxation of businesses included in this group is not essential, for their number is so small that inability on the part of the Governments concerned to agree upon the manner in which their taxable income should be determined would cause little inconvenience to the great body of taxpayers.

845. A consideration which has influenced us to some extent is that we received little evidence in regard to these businesses, and in some cases none on behalf of the more important organizations. We must assume, therefore, that they are satisfied with the existing arrangement in regard to the taxation of their profits, both for Commonwealth and State purposes. Such recommendations as we may make will, therefore, be based upon what we consider to be the most suitable provisions of the existing Acts, and the extent to which these are already in agreement.

SHIPPING.

846. A shipping business may be carried on by an individual or a company, but for convenience we make no distinction between the liability of an individual and of a company.

847. When a shipping company either regularly or casually takes passengers and freights from a number of ports, it is exceedingly difficult to apportion the profits of the voyage between the countries or States in which the business was obtained. For that reason an arbitrary method of arriving at the taxable income must be resorted to, and it is the practice to assess non-resident ship-owners, both for Commonwealth and State purposes, on a percentage of the fares and freights earned in Australia, or in any particular State, as the case may require. The taxable income of an Australian company which carries on its operations in more than one State is determined, for State purposes, in the same manner. The percentages at present applied are as follow :—

Queensland and Tasmania— $7\frac{1}{2}$ per cent. on outward fares and freights.

All other States (except Western Australia)—5 per cent. on outward fares and freights.

Western Australia—5 per cent. on outward and inward fares and freights.

Commonwealth (non-residents only)—5 per cent. on outward fares and freights.

848. Although the Acts of New South Wales and Queensland provide that the shipping company shall be assessed on its profits, the difficulties incidental to the determination of these profits are so great that a percentage basis is invariably adopted.

849. The only evidence we received on this subject was from a representative of the Australian Overseas Transport Association, who objected to the taxation of the members of his Association on an assumed profit represented by a percentage of gross fares and freights. It may be admitted that taxation on the basis of an arbitrary percentage of income is never satisfactory, because it assumes a fixed relation between gross and taxable income and applies this to every transaction. In practice the margin of profit varies in every port, and even as regards the business as a whole varies from year to year.

850. Our attention has been directed to a recommendation by the Imperial Economic Conference of 1923, which has been adopted by a number of countries and British Dominions. This may be described briefly as the ratio system. The ship-owner furnishes the complete accounts of his business to the taxing authority of the country from which his business is directed and controlled, which, upon request, furnishes him with a certificate stating (1) the ratio of the profits of any accounting period (as computed according to the Income Tax law of that country) to the gross earnings of the ship-owner's fleet; or (2) the fact that there were no such profits. The non-resident ship-owner then produces the certificate, together with the return of the amount of his fares, freight, &c., to the taxing authority of each country in which such income arises, and the profits subject to tax in that country are computed by applying the ratio as shown by the certificate to the amount of the fares, freight, &c., earned in that country. It was also stated that the ratio system has been adopted in India, Union of South Africa, New Zealand, Ceylon, Mauritius, and a number of other colonies that tax non-resident shipping. Other parts of the Empire give the option of the ratio system or proof of actual profits.

851. It may be admitted that this system is open to some technical objections, the chief of which is that the ratio of the Australian profits may be either greater or less than the ratio of the profits of the business as a whole. But that objection applies to any arbitrary basis of assessment, including the fixed percentages now employed by the Commonwealth and all the States.

852. In our opinion the ratio system is more equitable than assessment on any percentage basis. At times it may be necessary to assess on the basis of an estimated profit, as, for example, in the case of the casual call of a tramp ship at a port where the owner has no responsible agent, but in such cases the owner should have the right to claim adjustment in due course on production of the ratio certificate.

853. At present the Commonwealth taxes all non-resident ship-owners on the same basis. The States make no discrimination between non-resident ship-owners and Australian ship-owners who trade in more than one State. There is, therefore, a considerable degree of uniformity in practice which it would be undesirable to disturb unless all Governments were prepared to adopt some other basis. If, however, the ratio system were substituted, it should be applied by the Commonwealth to non-resident ship-owners, and by the States both to non-resident ship-owners and to Australian ship-owners who do not confine their operations to one State. But as we received no evidence from Australian ship-owners, we are not aware of their views on the ratio system, and must assume that they are satisfied with the existing conditions. In these circumstances we think that we can merely draw attention to the existence and merits of the ratio system without making a specific recommendation that it be adopted.

LIFE ASSURANCE COMPANIES.

Three different methods of taxing life assurance companies are adopted in Australia. These are as follow :—

On the basis of the Investment Income.

854. This is used by the Commonwealth, New South Wales, and Western Australia, but the method is not applied in exactly the same manner. The Western Australian method is the simplest. A company is taxed on the interest on its investments in Australia, subject to the deductions apportionable to the investment income. In New South Wales the taxable income is arrived at by taking all assessable income from investments and rents, both in and out of the State, and treating as income in the State the proportion based on the amount assured under New South Wales policies. A deduction is allowed for the proportion of the expenses of general management attributable to investment income. No assessment is made unless the company derives a profit and surplus from its business. The Commonwealth arrives at the taxable income in another manner. From the total income of the company premiums received in respect of life policies are excluded. Conversely, the expenses incurred in gaining these premiums are deducted from the total expenditure. A deduction is allowed of that portion of the expenses of general management incurred in gaining the investment, and also of an amount equal to 4 per cent. of that part of the valuation of liabilities at the end of the year which bears to that valuation the same proportion as the value at that date of the assets from which the company derived assessable income bears to the value at that date of all the assets of the company. The method of valuing the liabilities is specified in the section.

On the basis of the Premium Income.

855. In Victoria and Tasmania life assurance companies are assessed on a percentage of the premium income they receive. Queensland arrives at the taxable income in the same manner, but adds to it the profit on the sale or writing up of any Queensland assets, and deducts interest received by the company from the Queensland Government Loan of 1920 or any conversion thereof less the expenses of earning such interest.

On the basis of Profits.

856. In South Australia the taxable income is that portion of the company's profits and surplus from life assurance which would be actuarially distributed among the South Australian holders of the company's policies. Interest on Commonwealth Government securities is excluded from the actuarial calculation of surplus.

857. Most of the evidence submitted was directed towards proving that a life assurance company derived no taxable income until the assumed rate of interest had been earned upon an amount representing the valuation of liabilities. This has now been conceded by the Commonwealth, by an amendment made in 1933.

858. The problems which arise in regard to the taxation of life assurance companies fall into two parts: first the determination of the taxable profits of the company, and next their apportionment between the countries or States in which the company carries on its operations. In our opinion a life assurance company should be taxed on the basis of its investment income, which cannot be correctly determined without providing for the interest assumed to be earned on the investments set aside to provide for the payment of the liabilities of the company to its policy-holders. If all States would agree to adopt this principle the way would then be clear for a uniform method of apportioning those profits between them, and, in that event, the total taxable income of the company should be apportioned between the States in which it transacts business, on the basis of the amount assured under policies in each State.

INSURANCE COMPANIES (OTHER THAN LIFE ASSURANCE).

859. Under this heading are included fire, accident, fidelity guarantee, and marine insurance companies. In this case also most of the difficulties arise when the company carries on business in two or more countries or States, and, as in the case of shipping, an arbitrary method of determining the taxable income is generally adopted. The practice under the various Acts is as follows :—

Commonwealth.—The taxable income is based on the accounts of the company.

New South Wales.—The company is taxed on the profit made in the State, but if this cannot be determined to the satisfaction of the Commissioner an apportionment is made.

Victoria.—The net premium income is exempt, being subject to Stamp Duty. The company is taxable only upon its investment income.

Queensland.—The company is taxed on the profits earned in Queensland, but if these cannot be determined to the satisfaction of the Commissioner he may deem the taxable income to be an arbitrary percentage of the premium income, plus any profit made on the sale or writing up of assets in Queensland.

South Australia.—The company is taxed in the same manner as in New South Wales.

Western Australia.—The total net premium income is taxed at a rate specified in the Act.

Tasmania.—The taxable income is deemed to be an arbitrary percentage of the net premium income.

860. The objections to assessments on a percentage basis, to which we have referred in the case of shipping companies, apply also to insurance companies. There appears to us to be no good reason why such companies should not be assessed on their actual profits in each State. That information is available, and its verification by the Department should not present any greater difficulties than in the case of any other company. The Commissioner is in a position to demand any information which he may require, and to satisfy himself that the return is correct, and in these circumstances percentage assessments should be unnecessary.

861. We recommend that insurance companies (other than life) be assessed in each State on the income derived by them in that State.

ABSENTEE INSURERS.

862. The Commonwealth Act provides for the taxation of absentee insurers who do not carry on business in the Commonwealth by means of a branch or agency. In such cases tax is levied on the actual profits, or, if these cannot be determined to the satisfaction of the Commissioner, on 10 per cent. of the premiums. If no other arrangement is made, the tax is payable by the person paying the premium, and he is not allowed the premium so paid as a deduction. The Queensland Act contains a provision of a similar nature with respect to insurers not carrying on business in Queensland.

863. This method of imposing tax upon absentee insurers appears to have proved efficacious in the case of the Commonwealth, and as we see no reason for exempting them from the liability to pay tax in Australia on the income which they derive there, we recommend that a clause similar to that contained in the Commonwealth Act be generally adopted.

BANKS.

864. As in the case of other companies referred to in this section, the principal difficulties incidental to the taxation of banks arise only when the business extends over two or more States. None of the State Acts, other than those of Queensland and Tasmania, specify a basis of apportionment. The Acts of Queensland and Tasmania provide that the income taxable in the State shall be a sum which bears the same proportion to the total income as the amount of the assets and liabilities in the State bears to the total assets and liabilities of the company. In the other States the method of apportionment must be agreed upon with the Commissioner.

865. A witness, who stated that he had been instructed by a number of banks to make representations on their behalf, said that the methods of apportioning the profits of banks between the various States was unsatisfactory, and that his clients desired that some uniform and equitable basis should be adopted. He suggested that the method employed by Queensland and Tasmania, to which we have referred, should be adopted by all the States. But no evidence was submitted by the Associated Banks in support of, or in opposition to, the opinion so expressed.

866. Subject to the general considerations referred to in paragraph 843 we think that the profits of banks and financial institutions which carry on business in more than one State should be apportioned between the States concerned in proportion to the amount which the assets and liabilities in the State bear to the total assets and liabilities of the company.

SECTION XLV.

MINING AND MINING COMPANIES.

867. Some of the Acts grant concessions to persons and companies engaged in mining. These may take the form of allowable deductions for capital expenditure and development, for the exemption of the income derived from certain classes of mines, or the exemption of the profits derived from the sale of certain mining leases. We shall consider these under the following headings:—

DEDUCTIONS ALLOWED IN RESPECT OF CAPITAL EXPENDITURE AND DEVELOPMENT.

868. The Commonwealth allows a person carrying on mining operations (other than coal-mining) to deduct from the income of the year an amount ascertained by dividing the difference between the capital expended in necessary plant and development and the income

derived up to the end of the year of income by the estimated payable life of the mine. As an alternative, a deduction may be allowed of any income of the year expended in that year for development and new plant.

869. The provisions of the New South Wales Act are not so liberal, and the deduction is restricted to income expended during the year on mining operations (other than coal-mining or quarrying) in the State for shaft sinking in a producing mine and in extending operations.

870. The Queensland Act restricts the concession to companies, and allows as a deduction (i) development costs in respect of labour and material (including the cost of housing, roads, dams, and community services); (ii) expenditure on plant used for the preparation or treatment of gold, silver, base metals, rare minerals, or oil for the market; (iii) the recoupment of three-fourths of the cost of machinery erected for the purpose of raising ores and other materials from the mine.

871. In Western Australia a person who derives income from a mining tenement is liable to pay Income Tax only on the amount by which the income derived from such mining tenement exceeds the total amount of his capital expenditure thereon. A mining company is liable to tax on the amount by which the profits of the company made after the 30th June, 1924, exceed the share capital paid up in cash after that date. The cost of development and of testing and working mines held under an option of purchase is allowable as a deduction to a mining company. Coal companies are not specifically excluded.

872. In Victoria relief is given to mining companies in a different manner. The taxable income of a company, the sole business of which consists in carrying on mining operations (other than gold-mining) is deemed to be the dividends declared and debenture interest paid by the company during the year of income. Although not specifically expressed in the Act, the effect of assessing mining companies in this manner is to allow as a deduction from income any portion of the income of the year that has been capitalized or used for development.

873. South Australia and Tasmania make no concessions to mining companies in respect of capital expenditure or development.

