COMMONWEALTH OF AUSTRALIA.

INCOME TAX.

Explanatory Notes on Amendments contained in a Bill

FOR

AN ACT

TO AMEND THE

Income Tax Assessment Act 1922-1929.

(Issued under the Authority of the Commonwealth Treasurer, Hon. E. G. THEODORE, M.P.)

By Authority:
H. J. GREEN, GOVERNMENT PRINTER, CANBERRA.
1488.

2424

Explanatory Notes on Amendments contained in a Bill for an Act to amend the *Income Tax Assessment Act* 1922-1929.

CLAUSE 2, AMENDMENT (a).

A new definition of "absentee" has become necessary in consequence of the introduction of a definition of "resident" for the purposes of those provisions in the Bill (*see* clause 4 (*a*) and clause 5 (*c*)) which will cause Commonwealth income tax to become payable by a resident of Australia on income derived by him from sources outside Australia to the extent that such income is not chargeable with income tax in any country outside Australia, or is not derived from the sale of produce upon which the taxpayer is chargeable with tax by way of royalty or export duty in any country outside Australia.

The existing definition of "absentee" is based primarily on non-residence, and is designed to exclude non-residents from the benefit of the general exemption and of certain other concessional deductions.

Public servants absent from Australia on duty are specifically excluded from the existing definition of "absentee" in order that they, as residents, may get the benefit of the concessional deductions from any Australian income they may derive.

It is now proposed to define an absentee as a person who does not fall within the definition of "resident." Such a definition of "absentee" is necessary in order to obviate the possibility of any overlapping of the two definitions, i.e., in order to avoid the possibility of a resident person who is taxed on ex-Australian income being deprived of the concessional deductions or of an absentee person who is deprived of concessional deductions as stated being taxed on ex-Australian income.

It is not, however, desired to alter the class of persons who are at present treated as absentees; nor is it desired in any way to alter the scope and application of the existing law in regard to such persons. The *status quo* is preserved, as regards the scope and application of the existing law in this connexion, by declaring in clause 4 (*a*) of the Bill that an absentee shall only be taxable on income derived from sources in Australia, and, as regards the class of persons who are to be treated as absentees, by basing the definition of "resident" primarily on the fact of residence in Australia.

No person who is in fact resident in Australia will be treated as an absentee, but a person who is not actually residing in Australia might, in a rare case, be treated as a resident because that term is defined to include a person who is domiciled in Australia or who has actually been present in Australia for more than half of the relevant financial year unless the Commissioner is satisfied that his permanent or usual place of abode is outside Australia. A typical example of the last-mentioned class of case in which legal domicile determines residence is that of a public servant of the Commonwealth engaged for a term of years on official duties outside Australia.

CLAUSE 2, AMENDMENT (b).

This amendment is a necessary part of the provisions of this Bill which are designed to tax Australian residents on ex-Australian income which is not taxed, or is derived from the sale of produce which is not taxed, outside Australia.

CLAUSE 2, AMENDMENT (b)—*continued.*

Section 13 of the Principal Act as proposed to be amended by clause 4 (*a*) of the Bill will provide (*inter alia*) that income tax shall be levied and paid upon the taxable income derived by every resident from all sources, whether in Australia or elsewhere.

Section 23 (1) (*a*) of the Principal Act provides that in calculating the taxable income of any person the total assessable income shall be taken as a basis and from it there shall be deducted the prescribed deductions.

It follows that the taxable income of a resident could not be calculated unless assessable income, in such a case, meant income derived from all sources—whether in Australia or elsewhere.

The definition of "assessable income" has therefore been altered in order to make that meaning clear.

The position of absentees in relation to the definition as proposed to be amended will be precisely the same as it is under the existing definition—i.e., assessable income, in the case of absentees, is limited to income derived from sources in Australia.

It is essential that that position should be preserved, because it is not competent for the Commonwealth to levy taxation on a person outside its jurisdiction in respect of a subject of taxation which is also outside its jurisdiction.

The word "exempt," which also appears in the existing definition, has a new significance in the proposed definition as it must there be read in relation to proposed paragraph (*q*) of section 14 (1) (*see* clause 5 (*e*), new paragraph (*q*) of the Bill) which will provide for the exemption of ex-Australian income of a resident to the extent to which that income is taxed, or is derived from the sale of produce which is taxed, outside Australia. In the result the ex-Australian income upon which a resident will be liable to pay tax under section 13 of the Principal Act, as proposed to be amended, will be limited to so much of that income as is not subject to income tax, or is not derived from the sale of produce which is taxed, in any country outside Australia.

CLAUSE 2, AMENDMENT (c).

This amendment is merely a statutory declaration of what has for many years been accepted as settled law in Australia, viz., that a profit derived from any transaction or scheme entered into for the purpose of profit-making is income which is assessable to income tax notwithstanding that the transaction or scheme does not amount to or is not part of, a trade or business.

The amendment is necessary in consequence of the fact that within the last few weeks the House of Lords has given a decision on an appeal against an assessment under the English Income Tax Act to the effect that the profit arising from an isolated transaction of the purchase and sale of property is not income, but is an accretion of capital, even where the property was purchased for the purpose of profit-making by sale. (Jones v. Leeming, 46 *Times Law Reports* 296.)

Although the decision was given in relation to English income tax law and the actual terms of the decision were that where an isolated transaction of the purchase and sale of property is not an adventure in the nature of trade, it is not assessable to income tax, the reasons for judgment make it clear that the effect of the decision is as stated and that the general principles upon which it was based are applicable equally as well to Commonwealth as to English income tax law.

CLAUSE 2, AMENDMENT (c)—*continued.*

The scheme of the Commonwealth law is to tax income.

Various classes of income are specifically described, e.g., the proceeds of any business; but income not so described is required to be ascertained by the application of general principles.

The general principle which is applied in the case of a profit made on the realization of property is that if the property was acquired for the purpose of profit-making by sale, the profit is income, and that in any other case the profit is capital.

It has long been the practice of the Department to apply that principle to isolated transactions, many thousands of which arise annually. That practice has in several instances been ratified by decisions of the Courts.

The High Court itself, sitting as a Full Court, has not yet decided that profit on an isolated transaction of purchase and sale, entered into for the purpose of making a profit, is income, but the dicta of a majority of the Judges who decided Blockey's case (31 C.L.R. 503) indicated that the question, if it ever arose, would be decided in favour of the Department.

However, in view of the decision of the House of Lords in Jones v. Leeming, there is a possibility that the Department's practice may not continue to be supported by the High Court, and that an amendment of the law is necessary in order to prevent a very serious loss of revenue.

The distinction between capital and income which emerges from the decision of the House of Lords, is highly artificial, and is entirely foreign to established Australian conceptions.

The explanation of the decision, which at first sight appears to be a gratuitous interpolation into the general law of income tax, is that it represents, not so much the result of a search for a general principle as the historical product of a long line of decisions commencing many years ago in a different state of society and purporting to interpret statutory provisions which are widely different from those of the Commonwealth law.

Where anything is sold at a profit all that the English law literally requires to be decided is whether the profit arose from a trade or a trading adventure. If it does so arise it is specifically assessable, if it does not so arise, its assessment is not provided for.

In the earlier English cases that was all that the Courts attempted to decide.

Later on (in 1901) it was pointed out in the House of Lords that although the English Act was a specification of the various matters which fell to be taxed, the tax was in reality a tax upon income.

For some time thereafter various English Judges were inclined to take the view that because a profit which does not arise from a trade, &c., is not within the specification of income, it must be regarded as an accretion of capital.

More recently, the Courts have indicated a tendency, in determining whether a profit arises from a trading adventure, to approximate to the test which is applied in Australia, in determining whether a profit is capital or income.

Thus, only a few months ago, in Rutledge v. Commissioners of Inland Revenue, 14 Tax Cases 490, the Scottish Court of Sessions held that a profit arising from a purely isolated transaction of the purchase

CLAUSE 2, AMENDMENT (c)—*continued.*

and sale of one lot of paper was assessable to income tax, and the Lord President (Clyde) in giving his decision expressed the following view:—

> " If, as in the present case, the purchase is made for no purpose except that of re-sale at a profit, there seems little difficulty in arriving at the conclusion that the deal was in the nature of trade, though it may be wholly insufficient to constitute by itself a trade."

That decision, which appears to have been an attempt to bring the interpretation of the law into line with the realities of modern conditions, must be taken to have been overruled by the more recent and authoritative case of Jones v. Leeming.

It is not considered that the case of Jones v. Leeming contains any principle which is worthy of acceptance for the purposes of the Commonwealth law. On the contrary, the one rule which emerges from the case is a distinguishing test which is so much a question of degree and so little a matter of principle that it will inevitably give rise to many anomalous distinctions.

For example—

1. A makes one purchase of wheat for £1,000, and two months' later he sells it for £2,000.
   B makes four purchases of wheat in the course of one month amounting to £1,000, and sells the wheat for £2,000, in the course of the next month by means of four separate sales. Both A and B bought the wheat to sell, and both make the same profit in the same period.
   According to Jones v. Leeming A's profit is an accretion of capital, and, according to cases which determine what is a trade, B's profit is income.
2. A a doctor, has two dealings in land for profit in one year. B, a doctor, has five or six such dealings. A's profit is capital and B's is income.
3. A and B, who are not business men, jointly purchase a large quantity of salvage stock for the purpose of selling it at a profit. A sells his share outright to C for a profit. B sets himself up temporarily in a shop and retails it to the public for the same profit. A's profit is capital and B's is income.

Such distinctions are unreal and invidious, and ought not to be allowed to arise.

It is considered, on the other hand, that the Commonwealth practice of taxing as income the profit resulting from any transaction or scheme which is entered into for the purpose of profit-making is sound in principle, is reasonable and equitable in its incidence, and is in harmony with the general scheme of the Commonwealth Act.

CLAUSE 2, AMENDMENT (d).

This amendment will limit the exemption granted by the Act in respect of rebates received by members of co-operative societies based upon the members' purchases from the society, to the rebates paid by bona fide co-operative societies which are formed to enable their members to purchase food, clothing and other necessities of life for their own use at the lowest possible cost.

CLAUSE 2, AMENDMENT (d)—*continued.*

The definition of "income" in section 4 of the Principal Act reads:—

"Income" includes—

(*a*) .....

(*b*) .....

but does not include—

(*c*) any rebate received by a member of a co-operative company based on his purchases from that company, where the Commissioner is satisfied that 90 per centum of its sales is made to its own members.

The intention of that provision was to refrain from taxing the member of the ordinary co-operative society on rebates of his expenditure with the society for food and household goods, based upon the volume of that expenditure during the year. It was never intended that a merchant carrying on a business of buying and selling goods for profit and belonging to a Merchants' Buying Association in order to buy more cheaply, should be allowed to escape income tax on the part of his true business profit, which is represented by a rebate of part of his original outlay for the purchase of his trading stock which is returned to him during his trading year by the association.

Recently the Taxation Department found that there were a number of these Merchants' Buying Associations in Australia, and that some of the members of them have been claiming that the associations are co-operative societies, and, therefore, all amounts returned by a society to its members, being the excess of the members' conrtibutions towards the purchase price of goods, should be exempted in the assessments of the members as being rebates based on the members' purchases from the associations.

In those cases the merchant members claimed as deductions the full amounts originally paid by them to the association in respect of their orders for goods to be obtained through the association. In practice, the association, apparently, cannot state definitely the exact cost which the member will ultimately have to meet. Therefore it requires the member to contribute an amount which would represent the probable maximum cost to the member. By purchasing at one time the whole of the goods ordered by its members, the association secures special trade discounts and transport concessions, so that at the end of its business year, and after paying its own expenses, it has a surplus which is returned to the members by way of rebate. These rebates represent reductions in the actual cost of goods to the members compared with their original contributions to the association. Therefore the deduction allowable in assessments in respect of the purchase price of their goods should not represent anything more than the actual net final cost after taking the rebates into consideration.

Recently a member of such an association appealed to the High Court against his assessment, in which the deduction allowed for his purchase price was the net amount remaining of his original contribution after deducting the rebates received. He contended that he was entitled to deduct the original amount contributed by him to the association before the order for his goods was placed by the association, and that the rebate should not be brought to account as a credit in order to reduce his deduction for cost of goods.

CLAUSE 2, AMENDMENT (d)—*continued.*

The High Court held that the member was entitled to deduct the amount originally contributed y him to the association, but that, because the particular association of which the appellant was a member was not a co-operative company, the rebate received by him had to be brought to account as income. If, however, the association had been a co-operative company, the member would have escaped income tax on the rebate and consequently would have been allowed a deduction of an amount in excess of the real expenditure by him in the purchase of his goods for re-sale.

The rebates received by a member of a Merchants' Association represent part of the profit of that member's business transactions resulting from a diminution of his costs. It is not right or reasonable that such part of a business profit should escape taxation.

The vital distinction between the two kinds of co-operative societies is, that in the one case the members purchase and consume the goods themselves and do not re-sell them, whilst in the other the members definitely obtain the goods for the purpose of re-selling them at a profit.

The proposed amendment will prevent the abuse referred to, and will protect the revenue against unfair loss.

CLAUSE 2, AMENDMENT (e).

This amendment is designed to prevent double deductions in connexion with pensions and annuities.

Under the present definition of "income" in section 4 of the Principal Act, exemption is provided for that part of a purchased annuity which represents the proportion of the purchase price which is being returned in the annuity.