874. A perusal of the foregoing will show that it is difficult to discern any uniformity in the concessions allowed by the Commonwealth and States to persons and companies engaged in mining. If the question were one of taxation only we should feel inclined to recommend that any concession should be limited, as in the case of New South Wales, to income expended during the year on mining operations (other than coal-mining or quarrying), for shaft sinking in a producing mine and in extending operations, and, in addition, some allowance for the cost of erecting and installing machinery and plant. All such expenditure is represented by a wasting asset, and we think that some allowance should be made for it in arriving at the taxable income of a mining property. **We recognize, however, that the concessions allowed to mining companies are influenced by other considerations and that they must be determined by each Government as a matter of policy. For that reason we refrain from making a specific recommendation.**

GOLD-MINING.

875. The Commonwealth and some of the States exempt income derived from the working of a mining property carried on for the purpose of obtaining gold, or gold and copper, provided that the output of gold is not less than 40 per cent. of the total output of the mine. This exemption also extends to dividends paid by a company out of such income. The provisions of the respective Acts are not identical, the differences being as under :—

Commonwealth.—The mining property must be in Australia or New Guinea.

New South Wales.—The mining property must be in Australia, Papua, or New Guinea. The concession is limited to a period ended on the 30th June, 1933.

Queensland.—The property must be in Queensland, and the concession is limited to the period ending on the 30th June, 1939.

South Australia.—The property must be in South Australia, and there is no limitation in the percentage of income from gold. The concession is limited to a period ended on the 30th June, 1933.

Victoria exempts all income derived by any mining company in respect of gold-mining operations carried on by it in Victoria.

Western Australia and Tasmania allow no concessions in respect of income derived from gold-mining operations.

876. In this case also the concessions to be allowed in respect of income derived from a gold-mining property appear to be a matter of policy to be decided by each Government, and we do not desire to submit any recommendations on the subject.

DISPOSAL OF RIGHTS.

877. The Commonwealth exempts income derived by a bona fide prospector from the sale, transfer or assignment by him of his rights to mine for gold. New South Wales, Queensland and Tasmania exempt the consideration received by a bona fide prospector for the sale, transfer or assignment of the lease of a mining property (other than coal-mining). The Acts of Victoria, South Australia and Western Australia contain no specific provisions relating to such income.

878. We recommend that the consideration received by a bona fide prospector for the sale, transfer or assignment of his rights in a mining property (other than a coal-mining property) be exempt from tax.

CALLS PAID TO MINING COMPANIES.

879. The allowance for calls paid to mining companies has been discussed in paragraph 620.

SECTION XLVI.

CO-OPERATIVE COMPANIES.

880. This is one of the subjects in regard to which the provisions of the Acts differ materially. It would appear that in some cases the concessions allowed to these companies have been based, not on any settled principles, but on the grounds of expediency, and influenced, to some extent at least, by political pressure. The effect of the provisions of the Commonwealth Act is that the co-operative company is assessed only on its undistributed income, interest and dividends on shares and rebates to members being allowed to the company as a deduction. The shareholder is taxable on the dividends or interest received by him, and, where he carries on a business, is also taxable on the rebate he receives from the company, based on goods purchased by him from the company or sold to it by him in the course of his business. The member who does not carry on business is not taxable on any rebates he may receive. A co-operative company is also allowed as a deduction amounts applied by it for or towards the repayment of moneys borrowed by the company from the Government of the Commonwealth or a State to enable it to acquire assets for the purpose of carrying on its business.

881. In New South Wales the income of co-operative companies registered under the *Co-operation Act* 1924-1928 is taxed, but the taxable income does not include any undistributed profits or profits paid to members by way of rebates or bonuses based on the business done with the company where 90 per centum of its business is done with its own members. Other co-operative companies in this State are assessed on a similar basis to that prescribed by the Commonwealth Act, subject to the reservation that interest in respect of, or dividends on, shares, and amounts applied to the repayment of loans from Governments are not allowed as a deduction to the company.

882. The Queensland Act exempts the profits of any co-operative company whose Memorandum and Articles of Association provide that profits shall not be distributed amongst the shareholders as dividends, and which is declared to be exempt by the Governor-in-Council. Co-operative companies consisting of shareholders who produce primary products used for food purposes are liable to tax only upon their undistributed profits. Certain other primary producers' Associations or Federations are also liable to tax on their undistributed profits, but dividends and interest on shares are not allowed as a deduction. The shareholder or member of a company is taxable on the amounts received by him.

883. The relevant section in the South Australian Act is based on the same principles as is that of the Commonwealth Act, except that dividends on shares and moneys applied to the redemption of loans are not allowed as deductions. If the rebates paid by a co-operative company to a taxpayer arise out of purchases made by him for the purpose of his business, such amount is taxable in his hands as income from personal exertion.

884. Western Australia adopts an entirely different principle. It exempts the rebate or discount received by shareholders of a co-operative company on their trading with such company, but, apparently, makes no concessions to the company.

885. The Acts of Victoria and Tasmania contain no provisions which deal specifically with co-operative companies.

886. In considering the liability of a co-operative company a clear distinction must be made between payments to persons because they are shareholders, and payments made to persons because they are customers. For example, interest paid on or in respect of shares is to all intents and purposes a dividend, as it arises from the possession of a share interest, and not because of the business transacted with the company. Rebates to persons who deal with the company are in a different category. If the co-operative company charged the exact price for the goods which it sold, or paid the exact price for those which it bought, no rebates would be

payable. But the societies, for good reasons, prefer to fix a scale of prices which leaves a margin. Thus an adjustment has to be made periodically, and so much of the balance as the directors think fit to divide is distributed among the members or customers in proportion to the value of the business they have done with the company. This rebate is clearly not profit, but merely an adjustment of the sale or purchase price.

887. Now if a co-operative company is to be regarded in the same light as any other company, there is no reason why the interest paid on or in respect of shares, or dividends, should be allowed as a deduction to the company, for they represent a distribution which, if made by another company, would not be allowed as a deduction to the company, and which would be subject to tax in the hands of the recipient. We do not see why an exception should be made in the case of co-operative companies. Nor can we see any justification for allowing as a deduction to the company profits applied to repay loans. This is a concession which is denied to other taxpayers.

888. We recommend—

- (1) That rebates paid by a co-operative company to its members in respect of goods purchased by them from the company or sold by them to the company be allowed as a deduction to the company, but that in every other respect the taxable income of a co-operative company be determined in the same manner as that of any other company.
- (2) That dividends and interest paid on, or in respect of, shares, or amounts applied to the re-payment of loans, be not allowed as a deduction to a co-operative company.
- (3) That the definition of a co-operative company be extended to include one which provides "services" to its members, as, for example, shearing, or any similar activity.
- (4) That a member of a co-operative company should include as income rebates received by him from that company when such rebates arise out of dealings by him with the company for the purpose of his business.

SECTION XLVII.

MISCELLANEOUS.

AUSTRALIAN BUSINESSES CONTROLLED ABROAD.

889. Section 28 of the Commonwealth Act provides that when any business carried on in Australia is controlled principally by persons resident outside Australia, and it appears to the Commissioner that the business produces either no taxable income or less than the taxable income that might be expected to arise from that business, the person carrying on the business in Australia shall be assessable on such percentage of the total receipts of the business as the Commissioner in his judgment thinks proper. Similar powers are to be found in the Acts of New South Wales, Victoria, Queensland and South Australia, but not in the Acts of Western Australia and Tasmania.

890. Witnesses, generally, approved of the Section, but objected to the power of the Commissioner to make an arbitrary assessment. **It must be recognized, however, that a Section of this nature is necessary to deal with cases where the Australian profits are reduced by unfair means, as, for example, by invoicing goods at prices in excess of the fair market value in the country of shipment.**

891. Official witnesses considered that the powers given to the Commissioner are necessary, because the affairs of the company are entirely in the hands of the foreign controllers, and the accounts kept locally may not disclose the true position. We have been assured, however, that where there is no reason to doubt the accuracy of the accounts submitted there is no necessity to apply the Section, and in practice it is not applied.

892. We recommend that a Section of similar import to Section 28 of the Commonwealth Act be included in the Uniform Act.

THE INCOME VALUE OF A RESIDENCE OR QUARTERS.

893. *Residence.*—The annual rental value of a residence owned by the taxpayer is taxable only in Victoria. Arguments may be advanced to justify either the taxation or the exemption of this item. But in practice it is probable that the additional tax produced by the inclusion of this amount as income is offset by the deductions which are allowed against it, as, for example, interest paid on a mortgage of the property. For that reason, and to obtain uniformity, we recommend that the annual rental value of a residence owned by the taxpayer shall not be included in his assessable income.

894. *Quarters*.—Somewhat akin to the taxation of a residence is the question whether an employee should be taxable on the value of a residence or quarters provided for his use by his employer. Under the Commonwealth Act he is not liable unless a specific deduction on that account is made from his wages or salary. The relevant Section of the Western Australian Act is in substantially the same words. In all other States the employee is taxable.

895. We think that income tax should be based on the true remuneration of employment, including subsidiary benefits arising out of the employment, otherwise the anomaly exists that Employee A. is liable to income tax on the salary which constitutes his sole remuneration, while his fellow Employee B. who receives the use of a residence or quarters in addition to the same salary, pays only the same amount of tax. Yet from the point of view of ability to pay there is no doubt that B. is capable of paying more tax than A.

896. We recommend that the rental value of a residence or quarters provided by an employer for use of an employee be included as part of the taxable income of the employee.

ANNUITIES.

897. Annuities may be divided into two classes—(a) those that are purchased by the annuitant, and (b) those which are provided by some other person, usually by testamentary disposition. The Commonwealth Act provides that the income of an annuitant shall not include that part of the annuity which represents the purchase price to the extent to which that price has not been allowed as a deduction under the provisions of the Act. The Acts of New South Wales, Queensland and South Australia allow as a deduction that proportion of the annuity which represents the repayment of capital invested by the annuitant, though the relevant Sections are not expressed in the same words. In Victoria, Western Australia and Tasmania the whole amount is subject to tax.

898. In our opinion it is inequitable to tax an annuitant who has purchased the annuity, on that proportion of his annual income which represents a return of capital, and we recommend that a provision similar to that contained in the Commonwealth Act be included in the Uniform Act.

899. The next question which arises is whether the income derived by an annuitant, whether a purchaser or a beneficiary, should be taxed as income from personal exertion or from property. The practice of the Commonwealth is to tax such income according to its source. If the annuity is paid out of the profits of a business it is taxed to the recipient as income from personal exertion. If paid out of *corpus* or income from property, it is taxed as income from property. If payment is made from a mixed fund the annuity is apportioned partly to one source and partly to another. The same practice is followed in New South Wales and Tasmania. In Victoria, Queensland and South Australia it is specifically classified as income from property. In Western Australia the question does not arise because of the absence of differentiation.

900. In our opinion the income of an annuitant should be taxed as income from property. If the annuity has been purchased, it is clearly the income of an investment. If the annuity has been created by some other person, either by testamentary disposition or otherwise, it is immaterial to the recipient from what source the annuity is paid. If it is derived from the income of an investment it is at present taxed to him in every case as income from property. If it is derived wholly or in part from the income of a business, it cannot be argued that it retains its character when paid to the annuitant. That payment is not contingent either upon the profit earned or upon the personal effort exerted by the annuitant.

901. For these reasons we recommend that that part of an annuity which represents income should be taxed to the recipient as income from property.

SEPARATION ALLOWANCE AND ALIMONY.

902. The Commonwealth Act provides that a wife living apart from her husband pursuant to a decree, judgment, order, or deed of separation which provides that a husband shall periodically pay to her specified moneys, is not liable to be assessed in respect of those moneys. The South Australian Act provides that moneys paid for the maintenance of a taxpayer by a person liable by law to maintain or contribute to the maintenance of the taxpayer shall not be taken into account as income of the taxpayer if the person paying the amount has paid tax on the income from which it is paid. The effect of the Sections quoted is that the person (in this case the husband) who pays a separation allowance is not allowed to claim that amount as a deduction from his income, but the wife who receives it is exempt from tax upon it. This concession is not granted in any of the other States, where the husband is not allowed a deduction, and the wife is liable to pay normal Income Tax on an amount paid to her as a separation allowance.

903. It is clear that where the wife is liable to pay tax on a separation allowance some duplication of taxation occurs, and this anomaly was commented upon in a case recently decided. It was because of that comment that the Acts of the Commonwealth and South Australia were recently amended.

904. In our opinion the principle now embodied in the Commonwealth Act should be included in the Uniform Act, and we recommend that a wife shall not be liable to pay tax on moneys paid to her by her husband under a deed of separation or order of a Court, and that no deduction be allowed to the husband for such payments.

905. It may happen, however, that a husband and wife who are living apart agree to the creation of a trust to secure payments to be made to the wife. In these circumstances the husband has permanently reduced his income, and therefore obtains indirectly relief from the tax on that part of his income which is payable to his wife. In such circumstances we recommend that the amount received by the wife as income from the trust be regarded as an annuity in her hands and taxed accordingly.