This provision, in conjunction with the provisions of section 23 (1) (*g*) of the Principal Act, results in a double deduction being allowed for the purchase price of an annuity. That section allows a deduction in an assessment of payments not exceeding £100 in the aggregate made for the personal benefit of the taxpayer or his wife or children if the taxpayer is in receipt of salary, wages, allowances, stipends, or if his taxable income does not exceed £800, to a superannuation, sustentation, widows' or orphans' fund established in Australia.

All persons who make contributions to pension funds are, subject to the conditions prescribed, entitled to that deduction.

Hence, a person who is to be ultimately entitled to a pension secures exemption from income tax of up to £100 of the purchase price of his pension during the years in which he contributed to the pension fund out of which his pension is paid.

Pensions are liable to income tax, and, as the Courts have established that pensions are annuities, it follows that contributions to a pension fund are amounts which represent the purchase price of the annuity within the meaning of the definition which is the subject of this amendment. It then follows that when a contributor to a pension fund subsequently receives his pension, he is, under the present wording of the law, entitled to have excluded from his assessments the part of each pension payment received by him which represents a part of the total amount contributed by him for the pension. But as he has already

CLAUSE 2, AMENDMENT (e)—*continued.*

received deductions in respect of the whole or part of those contributions that were made by him since the income tax was imposed, it is not right that he should again secure a deduction of the same amounts.

The amendment, accordingly, will prevent double deductions in such cases.

The new provision will operate as follows:—

Suppose A contributes for a pension at the annual rate of £20, and has been so contributing for twenty years, that is for five years prior to the imposition of the income tax, and for the fifteen years during which it has been in force. He will have been allowed a deduction in his annual assessments of the amount contributed annually to the pension fund. Suppose also that A then retires and draws a pension of £200 per annum. He will have paid £400 in all to the pension fund, being £100 prior to the income tax and £300 since the tax was imposed. As he will already have received deductions in his annual assessments for the £300, he will be entitled under the amendment to exemption in respect of that part of his pension which represents the contributions totalling £100 made prior to the income tax, and which were not allowed or allowable as deductions in his assessments.

The pension will be received by the pensioner during his expectation of life. Suppose this is ten years. The law will assume that each annual amount of pension will contain 1-10th of the £100=£10, and that part of the pension will be excluded from the assessment. The part of the pension which represents a proportionate part of the £300 of contributions in this case will not be excluded from the assessment because it will already have escaped tax by way of deduction under section 23 (1) (*g*).

There is no provision proposed to adjust assessments in cases in which the pensioner dies earlier than his estimated expectation of life. It is considered that these are complications which it is not necessary to provide for.

CLAUSE 2, AMENDMENTS (f) and (h).

These amendments are merely drafting amendments, consequential upon the proposed alteration in the law so as to tax residents of Australia on ex-Australian income which is not taxed, or is derived from the sale of produce which is not taxed, outside Australia.

CLAUSE 2, AMENDMENT (g).

See Notes on Amendment (c).

CLAUSE 2, AMENDMENT (i).

The definition of "resident" and of "resident of Australia" inserted by this amendment is required in consequence of the provisions in clauses 4 (amendment (*a*)), 5 (amendment (*e*)), and 6 (amendment (*a*)) relating to the proposed taxation of residents of Australia on all income derived from sources outside Australia which is not taxed to them, or is derived from the sale of produce which is not taxed to them, outside Australia.

The definition provides for the application of three alternative tests in ascertaining whether an individual is a resident.

The primary test is actual residence in Australia. If a person is in fact residing in Australia then, irrespective of his nationality, citizenship or domicile, he is to be treated as a resident for the purposes of the Act.

CLAUSE 2, AMENDMENT (i)—*continued.*

The result will be that the extension of the scope of the Act to income from sources outside Australia will apply not only where such income is derived by an Australian who ordinarily lives in Australia, but also where it is derived by a person of foreign origin who, though he may recognize Australia as his usual place of residence, has not abandoned his foreign nationality, citizenship or domicile.

The second test which may be applied is, subject to certain conditions, domicile in Australia.

Domicile is a term of strictly legal significance, the ascertainment of which is essential to enable the Courts of this country, and of various other countries, to ascertain, for certain purposes of private international law, whether they have jurisdiction over a particular person or his effects. Although the term arose from the conception of residence, it has now achieved a technical meaning which enables it to be determined that a person is, in certain circumstances, domiciled in a particular country although he is not actually residing there, and, in some cases, although he has abandoned his residence in that country and has no intention of residing there.

The application of the test of domicile will cause the High Commissioners for Australia and Agents-General for the Australian States, together with the members of their staffs, to be treated as residents of Australia liable to income tax assessment on Australian and extra-Australian income as proposed for other residents.

At present the High Commissioner for Australia in London, together with each Australian member of his staff, does not pay Australian income tax on his official income because he renders service for it outside Australia. In addition, he escapes British income tax, because all such representatives are specially exempted by the British Treasury from that tax. These persons, therefore, do not pay any income tax except on unofficial income derived by them from other sources. When such income is derived from Australian sources, the recipients are treated as residents of Australia and they obtain the benefit of the general exemption of £300.

In regard to all foreign nations, their official representatives in other countries pay income tax to their own home government on their official remuneration. In Australia, the official salary of the chief representative of a foreign government is exempt from income tax. So also is the official salary of a Trade Commissioner of any part of the British Dominions.

As regards Australian public officials who are located abroad, the proposed amendments will merely place them in a similar position to that of public officials from places outside Australia who are located in Australia representing their respective countries.

In order that the test may not be applied to persons who have definitely abandoned their Australian residence, a condition is provided that a person whose legal domicile is in Australia is not to be treated as a resident if the Commissioner is satisfied that his permanent place of abode is outside Australia.

The third test to be applied is, subject to certain conditions, actual presence in Australia for more than half the financial year in which the income the subject of assessment is derived.

CLAUSE 2, AMENDMENT (i)—*continued.*

This test is necessary in order to obviate the great difficulties which occasionally arise in establishing to the satisfaction of a Court that a person is resident in any particular country.

In order that there may be no danger of treating as residents persons who are purely visitors, the condition is imposed that this test is not to be applied to treat any person as a resident if the Commissioner is satisfied that that person has his usual place of abode outside Australia and does not intend to take up residence in Australia.

The definition of "resident" would not be complete without a reference to companies. Paragraph (*b*) therefore causes the definition to apply to companies incorporated in Australia wherever the head office of control may be situated, and to other companies whose central management and control is in Australia, or whose shareholders controlling the voting power of the company are residents of Australia.

Such a definition is necessary because of the number of companies incorporated outside Australia whose sole or principal business is located in Australia. The companies will be taxable in Australia on the whole of their profits to the extent that those profits are not charged with income tax, or are derived from the sale of produce which is not taxed, outside Australia and the shareholders who are resident in Australia and who receive dividends out of those profits will be taxable on the dividends if, as dividends, they are not chargeable with income tax outside Australia to those shareholders.

The definition will embrace those companies which have been incorporated in Australia to operate outside Australia.

CLAUSE 3.

This amendment is consequential upon the proposal to amend the Principal Act so as to extend the liability to tax of a resident of Australia to all income derived by him from sources outside Australia to the extent that that income is not chargeable with income tax, or is derived from the sale of produce which is not taxed by way of royalty or export duty, in any country outside Australia.

Section 5 of the Principal Act causes the act to extend to the Territory of Papua, but exempts from the act any income derived from sources in Papua by a resident of Papua, and also any income earned in Papua by personal exertion by any person while there.

The underlined portion of this provision was inserted in the law to meet the case of persons resident in Australia who might go or be sent to Papua to render services for a limited time.

In view of the new proposals regarding the taxation of residents of Australia on all income, it is not now necessary to retain the part of the provision represented by the words underlined. The new proposals will require payment of income tax by an Australian resident upon any income derived by him from outside Australia if it is not taxed to him abroad. This will cover cases in which employees of Australian businesses go abroad to render services for which they receive remuneration. There is, therefore, full justification for applying similar treatment to persons who leave Australia for New Guinea to render remunerated services there, provided they do not go to that country as permanent residents of it.

CLAUSE 4, AMENDMENT (a).

This amendment is that which will cause a resident of Australia to be liable to pay income tax upon all income derived by him from sources outside Australia.

When read alone without reference to or dependence upon any other provisions of the Bill, it would mean that Commonwealth income tax would be payable on income derived from sources outside Australia even though that income may be chargeable to its recipient with income tax outside Australia.

It is necessary, therefore, to read this amendment in conjunction with new paragraph (*q*) proposed to be inserted in section 14 (1) of the Principal Act by amendment (*e*) of clause 5 of the Bill as that new paragraph expressly exempts income derived from sources outside Australia by a resident of Australia if that income is chargeable with income tax, or is derived from the sale of produce which is chargeable with a royalty tax or an export duty, in any country outside Australia.

Further notes on other phases of this proposal are to be found under clauses 2, 5 (amendment (*e*)), 6, 13.

CLAUSE 4, AMENDMENT (b).

This amendment has become necessary in order to prevent an unfair advantage being secured under the present law by a person who, after having derived income from taxable sources, which has been assessed in accordance with the averaging provisions, decides to transfer some of his investments from the class producing taxable income into a class or classes which produce tax-free income but without materially altering the total amount of his income. In such a case the person concerned, relying upon a strict reading of sub-section (9) of section 13 in its present form in the Act could claim that his taxable income, if any, which remained had been permanently reduced to an amount which is less than two-thirds of his average taxable income, and that therefore he would be entitled to commence a new averaging period beginning with the year in which the reduction of taxable income took place. By this means, the former large taxable incomes would not be brought into the calculation of his average income. His average income in the year of reduction of taxable income would be the actual amount of that reduced income. As the rate of tax is determined by the amount of the average income, the rate of tax in the case mentioned would be very materially reduced and the taxpayer would greatly benefit. At the same time he would be in enjoyment of substantially the same amount of income as formerly.

The benefits of the section were intended for persons who had suffered an actual diminution in income and not for a person who deliberately reduced his taxable income by changing over to income from exempt sources.

CLAUSE 5, AMENDMENT (a).

Section 14 of the Act deals with exemptions of incomes from tax.

The present provisions of paragraph (*h*) of the section exempt from tax the official salaries of foreign consuls and the trade commissioners of any part of the British Dominions.

This provision was inserted in the Act in 1915 when the Commonwealth income tax was originally imposed.

CLAUSE 5, AMENDMENT (a)—*continued.*

Since then there has been considerable development in the scope of consular representation by the appointment of commercial attaches and, occasionally, experts of other kinds, to the staffs of the consulates in Australia representing foreign Governments.

Quite recently representations were made by one foreign consul on behalf of his commercial attache. The consul pointed out that under the income tax law of his country, Australia's trade representative in that country was not subject to that country's income tax law. It was suggested, therefore, that reciprocal arrangements should reasonably be made by the Commonwealth.

The Government agrees with these representations.

It is considered both necessary and desirable to extend the scope of the amendment in the manner expressed by the terms of new subparagraph (iv) of the amendment, as some members of the staffs in some consulates are specialists in other directions than commerce, and, if the taxation laws of their countries would exempt similar experts from Australia who may occupy corresponding positions in an official representation of the Commonwealth in those countries, there is every reason why the Commonwealth should reciprocate in its taxation laws.

The form of the amendment follows closely on the lines of the corresponding legislation of Canada. It is being made to operate retrospectively in order to allow the exemption to apply to assessments for past years which have not been paid by the persons on whose behalf representations for exemption were made. Those representations were first made to the former Government which decided to accede to them.

CLAUSE 5, AMENDMENT (b).

This amendment is designed to prevent loss of revenue due to the present wording of section 14 (1) (*j*).

That section exempts from tax:—

> "The income of any society or association, not carried on for the purpose of profit or gain to the individual members thereof, established for the purpose of promoting the development of agricultural, pastoral, horticultural, viticultural, stock-raising, manufacturing, or industrial resources of Australia."

Under this section the income of a Chamber of Manufactures is exempt. These Chambers have, however, through separate legal companies entered the business of insurance, and the Chambers of Manufactures, *per se*, render active business assistance to Chamber of Manufactures insurance companies.

These insurance companies are taxable on their profits just as any other company is taxable. But the Chambers of Manufactures which render active business assistance to the companies receive remuneration for those services. The insurance companies concerned obtain a deduction of those payments in their assessments, but the Chambers of Manufactures do not pay any income tax on the amounts so received although they are actually remuneration for services rendered. The amounts cannot be taxed because of the specific exemption quoted above.

The Government considers it is not reasonable that the income derived by the Chamber of Manufactures for the services mentioned should escape income tax any more than that similar income should escape tax in the hands of individuals.

CLAUSE 5, AMENDMENT (b)—*continued.*

The Bill will amend the Act in this particular so as to cause tax to be payable on the income of an association covered by section 14 (1) (*j*) to the extent to which the income is derived from a trade or business carried on by the association or in respect of service performed by it.

CLAUSE 5, AMENDMENT (c).

This is merely a drafting amendment necessitated by the proposed addition of further paragraphs to sub-section (1) of section 14.

CLAUSE 5, AMENDMENT (d).

By this amendment residents of Pacific Islands, which are British possessions or are held under British mandate or by a Condominium in which Britain or any of her dominions is concerned, will become unconditionally exempt from income tax on the proceeds of the sale of island produce in Australia.