906. Where the parties have been divorced, and no longer stand in the relation of husband and wife, the considerations which justify the exemption of the moneys received by the wife no longer apply. In dealing with the position that then arises, three alternatives may be considered. (For convenience we continue to describe the parties as husband and wife.)

- (1) That the husband should receive no deduction, and the wife be exempt from tax on the alimony.
- (2) That the husband should be allowed a deduction, and the alimony be taxable as income of the wife.
- (3) That the husband should receive no deduction, and the alimony be taxable as income of the wife.

907. In our opinion the position of a wife receiving alimony after divorce cannot be distinguished in principle from that of any man or woman entitled to receive income from another person who has incurred a legal obligation to pay it. Whether such an obligation has arisen under contract, or has been imposed by a judgment as compensation for an injury, the person making the payment is allowed no deduction unless the obligation had arisen in connexion with his business. In our opinion, therefore, a husband should not be allowed a deduction for alimony paid, and as the amount becomes income of the wife, it is properly taxable in her hands.

908. We recommend that alimony paid by a husband to his wife after divorce be not allowed as a deduction to the husband, and that it be taxed as income of the wife in the same manner as an annuity.

TRUSTEES IN BANKRUPTCY AND LIQUIDATORS.

Retention of funds by trustees to pay Income Tax.

909. Section 59 of the Commonwealth Act provides that where a company is being wound up the liquidator must give notice of the liquidation to the Commissioner and must set aside such sum out of the assets of the company as appears to the Commissioner to be sufficient to provide for any Income Tax that then is or will thereafter become payable, and that a liquidator who fails to comply with these provisions shall be personally liable for any Income Tax payable in respect of the company. Clauses of similar import are found in the Acts of New South Wales and Queensland, but in each of these the provisions cover also certain other representative taxpayers, as, for example, trustees in bankruptcy and receivers. In South Australia the liability is imposed upon the public officer of the company. The Acts of the other States contain no specific references to the subject.

These provisions are necessary for the protection of the Revenue, and, provided that they are exercised with due regard to the rights of other creditors, are not open to objection. But the amount set aside should bear some relation to the probable tax, and distribution to creditors should not be delayed by the failure or omission of the Commissioners to assess the company within a reasonable time.

The liquidation of a company is governed by the Companies Act and Rules of the State in which the company is incorporated, and in some respects these impose other and different obligations upon the liquidator. A witness representing the Bankruptcy Trustees Association therefore asked that the Commissioners should be subject, as other creditors are, to the provisions of the State law, and that the liquidator should not be required to set aside or pay an amount in respect of tax which has not been the subject of due proof in the liquidation, and also that he should not be personally liable for any claim for tax not received by him within a specified time after he has given due notice of his intention to declare a dividend.

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Whilst we are not prepared to recommend the acceptance of these suggestions without some qualifications, we are of the opinion that there is some justification for them. We cannot agree that the liquidator should not be required to set aside a sufficient amount to provide for the tax that may become payable, but we see no reason why claims subsequently made for Income Tax should not be proved in the manner provided by law as in the case of other creditors. The fact that such claims are preferential makes it even more desirable that this course should be followed. Further, having regard to the fact that the work incidental to the winding-up of the affairs of the company, realizing its assets, and adjusting the claims of its creditors usually takes a fairly long time, it should be possible to complete the assessment of the company by the time the liquidator is in a position to make a final distribution to creditors, or, at least, within a specified time after notice has been given to the Department by the liquidator that it is his intention to do so.

Preparation of returns by trustees and liquidators.

910. It was stated by the same witness that trustees and liquidators are at times called upon by the Commissioners to furnish returns of the income of bankrupt debtors or companies in liquidation, and that when they have declined to attempt to comply with this request threats of legal proceedings have followed.

The position of a trustee in bankruptcy differs from that of an individual. The trustee usually has no previous knowledge of the affairs of the insolvent and is not responsible for acts or defaults which occurred prior to his appointment. For that reason some distinction may be drawn between the obligations of an individual and those of an official appointed by or on behalf of the creditors to take control of the affairs of an insolvent. The same considerations apply to a liquidator.

In our opinion the obligation to furnish returns which relate to a period prior to the date of sequestration or liquidation should rest upon the insolvent or the public officer of the company in liquidation, and not upon the trustee or liquidator, except in those cases when it is impossible to obtain the information from the persons first-named. In the latter event the trustee should not be held personally responsible for the accuracy of the information which he furnishes, but only to the extent that it is a correct statement of the facts according to the information available to him. Such information can be obtained only from entries in books and other records which are sometimes found subsequently to be false. In these circumstances it is not reasonable that the trustee or liquidator should be asked to assume a responsibility for which he may later be called to account either by the creditors or the Department. Another reason is that it is undesirable that the trustee or liquidator should be personally responsible for the preparation of a return to be used for the calculation of a claim which he will subsequently have to accept, modify or reject in his official capacity.

We think also that penalties for the non-performance of routine acts by an insolvent or the public officer of a company in liquidation, as, for instance, the failure to lodge a return, should fall upon the person responsible and not upon the creditors. It does not appear to be fair that creditors should be deprived of a portion of their dividends to provide a penalty for an omission or default for which they are in no manner responsible.

SECTION XLVIII.

OBJECTIONS AND APPEALS.

THE OPINION OF THE COMMISSIONER.

911. Before we discuss what may be termed the machinery provisions of the Acts relating to objections and appeals, it is desirable to discuss a matter that was frequently referred to by witnesses in the course of our inquiry, namely, the results which follow if "in the opinion of the Commissioner" a certain state of facts exists. Witnesses representing the public were unanimously of the opinion that the liability of the taxpayer should in every case depend upon the actual facts and not upon the opinion which the Commissioner might form upon the facts, and that the taxpayer should always have the right to have the opinion of the Commissioner reviewed on appeal.

912. The complaints made, so far as they rested upon the mere use of the words "in the opinion of the Commissioner" in various sections of the Acts had not always much justification. Whether the words are there or not, in every case where the Commissioner takes any step under the Act, he must be guided by his opinion, that is by his view of the facts. If he allows a deduction, it is because in his opinion it is allowable; if he disallows it, it is because he is of the opposite opinion. At that stage, therefore, it is immaterial whether the Act expressly authorizes him to act on his opinion or not, and in many cases the words might with advantage be omitted, and should be omitted, even if only because they are superfluous.

913. The matter takes on a different aspect when a question arises as to the right of appeal. Here again, however, we found that many of the objections were based upon a misapprehension. In some cases they arose from ignorance on the part of the witnesses of the provisions in the Act that allow an appeal to the Board of Review. In other cases, where reference was made to decisions which were understood to determine that there was no right of appeal, the only thing actually decided was that at a stage when the Court's appellate power was limited to questions of law, it could not entertain an application to review findings of fact.

914. There are, however, provisions in some of the Acts under which the decision of the Commissioner is expressly made final and conclusive, or is practically so in effect. In so far as these provisions relate to the exercise of discretion in mere matters of administration, there is generally no good ground for subjecting the discretion to review. But it was strongly urged upon us that where the Commissioner's decision determines the question whether a subject is liable to tax or not, or what should be the amount of his tax, the taxpayer, if aggrieved, should have a right to the reconsideration of the question by an independent tribunal.

915. One consideration put before us by several witnesses, was that in view of the number of matters left to the "opinion" or "discretion" of the Commissioner, it was physically impossible for one man to deal with them all upon an independent investigation of the facts, and that his so-called opinion or discretion must inevitably be that of some subordinate official, or be at least based upon opinions formed by such official on his view of the facts. To take one of the least important examples as an illustration, one could hardly expect the Commissioner to form an independent opinion of much value on the question he might have to decide under Section 16 (h) of the Commonwealth Act, whether certain bullocks in North Queensland or Western Australia were ordinarily used as beasts of burden.

916. In this connexion it may be of service to refer to some passages from *The New Despotism* by Lord Hewart, Lord Chief Justice of England. The reference to the Minister in the first quotation might equally be applied to the Commissioner.

"When it is provided that the matter is to be decided by the Minister, the provision really means that it is to be decided by some official, of more or less standing in the department, who has no responsibility except to his official superiors. . . . The official who comes to the decisions is anonymous, and, so far as interested parties and the public are concerned, is unascertainable. He is not bound by any particular course of procedure, unless a course of procedure is prescribed by the Department, nor is he bound by any rules of evidence, and indeed he is not obliged to receive any evidence at all before coming to a conclusion. If he does admit evidence, he may wholly disregard it without diminishing the validity of his decision. There is not, except in comparatively few cases, any oral hearing, so that there is no opportunity to test by cross-examination such evidence as may be received, nor for the parties to controvert or comment on the case put forward by their opponents.

All that is involved and implied in the term 'Court' is essential. It may well be that, in a particular case, a perfectly correct opinion might be obtained from some anonymous person, incapable of identification, who heard none of the parties to the controversy, but brought his individual reason to bear in private upon a miscellaneous bundle of correspondence. It is even possible that, in a particular case, a mysterious individual of that kind might not be in the smallest degree tempted or diverted from a sound opinion by the fact, if it happened to be the fact, that he was closely associated with one of the parties to the controversy. But it is manifest that an opinion so arrived at differs by the whole width of the heavens from the decision of a Court. The work of a Court involves many important ingredients, as for example, (1) that the judge is identified and is personally responsible for his decisions; (2) that the case, subject to rare exceptions, is conducted in public; (3) that the result is governed by the impartial application of principles which are known and established; and (4) that all parties to the controversy are fully and fairly heard. In other words, the decision of a Court is in every important respect sharply contrasted with the edict, however benevolent, of some hidden authority, however capable, depending upon a process of reasoning which is not stated and the enforcement of a scheme which is not explained. The administration of the law of the land in the ordinary Courts pre-supposes, at least, personal responsibility, publicity, uniformity, and the hearing of the parties.

One would have thought it perfectly obvious that no one employed in an administrative capacity ought to be entrusted with judicial duties in matters connected with his administrative duties. The respective duties are incompatible. It is difficult to expect in such circumstances that he should perform the judicial duties impartially.

Although he acts in good faith, and does his best to come to a right decision, he cannot help bringing what may be called an official or departmental mind, which is a very different thing from a judicial mind, as everybody who has had any dealings with public officials knows, to bear on the matter he has to decide."

917. In some cases, no doubt, the departmental reason for desiring to give statutory effect to the opinion of the Commissioner is that fraudulent evasion may be very difficult to establish by convincing evidence, even where the circumstances give rise to grave suspicion approaching moral certainty. We do not think that this difficulty should of itself be made the ground for empowering the Commissioner to act upon an inference of fraud based upon anything less than facts capable of proof and justifying the inference. There may be good reason in such cases for throwing a substantial burden of proof upon the taxpayer. Under section 37 of the Commonwealth Act, for example, which authorizes the Commissioner to re-open assessments after three years if he is of opinion that tax has been avoided by fraud or evasion, there would be no hardship in providing that once it appeared that income really taxable had escaped tax, the onus should be upon the taxpayer to show that it was not due to fraud or evasion on his part. **Moreover, bearing in mind that the information relating to the taxpayer's affairs is a matter peculiarly within his own knowledge, we think that upon all objections to assessments the burden of proof should lie upon him. A provision to this effect is contained in the New Zealand Act.**

918. In the discussion of this subject, however, it is impossible to dissociate the question of the right of appeal from that of the constitution of the appellate tribunal. We shall in a later part of this Report make a recommendation as to the form of the tribunal to which in our opinion appeals should lie. If effect is not given to that recommendation, and if the present diversity of provisions regulating appeals is to continue, we should hesitate to recommend that in every State there should be an appeal from every discretion vested in the Commissioner. Every legislature finds it expedient at times to clothe with wide discretionary powers officers possessing special experience and qualifications, and it might well be thought advisable in some cases to make that discretion absolute and unchallengeable if the only alternative is to be its review by some body not possessing at least equal qualifications. **Subject to this consideration we recommend that in every case of appeal from an assessment the appellate tribunal should have full authority to review any decision, opinion or discretion of the Commissioner which may come into question.**

PROCEDURE UPON OBJECTIONS AND APPEALS.

919. The provisions of the various Acts differ considerably in regard to the procedure incidental to objections and appeals. The taxpayer who is dissatisfied with an assessment may, within a specified time after receipt of that assessment, lodge with the Commissioner an objection in writing against it. The times specified are as follow :—

Commonwealth.—42 days, but a further period of 30 days may be granted.

New South Wales.—60 days, but the Court may grant a further period of nine months.

Victoria.—No time is specified, but in practice fourteen days are allowed.

Queensland.—60 days.

Western Australia.—42 days, but a period of 90 days is allowed to a taxpayer resident in the north province.