As the law stands, the exemption only applies where the person who purchases the produce in Australia does so for the purpose of exporting it from Australia and where the Commissioner is satisfied that the produce is so exported without unnecessary delay.

The Associated Chambers of Commerce of Australia, at a conference in Brisbane last year, drew attention to the difficulty which the islander or his selling agent has of establishing that the produce is purchased for export. If the buyer is not disposed to volunteer information as to the purpose and course of his business, the necessary proof cannot be adduced. Where, as frequently happens, the produce is sold by auctioneer, the difficulty of obtaining proof is accentuated.

In view of these difficulties which, it is alleged, are having the effect of driving trade away from Australia, it is proposed to omit from the paragraph the words which impose the condition attached to the exemption.

Very little revenue is derived as the result of the existence of that condition, and it would have been reduced to a negligible quantity upon the making of certain proposed regulations under section 16c of the Principal Act.

CLAUSE 5, AMENDMENT (e).

New Paragraph (p).

This amendment provides, subject to reciprocity, exemption from income tax in respect of the official remuneration of Government officials of any part of the British Empire outside Australia who come to Australia, either on exchange with Australian Government officials, or to perform special duty in Australia, by arrangement between an Australian Government and the Government of the other part of the Empire.

The subject has been brought prominently under notice by the British taxation authorities in connexion with the taxation of the official salaries of school teachers who go to England from various parts of the Empire on exchange with British school teachers who come to Australia or other parts of the Empire. The suggestion of the British taxation authorities is that United Kingdom income tax only should be paid by United Kingdom school teachers who visit Australia under a scheme of exchange of school teachers, and that Australian school teachers who go to the United Kingdom on exchange should pay Australian income taxes only.

CLAUSE 5, AMENDMENT (e)—*continued.*

New Paragraph (p)—*continued.*

At present, Australian school teachers who reside in England for more than six months in any year, are subject to British income tax with right to rebates to avoid double taxation. The net result in such cases is the payment by the Australian school teachers of income tax at the British rates, which exceed the Australian rates applicable to the income.

The British teachers who visit Australia similarly become liable to Australian income taxes. They, also, are entitled to have double taxation eliminated as between the United Kingdom and the Commonwealth.

The Government considers it most desirable to adopt the suggestion of the British taxation authorities, and has also decided to extend the sceme so as to embrace other classes of Government officials, e.g., naval and military officers, scientific officials, &c., who may be in a similar position to the school teachers.

The only condition of the scheme is that reciprocal exemption should be provided for in the income taxation law of the other part of the Empire concerned.

CLAUSE 5, AMENDMENT (e).

New Paragraph (q).

This amendment is part of the statutory provisions which are required to enable the Commissioner of Taxation to collect income tax from residents of Australia upon income derived by them from sources outside Australia. This provision will operate as a limitation upon the general words inserted in the Principal Act by amendment (*a*) of clause 4 of the Bill.

In clause 4 is an amendment of section 13 of the principal act, which provides for levying of income tax, subject to the provisions of the Act, upon the incomes specified in the section.

The amendment in the Principal Act made by clause 4 is, therefore, to be applied "subject to the provisions of the Principal Act."

New paragraph (*q*) which amendment (*e*) of clause 5 seeks to incorporate in the Principal Act is a provision of the Act subject to which the amendment made in section 13 by clause 4 of the Bill must be applied. When the two provisions are taken together, the result is that a resident who derives income from a source outside Australia is taxable upon it only when that income is not chargeable with income tax to him outside Australia, or when it is derived from the sale of produce which is not taxed by way of royalty or export duty in any country outside Australia.

The reason for the exemption of income from sources outside Australia when it is derived from the sale of produce which is subject to a royalty or an export tax outside Australia is that information has been supplied which shows that persons deriving income from productive operations in certain countries which have no income tax, such as Malaya and Siam, are subject to even more burdensome charges (by way of export tax, &c.), than are persons carrying on similar operations in countries, such as Burma, which impose income tax.

In the circumstances, it is considered inequitable to discriminate between income derived from sources in Burma and similar income derived from similar sources in Malaya or Siam merely because Burma

CLAUSE 5, AMENDMENT (e)—*continued.*
New Paragraph (q)—*continued.*

imposes an income tax on the proceeds of the sale of produce of that country whilst Malaya and Siam attain the same result by means of royalty and/or export duty.

The new paragraph (*q*) also exempts income from sources outside Australia which may be derived by a person occupying for the time being the position of Governor-General of the Commonwealth or Governor of a State, or by the official representative in Australia of a foreign country, and by a member of his staff who is a national of the country represented, by experts brought to Australia temporarily by the Commonwealth or a State Government for special duties, &c., or by Government officials of other parts of the Empire who are in Australia on exchange with Australian Government officials. It would not be proper for the Commonwealth to seek to tax these special persons on any ex-Australian income derived by them, because they are, strictly speaking, not residents of Australia, although their duties involve temporary residence here.

CLAUSE 5, AMENDMENT (e).
New Paragraph (r).

This paragraph, with the exception of sub-paragraph (ii), merely re-states the provisions of section 54 (4) of the Principal Act. Those provisions relate to the necessity for persons, leaving Australia, first to obtain a certificate from the Taxation Department, either that they are not taxpayers or, if taxpayers, that their tax has been paid, or that satisfactory arrangements for its payment have been made. Then follows a provision which excludes from that necessity the persons who are mentioned in new paragraph (*r*), (i), (iii), (iv), (v) and (vi), which it is proposed to include in section 14 of the Principal Act, which deals with what incomes are exempt.

The existing arrangement under section 54 (4) is not the most satisfactory which is possible. The intention of that arrangement is to allow unrestricted departure from Australia of the persons specified in the sub-paragraphs of paragraph (*r*) mentioned above, it being considered that these persons would not, while in Australia, derive income from Australian sources, other than the remuneration they would receive for those services performed by them in Australia which were the cause of their visit to Australia. It is considered preferable to make a definite exemption from income tax of that income, in order that, if those persons should derive other income from Australian sources, they would be obliged to obtain the taxation clearance certificate already referred to before leaving Australia.

CLAUSE 5, AMENDMENT (e).
New Paragraph (r) (ii).

Questions were raised in connexion with the recent visit to Australia of the English test cricket team, as to the liability of the bodies in England and Australia which controlled the tour of that team, to pay Commonwealth income tax on their respective interests in the moneys derived from the tour of the various States of the Commonwealth.

The questions were not capable of decision before the visiting team left Australia or before the governing body in Australia had transmitted to the English controlling body the share of the proceeds of the tour which were payable to that body. When the questions were decided, it was found that the facts caused a liability to income tax to rest

CLAUSE 5, AMENDMENT (e)—*continued.*
New Paragraph (r) (ii)—*continued.*

upon both controlling bodies in England and Australia to the extent to which those bodies retained for the use of the bodies any part of those proceeds.

There was, however, no means then available by which income tax could be recovered from the controlling body in England.

The Government considers it is desirable that a liability to Commonwealth income tax in such cases should not rest upon the outside controlling body in respect of its share of the proceeds of the Australian tour of a team of cricketers, footballers, or the like, which is sent to Australia from another part of the Empire by a recognized controlling body in that country for the purpose of engaging in contests with similar teams in Australia when the team is recognized by the board in Australia, which controls the Australian tests as being representative in that other country of the particular branch of sport in which the team engages.

It is not, however, considered proper that any similar body in Australia should be exempted from Commonwealth income tax in respect of similar income.

CLAUSE 6, AMENDMENT (a).

This amendment is a re-arrangement of the existing provision relating to the liability to income tax on dividends, bonuses or profits credited paid or distributed by a company to a member or shareholder so as to include the additional provision which is consequential upon the other parts of the Bill which provide for the taxation of Australian residents on income received by them from sources outside Australia when that income is not chargeable to income tax, or is not derived from the sale of produce which is subject to royalty or export tax, in their hands outside Australia.

The additional provision now being made will cause a resident of Australia who is a shareholder in a company which derives income from sources in Australia and from sources outside Australia, to be liable to Commonwealth income tax on the part of his dividend which is distributed out of profits from sources in Australia, and out of such of the extra-Australian profits of the company as are not charged with income tax, or are not derived from the sale of produce which is charged with royalty or export tax, to the company by any taxing authority outside Australia.

In drafting this amendment so as to achieve the purpose mentioned, it has been necessary to use somewhat lengthy terminology, because it has been necessary to distinguish between shareholders who are residents of Australia and shareholders who are absentees.

The new scheme of the income tax providing for the taxation of certain income which is derived from sources outside Australia, distinguishes between residents and absentees. The Commonwealth has full power to tax residents of Australia on all their income from all sources, but it has no such jurisdiction over absentees. Therefore, it is necessary in the Amending Bill to preserve the limitations of the existing law in regard to liability of absentees to pay Commonwealth tax.

In attaining the foregoing results, care has been exercised to preserve the effect of the present law in relation to persons holding shares in an absentee company which is a shareholder in another company which derives income directly from sources in Australia.

CLAUSE 6, AMENDMENT (a)—*continued.*

The present law imposes a liability upon such a person to pay income tax on so much of the dividend received by him from the absentee shareholding company as was distributed by that company out of the part of the dividend which it received from the primary company which the primary company had distributed out of income derived by it from sources in Australia.

For example, company A carries on business in Australia, and distributes dividends out of its Australian profits. Among its shareholders is company B located and controlled, say, in London. Company B is therefore an absentee. Company B in turn distributes dividends out of its profits, which include the dividend received from company A. Among the shareholders of company B is individual C who is a resident in Australia. C receives his dividend from company B, partly out of the dividend which that company has received from company A, and partly out of company B's other income.

Under the first part of the new provision in amendment (*a*) dealing with shareholders who are residents of Australia, individual C would be required to take into consideration the whole of his dividend from company B. He would be entitled to submit evidence to the Commissioner of Taxation to show the part of company B income which has been taxed outside Australia to company B, or which has arisen from the sale of produce upon which company B has been charged with royalty or export tax outside Australia, and he would be entitled to exemption from Commonwealth income tax in respect of a corresponding proportion of his dividend.

If it should happen that C's dividend from company B were taxed to him outside Australia, he would be entitled to exemption from Commonwealth tax in respect of the whole of the dividend.

The above explanation of the effect of the proposed law may be compared with the effect of the existing law as follows:—

The existing law provides for the taxation of any member or shareholder of a company, whether a resident of Australia or not, on so much of the dividend paid by a company, as is credited paid or distributed out of income derived by that company from sources in Australia.

In the case instanced above, shareholder C (resident in Australia) is taxable only upon the part of the dividend received by him that has been distributed out of income which the present law treats as income derived by company B from sources in Australia. Under the new proposals C would, in addition, be taxable on that part of his dividend, which has been distributed out of income derived by company B from sources outside Australia, provided that such income has not been charged with income tax, or has not arisen from the sale of produce which has been charged with royalty or export tax, by any taxing authority outside Australia.

As regards the absentee company B and a shareholder in that company who is an absentee, the position under the present law is that the company is technically assessable on that part of the dividend received from company A which has been distributed out of profit derived by company A from sources in Australia, but as the rate of tax payable thereon by company B is the same as that which has been paid by company A on all its profits including the dividend, no further

CLAUSE 6, AMENDMENT (a)—*continued.*

tax on that dividend is payable by company B. When, however, company B distributes that dividend to its own shareholders, those shareholders who are absentees are, in accordance with the terms of the law, deemed to be in receipt of income derived from sources in Australia. But as they and company B are outside the jurisdiction of the Commonwealth in regard to legal process for recovery of taxes, it is not possible for the Commonwealth to recover any tax which may be assessed to the individual absentee shareholders.

This position is not altered by the proposed amendment of section 16 (*b*) (i) made by amendment (*a*) in clause 6.

CLAUSE 6, AMENDMENT (b).

This amendment is proposed in order to remove two anomalies which exist under the present wording of the law, in regard to dividends paid partly out of taxable income and partly out of exempt profit arising from the sale by a company of assets not acquired by it for resale at a profit, viz.,

(1) The exemption of dividends paid exclusively out of profit arising from the sale of such assets without any provision to exempt dividends paid exclusively out of profit arising from the compulsory dispossession of a company of such assets.

The amendment will exempt both classes of dividends.

(2) The taxation in full of dividends paid partly out of taxable income and partly out of exempt profit derived from the sale of assets which were not acquired for resale at a profit, whilst at the same time, in other provisions of the Act, namely, sections 14 (2) and the second proviso to section 16 (*b*) (i) the law allows exemption of a dividend to the extent to which it is paid out of exempt income specified in those other provisions.

There is no sound reason for the continuation of this inconsistency. It has merely placed upon companies the necessity, frequently overlooked through ignorance, of specifically declaring one dividend out of the income mentioned in the proviso which is being amended and another dividend out of other income, when income from several sources is being used for the purposes of the dividend.

The proposed amendment will remove this inconsistency and anomaly.

CLAUSE 6, AMENDMENT (c).

This amendment relates to shares distributed out of the money received as compensation for the compulsory resumption of assets which had not been acquired by a company for purposes of resale at a profit.

Under the present terms of the law, exemption is allowed in respect of shares distributed out of profit representing the amount by which assets have been written up in value, or representing the proceeds of the sale of assets which had not been acquired for purposes of resale at a profit.

As a logical sequence to amendment (*b*) previously described, amendment (*c*) should be made.