Tasmania.—No time is specified.

South Australia.—The Act does not provide for an objection in the sense in which that term is used in the other Acts, and a taxpayer who is dissatisfied with his assessment must appeal to the Court within two months.

920. We recommend that a uniform period of 60 days be allowed in all cases for lodging an objection against an assessment.

TIME LIMIT FOR THE DETERMINATION OF OBJECTIONS.

921. A few witnesses complained that in some cases undue delay occurred in dealing with objections, and suggested that a time limit should be fixed within which the Commissioner must arrive at his decision. A variant of this suggestion was that a taxpayer should have the right, upon notifying the Commissioner that he did not desire to make any further representations, to require the latter to dispose of the objection within a stated time.

922. No doubt there are exceptional cases which have taken a very long time to decide, but it is probable that the ordinary objection can be, and is, dealt with promptly by the Departments. We have been assured by every Commissioner that efforts are made to do this, but it must be recognized that some objections raise matters which involve detailed discussions with taxpayers and requests for further information. In many cases it is necessary to allow reasonable time for consideration by Counsel or the expert advising the taxpayer.

923. In our opinion, therefore, it is impracticable to fix a time limit within which objections must be decided by the Commissioner. It is possible that this might operate as much to the disadvantage as to the advantage of the taxpayer, and we do not recommend it.

924. Those witnesses who complained about delay in determining objections used as an argument the provisions of the Acts which require tax to be paid on the due date, notwithstanding that an appeal or reference is pending, and urged that in consequence delay operates to the disadvantage of the taxpayer who is deprived of his money and the interest which it might earn. If this were the case there would be good ground for the complaint, but we have been informed that it is the practice of the Departments not to insist upon payment of the full tax in cases where the taxpayer has reasonable grounds of objection, or where there is a doubt about the legal position. In that event we do not think that the taxpayer is prejudiced by any delay, except to the extent that the matter remains in suspense.

925. In these circumstances there is no merit in the suggestion that a Section similar to Section 49 (3) of the Land Tax Assessment Act should be embodied in the Income Tax Assessment Act. That Section provides that where tax has been paid subject to objection it shall be refunded to the taxpayer if the objection be not determined within six months from the date of payment or such further time as is specified. In any event the conditions are not similar, as in Land Tax the principal factor is valuation, but in Income Tax many other considerations arise, which make assessment a much more difficult matter.

TIME LIMIT FOR NOTICE OF APPEAL.

926. The taxpayer who is dissatisfied with the decision of the Commissioner upon an objection may, within a specified time after notice of that decision, in writing request the Commissioner to refer the decision to the appellate tribunal provided for in the various Acts. The time allowed for this varies from 30 days to two months.

We recommend that 60 days be allowed in all cases.

REFERENCE BY THE COMMISSIONER TO THE APPELLATE TRIBUNAL.

927. The Commonwealth Commissioner must refer the request of the taxpayer to the Board of Review within 30 days; but none of the Acts (except that of South Australia) specify the time within which an appeal must be sent on to a Court. In South Australia the Commissioner must set down the appeal for hearing at a sitting of the local Court of full jurisdiction to be held within four months from the expiration of the time allowed for appealing.

928. We recommend that a period of 60 days be specified in all cases within which the Commissioner must refer the request of the taxpayer to the appellate tribunal.

GROUND OFS OF APPEAL.

929. The next question that arises is whether the taxpayer should be limited to the grounds stated in his objection. This is the law in the Commonwealth, Queensland and Western Australia. In New South Wales the Court of Review may give leave to add further grounds. In Victoria, South Australia and Tasmania the taxpayer is not limited to the grounds stated in his appeal, and, apparently, it is within the discretion of the Court hearing the case to permit amendment of the grounds stated in the objection.

930. The taxpayer is conversant with the whole of the facts. The Commissioner on the other hand is dependent upon the taxpayer to supply him with these facts. We are assured that every facility is given to the taxpayer to discuss his case with the Commissioner before the time specified for lodging a notice of objection. It is then open to the taxpayer to discuss with the representatives of the Department any new aspects of the case or facts that may have come to his notice, and, in that event, the Department may settle the objection, without recourse to the Court. If the taxpayer neglects to avail himself of these opportunities, we think it is not unreasonable that he should be limited to the grounds stated in his objection.

DEPOSIT ON APPEALS.

931. The practice under the Commonwealth Act is to require the taxpayer to lodge as a deposit in cases referred to the Board of Review one per cent. of the income in dispute, but not exceeding £50. The object is to discourage frivolous appeals, but as we understand that the deposit is invariably refunded in full it would not seem that the deterrent can be very effective. In New South Wales a taxpayer who requests that his case should be submitted to the Court of Review is required to pay a fee of one guinea, which is not refunded.

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932. In our opinion, it is desirable that a fee should be paid in connexion with every appeal, whether to the Board of Review or any Court, and we recommend that the amount of such fee be fixed at one guinea and that it be not returned.

THE APPELLATE TRIBUNAL.

933. In the assessment of the income of the average taxpayer, there is probably in the great majority of cases no serious question either as to the facts or as to the principles of law applicable to them. But in cases where a difference does arise between the taxpayer and the Department, which cannot be settled by negotiation, there must be some independent tribunal to decide the matter.

934. In considering the constitution and procedure of such a tribunal, there are two opposite evils to be guarded against. One is the risk of so facilitating appeals as to encourage taxpayers to have recourse to them on frivolous grounds, or upon unimportant disputes. The other is the risk of interposing such obstacles in the way of appeals, or making them so expensive, as to hamper the review of an assessment in a case where the taxpayer has reasonable ground for feeling that he is being unjustly treated.

935. No doubt the most effective means of discouraging unnecessary appeals is the promotion in the mind of the taxpayer of a sense of confidence in the Department. If he is satisfied that his case will be handled by men of competent knowledge, that objections raised by him will be properly appreciated and fairly dealt with, and that he has ready access to a responsible officer for the frank discussion of debatable points, it will be only in rare cases that he will think it necessary to go farther, unless questions of real difficulty arise for decision. We are glad to be able to say that from the evidence given before us, and from the observations we ourselves have been able to make, we have come to the conclusion that in these respects a very high standard is reached by the Commissioners and their chief assistants in every State. No effort should be spared to guard against any lowering of this standard.

936. But of course no departmental efficiency can obviate the need of providing an entirely independent body to decide cases where the views of the Commissioner and the taxpayer cannot be brought into line. The Commissioner's functions as a tax collector must make it practically impossible for him to forget his obligations in regard to the revenue; and the more conscientious he is as a public servant, the more heavily these obligations are likely to weigh upon him. In a dispute to which he is himself of necessity a party, he should not be allowed to be the final arbiter. Fully recognizing this, the laws of the Commonwealth and of every State make provision for an appeal in all cases where a taxpayer desires to pursue an objection to his assessment.

937. These provisions, however, vary widely. The tribunal to which the taxpayer's objection is in the first instance referred under the several Acts is as follows:—

Commonwealth.—The Board of Review, or a Justice of the High Court or of a State Supreme Court, at the taxpayer's option.

New South Wales.—A District Court Judge sitting as a Court of Review, assisted in some cases by assessors; or a Supreme Court Judge, at the taxpayer's option.

Victoria.—A County Court Judge.

Queensland.—A Supreme Court Judge sitting as a Court of Review.

South Australia.—A Local Court of full jurisdiction.

Western Australia.—A Magistrate of a Local Court sitting as a Court of Review, or a Supreme Court Judge at the taxpayer's option.

Tasmania.—A Local Court sitting as a Court of Review.

938. In a Commonwealth case the Judge or Board hearing the appeal may refer a question of law to the High Court. Either the Commissioner or the taxpayer may also appeal to the High Court. In cases of decisions of the Board the right of appeal is limited to those which involve a question of law.

939. In each State the case may be carried to the Supreme Court, sometimes by way of appeal from the first tribunal, sometimes in the form of a case stated by it, sometimes by choice of either way. This further review again is in some States limited to questions of law, while in others there is no such limitation. The right of appeal from a State Supreme Court to the High Court depends upon the amount involved, except where the High Court grants special leave to appeal.

940. We have endeavoured without much success to obtain evidence showing which of the various forms of appellate tribunal is the more satisfactory in the view of those whose experience qualifies them to express an opinion. Not unnaturally, perhaps, there seemed to be a general disinclination on the part of witnesses professionally engaged in the conduct of appeals before more than one tribunal to discuss their relative merits. So far as there was any express preference, it seemed to be generally in favour of a Court.

941. As to the Commonwealth Board of Review, objections were raised by some witnesses to its present constitution, on the ground that the fact of its Chairman having been a departmental official tended to give the Board an unconscious bias in favour of the departmental point of view. A complaint of this kind is very difficult either to justify or to rebut. In the case of some witnesses, it did not appear to have any basis of actual experience. An examination of the published decisions of the Board certainly does not disclose a lack of the fullest readiness to review, and, if necessary, dissent from departmental conclusions. It is right to mention that from a return supplied to us it appears that out of fourteen appeals from the Board to the High Court during the past six years, the decision of the Board was reversed in only two cases, and in three other cases reversed in part only.

942. We could not avoid being struck, however, by the small number of cases taken to the Board. The Annual Reports of the Commonwealth Commissioner of Taxation state that during the year ended 30th June, 1931, twenty-seven cases, and during the succeeding year 33 cases, were actually decided. There are of course many cases in which taxpayers, although they may be dissatisfied with their assessments, do not institute an appeal, either because they are unwilling to incur the expense, or because of the smallness of the amount involved. But making full allowance for these cases, the infrequency of appeals to the Board seems to suggest that there is less dissatisfaction with the Commissioners' rulings than one would expect or a reluctance on the part of taxpayers to have recourse to the Board.

943. If the States alone were concerned, no great inconvenience, perhaps, would follow from the existence of these different tribunals and different methods of procedure to deal with appeals. But the taxpayer in each State is also liable to taxation by the Commonwealth, and it is exceedingly undesirable that his rights in respect of the same matter should be subject to two different laws. Under the present arrangement for the collection of Income Tax, most taxpayers make one return, and are assessed for both Federal and State tax by the one Commissioner. The same questions, both of law and fact, generally arise under both the Federal and the State assessments, and the Commissioner naturally decides them in both cases in the same way. If the taxpayer challenges the decision, he must incur the expense of instituting separate appeals to two different tribunals, with different systems of procedure; and it is by no means improbable that the appeals will result in two conflicting decisions, either as to the facts of his case, or as to the law governing it, or as to both.

944. Where the law gives him an option in the method of appeal, he runs a new risk if he happens to make what in the result turns out to be the wrong choice. If, for example, a question arises upon the exercise by the Commissioner of a discretion vested in him, it may depend upon the selection of the tribunal, or the procedure by which the question is brought before it, whether the discretion can be reviewed or not. If it is an appeal in the full sense of the word, the Appellate Court may hold itself free to substitute its own view for that of the Commissioner; but where the appeal is limited to questions of law, it will probably decide, even if it disagrees with the Commissioner's view, that it is powerless to interfere.

945. One serious defect in most of the State systems seems to be the want of permanence in the constitution of their Appeal Courts. The Commissioners themselves are men whose training and experience tend to give them a special acquaintance with problems of much the same general character arising over and over again for consideration in different forms, and they become familiar, not only with the obvious elements of these problems, but with many of their less obvious implications. Some measure of the same kind of experience is very desirable in a tribunal called upon to review the decisions of the Commissioners. Where a Judge has to deal only with a question of law, his lack of this experience creates little difficulty, as in interpreting the law he is guided by principles the application of which is part of his daily duty. If, again, he habitually sits in the same appellate jurisdiction, he gains experience which enables him to give full weight to considerations which he might otherwise be more slow to appreciate. But unfortunately it seems to be the practice in some of the States to leave the decision of taxation appeals to the Judge or Magistrate who happens to be presiding in the Court when the appeals come on for hearing, so that the parties do not get the benefit of a tribunal specially experienced in that class of case.