CLAUSE 6, AMENDMENT (d).

This amendment is necessary in order to prevent loss of revenue through the capitalization of profit which, through being allowed as a set off against former losses, is "profit which is not subject to income tax".

The following example will illustrate the position:—

The actual figures of the case from which this example is taken are replaced by others without altering the substance of the case.

	£	£
A company made in 1927 a profit out of which it carried forward		40,000
In 1928 there was a loss of		30,000
At that time the accounts showed a net profit for the two years of		10,000
In 1929 there was a profit of	60,000	
Out of this there was a cash dividend of	20,000	
Leaving carried forward		40,000
Total amount in hand		50,000

The company decided in 1929 to make a bonus share distribution of £40,000.

Under the provisions of section 16 (*b*) (ii) (4) exemption from tax is allowed in respect of share distributions which are made "out of profits which are not subject to income tax".

In determining the shareholders' liability to tax on any bonus shares, it is necessary to ascertain the extent to which the shares were distributed out of profit subject to tax.

In the example, the bonus shares were distributed out of £60,000 profit made in 1929, and apparently represented the balance of that profit which had been carried forward after payment of the cash dividend of £20,000.

Now, the company's assessment would be on the total profits of £60,000 less any allowable deductions. The allowable deduction in this case would be the loss of £30,000 sustained by the company in 1928. The company would therefore be taxed on—

	£
Total profit	60,000
Less deduction of loss	30,000
Profit subject to tax	30,000

It is clear, therefore, that only one-half of the company's profits for 1929 was "subject to income tax" so that one-half of the bonus share distribution would be made out of profit "not subject to income tax" and therefore that proportion of the shares would be exempt to the shareholders.

But there is a further complication, viz., that the law also exempts shares paid out of one-third of the profits, because section 21 permits a company to retain that proportion of its annual profits without rendering the shareholders liable individually, or through the company under section 21 to payment of any additional tax.

CLAUSE 6, AMENDMENT (d)—*continued.*

One-third of £60,000=£20,000, so that bonus shares to that extent are also exempt in this case.

The net position in the illustration is therefore:—

	£	£
Total profit	60,000	
One-third exempt under section 21		20,000
Cash dividend already taxed		20,000
One-half of bonus distribution exempt as it is paid out of profit not subject to income tax		20,000
		60,000

It is clear that income tax in this case may only be charged on the cash dividend of £20,000, and that the whole of the bonus share distribution is exempt, one-half being exempt through the freedom from additional tax of one-third of the profit of £60,000, and the other half through having been distributed out of profit "not subject to income tax".

It is, therefore, considered that the term in section 16 (*b*) (ii) (4), viz., "not subject to income tax" should be amended to read "not assessable income of the company". Such an amendment would enable the Department to assess shareholders on—

	£
Cash dividend	20,000
One-half of the bonus share distribution	20,000
	40,000

leaving £20,000 in shares free of tax to the shareholders as representing the one-third of the profits which section 21 permits a company to retain without liability for additional tax at shareholders' rates.

CLAUSE 6, AMENDMENT (e).

This amendment is designed to prevent unnecessary loss of revenue which now results from the present wording of the fourth proviso to section 16 (*b*). This proviso in the Principal Act follows sub-paragraph (iii) of paragraph (*b*) of section 16.

The proviso is intended to prevent double taxation of dividends, first, in the assessment of the company on its total profits, and later, in the hands of the shareholder. In its present form the proviso requires that when the shareholder's rate of tax is less than the company rate, his rebate is the amount of additional tax assessed to him through the inclusion of the dividends in his assessment.

When the shareholder's rate of tax is equal to or greater than the company rate, his rebate to prevent double tax is allowed at the company rate.

In the application of this provision it transpires frequently that a shareholder whose rate is less than the compary rate receives rebate of an amount of tax which exceeds the amount previously paid by the company on the dividends. For example—

A taxpayer's net income derived from property is £1,160. It includes £332 dividends. After the allowance of the statutory exemption the taxable income is £1,146.

CLAUSE 6, AMENDMENT (e)—*continued.*

This taxable income is taxable at the rate of 14.1285d. in the £1, and the total amount of tax thereon is £67 9s. 3d. Because the rate is less than the company rate of 14.4d., this taxpayer is entitled to a rebate of the amount by which his tax has been brought up to £67 9s. 3d. through the inclusion of his dividends in his assessment.

He must therefore be again assessed, this time on the residue of his income after excluding the dividends—

	£	s.	d.
Total income	1,160	0	0
Less dividends	332	0	0
Net income	828	0	0
From this there must be deducted the statutory exemption =	124	0	0
Taxable income	704	0	0
The rate of tax on £704 is 9.0736d. in the £1. .. Tax =	26	12	4
Amount of rebate granted	40	16	11
Tax previously paid by the company on £332, at 14.4d. in the £1 = ...	19	18	5
Gain to the shareholder through the present form of the law = ...	20	18	6

The proposed amendment would operate thus—

Tax on £1,146	67	9	3
Proportion of tax applicable to £332 dividends	19	10	11
Tax previously paid by the company on £332 at 14.4d. ..	19	18	5
Rebate which will be allowed in the shareholder's assessment of the part of his own tax which is applicable to the dividends	19	10	11

Gain to the revenue—

	£	s.	d.
Present rebate	40	16	11
Proposed rebate	19	10	11
	21	6	0

This class of shareholder is very numerous, and the aggregate loss of tax is large.

The proposed amendment will prevent allowance of any rebate in such cases in excess of the amount of tax paid by the company on the dividends.

CLAUSE 6, AMENDMENT (f).

The first part of this amendment down to the words "demanded and given in connexion with a lease" repeats the substance of the existing wording in paragraph (*d*) of section 16 of the Principal Act.

Royalties and Bonuses.—This covers royalties and bonuses of all kinds and is not limited to those which may be connected with leasehold estates. The law has always operated in this manner in relation to these two classes of income since the Income Tax was imposed in 1915.

Fines, premiums and foregifts or consideration of that nature demanded and given in connexion with a lease have always been liable to income tax since that tax was imposed in 1915.

CLAUSE 6, AMENDMENT (f)—*continued.*

Amounts received by way of consideration for the sale, assignment or transfer of leases were made taxable for the first time by the *Income Tax Assessment Act* 1916. They continued to be taxable until 1923-24. They were removed from the provisions of the *Income Tax Assessment Act* 1922-1923 by the *Income Tax Assessment Act* 1924 for the purpose of being incorporated in a separate Bill for an Act to be entitled the *Lessee Tax Act* 1924.

The Senate rejected the Bill and the Government of the day accepted the Senate's decision, so that amounts received upon the assignment or transfer of leases ceased to be taxable after the 1922-23 assessment.

There was, however, no alteration made in the provision which allows a deduction of the sinking-fund required to amortize an amount paid by a person to secure the assignment or transfer to him of a lease. The right to such a deduction was created by the *Income Tax Assessment Act* 1916 because that Act imposed a tax on the amounts paid to the assignor or transferor, and it applied to the assessments for 1916-17 and all subsequent years. It is still in operation.

It will be observed that, since the 1922-23 assessment, the law has been operating in a one-sided manner, by granting a deduction to a purchaser of a lease of the annual sinking-fund required to amortize his purchase, but not taxing the vendor on the amount received by him.

The present Bill seeks to re-impose tax on profit in payments received in respect of the sale, assignment or transfer of a lease.

There are two principal reasons for this—

(1) All such payments are in the nature of rent paid in advance. No ingoing payment for a lease or licence or goodwill is justifiable unless the rent reserved by the lease is less than the full economic rent of the property having regard to all the circumstances. An ingoing is, therefore, commuted rent paid in advance.

(2) The proposal is the natural corollary to the allowance to a purchaser of a lease of a deduction of the annual sinking-fund required to amortize the payment he made to acquire the lease.

The present loss of revenue through this one-sided arrangement is very substantial, because sales and transfers of leases are very common.

One of the arguments advanced in subsequent discussions of a proposal to re-impose the tax on the payments in question is—

(*a*) A leasehold estate in land is a capital asset; so is a freehold estate in land.

(*b*) There is no tax levied on profit on the sale of a freehold estate unless the sale has been made as a business operation in the carrying out of a profit-making scheme entered into. Why, therefore, should any tax be charged on profit on the sale of a leasehold estate in similar circumstances?

CLAUSE 6, AMENDMENT (f)—*continued.*

The reply is—

(i) There is a deduction allowed to a purchaser of a lease of the annual sinking fund to amortise his cost, whether the vendor of the lease has or has not traded in leasehold estates.

(ii) There is no deduction allowed to a purchaser of a freehold estate in respect of any part of his purchase price unless the profit on his sale is liable to income tax. Where the profit is not liable to tax, the purchaser of the property gets no deduction even if he should resell the land at a loss.

In every instance the purchaser of the lease gets his deduction.

(iii) The purchase price of a freehold estate is a definite capital outlay which may at any time in the future be recovered by the sale of the property, sometimes with a profit.

(iv) The purchase price of a leasehold estate is and must be treated by the purchaser in his accounts as commuted rent paid in advance. The purchaser's accounts usually spread this payment over the period of the lease as additional rent. This is done by debiting profit and loss account with the annual sinking fund required to write off the cost price.

(v) All rent is income liable to tax, and all rent should be so liable whatever form its payment may take.

This shows that the vendor of a lease who has demanded a profit ingoing from the purchaser has in fact made an indirect levy upon that owner in the shape of rent additional to the rent reserved under the lease. If the payment were made to the freehold owner of the property there would be no doubt whatever that it would represent commuted rent paid in advance. There is no essential difference in the character of the payment merely because it is made to a prior lessee who has decided to sell.

(vi) There have been several judgments of English courts, which have decided that payments of the kind mentioned are payments of rent in advance.

There are still other reasons why persons who make profit upon the sale of leases should pay tax on the profit. The most important of these is the fact that owing to the absence of a provision imposing tax on the profit in such cases, it has been possible for leaseholders who are not entitled to any deduction of a sinking fund under section 25 (*i*) of the Principal Act, because they have not paid any amounts to obtain their leases, to secure a deduction indirectly.

Cases have come under notice in which individuals and partnerships who are the owners of leasehold estates in land which they are using for the production of assessable income and who have not paid anything to obtain the leases, have formed themselves into companies controlled by themselves and almost, if not entirely owned by them. These persons and partnerships have then "sold" their leases to the

companies for amounts which when shown in the companies' balance-sheets, will appear to be very substantial. No money passes from the company to the vendors of the leases in these cases, but the vendors "agree" to take shares in the company in satisfaction of the consideration to be paid to them for the "sale" of the leases.

The High Court has recently held that the allotment of shares in such a case constitutes a payment in cash and entitles the company to the deduction under section 25 (*i*) of the Principal Act of the sinking fund required to amortize the "payment" made for the lease.

If the sale price to the company is fixed at a sufficiently high amount, the annual sinking fund to be deducted in the company's assessment will be so large as to equal or exceed the true annual profits derived from the working of the leasehold property.

Thus the company will have no taxable income.

The company in such a case really consists of the former owner or partnership owner of the leasehold estate, and that person or those persons will be quite free to leave as much of the true profits of the company in the business as they choose without any liability to pay tax upon it at the ordinary rate payable by companies, to say nothing of any additional tax under section 21 for failure to distribute a reasonable amount of the taxable income among the shareholders.

The present position under the law has proved of the greatest advantage to the persons concerned in several cases which have come under notice. They have escaped payment of very substantial amounts of income tax.

Comparison of the terms of the new proposal with the terms of the law as it stood from 1916 to 1923, will show that the new proposals differ from the former provisions in the following respects:—

(*a*) the new proposals include in the assessable income payments made to secure the surrender of a lease and payments made for the sale, assignment or transfer of goodwill or licence associated with a lease; and

(*b*) the new proposals provide that, in certain cases, assessable income shall not include payments for leases made by way of shares in a company which is formed by a lessee to take over his lease and in which he takes the shares in payment for his lease.

Re Paragraph (a)—Surrender of a Lease.

A case recently dealt with by the Income Tax Board of Review adversely to the taxpayer shows the necessity to amend the law to prevent a repetition of the injustice which was unavoidable in that case because of the present limitations of the Income Tax Assessment Act.

The Act brings into the taxable field fines, premiums and foregifts received in respect of leases granted by an owner of land, but, if the owner should pay the lessee a sum of money to surrender the unexpired period of the lease, in order that the owner might grant another and more profitable lease to another person for a new fine, premium or foregift, the owner cannot receive any deduction in respect of that cost

against his new fine, premium or foregift, because that cost is a capital outlay which, in the absence of any saving clause, falls into the specific prohibition in the Act against deduction of expenditure which is capital or in the nature of capital.

The present form of the law in this connexion provides only for the simple case in which a freeholder grants a lease of his property for a fine, premium or foregift in addition to a reserved rent, and is not thereafter called upon to consider any offer of a better rent or higher fine, premium or foregift from another person, which could only be accepted if the lessee in possession could be induced to surrender his lease to the freeholder.

The Board of Review case may be illustrated thus:—A (a freeholder) grants a lease for six years to B for a premium of £2,000 payable in full at once. A is taxed on the £2,000 in the assessment year following the year of receipt of that amount. B becomes entitled in his annual assessment to deduct £2,000 divided by 6 = £333, being the sinking fund required to recoup his premium of £2,000 during the period of his lease. About the end of the fourth year of the lease, C approaches A and offers £4,000 for a lease for six years, the lease to commence at once. A goes to B and induces him to surrender the balance of his lease for £1,500. A thereupon grants C a six-years' lease for £4,000 and his net profit is £4,000 minus £1,500 equal to £2,500. But A must be taxed on £4,000 in full, because the law does not provide at present for a deduction of £1,500 paid to secure the surrender of the lease.

The result is harsh and inequitable upon A. Nor does the law require B to pay tax upon the £1,500 obtained by him from A upon the surrender of his lease. B is thus unfairly advantaged. Having paid £2,000 he will have recouped £999 of this by the end of the fourth year of his lease through deductions of the sinking fund of £333 allowed in assessments of his income of the three preceding years. The income of the fourth year would not have been assessed at the time of the surrender of the lease, but upon it being assessed B would be entitled to another deduction of £333 in his assessment, so that he will have recouped £1,332 in all by these deductions. He has therefore another £668 to be recouped. He recoups this amount out of the £1,500 received from A for the surrender of the lease and has a net profit of £1,500 minus £668 equal to £832.

The present amendment will cause B to be liable to be assessed on the £1,500 received from A. The provision contained in amendment (*c*) of clause 12 of the Bill, will permit B to deduct the £668 not previously recouped by way of sinking-fund deduction, so that his liability to tax will be limited to his profit of £832.

Re Paragraph (a)—Goodwill and Licence.

The necessity to cover goodwill and licence by the new proposals arises out of the attempts being made with more or less success by persons who sell hotel leases, to secure exemption from tax in respect of parts of the sale price which are alleged to have been paid for goodwill and licence.

Litigation has taken place on this question. In the one appeal on the point, which was heard in Brisbane, the appellant was unable to demonstrate to the court that any part of the lump sum payment which he had made was specifically attributable to goodwill or licence.

CLAUSE 6, AMENDMENT (f)—*continued.*

The appeal was disallowed, but it showed that the court would probably hold that the goodwill and licence, *per se,* are distinct from a lease, and if a contract of sale of lease, goodwill and licence specified certain sale prices for the goodwill and licence separately from a sale price for the lease, the department would be obliged to exempt from tax the price specified for the goodwill and licence.

The experience of the department, especially in Queensland and Victoria, has shown that in almost every instance, the ingoing is really a payment made in respect of the right to use the premises, and that right depends entirely upon the leasehold estate in the business as a whole being vested in the purchaser.

The value of the property to the purchaser of an hotel lease generally lies in its situation. Situation is a locality goodwill and essentially forms part of the property itself. Any other goodwill is personal to the vendor and cannot really be sold by him. It might be difficult, however, to prove that fact in a Court. It might be added that if the purchaser gave better service than the vendor, he would increase the goodwill to himself; otherwise he would either maintain or lose the goodwill gained by the vendor. There is also a value attaching to the property from the fact that the lessee may apply annually for an hotel licence in respect of it, and might reasonably expect to receive the licence.

The only real measure or value for taxation purposes which may be employed in such cases is the value of a leasehold estate in the property taken as a whole with all its advantages and disadvantages.

Apart from the foregoing view, it may be argued that whatever the payments may be alleged to cover, they are all of the character of commuted rent paid in advance and must be so treated in the purchaser's accounts. In that view they are properly taxable as payments in the nature of rent.

In Clause 12 of the Bill (amendment (*c*)) there is a provision for the amendment of the present terms of section 25(*i*) of the Principal Act so as to provide for allowance of a deduction of the sinking fund required to amortize any payment made for goodwill or licence associated with leasehold estates to secure which a payment has been made by the lessee.

Re Paragraph (b)—Assessment of Shares in a Company.

The proposal conditionally not to tax shares in a company issued by the company to a vendor, assignor or transferror of a lease to the company in consideration of the sale, assignment or transfer of the lease, is the complement of the proposal in section 12 of the Bill, to treat such shares as not being a payment in respect of which a company may obtain a deduction in its assessment of a sinking fund.

A case recently arose in which a company purchased three sub-leases each for ten years from a person allegedly for the sum of £170,000 to be satisfied by the company issuing to the vendor 170,000 fully paid-up £1 shares in the company.

The vendor to the company had, about two months prior to the sale to the company, acquired the sub-leases without payment of any amount beyond the rent reserved by the lease. That rent was the full economic rent of the properties at the date when the vendor acquired the leases.

CLAUSE 6, AMENDMENT (f)—*continued.*

When the company subsequently claimed to deduct a sinking-fund of £17,000 in its assessment, the Commissioner of Taxation rejected the claim, being of the opinion that the arrangement between the company and the vendor of the leases was artificial, having regard to the facts that the vendor acquired the leases without payment of any amount other than the annual rent, and that the value of the leases had not changed between the date of their acquisition by the vendor and the date of their sale to the company.

The company appealed to the Board of Review. The Board, at the request of the company, stated a case for the opinion of the High Court as to whether a payment within the meaning of the Act had been made by the issue of the shares mentioned. The Court answered the question in the affirmative, and unless the Commissioner can prove that artifice was used by the company and the vendor, the company must be allowed the deduction of the sinking-fund of £17,000.

A reason why it is suggested that shares in such cases should not be treated as assessable income is that the person to whom they are issued usually does not receive money out of which he could pay any tax if it were assessed on the shares. In the case under notice the person who received the shares would have been unable to pay the very heavy tax that would have been payable if it had been assessable. He would probably have filed his schedule in bankruptcy, and could then have applied to the Income Tax Relief Board for cancellation of his liability to pay income tax on account of his bankruptcy. This would not affect the deduction allowable to the company, but the revenue would suffer unfairly. This illustration is an extreme case, but it indicates the possibilities and the risks to the revenue.

If the shares were to be regarded as taxable, the company issuing them would necessarily be entitled to deduct the sinking fund required to amortise the value of the shares. If, on the other hand, as is now proposed, the company was excluded from any right to deduct a sinking fund, it is proper to provide that the recipient of the shares shall not be taxable in respect of them.

It is, however, necessary to provide for an exception to the exemption from tax of shares taken in satisfaction of the consideration demanded for the granting of a lease or for the sale, assignment or transfer of a lease.

The exception is required to meet cases in which a freeholder or a mesne lessee desires to grant a lease of his property to some person, but does not wish to pay income tax on the ingoing, which he proposes to demand by way of fine, premium or foregift. To escape the tax he first forms himself into a company. The company is to take a lease of the property for a nominal ingoing which is to be satisfied by the company issuing to the lesser fully paid-up shares in the company equivalent to the amount of the ingoing.

A person who is seeking to avoid payment of tax on a lease ingoing demanded and received by him, and who does this through an intermediary company, usually fixes the ingoing (which is to be satisfied by the issue to him of shares), at an amount very much below the real value of the lease to be granted, having regard to the rent reserved by the lease. Very soon after the shares are issued by the company, the recipient sells them for the full value of the lease to the person who seeks the lease, and is willing to pay the ingoing.

CLAUSE 6, AMENDMENT (f)—*continued.*

In one recent case the ingoing paid by the company, and satisfied by the issue of shares, was £500, whilst the true value of the lease was £7,000. In that case the person to whom the shares were issued immediately sold them to the person to whom it was intended the lease should really be granted. The department assessed the £7,000 in that case, and the Income Tax Board of Review upheld the assessment. It is thought, however, that there is some risk of loss to the revenue in those cases, because it may be possible for the parties to adopt somewhat different procedure, which might render it impossible for the proceeds of the sale of the shares to be assessed as income. It is accordingly considered desirable to take precautionary measures in the Amending Bill to protect the revenue.

The liability to income tax when shares are sold as described, will only arise if the shares are sold during the unexpired period of the lease calculated from the date when the shares were taken or received, or within two years after that date, whichever period is the lesser. The limit of two years is taken from the provisions of section 12 (2) of the New South Wales *Income Tax (Management) Act* 1928, which deal with the same subject.

In all cases to which the new provision applies, the taxpayer will be assessed only upon the amount of the fine, premium or foregift, or consideration of that nature, or the amount of the consideration for the sale, assignment, or transfer of a lease, which is actually received by him during each year.

It is desirable to consider these amendments in conjunction with those in amendment (*c*) in clause 12 of the Bill relating to the provisions of paragraph (*i*) of section 25, which permit a deduction of the sinking fund required to amortize the purchase price of a lease with or without a licence and goodwill.

The application of the amendments to payments for licence and goodwill will facilitate administration by removing a cause of much dispute between the Department and taxpayers and at the same time deal more equitably with purchasers of such assets.

The proviso in amendment (*f*) in clause 6 of the Bill merely re-enacts the essence of the provision formerly in the law for a deduction in the vendor's assessment of any previous cost incurred by him to acquire the leasehold estate. This provision was incorporated in the law when, prior to 1924, it provided for the taxation of the vendor, assignor or transferror of a lease on the amount received by him from the sale, assignment or transfer.

It will be seen that paragraph (*ii*) of the second proviso specially preserves the existing exemption in the law in respect of income derived from the sale, transfer or assignment by a prospector of his right to mine for gold in a particular area.

Paragraph (*iii*) of the second proviso repeats an existing provision of the law dealing with leases from the Crown, being perpetual leases without revaluation, and leases with right of purchase. Leases with right of purchase are generally in process of being converted into freeholds. The rent paid for such leases is usually treated as part of the purchase price to be paid for the Crown Grant. Perpetual leases, as the name implies, are freeholds to all intents and purposes.

CLAUSE 6, AMENDMENT (f)—*continued.*

If any such lease were sold at a profit by a person who had not acquired it for resale at a profit, the profit would be exempt from tax in like manner to profit derived by a similar sale of land actually held in fee-simple.

It will be observed in amendment (*c*) in clause 12 of the Bill that there is a corresponding provision which prevents the allowance of a deduction of a sinking fund in connection with these two types of lease. This provision was first inserted in the law by section 10 of the *Income Tax Assessment Act* 1924, No. 51. The reason then stated to Parliament by the Treasurer for this legislation was that these two types of lease are practically freeholds. They differ in very essential features from the ordinary lease of Crown lands for definite periods. This latter class of lease is covered by the provision now under explanation and by that in section 12 of the Bill, so that a vendor, assignor or transferror of that class of lease will be taxable on any profit which he makes by the sale, assignment or transfer of a such a lease and the purchaser will be entitled to the sinking-fund deduction which will amortize his purchase price.

CLAUSE 6, AMENDMENT (g).

This amendment is necessary to make complete the present wording of paragraph (*h*) of section 16 of the Principal Act. That paragraph deals with the treatment of the proceeds of sale or other disposal of the whole or part of the assets of a business carried on by the taxpayer.

The principle of law which has been laid down by the Courts in England and Australia, in cases where businesses are sold as going concerns, is that a sale in such circumstances, not being a sale for the purpose of carrying on a business but a sale for the purpose of putting an end to a business, does not produce taxable profit.

The Commonwealth legislature has declined to recognize that principle so far as trading stock is concerned, its attitude being that profit made on the realization of anything acquired or produced for trading purposes should be brought to account and taxed as income, irrespective of the circumstances in which the realization took place.

For that reason, early steps were taken, after the establishment of the principle mentioned, to provide a basis for the taxation of the proceeds of trading stock sold on the sale of the business as a going concern.

Subsequently, persistent attempts were made by taxpayers to extend the principle established by the Courts to the case of the winding-up of a business in a series of separate sales over a period and not as a going concern, and also to the winding-up of a part of a business, either in one transaction or in a series of transactions.

In view of those attempts, and also in view of the narrow interpretation placed by the Courts on the term "trading stock" in its relation to live-stock, the law was amended in 1927 (by the enactment of section 16 (*h*) of the Principal Act), to ensure the taxation, in all of the cases mentioned, of the proceeds of the realization of all trading stock and live-stock (other than beasts of burden and working beasts, and, in the case of the winding-up of the whole of the business, live-stock which, in the opinion of the Commissioner, were ordinarily used for breeding purposes).

CLAUSE 6, AMENDMENT (g)—*continued.*

Recently, claims have been made for the exemption from income tax of the proceeds of abnormal sales of trading stock or live-stock, not falling either within any of the cases specified in section 16 (*h*) or within the ordinary course of the taxpayer's trading, e.g., the sale by a pastoralist of the whole or a considerable portion of his live-stock, with a view, not to the winding-up of his business, but to the avoidance of losses during an existing or anticipated drought, and to the subsequent replenishment of the stock.

As the cost of the replenishment in such a case would be an allowable deduction from the taxpayer's income, there is no sound reason why the proceeds of the abnormal sale should not form part of his income; but, in view of the expressed opinions of certain Judges of the High Court, it is not unlikely that such proceeds should be held to be an accretion of capital, so far, at least, as regards live-stock which were not acquired or purchased directly and solely for the purpose of sale.

In order to give clear and final effect to the policy of Parliament in this particular, the new paragraph (*c*), inserted by this amendment, is designed to ensure that the proceeds of the sale of trading stock and live-stock (with the exceptions mentioned), under any circumstances whatever, are brought to account for the purposes of income tax.

The new paragraph will apply, not only to sales, but also to disposals otherwise than by sale, and as the terms of the paragraph are of the same generality as the terms of the existing paragraph (*c*), which is limited to disposals otherwise than by sale, the existing paragraph becomes redundant.