946. Every lawyer knows from experience that in cases which involve the consideration of a special branch of law, nothing conduces more to uniformity and soundness of decision, as well as to the expeditious transaction of business, than to have the cases heard by a Judge who is a specialist in that branch. It saves time and expense, and facilitates the presentation and decision of the cases. **It seems very desirable that if the States continue to give a general right of appeal to the ordinary Courts, steps should be taken to ensure as far as possible that Judges or Magistrates should be specially assigned to hear the appeals, in the same way as it is usual to appoint Judges with experience in commercial cases to preside over Commercial Causes Courts.**

947. **We are very strongly of opinion, however, that a much more radical reform is called for.** Every argument adduced in favour of a uniform body of taxation laws may be invoked to support the establishment of a uniform system of interpreting and applying them. This could best be effected by entrusting to one tribunal the duty of reviewing on appeal the decisions of the officers administering all the Income Tax Acts, Federal and State; and it is difficult to see how it could be effected otherwise. **In our opinion, therefore, an attempt should be made to arrive at an agreement to appoint such a tribunal, the appointment to be jointly made by the Commonwealth and the States.**

948. In considering the constitution of such a tribunal, regard must of course be had to the nature of the questions which it would have to determine. They are questions of law, or fact, or both. After careful consideration of the several alternatives that suggest themselves, we have come to the conclusion that the requirements of the position would best be met by the appointment of a Judge or lawyer of standing, preferably one with special experience in commercial cases. The fact that his selection must be concurred in by the Government of the Commonwealth and all the States concerned should be sufficient guarantee that the holder of the office would command the confidence of the public. Having regard to the very responsible nature of his duties, we think that his status should not be less than that of a Judge of a Supreme Court. Whether his jurisdiction should be technically that of a Court or of a referee is a question involving constitutional considerations as to which we have no suggestions to offer. For the sake of convenience, we shall speak of the suggested tribunal as the Court of Review.

949. **The essential point is that, while the Constitution of the Court should be such as to justify its recognition as a tribunal of high authority, its proceedings should be so conducted as to involve a minimum of the expense, delay, and risk associated with the ordinary Courts of Law.** The procedure in these Courts is governed by rules which are of necessity numerous and complicated, as they must be framed to meet the requirements of an infinite variety of controversies. The Court of Review would have as its sole function the reconsideration of matters decided by the Commissioners, and the simplest form of procedure might be adopted, so as to interpose the least possible obstacle in the way of the appealing taxpayer. The cost need be no more than that of a reference under the present system to the Commonwealth Board of Review. The taxpayer should have the right of appearing either in person or by representative, legal or otherwise.

950. We have considered proposals put before us by some witnesses that the Court should contain members who have been engaged in commercial or financial pursuits. While recognizing the very useful help which in some cases a Judge would derive from having associated with him colleagues with these qualifications, we think the same purpose would best be served by empowering him in any case to call in such expert assistance as he might think necessary or desirable. The widening of the field of choice would enable him in special cases to draw upon stores of special knowledge and experience which would not be available in a standing body.

951. **The Court of Review should be invested, like the superior Courts of Law, with wide power to provide by regulation for the procedure upon references or appeals.** This might well include the power to fix limits of time for objections, and for other necessary steps, and to prescribe the conditions upon which, if at all, the grounds of objection should be amended. We think it might also be empowered to inquire into complaints of undue delay by a Commissioner in dealing with objections, and to give such directions as the justice of the case might require. Our specific recommendations already made on these matters would then be unnecessary.

952. The decision of the Court on questions of fact or matters of discretion should be final and conclusive, but an appeal should lie to the High Court on questions of law, and, in our opinion, this should be to the full High Court, as the intermediate consideration of the matter by a single Judge would seem to be unnecessary. The right of appeal might be restricted, as in ordinary appeals from a Supreme Court, to cases in which a certain minimum amount is involved, subject to the right of the Court of Review itself, or of the High Court to grant special leave to appeal in any case.

953. An important question arises in respect of the costs of an appeal from the Court of Review to the High Court. Where the Commissioner is the appellant, we agree with the recommendation of the former Royal Commission on Taxation that, irrespective of the result, the taxpayer's costs in the High Court should be borne by the Crown. In nearly every such case, the main reason for the appeal is that the decision appealed from not only affects the assessment directly in question, but applies to so many other cases as to require serious consideration in the interests of the Revenue. While this affords ample justification for the desire of the Crown to have the most authoritative declaration of the law on the point involved, it is unreasonable that the point should be settled at the expense of the single taxpayer who has successfully raised it. The costs allowed would, of course, be limited by taxation to those reasonably incurred. We may mention that a similar recommendation was contained in the Report of the Royal Commission on the Income Tax (Great Britain) 1920.

954. We recommend, therefore, that a tribunal consisting of a single Judge should be constituted with jurisdiction to review all decisions of Commonwealth or State Commissioners; that it should have power in any case to call in such expert assistance as it might think desirable; that its decisions should be final and conclusive upon all matters of discretion or questions of fact; that an appeal should lie from this tribunal on questions of law only to the full High Court; that such appeals should be limited to cases involving a specified minimum amount, subject to the right of the tribunal itself or of the High Court in any case to grant special leave to appeal; and that where an appeal to the High Court is instituted by a Commissioner the reasonable costs incurred by the taxpayer upon such appeal be borne by the Crown.

955. If the present system of separate Commonwealth and State appellate tribunals is continued, an effort should be made to get rid of the varying methods of procedure upon appeals, and to arrive by agreement at a uniform code. In most matters of detail, it is quite immaterial whether one or other of two courses is adopted, but the present differences are annoying and embarrassing to the taxpayer and to every one else concerned.

SECTION XLIX.

PENALTIES.

956. Even in regard to a simple administrative matter like penalties there is no uniformity between the provisions of the various Acts. The following summary will show the nature of the differences:—

Failure to Furnish Return.

957. In the case of a simple omission, where there is no suggestion of any intention to avoid tax, the Commissioner may impose a penalty. This is usually the sum of £1 or 10 per cent. of the tax on the omitted income. In more serious cases a prosecution is instituted, and in all States except South Australia the Courts may impose a fine ranging from £2 to £100. In South Australia the penalty is £20 and treble tax.

958. We recommend that uniform penalties be adopted by all Governments.

Late Payment of Tax.

959. In Victoria 8 per cent. per annum is charged on the amount of the tax. In the Commonwealth, Queensland, South Australia and Tasmania the rate is 10 per cent. per annum, but in New South Wales and Western Australia 10 per cent. of the amount of the tax is charged

960. Additional tax charged for late payment is in part interest and in part a penalty. It is designed to make delay in payment unprofitable and thus facilitate the collection of tax. We think, however, that the charge should be on a per annum basis and not at a flat rate.

961. We recommend that a uniform rate of 10 per cent. per annum be adopted.

Omission of income and/or claims for Excessive Deductions.

962. The under-statement of income arising from any of these causes exposes the taxpayers concerned to a penalty. Such cases may be dealt with by the Commissioner, but if he considers that the circumstances of the case warrant prosecution he may institute proceedings in a Court. When the Commissioner deals with the matter the usual penalty is a fine of £1 or double tax, whichever is the greater. In Western Australia the fine is limited to 10 per cent. of the tax on the omitted income.

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963. When a prosecution is instituted the Court may impose both a fine and additional tax. In the case of the Commonwealth, New South Wales and Tasmania, the fine may range from £50 to £500 and treble tax. In Victoria, Queensland and Western Australia the fine may vary from £2 to £100 and double tax. In South Australia the penalty is a fine not exceeding £50.

964. One special question brought under our notice was whether there should be an appeal from a decision of the Commissioner by which a penalty is imposed for a breach of the Act or (to state the matter more precisely, though not in fact differently) from his determination to what extent, if at all, the penalty imposed by the Act should be mitigated. In our opinion a matter of this kind is essentially one in which the rights of the subject upon a question arising between himself and a Department of the Government, and involving the possible application to him of drastic penalties, should not be left to the final determination of an officer of that Department, however highly placed. We do not suggest, however, that a taxpayer should have a right to appeal against a penalty imposed for the failure to carry out what may be termed a conventional obligation, as, for example, additional tax on late payment or the neglect to furnish a return, nor do we suggest that any fine imposed by a competent Court should be open to re-consideration. There is, however, some justification for the views that have been expressed by a number of witnesses that a taxpayer who has been charged with a penalty which automatically accrues in accordance with the provisions of the Acts, as, for example, in the case where income has been under-stated, should have the right to have such penalty reviewed, either by the Board of Review or a Court. The abstract justice of this request cannot be denied, but while the various Acts recognize a number of appellate tribunals of different status it is probable that there would be a lack of uniformity in the views that might be taken by such tribunals of the amount of any penalty that ought to be remitted. For these reasons, we cannot recommend that the right of appeal against penalties be given in existing conditions, but if an appellate tribunal of the nature recommended by us in paragraph 954 be constituted, the argument against allowing an appeal would be minimized, and, in that event, we think a taxpayer should have the right to apply to that tribunal for re-consideration of a penalty automatically fixed in any of the Acts.

SECTION L.

AMENDMENT OF ASSESSMENTS.

965. There is considerable diversity in the provisions of the respective Acts as to the right to amend assessments. The Acts of the Commonwealth and Victoria are in agreement, and provide that in normal circumstances an assessment may be amended within three years from the date when the tax was originally due and payable. If there has been an avoidance of tax owing to the failure or omission of the taxpayer to keep adequate books and accounts the assessment may be amended within six years, and if the Commissioner is of the opinion that there has been avoidance of tax due to fraud or evasion an assessment may be amended at any time. The provisions of the New South Wales Act are expressed in different words and give the Commissioner power to amend an assessment at any time, but there is a proviso that no amendment shall be made after the expiration of three years from the date when the tax payable was originally due, unless the Commissioner is of the opinion that there has been an avoidance of tax due to fraud or evasion. In South Australia an assessment cannot be re-opened, except on account of fraud, more than three years after the making of the return. The Acts of the remaining States empower the Commissioner to amend an assessment at any time.

966. There is perhaps no feature in the administration of the Income Tax laws which has given rise to more irritation and discontent than the re-opening of past assessments. Where this re-opening is due to the discovery that tax has been evaded by any fraudulent device, we do not think that any restriction should be imposed on the right of the Commissioner to make the fraud ineffective and unprofitable. No one has ventured to put before us any suggestion to the contrary. But very great dissatisfaction has been expressed with the practice of increasing a past assessment, not because of the discovery of new facts undisclosed by the taxpayer, but because of the discovery that the principle of law applied to the facts was too favorable to him.

967. In this connexion we think it right to refer to the strong expression of public feeling evoked by the action of the Commonwealth Commissioner in re-opening the assessments for some years past of companies affected by the decision in the Sennitt case to which we have already referred. It seems to us, without impugning the right, and perhaps the duty, of the Commissioner to make these retrospective assessments, that there was strong justification for the condemnation of the principle involved in them. When a taxpayer has fully and openly disclosed the

facts relating to his income ; when upon those facts an assessment has been made, based upon a well-known and officially declared practice in accordance with the current understanding of the law ; when he has accepted that assessment and paid the amount due under it ; he does seem to be morally entitled to consider the transaction closed, even although a subsequent judicial decision shows that a mistaken principle of law has been applied to his case. Had the mistake resulted in his paying more in tax than the amount for which under the law he was actually liable, the transaction would have been closed. In the absence of an objection by him within the specified number of days after receiving his assessment, he would have no legal right to have it re-opened and amended.

968. There is much to be said in favour of the application of a principle analogous to the common law rule that while money paid under a mistake of fact may be recovered, there is no such right where the mistake is one of law. It would be a regrettable thing if the unavoidable hardships which must in some cases result from the operation of the taxation laws were aggravated by a new element of uncertainty due to a widespread unsettling of past transactions whether in favour of the Department or of the taxpayer. It is very important in the public interest to reach finality in such matters, and we do not think that the advantages to be gained by the hopeless striving after ideal exactitude balance the evils that result from the unnecessary disturbance of things once settled.

969. No objection can be taken to a limited power being conferred upon the Commissioner to amend assessments, even when no imputation of fraud or improper evasion is made against the taxpayer. New facts may come to the knowledge of the Commissioner affecting the amount of the assessment, or mistakes may be discovered such as must occur under the conditions of pressure which inevitably obtain from time to time in the operations of the Taxation Department. There must be a provision for the amendment of the assessment in these cases, and we see no reason to recommend any abridgment of the period of three years specified in the Commonwealth Act and some of the State Acts as the time within which such amendments may be made.

970. We think, however, that there is a clearly marked distinction between cases of this sort and cases where the amendment is made in order to give effect to a changed departmental view of the law or of any principle affecting the assessment. A convenient illustration of the distinction is supplied by the re-opening of assessments after the decision in the Sennitt case. So long as it was the recognized departmental practice to allow to companies a full deduction of the remuneration allotted to themselves by the directors, a company which conducted its business upon that basis might reasonably complain if its assessments were subsequently re-opened and a large amount of additional tax demanded from it on the ground that the Commissioner had changed his view as to the law, whether in consequence of a judicial decision or not. We assume that the re-assessments were perfectly in accord with the law ; but one consideration to be borne in mind is that if taxpayers had not been lulled into the acceptance of the contrary view of the law by the attitude of the Commissioner, they might with more or less success have moved Parliament to amend it.