The amendment therefore proposes to omit the existing paragraph (*c*) and the words relating thereto.

CLAUSE 6, AMENDMENT (h).

This amendment is designed to overcome unnecessary inconvenience in the administration of section 16 (*h*) of the Principal Act when it is required to ascertain a market selling value of live stock which have been sold with other assets of a business without any specification of a separate selling price for the live stock, and, when in the opinion of the Commissioner, there is no evidence or insufficient evidence of the actual market value.

Under the present form of the law the value must be determined by the Commissioner.

The Crown Law Department has advised that the High Court might possibly hold that a determination by the Commissioner in such cases of a value for live stock is not effective until it is communicated to the taxpayer, and that until a determination is effective it cannot be applied in an assessment. This view would require the Department to issue a formal notification to the taxpayer that the determination had been made and then to apply the value so determined in an assessment to be notified to the taxpayer in the ordinary way.

The experience of the Department shows that a great variety of forms of notification of a determination would be necessary, because of the interdependence of section 16 (*h*) and section 17 of the Act in regard to sales of sheep in the wool.

CLAUSE 6, AMENDMENT (h)—*continued.*

Determinations by the Commissioner are specified in two places in section 17 of the Principal Act and in each provision which requires a determination there are many possible variations in cases. These variations would involve as many variations in the form of determination. Furthermore, there is some doubt as to whether the determination in every case would have to be made personally by the Commissioner or the Second Commissioner. It is obvious that if the Court should hold that the present form of the law in this connection requires the use of formal determinations as described, a large amount of work and possible confusion would arise. With the object of preventing this position it is considered necessary to amend the expression of the law so as to allow assessments in the cases referred to to be based upon values which, in the opinion of the Commissioner, fairly represent the market values of the relevant live-stock. The Commissioner's opinion is subject to review by the Board of Review.

If the High Court should decide as suggested, it would mean that a large number of assessments which have already been made without the issue of any formal notice of determination would be invalid. It would then be necessary to validate those assessments by retrospective legislation.

CLAUSE 6, AMENDMENT (i).

This amendment will remove an inequity which may easily arise under the present wording of paragraph (*h*) of section 16 of the Act.

The possibility of inequity was brought under notice by the Taxpayers' Association Ltd., of Western Australia. It may arise in the case of a pastoralist who may sell all his sheep in the wool at actual cost, thereby showing neither profit nor loss, but who, under the present wording of the law, must be taxed upon the value of the wool on the sheep's back without any deduction or any alternative.

For example—

An individual or a partnership might decide to form a company to take over the business as a going concern at actual cost. In such a case the sheep transferred might consist of a flock of, say, 20,000 sheep, one-half of which are to be excluded from an assessment under the terms of the law because they are breeding stock, and all the animals in the flock might carry growing wool of an assumed value of 6s. per head.

Although the transfer of the business to the company would not result in any profit to the transferror, and although the company would pay full income tax on all profit derived subsequently from the sale of the wool which it bought, the present form of the law would produce the following result in this case:—

	£
Sale of 10,000 breeding stock (including wool) at, say, 20s. per head	10,000
Opening value to be deducted (cost) at 20s.	10,000
Taxable profit	Nil
Value of wool on 10,000 breeding stock estimated at 6s. per head	3,000
Permissible deductions	Nil
Statutory taxable income	3,000

CLAUSE 6, AMENDMENT (i)—*continued.*

It is considered that this possible result from the present wording of the law should not be permitted. It will be prevented by the amendment set out in the draft Bill.

CLAUSE 6, AMENDMENT (j).

The object of this amendment is to remove all doubt on the question of the Department being compelled to allow a deduction in an assessment of the whole of the cost or value of breeding sheep sold in the wool when, by virtue of the first proviso to section 16 (*h*), the only part of the proceeds of the sale or disposal otherwise than by sale of those sheep required to be included in the assessment as income, is the part which is attributable to the wool on the sheep's back at the date of the sale or other disposal.

It would be incorrect to infer from the wording of the second proviso as amended by this amendment (*j*) of clause 6 of the Bill, that, by the exclusion from the assessment of that part of the proceeds of the sale or other disposal of sheep in the wool which is attributable to the carcase of the sheep, no deduction would be allowable in respect of any amount representing cost of the wool on the sheep's back. It is necessary to consider the second proviso to section 16(*h*) as amended by this part of the Bill, in conjunction with the amendment made in the first proviso to the section by the next preceding amendment.

That amendment, in fact, grants a deduction in all appropriate cases of the part of the cost price of purchased sheep which is attributable to the wool growing on them. It requires a net amount to be brought to account as assessable income. A maximum net amount which is to be brought to account as income in accordance with the provisions of section 16 (*h*), is indicated by the amendment in the first proviso to that paragraph. That net amount will be ascertained by the taxpayer by deducting the cost price of his sheep in the wool from the total proceeds of their sale in the wool in any case of a purchase made during the year in which the sale is subsequently made. In the case in which the purchase was made in a year prior to the year of sale, and in which the sheep have been brought to account at the end of the trading year at market value, the net amount to be treated as income in respect of wool growing on the sold sheep, is the difference between the sale price of those sheep in the wool and the market value previously brought to account as stated.

The fact that in any other class of case there is no deduction allowable in respect of cost of wool growing on sheep, will be due to the exercise by the taxpayer of his statutory option to select from prescribed values, a value at which he should bring to account at the beginning and end of each trading year all sheep on hand at those dates.

The High Court has ruled that words similar to those in the second proviso to paragraph (*h*) of section 16 do not require the department to disallow any part of the working expenses of the property from which the sheep were sold.

CLAUSE 7.

Two amendments which are proposed by this clause to be made in the wording of section 17 of the Principal Act are of the same kind as those explained in connexion with amendment (*h*) in clause 6. The notes on that amendment fully deal with the position involved by amendments (*a*) and (*b*) in clause 7 of the Bill.

CLAUSE 8, AMENDMENT (a).

Sub-section (1) of section 20 of the Principal Act entitles co-operative companies to certain deductions which are not allowed in the assessment of other companies. The general principle of the taxation of companies is that they shall pay tax at the company rate on the total profits derived without any deduction in respect of dividends paid to shareholders.

In the case of co-operative societies, an exception was made by the *Income Tax Assessment Act* 1927, No. 32, section 13, which provided for the allowance in the company's assessment of a deduction of so much of the assessable income of the company as is distributed among its shareholders as interest or dividends on shares, or as rebates based on purchases by shareholders from the company.

Quite recently some co-operative societies of cane-growers requested that the law should be further amended so as to allow a deduction in the assessment of co-operative societies whose members are primary producers, and provided not less than 75 per cent. of the capital of the society is held by primary producers, of any profit of the year which is transferred to reserves within nine months after the close of the company's trading year, and also of all undistributed profits. In effect, this meant the complete exemption of that particular type of co-operative company.

Having regard to the very definite recommendations made by the Royal Commission on Taxation 1920-1922 against the complete exemption of co-operative societies, after that Commission had exhaustively inquired into the incidence of the income tax on co-operative societies, the Government considers that the latest request cannot be acceded to. At the same time it is clear from the request that in certain cases there is justification for some further relief being granted. Those cases are those in which the co-operative companies concerned have either borrowed money from a State Government for the purpose of constructing buildings and acquiring plant for the proper conduct of the business, or have taken over from the State Government similar assets which had been constructed or acquired by the State Government. In such cases the co-operative company would have no capital or very little capital of its own, and would necessarily become indebted to the State Government for repayment of the moneys expended by that Government in acquiring the assets transferred to the co-operative company.

It has been the policy in practically all, if not all, of the States for the State Governments to encourage the formation of co-operative companies for the supply of goods to members or for the sale of the products of members. That is also the policy of the present Commonwealth Government. There is some evidence to show that the previous Commonwealth Government followed along similar lines.

It is therefore considered that the Commonwealth should not seek to levy income tax on that part of the profits of a co-operative company which is applied by it in repayment of advances made by a Government of the Commonwealth or a State to the company for the purpose of enabling it to acquire assets for purposes of the business of the company, or to pay for any similar assets taken over from a Government.

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CLAUSE 8, AMENDMENT (a)—*continued.*

In giving effect to the policy of encouragement the Government has found it necessary to make special provision to deal equitably with all cases, especially in view of the fact that there are some co-operative companies in which part of the capital is held by individuals who are not suppliers of primary produce to the company for the purpose of sale or for the manufacture of other products for sale on behalf of the members. This provision will limit the proposed deduction to companies in which shares representing 90 per cent. of the paid-up capital of the company are held by members who supply the company with the commodities or animals which the company requires for the purpose of its business.

CLAUSE 8, AMENDMENT (b).

The amendment also deals with what are considered to be mutual building societies. These are societies which are formed principally to secure funds from members for the purpose of making loans to members to enable them to acquire land or buildings to be used by the member for purposes of residence or for residence and business combined.

At present these societies do not come within the definition of "co-operative company" contained in sub-section (1A) of section 20. The amendment proposes to include them in that definition and thus enable them to secure the deductions provided by sub-section (1) of section 20 of the Principal Act. It will be observed that, to be entitled to these deductions, these societies must make loans to their members amounting to at least 90 per cent. of their total loans. This condition is similar to that imposed in the case of other classes of co-operative companies which purchase goods for disposal among members and others, or which acquire goods from members and others for disposal in the ordinary course of the industry, trade or business of the company.

It is considered that any reduction in this condition would expose the revenue to serious loss.

This amendment is reflected in the new form of the second proviso to sub-section (1A) of section 20 of the Principal Act.

CLAUSE 8, AMENDMENT (c).

This amendment is designed to remove two anomalies associated with the treatment of co-operative companies under the present law, viz.:—

(1) The existence of liability to tax on bona fide co-operative societies whose shares are not sold publicly. The liability arises from the technicality that the rules of the societies do not strictly comply with the terms of the definition in the Principal Act of "co-operative society", by failing specifically to prohibit the quotation of the shares of the society for sale or purchase at any Stock Exchange or in any other public manner whatever; and

(2) The technical exclusion from the definition "co-operative society" of those bona fide co-operative societies which carry on both purchase and sale of goods in the interests of members.

CLAUSE 8, AMENDMENT (c)—*continued.*

In connexion with the first anomaly, a number of co-operative societies which were recently assessed for tax for the technical reason mentioned, immediately amended their rules to express the specific prohibition regarding public sale of shares, and they desired that such an amendment in the rules should be deemed to have been made retrospectively, because at no time had the society's shares been offered publicly for sale. This request cannot be acceded to by the Commissioner of Taxation, unless the law is amended as proposed.

The prohibition of public sale of shares is considered necessary in order to prevent abuse of the benefits under the Act which are intended solely for bona fide co-operative societies.

The second anomaly will be removed by the proviso contained in the proposed amendment. In this connexion the intention of the definition of "co-operative society" was to grant the benefits of the law to societies which transact 90 per cent. or more of their business with or on behalf of members. The terms of the definition are sufficient to cover a society which does 90 per cent. or more of business with its members in any one of the kinds of business mentioned in the definition, if that is the only kind of business carried on by the society. The definition does not cover a case where a company carries on more than one of the specified kinds of business.

For example, if a company—

(i) purchases goods, &c., in the open market for sale to its members; and also

(ii) purchases goods, &c., from its members for sale in the open market on their behalf,

it cannot be classed as a co-operative society within the meaning of the Act because, when the aggregate amount of the two classes of trade, which are done with members only, is calculated, it is always found to be less than 90 per cent. of the whole trade of the society. The reason for the anomaly is best expressed by an algebraical statement:—

Let a = purchases from members,
b = purchases from outsiders.
c = sales to members.
d = sales to outsiders.

(The definition also refers to storage of goods, but it is not necessary to introduce that element into the illustration at present.)

The present wording of the law requires—

a plus c (purchases from and sales to members) shall equal 90 per cent. of $a + b + c + d$, in order that the society may obtain the concessions provided by the law for co-operative societies.

It is impossible for any society carrying on both of the activities (i) and (ii) mentioned at the beginning of the example to show the required result.

If such companies were to divide their activities between two companies, both consisting of members of the present company, so that one company were to purchase goods for sale to members and the other company were to sell goods on behalf of members, both companies would be co-operative companies as defined by the Act.

CLAUSE 8, AMENDMENT (c)—*continued.*

It is anomalous, when both of those activities are combined under one company, that that company cannot be treated as entitled to the concessions provided for bona fide co-operative companies.

This position will be remedied by the second part of the proposed amendment.

CLAUSE 9, AMENDMENT (a).

This amendment is consequential upon the proposal contained in clause 10, which deals in an entirely new manner with certain private companies. A full statement of the position appears under clause 10 in these notes.

CLAUSE 9, AMENDMENT (b).

This amendment is necessary in order to correct an anomaly which has come under notice in connexion with the application of the provisions of section 21.

Cases have arisen under that section in which the shares in the company are held wholly or partly by a company not incorporated in Australia. In order to put the proviso to sub-section (2) of the section into force it is necessary to ascertain who would be the eventual individual recipients of the notional distribution with which sub-section (1) deals, if the successive distributions referred to in the proviso concerned had actually taken place. This entails obtaining a list of the shareholders in the company not incorporated in Australia and the number and paid-up value of the shares held by each. The Australian company generally disclaims all knowledge of the shareholders in the ex-Australian company, and contends that such information is not available to it. It is not possible to compel the ex-Australian company to supply a list of its shareholders seeing that it is beyond the jurisdiction of the Commonwealth courts. This has forced the Commissioner, in order adequately to protect the revenue, to assume, for the purposes of the calculation of the additional tax under section 21, that the whole of the shares in the ex-Australian company were held by one person. This is done with a view to compelling the companies concerned to supply the department with a list of the shareholders in the ex-Australian company.

There is reason to think that an assessment for section 21 tax based upon such an assumption could not be maintained upon appeal if the company produced evidence that there was in fact more than one shareholder in the ex-Australian company, and that, probably, the Court would not assist the Commissioner by imposing on the taxpayer company an obligation to obtain and supply information which the Act does not require that company to obtain and supply, but would leave it to the Commissioner, if he requires that information, to obtain it in the best way he can.

Generally speaking, the only way in which the Commissioner can obtain the necessary information is from either the Australian or the ex-Australian company, and if such information is withheld then the company should be prepared to pay the maximum section 21 tax which would be payable in the circumstances.

CLAUSE 9, AMENDMENT (b)—*continued.*

If the proposed amendment is not incorporated in the law, companies whose shares are held wholly in Australia will be at a distinct disadvantage compared with companies whose shares are held partly or wholly by ex-Australian companies, in view of the fact that while section 21 can be freely and fully applied to the former class this cannot be done with the latter class.

CLAUSE 10.

The new section here provided for has become absolutely necessary in order to prevent loss of revenue in several directions.

Its necessity was first demonstrated by the formation of privately-owned companies in certain cases.

The various means of avoidance are stated below:—

(*a*) Several private companies have, in some instances, been formed by the same individuals who have, directly or indirectly, held all the shares. Each company, being a separate legal entity, becomes entitled to a separate general assessment, and also to separate treatment under the present terms of section 21. Under that section, each company is entitled to retain one-third of its profits without liability for the additional tax provided by section 21 in respect of two-thirds of the profits. There is no present provision in the law to treat all of these companies as one or to assess the profit of any one company or of the whole of the companies in the aggregate to the individuals who are the real owners and who have complete control over the whole of the profits.

In the interests of taxpayers generally, it is essential that the companies described above should be specially provided for in the Act.

(*b*) It has become a widespread practice for individuals carrying on business upon the profits of which they have individually been liable to tax at fairly high rates, to form themselves into private companies, the shareholders of which are the members of the family of the real owner of the business, and to distribute the profits of the year to the respective shareholders as directors' fees.

In one case the real owner of the business held the majority of the shares. His wife and children held the balance of the shares between them.

All the shareholders were appointed directors of the company.

Equal amounts of directors' fees were paid to each of the wife and husband, and sums ranging from £200 to £600 were paid to the respective children as directors' fees.

When all of these fees were debited in the company's accounts the net profit of the company was almost nil.

The business was conducted entirely by the husband who was the real owner of the business.

The statutory meetings of the company were attended by the husband and wife. Sometimes some of the children also attended.

The taxpayer claimed that he was merely making proper provision for his wife and children in the event of his death. The wife and children were always amply protected in this respect, and it was not necessary to form a company for that purpose.

There was only one object in forming the company, i.e., the avoidance of taxation as far as possible by arranging to pay "directors' fees" to his children. This person sought to relieve himself of tax on that part of his former income which he had been in the habit of applying for the education and maintenance and general advancement of his children.

(*c*) Two persons carried on a business in partnership on property owned by themselves. They decided to form themselves into a private company in which they were the only shareholders, and to sell the property upon which they were carrying on their business, in order that the partnership might take a lease of the property from the company for the purpose of carrying on the partnership business as usual.

The rent received by the company was taxable at the company rate, and the partnership would receive a deduction in its assessment of that rent.

The rates of tax payable by the partners on their interests in the partnership income were in excess of the company rate, so that by this arrangement the partners were reducing their income taxes.

(*d*) There is a growing practice among privately-owned companies for the companies to "loan" money out of profits to the principal shareholder or shareholders who have formed the company.

In the majority of cases the "loans" are without interest. In one case the company finally went out of business, and, upon its liquidation, the "loans" made to the principal shareholder (who was practically the only shareholder) were forgiven to him—no doubt upon a resolution, carried by the votes of that shareholder.

The following are typical of those cases. The names of the companies are not stated, and the amounts of the loans have been altered in order that the facts of any particular case may not be divulged:—

Case "A."—A privately-owned company carrying on a business formerly carried on by the principal shareholder individually.

The share capital of the company is made up as follows:—

	Shares.
Principal shareholder X (formerly sole owner) ..	42,000
Mrs. X	7,600
Miss X	7,000
Three others not related to X between them hold ..	1,800
	58,400

"Loans" made by the company to the principal shareholder up to date £71,000.

The company paid tax on the loans at the company rate, but X did not pay any tax on them.

The company was charged each year additional tax under section 21 upon the difference between two-thirds of the profits and dividends actually distributed. X has successfully avoided payment of very considerable sums of tax which he would have paid if he had continued individually to carry on his business instead of forming himself into a private company.

Case "B" is a private company consisting of several relatives who had formerly carried on business in partnership.

CLAUSE 10—*continued.*

The total capital of the company is £90,000.

The aggregate of the loans made to date to shareholders who were formerly members of the partnership is £60,000.

Case "C."—The business of this company was formerly carried on by the principal shareholder of the company, who holds all but four shares of the company.

The total capital of the company is £4,000.

The loans to the principal shareholder made to date amount to £1,800.

Case "D."—This company carries on the business formerly individually owned by the principal shareholder. That shareholder holds 29,994 shares out of 30,000 shares of the company.

The principal shareholder has received loans from the company to date amounting to £12,000.

Case "E."—In this case a company carries on the business formerly carried on by two persons in partnership. Those persons are the principal shareholders of the company. They also carry on a separate business in partnership.

The total capital of the company is £92,000. The two principal shareholders hold 70,000 shares in the capital.

The "loans" made to the two principal shareholders in their capacity as members of another partnership amount to £133,500.

Case "F."—This is a pastoral business carried on by a company, the principal shareholder in which was formerly the sole owner of the business. He now holds all but four shares of the company.

The total capital of the company is £30,000.

Loans to the principal shareholder and his wife to date exceed £40,000.

Case "G."—A manufacturing company has a capital of £50,000.

The two principal shareholders held all but 25 shares of the capital.

Each of the two principal shareholders, in one year, drew salary and directors' fees amounting to £11,000. In one year the company erected a residential building at a cost of nearly £10,000, "sold" it to one of the principal shareholders for £3,500, and claimed a deduction for taxation purposes of an alleged loss of the difference between the cost of the building and the "sale" price. The deduction was refused.

(*e*) The additional income tax which arises from the application of section 21 of the Principal Act to companies is being avoided by the formation of one or more subsidiary companies to hold the shares interests of the real owner of the business.

Section 21 provides that a company becomes liable to pay additional tax at shareholders' rates on such amounts of its profits which have not been distributed in dividends and which, in the opinion of the Commissioner, could reasonably have been so distributed. The Commissioner, however, may only require payment of additional tax upon

CLAUSE 10—*continued.*

an amount of profit which, when added to dividends actually distributed in cash, will amount to two-thirds of the distributable income of the company.

Quite recently it has been discovered that the shareholders of several privately owned companies have adopted the policy of forming one or more subsidiary companies for the purpose of holding their shares in the income producing company. For example, company A may be the income producing company. The shareholders form company B to hold the shareholders' shares in company A, and they take shares in company B in proportion to their former shareholdings in company A. Where it is thought the circumstances require it, another company —company C—will be formed by the shareholders of company B to hold their shares in that company, and the shareholders will then take shares in company C *pro rata* to their interests in company B.

At the close of the business year of company A, a cash distribution of two-thirds of that company's profit is made to company B. Company A pays income tax on the total amount of its profits at the company rate. Company B does not pay any additional tax on the cash dividend received by it because its rate of tax is also the company rate.

Company A retains one-third of its profits taxed at the company rate, without any liability for additional tax upon that amount at shareholders' rates. Thus the shareholders up to that point, have not paid tax at a rate greater than the company rate.

Company B then makes a cash distribution to company C of two-thirds of the dividend paid to it by company A. Company B retains one-third of that dividend without liability to pay any additional tax on it under the present terms of section 21. Company C does not pay any additional tax on the cash dividend received by it from company B because its rate is also the company rate. Then company C pays a cash dividend to its individual shareholders of two-thirds of the amount received by it from company B. The shareholders in company C then pay income tax in their individual assessments on the dividends received by them.

By this means the shareholders have avoided payment of additional tax under section 21 to an extent in excess of the one-third intended by section 21.

For example: Assume the profits of company A are £9,000; company A retains one-third—£3,000; company B receives a dividend from company A of two-thirds of £9,000—£6,000; company B retains one-third of £6,000—£2,000; company C receives a dividend from company B of two-thirds of £6,000—£4,000; company C pays a dividend to its shareholders of two-thirds of £4,000—£2,667 upon which the shareholders pay tax individually. Therefore the shareholders have escaped the additional tax of section 21 upon £2,000 through company B; £1,333 through company C. Total, £3,333.

If there had been one company only—company A—which had made a cash distribution of £2,667 only, the company would have paid additional tax upon £3,333, being the additional amount which could have been distributed so as to make a total distribution of two-thirds of the profits.

The previous Government recognized that many private companies are formed expressly to reduce the amount of income tax formerly assessed to the real owners of the company.

CLAUSE 10—*continued.*

Individual owners of businesses and partnership owners of businesses have found that considerable advantages in taxation are obtainable by the formation of private companies, especially through the operation of that part of the present wording of section 21 which permits a company to retain one-third of its profits without liability to additional tax.

It was noted that the Act had been specially amended at the instance of that Government to deal in a special manner with partnerships entered into between a husband and wife or between members of families for the express purpose of having the total profit assessed *pro rata* to the several persons in the partnerships. By this means the total amount of income tax payable was greatly reduced although the former beneficial enjoyment of the total income had not, in fact, been altered.

In such cases the law provided that the total profit should be taxed as the income of a single individual.

The previous Government decided to apply the same principle to private companies which have been formed obviously for the purpose of reducing their taxation liability, and more especially in view of the easy means already exemplified which are now available under section 21 of the Act to reduce the liability still further. The present Government approves that decision.

The means which the previous Government decided to adopt, and which are adopted by the present Government, are those expressed in this clause of the Bill, viz., in effect, to treat the relevant company as being individually or severally owned, as the case requires. Consequential upon this it is necessary to provide a special rate of tax to apply to the profits of the company so as to produce an amount of tax, which, with the tax payable by the individual, will represent, approximately, the same amount of revenue (but not more) as would have been derived from that individual or those individuals if the company had not been formed. The same principle is being applied by the Bill to partnerships formed by husbands and wives or among members of families to avoid tax. (*See* Clause 15 of the Bill, where examples of rates of tax by affected partnerships are given.) This new clause takes right out of section 21 of the Principal Act the particular class of company mentioned in the new clause.

The amendment makes provision in new sub-section (6) of section 21A to prevent double taxation of the members of the company who may receive dividends out of the profits which would already have been specially taxed to them in accordance with the new proposal.

It has been necessary to define the term "shares held on behalf of" so as to prevent avoidance of the new provisions by special family and analogous arrangements. This definition is set out in sub-section (2) of the new section. Its terms are somewhat similar to those in corresponding legislation in the United Kingdom and New South Wales.

CLAUSE 11, AMENDMENT (a).

This amendment is consequential upon the alteration of the law to cause a resident of Australia to be taxed on ex-Australian income in certain circumstances already described.

CLAUSE 11, AMENDMENT (b).

This amendment is necessary to give effect to the original intention of paragraph (*b*) of section 23 (1) of the Principal Act, in regard to the deduction to be allowed for rates and taxes.

CLAUSE 11, AMENDMENT (b)—*continued.*

Quite recently the department has received claims that the present wording of paragraph (*b*) of section 23(1) allows a deduction of customs duties paid upon privately imported goods, stamp duties of all kinds (even when not connected with business transactions producing assessable income) succession duties, and, in the case of a trustee, probate and Commonwealth estate duties.

There is room for doubt regarding the scope of the present provision in the law. The intention of that provision was to base the Commonwealth income tax assessment upon the net amount of income of the taxpayer after the ordinary municipal and State annual taxes had been paid.

It was never intended to apply to such taxes as those specified above which are not in any way connected with ordinary operations of trading for profit. Nor was it ever intended that the concession should embrace death and succession duties.

The remedy lies principally in the omission of the words "and tax" which follow the word "rates". There is also the necessity slightly to re-arrange the wording so that the intention may be made quite clear.

The amendment as drafted will attain the desired end.

CLAUSE 11, AMENDMENT (c).

This amendment is required to prevent double deduction in respect of depreciation of plant and machinery in cases in which depreciation deductions have been allowed in past assessments, and the assets in respect of which the deductions were allowed are sold for an amount in excess of those allowed deductions.

Paragraph (*c*) of sub-section (1) of section 23, in dealing with deductions for depreciation provides, in clause 4 of that paragraph, that on the sale of property in respect of which deductions for depreciation are allowed, the sale price shall be compared with the depreciated value of the property as at the date of sale, as written down by the allowed deductions.

If the sale price is less than the depreciated value, the balance of the depreciated value is allowable as a deduction in the assessment of the income of the year of sale of the asset.