971. But a very different position presents itself when it is found that the so-called directors, however formally appointed, were not in any real sense of the word directors at all. For example, in a case brought under our notice by the Commissioner of Taxes for Victoria, the five directors of a company engaged in supplying professional services were the husband, wife and three children, fourteen, eleven and eight years of age respectively. Profits amounting to nearly £10,000 were divided between them as payment for their services. Now the ground upon which directors' salaries are allowed to a company as a deduction is that they are expenses incurred in earning the company's income. Obviously the payment to the children was not made as remuneration for any services they rendered ; it was not an expense incurred in earning the company's income. It is more than probable that they never got the money. If a company in such a case succeeded in obtaining a deduction in respect of such an allocation of profits, the assessment ought to be re-opened and amended when the facts become known. We can see no possible justification for any complaint against a retrospective assessment of that kind.

972. We recommend that the Commissioner's right to amend assessments within three years in the absence of fraud or evasion should extend only to cases where the amendment is sought in consequence of the discovery of facts which were not fully disclosed to the Commissioner at the time of the original assessment, or in order to correct an error in calculation or other mistake of fact.

973. There is no good reason why the provisions of the relevant Section in all the Acts should not be in identical terms, and we think the time limits provided in Section 37 of the Commonwealth Act are satisfactory and suitable for general adoption.

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SECTION LI.

VARIOUS MATTERS RELATING TO ADMINISTRATION.

THE PRESENT ADMINISTRATION OF THE INCOME TAX ACTS.

974. The Administrative Office of the Commonwealth Income Tax Department is situated at Canberra, and that of each State in the capital city of the State. The arrangements for the assessment and collection of Commonwealth and State Income Tax have been described in paragraph 341 of our Report.

975. An opinion widely held and expressed by many representative witnesses, and in every State, is that it is undesirable that the administration of the Commonwealth Taxation Department should be centralized in Canberra, as this imposes expense and inconvenience upon taxpayers who have occasion to discuss their assessments with the Commonwealth Commissioner. For that reason it was suggested that the Federal Deputy Commissioner in each State should be empowered to deal with all matters relating to Commonwealth Income Tax which arise within his State, and to make decisions in regard thereto.

976. We have previously said in paragraphs 334 and 335 that, in our opinion, the collection of Commonwealth Income Tax by State Departments is not the most satisfactory arrangement that might be adopted. We foresee the possibility that each State Department will in time tend to develop along different lines. The delegation of additional powers to Deputy Commissioners in the States would increase this tendency and might result in a lack of uniformity on important matters, which would not be in the best interests either of the Commonwealth or the taxpayer. We are assured by the Commonwealth Commissioner of Taxation that the delegations have been made as wide as possible consistently with the proper control by him of the general administration of the laws, and especially in regard to those provisions which require him to form opinions, make determinations, or be satisfied as to particular matters. **In these circumstances it appears to us that a general control must be exercised by a Central Administrative Office, whether at Canberra or elsewhere.**

977. Another view also widely held and frequently expressed was that the Commonwealth Central Office in Melbourne is not required, and that a taxpayer who derives income in more than one State should lodge his Commonwealth return in the State in which his head office is situated, or in which he resides.

978. The proposal to abolish the Central Office in Melbourne and to distribute its work among the States must be considered from two aspects—that of the taxpayer, and its probable effect upon efficiency. Let us first consider the proposal as it affects the taxpayer individually.

979. It should be noted that Central Office does not deal with the returns of individuals whose only income from other States consists of dividends. These are dealt with in the State in which the income (other than dividends) is derived. Taxpayers who are assessed at Central Office, therefore, consist of those who derive trading or investment income in more than one State. The abolition of Central Office would not relieve these of the obligation of furnishing separate returns for Commonwealth and State purposes. In this respect, therefore, there would be no saving to the taxpayer, and it would make little difference to him whether he submitted his return to a Central Office or to the Taxation Department in the State in which he has his head office, or in which he resides.

980. If it is necessary for the taxpayer or his agent to interview the Department in regard to the return, it may be admitted that some inconvenience is imposed upon those who reside elsewhere than in the State in which the Central Office is situated. To some extent this is experienced also in regard to State taxation, for all taxpayers do not reside in the capital cities. But witnesses have not stressed this point, although some have referred to the inconvenience which they suffer in having to visit Melbourne to discuss their affairs with the Central Office. The extent of the inconvenience suffered by the taxpayer therefore depends upon the number of taxpayers who reside in cities other than that in which the Central Office is situated.

981. The following statement, prepared some years ago, shows the head office or residence of taxpayers whose returns are assessed by the Commonwealth Central Office in Melbourne, and it is probable that these percentages are still substantially correct:—

					Companies.	Individuals.
					%	%
New South Wales	..	..	..	..	40	33
Victoria	..	..	..	..	50	45
Queensland	..	..	..	..	4	8
South Australia	..	..	..	..	5	8
Western Australia	..	..	..	..	1	2
Tasmania	..	..	..	..	0.3	3

This statement shows that 50 per cent. of the companies and 45 per cent. of the individual taxpayers who are assessed at Central Office have their head office in Victoria, or reside in that State. It would make no difference to these whether they submitted their returns to the Central Office or to the office of the State Taxation Department in Melbourne. It may be admitted that it would be more convenient to companies who have their head office elsewhere, or for individuals who reside in other States, to lodge their returns with the Federal Deputy Commissioner in their own State. Except in New South Wales, the number of taxpayers so inconvenienced is not considerable.

982. But when the information relating to Central Office is examined, certain important facts emerge which cannot be ignored. The following statistics relating to the number of taxpayers, and the amount of Commonwealth Income Tax collected in the Commonwealth and at Central Office, are taken from the 15th Annual Report of the Commonwealth Commissioner of Taxation :—

1931-32 ASSESSMENT.

	Taxpayers.			Tax.		
	Total.	Central Office.	Central Office.	Total.	Central Office.	Central Office.
			%	£	£	%
Residents	296,765	7,351	2.4	8,055,705	1,349,652	16.7
Absentee Individuals	9,163	1,774	19.3	457,640	121,316	26.5
Companies	5,815	829	14.2	4,189,174	2,860,650	68.3
Casual Taxpayers	653	228	34.9	102,194	84,249	82.5
	312,396	10,182	3.2	12,804,713	4,415,867	34.4

983. It will be noted that Central Office collects slightly more than one-third of the Commonwealth Income Tax from 3.2 per cent. of the taxpayers. A figure of even greater significance is that relating to companies, and the table shows that 68.3 per cent. of the tax payable by companies is collected at Central Office from 14.2 per cent. of the companies assessed. Central Office was established to focus at one centre all returns of an interstate character. Generally speaking, these include the majority of the largest taxpayers, and include banks, life assurance companies and other insurance companies, shipping companies, large interstate mercantile houses, and individuals with interstate interests. If the practice of the Commonwealth and States were uniform, or substantially so, it might be possible to transfer some of the work now performed by Central Office to the Federal Deputy Commissioners in each State. But it must be recognized that the officers employed in the State Taxation Department are State officers, and that they are influenced to some extent by the provisions of the Act of the State in which they are employed. There is no uniformity in the methods adopted by the States for the assessment of some of these taxpayers, as, for example, banks, life assurance companies, and fire insurance companies, and there is some justification for the belief that if they were assessed in the State in which the head office is situated the same degree of uniformity would not be achieved. The present arrangement ensures that each case will be dealt with by officers who are specialists and who will, therefore, assess each in the same way. That advantage would be lost if the present arrangements were altered.

984. As a matter of administration it is more efficient to have all the information relating to interstate businesses in a Central Office than to have it distributed between the Departments in each State. Information is readily available and comparisons may be made. Investigation is facilitated, and correspondence can be dealt with with greater expedition than in an office where such taxpayers constitute only a small minority. We are doubtful whether the work now performed by Central Office could be done as efficiently in any other conditions.

985. There are other advantages to be derived from the maintenance of a Central Office. For instance, it enables the administration to obtain, without delay, statistics and information which are a guide to the yield and probable incidence of any fresh proposals relating to taxation. It is also in a position to supply temporary assistance which may be required by the Central Administration. Finally, it is, to some extent, a protection against the very serious position which might arise from the refusal of a State to carry out its obligations to collect Commonwealth Income Tax in that State.

986. It is questionable whether the distribution of the work now performed by Central Office between the States would reduce the total cost of assessment and collection. The State Departments could not undertake this work without an increase of staff which would cost in the aggregate more than the present cost of Central Office. We are informed that it costs

approximately 1½d. in the pound to collect Commonwealth Income Tax at Central Office, or, say, something less than £30,000 per annum. That amount would probably be insufficient to compensate all the States for the extra work and responsibilities which they would be required to undertake.

987. Appreciation of these facts makes it clear that the abolition of Central Office and the distribution amongst the States of the work performed by it is unlikely to result either in greater efficiency or less cost. Some inconvenience to taxpayers who reside elsewhere than in the State in which the Central Office is situated may be admitted. But it is doubtful whether this is sufficient to justify a radical alteration in the present methods of assessing and collecting tax from taxpayers with interstate interests. When allowance is made for those who reside or have their head office in Victoria, it would appear that the inconvenience is restricted to less than 2 per cent. of the total number of taxpayers, and this must be regarded as a part of the price which must be paid for the benefits which taxpayers as a whole derive from collection of Income Tax by the States.

988. For these reasons we are not prepared to recommend that the Central Office in Melbourne should be abolished. If our proposals for the creation of a joint taxing authority be approved, it will be necessary to review the functions of Central Office, but even in that event we think it may be found more efficient and economical to continue to assess the returns of certain classes of taxpayers with interstate interests, at a Central Office.

Decentralization in States.

989. In all States, other than Tasmania, assessments of Commonwealth tax on income derived within the State, and of State Tax, are made at an office in the capital city of each State. This makes it possible for members of the staff to specialize on certain matters, and ensures that all information relating to the affairs of a taxpayer is immediately available. In the Questionnaire circulated, witnesses were asked whether they considered this policy to be the most efficient, or whether any improvement might be expected to result from some measure of decentralization, such as the opening of sub-offices in the principal country centres. In almost every case the reply was that the present system should not be altered, and that the establishment of branch offices would reduce efficiency, impair internal check, and increase the cost of administration. In this opinion we concur.

990. We were, however, interested to note that in some States members of the staff of the Income Tax Department pay occasional visits to large industrial establishments and country centres to give information concerning Income Tax to persons employed therein. This practice might be extended with advantage both to the taxpayers and to the Departments.

AVOIDANCE AND EVASION OF TAX.

991. One of the most important features of Income Tax legislation relates to the prevention of fraud or evasion, and a report which ignores this aspect would be incomplete.

992. That some evasion of income tax occurs is beyond question, and the investigations of the Commonwealth and State Taxation Departments show that this is not confined to any particular class. Reports which appear in the press might suggest that only taxpayers with large incomes are concerned, but there are many cases in which small taxpayers are involved which are not reported. Other cases involving both large and small taxpayers are not brought before the Courts but are dealt with by the Department. Practically every class is found to have its proportion of persons who submit incorrect returns or no returns. The position is well expressed in paragraph 625 of the Report of the Royal Commission on the Income Tax (Great Britain) 1920, in the following words:—

“Although a taxpayer is obliged by law to make a return of his income, in many cases that return is, in the nature of things, capable of only a partial or imperfect check, and when this is known or suspected by the taxpayer he is tempted to speculate on the chance of escaping detection if the return is inaccurate. He may not always be guilty of fraud; he may be culpably careless; he may decide every doubtful point in his own favour by deliberately refraining from inquiry; he may cultivate a profitable ignorance or a negligence that is not free from guile. His conduct may, in short, occupy any position in the scale from something less than complete honesty down to absolute fraud. The one common feature in all such cases is that the revenue suffers, which is only another way of saying that the evader contrives to make his fellow citizens pay something that ought to have come out of his own pocket.”

993. The experience of the Commonwealth Department is that at least 80 per cent. of taxpayers make honest attempts to lodge correct returns. The balance consists of those who—

- (a) deliberately attempt to evade tax ; or
- (b) under-state their income because of an absence of business accounts or through reliance upon accounts which are incomplete or misleading.

994. It is probable, however, that avoidance of tax is more difficult to frustrate than evasion. There is a small minority of taxpayers who seek to avoid tax by so arranging their affairs that the intention of the law is defeated. Some of the provisions of the Acts which have been criticised have been introduced to deal with the expedients adopted by such persons. It is said that some of these provisions are too rigid or too arbitrary. But it is an accepted principle of law that a taxing Act must be strictly construed. "In taxation you have to look simply at what is clearly said. There is no room for any intendment ; there is no equity about a tax ; there is no presumption as to a tax ; you read nothing in ; you imply nothing, but you look fairly at what is said and at what is said clearly, and that is the tax." For these reasons the provisions of a taxing Act must be definite and rigid.

995. To meet border-line cases, discretions are vested in the Commissioners. The only way in which rigidity might be lessened is by the extension of these discretions, but the public dislike them, and the evidence we have received indicates that they would rather see them limited. In these circumstances there is no alternative to rigidity, which is essential in the interests of honest and scrupulous taxpayers, and we think that the public will not object to it provided that they are satisfied that equity will be maintained.

996. We have said that the prevention of avoidance is even more difficult than the prevention of evasion of tax. For that reason it is necessary that a taxing Act should contain provisions which invalidate, for the purposes of assessment, any fictitious or artificial transaction entered into with the object of evading or avoiding Income Tax. Section 93 of the Commonwealth Act purports to confer this power, and Sections of similar import are to be found in the Act of each State.

997. A perusal of these Sections shows that they not only purport to disallow fictitious or artificial transactions so far as these affect Assessments, but they invalidate any contract or arrangement which seeks to alter the incidence of tax or to relieve any person from the liability to tax. The same intention is expressed in Section 94 of the Commonwealth Act. The inclusion of that power in an Income Tax Act therefore raises questions of considerable importance.

998. A taxpayer cannot by any contract with another person relieve himself from liability to pay a tax imposed upon him. The provisions in question, therefore, have no effect upon the assessment of the tax or its enforcement, or the relations in any other respect between the Department and the taxpayer, but operate only to disturb contractual arrangements between one subject and another for the allocation of the tax between them.

999. It is beyond our province to inquire how far such a provision in a Commonwealth Income Tax Act is constitutionally valid. But it seems to us on other grounds to be very objectionable. No better illustration of the way in which it operates need be sought than the case of *de Romero v. The Executors of Hordern's Estate*, decided by the High Court in 1932. The testator had covenanted in a separation deed to pay his wife the clear annual sum of £10,000 free from all State Income Tax, and to refund and repay to her any such tax which she might pay in respect of such annuity. An action brought by her against his Executors to recover an amount of tax paid by her was dismissed on the ground that the covenant was one to alter the incidence of the tax and was therefore void. It would have been quite competent for the husband to agree with his wife to pay her an allowance which would have left her a clear annual income of £10,000 after payment of the tax, but his intention to do this and his agreement to do it were defeated simply because of the form of words in which the agreement was expressed.

1000. Now, while it is clear that the Act ought to contain the most effective provisions possible to defeat devices to evade tax by fraudulent or colorable arrangements, it seems to us that enactments which are in no way concerned with the imposition, assessment, or collection of Income Tax, and which are operative or not according to the language which the taxpayer happens to employ in his dealings with some other person, have no proper place in an Income Tax Act, and should be omitted.

1001. We recommend that neither the Commonwealth nor the State Acts should contain provisions forbidding or invalidating, as between the parties thereto, any bona fide arrangement for the allocation between them of Income Tax imposed upon any of them.

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Investigation.

1002. Efficient investigation is one of the most effective means of discovering evasion. The extent to which investigation is employed varies considerably in the different States. In some, it is adequate and efficient, and information supplied to us shows that it has been the means of recovering large amounts from defaulters. In others, little attention appears to be paid to investigation, and in our opinion steps should be taken to make the system efficient throughout.

Books of Account.

1003. The subject of investigation raises the question as to whether a taxpayer carrying on business should be required to keep proper books of account of such a nature and in such a manner that his income can be readily ascertained. The Acts of Queensland and South Australia impose this obligation on the taxpayer, and provide further that if the books are not kept in a satisfactory manner the Commissioner may require the taxpayer to alter the methods employed. Similar provisions are not contained in the Commonwealth Act or in the Acts of the other States.

1004. In our opinion the power of dictating the method of account keeping is not one that should be contained in an Income Tax Act. It is not a function of Income Tax law to interfere with the right of the taxpayer to conduct his business in any manner that he chooses. Provisions contained in the Commonwealth and Victorian Acts appear to be preferable, in that they expose the taxpayer to the risk that his assessment may be re-opened within six years from the date when the tax payable was originally due, if the Commissioner is of the opinion that there has been an avoidance of tax owing to the failure or omission to keep books of account and records from which the income might reasonably be ascertained. The effect is to make the taxpayer responsible for the consequences if he omit to keep proper records. That is as far as we think an Income Tax Act should go, and **we do not recommend that the Uniform Act should contain a Section requiring a taxpayer to keep proper books of account.**

THE REGISTRATION OF TAX AGENTS.

1005. All the official witnesses who gave evidence appreciate the benefit which the Departments derive from the employment by the taxpayer of Accountants, Solicitors and Taxation Advisers in the preparation of returns. If this advice were not available to the taxpayer it would probably be necessary to increase the staffs of the various Departments. It was stated, however, that certain persons employed by taxpayers apparently set themselves out to mislead the Department. Where this is detected returns submitted by those agents are specially scrutinized, and, if necessary, the accounts of the clients are investigated, but in our opinion it is desirable that the Department should be in a position to exercise some direct control over persons who act as tax agents.

1006. In 1922 the Queensland Act was amended to require tax agents to be registered. The Commissioner of Taxes in that State informed us that registration had operated most beneficially both to the taxpayer and to the Department. It had facilitated the elimination of unscrupulous and incompetent agents, and had resulted in the submission of correct returns. He strongly recommended that the principle should be adopted for Commonwealth purposes.

1007. Registration has also been required in South Australia since 1924, and the official witnesses in that State claimed that it had positive advantages from the point of view of both the taxpayer and the Department, but stated that it was becoming more obvious that a greater measure of control was necessary.

1008. Provisions for the registration of tax agents, based on the Queensland Act, were embodied in the Income Tax (Management) Bill 1928, New South Wales, but were not approved by Parliament. Registration is not required by the Act of the Commonwealth or any State other than those specified.

1009. In our opinion registration of tax agents would be in the best interests both of the taxpayer and the Departments. It would be an assurance to both that a person authorized to act on behalf of a taxpayer is reputable and competent. It would prevent exploitation of the taxpayer by unscrupulous persons who may ultimately involve him in serious trouble, and, perhaps, penalties. It would also enable the Departments to deal effectively with such persons.

1010. If this recommendation be accepted it will be necessary to decide whether tax agents should be registered under both the Commonwealth and a State Act. If registration be required under the Commonwealth Act, we think the States might accept a registered agent without further inquiry. This would be of advantage to those who require to lodge returns on behalf

of their clients in more than one State. If, however, it is not considered practicable for the Commonwealth to register tax agents, virtually the same result would be obtained if all the States agreed to do so, and, in that event, the Commonwealth should recognize a tax agent registered in any State.

1011. If registration be adopted by any Government which does not now require it, it will be necessary to provide machinery for its administration. We think that the provisions of the Queensland Act and Rules might be taken as a guide, and the suggestions which follow are based upon these :—

- (1) The provisions of the Act and Rules relating to the admission and control of tax agents should be administered by a Board. The Board should consist of persons not directly connected with the Taxation Department.
- (2) Only such persons as satisfy the Board as to their qualifications and fitness to so act shall be registered as tax agents.
- (3) The period of registration should not exceed one year ending on the 30th June next ensuing.
- (4) The Board should be authorized to inquire into any complaint concerning the conduct of a tax agent, and, where sufficient ground is shown, to cancel, suspend or refuse to renew the registration of such agent.
- (5) Procedure should be prescribed by Regulation.

1012. We think it is essential that there should be a Board in each State. If the proposal be adopted by the Commonwealth, we suggest that arrangements be made with each State Government for the appointment of the Auditor-General and an officer representing the Treasury as members of the Board in each State. If the States only adopt registration, we suggest that the same officers should be appointed. In either case the third member should be a Public Accountant to be nominated either by the Governor-General-in-Council or by the Governor-in-Council of a State, as the case may require.

1013. We recommend—

- (1) That provision be made for the registration of tax agents ;
- (2) That registration be effected either by the Commonwealth, or alternatively by all the States ;
- (3) That registration by one Government be accepted by all other Governments during the period for which it is effective.

PAYMENT OF TAX BY INSTALMENTS.

1014. The South Australian Act, under which Income Tax upon employees is collected by instalments at the source, provides further that any taxpayer not being an employee may, at any time before the 30th November, make arrangements with the Department for the payment of State Income Tax by instalments up to the 15th June following, any balance unpaid at that date carrying interest. We are informed that not many taxpayers avail themselves of this provision.

1015. The Western Australian Act contains a provision requiring taxpayers to make application within fourteen days after a date to be fixed by proclamation for payment of tax by instalments. We understand, however, that a proclamation has never been made and that the provision is ineffective, although some taxpayers make arrangements with the Department to pay their tax by instalments.

1016. No provision for the payment of tax by instalments is contained in the Commonwealth Act or in the Act of any of the other States.

1017. Having regard to the fact that many persons in receipt of salary and wages prefer to pay their tax by instalments, it is probable that other taxpayers would also appreciate the opportunity to do so. We think that the Uniform Act should include a clause empowering the Commissioner to make arrangements for or to accept payment of tax by instalments prior to the issue of an assessment.

SIMPLIFICATION OF RETURNS.

1018. The statistics included in paragraph 982 show that approximately 97 per cent. of the total number of taxpayers liable to Commonwealth and State Income Tax make their returns to the Income Tax Department of the State in which they reside or carry on their business, on a form which shows in parallel columns the information required by the Commonwealth and that State.

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1019. The numerous differences in the provisions of the various Acts, to which we have so frequently referred in this Report, make it clear why it is impracticable to devise standard forms of return which will meet the requirements of the Commonwealth and every State, and hence returns used in each State differ to a greater or lesser extent from those used for similar purposes in every other State, and none are exactly the same as those used for Commonwealth purposes only.

1020. The decision arrived at some years ago to include in one form the requirements of the separate Governments cannot, in itself, be regarded as marking any real progress towards uniformity. The combined return may facilitate assessment, but it is questionable whether the taxpayer finds it much less troublesome to enter two sets of figures, which inevitably differ in some respects, on one form instead of two. We do not suggest, however, that separate forms should be used for the purposes of Commonwealth and State, but rather that other measures should be adopted to make it easier for the taxpayer to comply with his obligations.

1021. Disregarding for the time being any simplification that it may be possible to effect as a result of a greater measure of uniformity in the respective Acts, consideration may be given to a suggestion put forward by some witnesses. This was that virtually all the detail contained in the forms at present used by individual taxpayers should be eliminated; that a taxpayer who does not carry on a business should be required to lodge a simple form showing only the gross receipts from all sources and the deductions claimed. In this he should set out, in his own way, details of the receipts and deductions. The form should be accompanied by an explanatory sheet setting out clearly the deductions that can be claimed. It was suggested that a separate form should be provided for the use of taxpayers, including companies, who carry on a business which would show only the profit as per the Profit and Loss Account attached, other income, and deductions claimed.

1022. In considering a form to be used for the return of income, regard must be had not only to the convenience of the taxpayer, but to the requirements of the Department. In the opinion of experienced administrators the form must be comprehensive and include every class of income and every allowable deduction in accordance with the Act. The taxpayer then has no justification if he fail to return income or to claim a deduction. It is contended that this course is in the best interests of taxpayers, for unless full information is supplied to the Department errors will occur leading to correspondence and explanations. We accept this view, and are not prepared to recommend the adoption of the suggestions referred to in the previous paragraph. In our opinion it would be less troublesome to the taxpayer to fill in a return upon which the various items of income and deduction are clearly shown than to peruse a lengthy instruction form, decide how much of it applies to his own case, and prepare explanatory schedules in his own way.

1023. We have considered the extent to which the detail at present included in the returns used by the general body of taxpayers might be reduced by providing separate forms for the use of special classes of taxpayers. It is, of course, impossible to provide each taxpayer with a form specially designed to suit his needs, and the form provided for general use must, therefore, be devised to cover a great diversity in circumstances. But, in our opinion, it is undesirable to attempt to include in one return every type of income and every allowable deduction that may be required by any taxpayer, and to add to these particulars a number of schedules and statements that obviously concern only a limited number of them.

1024. It appears to us, therefore, that some progress towards simplification might be effected by a judicious extension of the number of separate returns, to meet the requirements of special classes of taxpayers. Some witnesses have expressed the opinion that the adoption of this suggestion would confuse the taxpayer and create difficulties in administration. But the information supplied to us shows that this policy has been adopted in at least three States, and we have no evidence which indicates that it has not been satisfactory to both the taxpayer and the Department.

1025. We recommend that separate forms for the return of income be adopted by each Government for the use of :—

- (1) Individuals who do not carry on a trade, business or profession ;
- (2) Individuals and partners who carry on a trade, business or profession ;
- (3) Companies ;
- (4) Certain classes of taxpayers whose requirements are such that provision cannot conveniently be made for them in the returns provided for use by the general body of taxpayers. The number of such special forms should be determined by agreement between the Departments.

1026. An examination of the forms in use by the Commonwealth and State Departments discloses a remarkable diversity in contents and arrangement, which is not entirely due to the lack of uniformity in the respective Acts. Even if there were no reason to believe that it is possible to bring the Acts into closer agreement, we think that some of these might be remodelled to conform more closely to a standardized pattern.

1027. The possibility of further simplification depends principally upon the extent to which the respective Governments are prepared to bring the provisions of their Acts into closer agreement. If this can be done it should be possible to make material progress towards standardization and simplification of the returns.

SECTION LII.

THE FORM OF THE LEGISLATIVE PROVISIONS.

1028. It was pointed out in Section XVIII. of this Report that the Acts of the Commonwealth and the States are not constructed in accordance with any common plan. As a liability to income tax is imposed by the Commonwealth and each State, each taxpayer is directly concerned with at least two Acts or sets of Acts. Taxpayers who derive income from more than one State are subject to the Acts of each State from which they derive income as well as to those of the Commonwealth. The Acts are frequently consulted by or on behalf of many taxpayers, and it is important that their sequence and arrangement should be uniform. In the Commonwealth, New South Wales and Queensland the same general plan is followed. The arrangements of the Acts of the other States differ materially from that plan and also from one another. In addition, in some cases land tax and income tax are dealt with in the same Act, and in one case the assessment of companies is dealt with in a separate Act. **In the interests of standardization, facility of reference and simplicity we recommend :—**

- (1) That the Acts of the Commonwealth and each State should be arranged in parts in the sequence now adopted for the parts of the Commonwealth Act ;
- (2) That the Acts should contain provisions relating to income tax only, and that the whole of the provisions relating to income tax assessment be contained in one Act ; and
- (3) That the rates of tax be imposed by separate Income Tax Acts.

1029. It was also pointed out in Section XVIII. that if the principle of the Uniform Act be adopted the provisions of the Acts of the Commonwealth and the States will not be identical. Many of the provisions of the Commonwealth Uniform Act could be adopted without alteration by the States, but others would have to be modified for State purposes. Some provisions may be altogether omitted from the State Acts, and again those Acts will contain provisions which have no place in the Commonwealth Act. Each Government should, however, subject to its own domestic law of interpretation, have its Act drafted as nearly as possible along uniform lines, and **we recommend that a Uniform Act be drafted and adopted by the Commonwealth and that that Act serve as a model for the State Uniform Acts.** Where provisions which will be necessary in all States are not contained in the Commonwealth Act, a model draft of those provisions should be settled and adopted by the States.

1030. The most important and difficult part of the Assessment Acts is that dealing with the liability to taxation. A draft covering the provisions of that part as they should appear in the light of our recommendations is forwarded separately. The draft, with the exception of the division "Interstate Profits", is submitted for Commonwealth purposes, and while many of the sections can be taken verbatim for State purposes, others which are concerned with aspects of Commonwealth taxation which do not apply in the States, or with the linking up of the recommended and previous provisions, are not applicable for State purposes. **It is recommended, however, that the provisions of the State Uniform Acts follow the same order as has been adopted in the draft, with such modifications only as are necessary to adjust the new provisions to the existing State system, to carry into effect the recommendations contained in these Reports as to State taxation, and to cover the domestic provisions peculiar to the individual State.**

1031. The division "Interstate Profits" is included solely for State purposes. Its adoption by all States is recommended, and it has been included because of the universality of its application. It should not, of course, be included in the Commonwealth Act, having no application except for State purposes.

1032. In drafting the provisions an effort has been made to make each section as clear and concise as possible. Clarity and conciseness are not features of the present Acts. On the contrary, while many branches of legislation are inherently as difficult and technical as income tax, it is safe to say that no other Acts can compete with the Income Tax Acts for length of

sections, length of sentences and difficulty of construction. One section of the Act of one of the States extends over sixteen pages of printed matter. The first proviso to section 25 (i) and portion of the proviso to section 26 (2) of the Commonwealth Act each extend over more than half a page of print, without any assisting punctuation other than commas. These instances are not isolated, but are typical of many of the provisions in the Acts we have been considering, and illustrate methods of drafting which are not used in other Acts and should in our opinion be avoided as far as possible.

1033. In New South Wales and Queensland an indexed Act is issued to the public. We recommend that this example be followed by the Commonwealth and all the States, that in printing the Acts a uniform size be adopted, and that the section numbers be printed at the top of each page, as in the Queensland Act. The assistance afforded by these expedients to persons consulting the Acts is very material.

ACKNOWLEDGMENT.

1034. We cannot bring to a close this instalment of the task committed to us without saying a word as to the assistance we have received from our Secretary, Mr. J. A. Neale. The least part of his services has consisted in the ordinary duties associated with a secretarial position, and in their discharge his faculty of organization has enabled the work of the Commission to go forward without a hitch. It is in the collection and arrangement of the material upon which our Report has been based, and in its consideration for the purpose of the Report, that his most valuable work has been done. His experience in the Department has given him a wide knowledge of the operation of the Income Tax Acts, and there is hardly a section that he was not able to elucidate by illustrations of its working in actual practice. Bringing to the task a clear and open mind, a quick appreciation of new points of view, and a keen sense no less of the rights than of the obligations of the taxpayer, he has given us invaluable aid in the discussion of every problem that presented itself, and has been in all respects a very helpful colleague.

This completes our Report upon the simplification and standardization of the Income Tax Laws of the Commonwealth and of the States, and our recommendations for the purpose of obtaining uniformity in legislative provisions, including provisions relating to procedure and forms of returns.

The subjects of Land Tax and Death Duties, referred to us by Your Excellency, will be dealt with in our subsequent Report.

DAVID G. FERGUSON (Chairman.)

EDWIN V. NIXON.

J. A. NEALE (Secretary),

Melbourne, 12th April, 1934.

CONCESSIONAL DEDUCTIONS ALLOWED BY THE COMMONWEALTH AND EACH STATE IN RECOGNITION OF THE DOMESTIC RESPONSIBILITIES OF A TAXPAYER.

Commonwealth.	New South Wales.	Victoria.	Queensland.	South Australia.	Western Australia.	Tasmania.
No allowance	£50 in respect of the wife of a resident taxpayer not separated from her husband, or, if separated, wholly maintained by him. Allowance reduced by £1 for every £1 by which wife's net income exceeds £200	£50 in respect of the wife of a resident taxpayer provided his net income does not exceed £800, and income of wife does not exceed £100. The deduction is also extended to a wife supporting her husband	WIFE (OR HUSBAND). £72 in respect of the wife of a taxpayer domiciled in Queensland whose net income does not exceed £640. Allowance reduced by £1 for each £5 by which the income exceeds £640, and further by the amount of any net income of the wife	£30 in respect of the wife of a taxpayer resident in Australia if wholly maintained by him and provided his net income does not exceed £850 and income of wife does not exceed £50. The deduction is also extended to a wife supporting her husband	Up to £40 actually expended in or towards support of wife or husband if a dependent resident in State, i.e., if taxpayer has contributed at least £26 and spouse's income does not exceed £100	A married taxpayer whose net income does not exceed £500 is allowed a special deduction of £1 for every £2 by which the net income is less than £500. An unmarried taxpayer is allowed a special deduction of £1 for every £3 by which the net income is less than £400
	£50 for each child under sixteen years of age and wholly maintained by a resident taxpayer	£50 for each child under sixteen years of age and wholly maintained by a resident taxpayer whose income does not exceed £800		£30 for each child under the age of sixteen years of a taxpayer whose net income does not exceed £650 and who resides in Australia and who wholly maintains the child. Child includes step child and child adopted <i>de facto</i> or <i>de jure</i> and grandchild of any age	£62 for each child under sixteen years of age residing with and dependent on the taxpayer	£39 for each child under sixteen years of age and wholly maintained by the taxpayer
No allowance	Expenses of educating children under sixteen years up to £50 for each if taxable income does not exceed £800 and no suitable facilities provided by State within reasonable daily travelling distance	No allowance	CHILDREN. Expenses of educating children under sixteen years up to £50 for each if no suitable facilities provided by State within reasonable daily travelling distance			
	No allowance	No allowance	EDUCATION OF CHILDREN. Expenses of educating children under sixteen years up to £50 for each if no suitable facilities provided by State within reasonable daily travelling distance			

CONCESSIONAL DEDUCTIONS ALLOWED BY THE COMMONWEALTH AND EACH STATE, ETC.—*continued.*

Commonwealth.	New South Wales.	Victoria.	Queensland.	South Australia.	Western Australia.	Tasmania.
No allowance	Up to £50 actually expended towards maintenance of dependants by unmarried resident taxpayer. Dependant means relative by blood, marriage or adoption, whose income does not exceed £100	No allowance	DEPENDANTS (OTHER THAN WIFE AND CHILDREN). (1) £72 for female relative wholly maintained by and residing with widower for purpose of caring for his child under sixteen years or his invalid child (2) £60 for mother wholly maintained by taxpayer and residing in Queensland Allowances restricted to taxpayer domiciled in Queensland and reduced by net income of dependant and where income exceeds £640 by £1 in £6 in the first case, and £1 in £5 in the second case of the excess over £640		Up to £40 actually expended for support of each dependant, i.e., if taxpayer has contributed at least £26 for such support and dependant resides in State and his income does not exceed £100	No allowance
Up to £50 paid for insurance effected in Australia on own life or that of wife, husband or children, or for deferred annuity or fidelity bond	Up to £50 paid for insurance effected in Australia on own life or that of wife, husband or children, or for deferred annuity or fidelity guarantee	Up to £50 paid for insurance with company carrying on business in Victoria on own life for benefit of self, wife or children Up to £50 paid to guarantee fund by taxpayer in receipt of salary, wages, allowances or stipend are allowed to the extent of £50	LIFE INSURANCE PREMIUMS, ETC. Up to £50 paid by taxpayer domiciled in Queensland for insurance on own life or that of wife or children or for deferred annuity or fidelity guarantee		Up to £50 paid for insurance on own life or that of wife or children or for deferred annuity Up to £50 for fidelity bond	No allowance
Up to £100 in all paid for the benefit of the taxpayer or his wife or children if he is a resident and in receipt of salary, &c., or his net income does not exceed £900 to superannuation, &c., funds established in Australia or Friendly Societies registered in Australia	Up to £100 in all paid for the benefit of the taxpayer or his wife or children if he is a resident and in receipt of salary, &c., or his net income does not exceed £800 to superannuation, &c., funds established in Australia or Friendly Societies registered in Australia	Up to £50 paid by taxpayer to superannuation, &c., fund and contributions by taxpayer ordinarily resident in Victoria whose income does not exceed £800 to a Friendly Society registered in Victoria	SUPERANNUATION PAYMENTS. Up to £100 in all paid for the benefit of the taxpayer or his wife or children if he is domiciled in Queensland and in receipt of salary, &c., or his net income does not exceed £800 to superannuation, &c., funds established in Australia or Friendly Societies registered in Queensland. In the case of payments under the Public Service or Railways Acts the limitation to £100 does not apply		No allowance	Up to £20 in all paid for the benefit of the taxpayer in receipt of salary, &c., or his wife or children to any superannuation fund

CONCESSIONAL DEDUCTIONS ALLOWED BY THE COMMONWEALTH AND EACH STATE, ETC.—*continued.*

Commonwealth.	New South Wales.	Victoria.	Queensland.	South Australia.	Western Australia.	Tasmania.
Part of assessable income of a resident taxpayer whose net income does not exceed £900 paid to doctor, hospital, nurse or chemist in respect of self, wife, husband or children under 21 years	Sum paid by a resident taxpayer whose taxable income does not exceed £400 to doctor, dentist, hospital, nurse or chemist in respect of self, wife, husband or children or dependants	Sum over £2 paid by a resident taxpayer whose net income does not exceed £800 to doctor, hospital, nurse or chemist in respect of self, wife or children under 21 years	MEDICAL EXPENSES, ETC. Part of income of taxpayer domiciled in Queensland whose net income does not exceed £900 paid to doctor, hospital, nurse or chemist in respect of self, wife or children under 21 years	No allowance	Medical expenses incurred by taxpayer for self or dependants if income does not exceed £350	No allowance
Part not exceeding £20 of assessable income of a resident taxpayer whose net income does not exceed £900 paid for funeral and burial expenses of wife, husband or children under 21 years	Sum not exceeding £20 paid by resident taxpayer whose taxable income does not exceed £400 for funeral, burial or cremation expenses of wife, husband, child or dependant	Payments not exceeding £20 by a resident taxpayer whose net income does not exceed £800 for funeral or burial expenses of wife or child under 21 years	FUNERAL EXPENSES. Part of income not exceeding £20 paid by taxpayer domiciled in Queensland whose net income does not exceed £900 for funeral and burial expenses of wife or child under 21 years	No allowance	No allowance	No allowance