On the other hand, if the sale price exceeds the depreciated value, the taxpayer must bring to account as income in the year of the sale, so much of the excess of the sale price over the depreciated value, as represents deductions previously allowed for depreciation.

The depreciated value as at the date of the sale is the cost less deductions previously allowed under the Act to the taxpayer in his past assessment, for example—

	£
Cost	100
Deductions previously allowed	50
Depreciated value	50
Sale price, say	110
Less depreciated value	50
Residue	60

As £60 exceeds £50 deductions allowed, the £50 must be brought to account as income of the year of sale. But when that income falls to be assessed, the taxpayer must be allowed a deduction (as for a

CLAUSE 11, AMENDMENT (c)—*continued.*

full year) for depreciation of the asset because he used it during the income year upon which the later assessment is based. So, he brings £50 to account as income, as previously stated, and deducts the depreciation allowance for a year, say £10, and is taxed on a net £40.

This position arises because the taxpayer makes a return of his income for a financial year ending on 30th June, and accounts therein for all transactions of that year. Therefore, when he sells an asset during a financial year, the effect is not recorded until he prepares his return during the month of July or August following the close of that year. The Department does not usually make an assessment on that return until the following January or later in the financial year.

In that return the taxpayer is entitled to claim a deduction (as for a full year) in respect of depreciation on the asset because he will have used it in his business for part of the income year covered by the return. But that deduction cannot, at present, be taken into consideration by the Commissioner in ascertaining the amount which the taxpayer should treat as income arising from the sale of the asset.

The proposed amendment supplies the remedy.

Result of the amendment—

	£
Cost price	100
Deductions previously allowed	50
Depreciated value as at the date of sale	50
Sale price	110
Depreciated value	50
Excess of sale price	60
Amount of deductions previously allowed to be treated as income	50
Amount of deduction to be subsequently allowed to be treated as income	10
	60
Less deduction to be subsequently allowed	10
Net income in the assessment	50

Compare this result with the following:—

	£
Cost	100
Deductions previously allowed £50 Deduction subsequently allowable £10	60
True depreciated value as at date of sale	40
Sale price	110
Less depreciated value	40
Excess	70
Amounts of deductions for depreciation taken into account, to be treated as income	60
Less amount of deduction subsequently allowable	10
Net income in the assessment	50

This latter scheme would be more difficult to express in the law than that suggested.

CLAUSE 11, AMENDMENT (d).

This amendment is necessary in order to confine to resident taxpayers the concession granted by paragraph (*g*) of sub-section (1) of section 23, which allows deductions for contributions to superannuation and similar benefit funds established in Australia under a law of the Commonwealth or a State.

CLAUSE 11, AMENDMENT (e).

The purpose of this amendment and of amendments (*j*) and (*k*) in this clause is to reduce work in all assessing offices. The amendment will not operate in any way to alter the amount of the deduction at present allowable under paragraph (*g*) and (*o*) of sub-section (1) of section 23 of the Principal Act.

These two paragraphs (*g*) and (*o*) in the present law allow the deductions specified thereunder to persons whose "taxable" income does not exceed—

Paragraph (*g*)	£800
Paragraph (*o*)	£900

Paragraph (*g*) allows deductions of contributions to superannuation, sustentation, widows' or orphans' funds established in Australia or to any society duly registered under any Friendly Societies Act of the Commonwealth or a State, when the taxpayer is in receipt of salary, wages, allowances, stipend or annuity.

Paragraph (*o*) allows deductions in respect of medical and funeral expenses.

"Taxable income" is defined in the law as being the assessable income remaining after allowing all deductions allowed by the Act.

In connexion with cases coming under either or both of paragraphs (*g*) and (*o*) of sub-section (1) of section 23 of the Principal Act, the following procedure is necessary:—

(1) Ascertain the net income of the taxpayer apart from those two deductions, and before any deduction is made on account of the general exemption of £300.

(2) Calculate the general exemption (£300, diminished by £1 for every £3, by which the net income exceeds £300) allowable on that net income. The result is a taxable income ascertained apart from paragraphs (*g*) and (*o*).

(3) If the taxable income under (2) does not exceed £900, the deduction under paragraph (*o*) is allowable, and the following further rules must be observed:—

(4) Ascertain afresh a new net income by deducting the allowance under paragraph (*o*) for medical and funeral expenses from the former net income.

(5) Calculate afresh a general exemption allowable on the reduced net income. The result is a fresh taxable income.

(6) If the fresh taxable income under (5) does not exceed £800, the deduction under paragraph (*g*) is allowable, and the following further rules must be observed:—

(7) Ascertain a third net income by deducting the allowance under paragraph (*g*) from the former reduced net income mentioned in (4).

CLAUSE 11, AMENDMENT (e)—*continued.*

(8) Calculate a third general exemption allowable on this further reduced net income. The result is the finally taxable income upon which tax is payable.

The amendments will operate as follows:—

(*a*) Ascertain the net income as in (1) above, apart from paragraphs (*g*) and (*o*). If that net income does not exceed £900, the deduction under paragraph (*o*) is allowable and a new net income results.

(*b*) If the new net income under (*a*) does not exceed £800, the deduction under paragraph (*g*) is allowable and a reduced net income results.

(*c*) Calculate the general exemption on the final net income ascertained which is appropriate to the facts and deduct it to ascertain the taxable income upon which tax is payable.

The amendments will very greatly reduce the departmental work in the assessment of a large number of taxpayers.

At present a net income of £975 produces a taxable income of £900 and a net income of £900 produces a taxable income of £800.

The only persons who are liable to be disadvantaged by this proposal are those with a present net income from £801 to £975. The number of such cases is not large.

The saving in cost of administration will be very considerable.

CLAUSE 11, AMENDMENT (f).

This amendment is necessary in order to prevent a double deduction for calls on shares being obtained by a person who is a dealer in shares and is taxable on profits from dealings. When such a person pays a call of the kind mentioned in section 23 (1) (*i*) of the Act he becomes entitled to a specific deduction of that call in the assessment based on the income of the year in which the call was made. If the shares should be sold at any time after the call is made, the profit, if any, on the shares must be calculated by deducting the actual cost of the shares from the proceeds of their sale. The actual cost includes the call, so that such a taxpayer will obtain a deduction twice for the one call.

It was not intended that there should be any double deduction of any expenditure.

The amendment proposed will prevent the double deduction in this case.

CLAUSE 11, AMENDMENTS (g) and (h).

These amendments are necessary so as to limit the deduction of—

"so much of the assessable income as is set aside or paid by an employer of labour as or to a fund to provide individual personal benefits, pensions or retiring allowances for employees," to employers of labour and employees who are residents of Australia.

The present wording of the law would entitle an absentee, who is deriving income from Australian sources, and who usually takes it away from Australia, to a deduction in his assessment of so much of

CLAUSE 11, AMENDMENTS (g) and (h)—*continued.*

that income as he may contribute as or to a fund to provide the benefits specified in the section for his employees overseas. There are numbers of such persons who have no employees in Australia.

It was not intended that the Commonwealth should deplete its revenue from income tax in order to encourage absentee employers, at the expense of the Commonwealth, to provide benefits for overseas employees.

CLAUSE 11, AMENDMENT (i).

This amendment is an extension, recently shown to be necessary, of the restrictions placed by the 1927 Act upon the allowance of the deduction, under section 23 (1) (*n*), in respect of expenditure covenanted to be made by a lessee on improvements in which he has no tenant rights. Such expenditure is an outlay of capital, but as the lessee, at the expiration of his lease, has no interest in the asset created by the expenditure, he is bound, in ascertaining his true profit for any year of his term, to set aside the annual sum necessary to recoup such expenditure.

The allowance is, therefore, a concessional deduction designed to prevent hardship in a bona fide case.

It was not intended that the allowance should be granted where the person effecting such expenditure was, for all practical purposes, merely the agent or dummy of the person in whom the ownership of the asset created by the expenditure remained at the expiration of the lease.

To defeat the various artifices which were being resorted to with the object of bringing such cases within the benefits of the allowance under section 23 (1) (*n*), the law was amended in 1927. That amendment was specifically directed against the following class of case:—

> A taxpayer owned the freehold of his business premises, which he was desirous of re-building. He formed a company, of which he became practically the sole shareholder, transferred the business to the company, and granted it a lease in consideration of a covenant to re-build the premises. Thus, as practical owner of the company, he was able to obtain a deduction under section 23 (1) (*n*) from the income of the business of the annual sum necessary to recoup the cost of the new building.

Since that amendment was made, the converse case has arisen, viz.:—

> A taxpayer formed a company to which he transferred the freehold of his business premises.
>
> The company, of which taxpayer was the controlling and practically the sole shareholder, leased the premises to the taxpayer in consideration of a covenant by taxpayer to re-build those premises. By this arrangement the taxpayer was able to obtain a deduction under section 23 (1) (*n*) of the annual sum necessary to recoup the cost of a new building of which, in view of his shareholdings in the company, he was substantially the owner.

The present amendment is designed to prevent the allowance being made in that class of case.

CLAUSE 11, AMENDMENTS (j) and (k).

The first part of these amendments is required for a similar reason to amendments (*g*) and (*h*), viz., to limit the concessional deduction (in respect of medical expenses) to residents of Australia. The present wording of the law would allow the deduction to an absentee having a taxable income from sources in Australia of £900 or less.

The second part of amendment (*j*) and amendment (*k*) are similar in purpose to amendment (*e*) where a full explanation will be found.

CLAUSE 11, AMENDMENT (l).

This is merely a drafting amendment which is required because of the proposal to add an additional paragraph to section 23 (1).

CLAUSE 11, AMENDMENT (m).

This amendment is required for reasons similar to those stated in connexion with amendments (*g*) and (*h*) in this clause. It is also consequential upon the new provision proposed to be inserted in the Act to cause a resident of Australia, in certain circumstances, to be assessed for tax on income derived outside Australia.

Paragraph (*q*) of sub-section (1) of section 23 which is affected by this amendment, is designed to encourage persons to take up fresh land in Australia or to increase the productivity of their existing holdings here by the eradication of animal and vegetable pests, clearing timber, draining, &c.

Seeing that, under the proposed extension of the field of income tax, it will be possible for residents to derive taxable income from land in overseas countries after they have eradicated animal or vegetable pests, cleared the land of timber, or drained it, &c., it is necessary to amend the present paragraph in the Principal Act in the manner suggested, otherwise the Commonwealth would be encouraging persons to carry out the improvements on land in countries outside Australia.

CLAUSE 11, AMENDMENT (n).

This amendment represents the transfer from section 25 of the Act of the provisions relating to the deductions to be allowed for bad debts, subject to some necessary modification in the transferred wording to remove some anomalies and to clarify the wording of the provision.

Section 25 is a prohibitive section which prohibits deduction of specified expenditure. It specifically prohibits a deduction for bad debts, but goes on to state some exceptions to the prohibition.

It is considered preferable to specify in section 23 the deduction for bad debts which is permitted by the Act, because section 23 deals with permissible deductions, and because the deduction for bad debts can be more conveniently expressed in that section.

The amended wording now proposed to be inserted in section 23 of the Act has been found necessary in order to meet the case of bankers and other money lenders who may make losses of moneys loaned through failure of the borrowers.

The present form of the law does not permit the deduction of such a bad debt in the assessment of the banker or money lender. Under an earlier form of the law the department had power to and did allow

CLAUSE 11, AMENDMENT (n)—*continued.*

the deduction to bankers and money lenders. The present anomalous position is accidental and will be remedied by the amendment now under consideration.

CLAUSE 12, AMENDMENT (a).

This amendment has become necessary, in consequence of a recent judgment by the High Court upholding a decision of Mr. Justice Dixon of the High Court, that the present form of the law authorizes the deduction of an annual subscription paid by a member of the Graziers' Association of New South Wales to that Association.

The department had disallowed the deduction on the grounds that—

(1) A subscription to a graziers' association is not, *per se,* an expense incurred in gaining or producing the assessable income of the subscriber; and

(2) That the taxpayer had not shown that any part of the subscription was used by the Association in common with other subscriptions and other incomes of the Association to defray the cost of any activity of the Association carried out on behalf of the subscribing members, which, if carried out by a member, would be an activity the expenses of which would be an allowable deduction to that person under the Act.

The Full High Court, in upholding the judgment of Dixon, *J.*, ruled that the disbursement by the taxpayer is the fact to be considered and not that of the Association, although the manner in which the Association expended its funds is relevant, because it showed the purpose for which the taxpayer laid out his money in paying his subscription.

The departmental view was that among the purposes of the Association were activities which, when undertaken individually by a member, are not activities the costs of which are expenses incurred in gaining or producing the assessable income, for example, legal costs of representation of the Association before the Arbitration Court for the purpose of contesting demands of employees for increased wages. The expense in that case is expressly for the purpose of reducing expenditure and not for the purpose of gaining or producing assessable income.

The Court held, however, that the taxpayer paid his subscription for the purpose of securing, through the Association all the benefits in the working of his business that membership of the Association might afford, and that as the object of the subscription comes within the terms of section 23 (1) (*a*) of the Act, and as the subscription is one and indivisible, the whole amount of it is deductible.

The effect of the decision of the High Court is to make it probable that the Department would be forced by the Court into allowing to a person carrying on an income-producing business deductions in respect of expenditure such as donations, subscriptions to trade associations, law costs of all kinds whether incurred for the purposes directly associated with the production of income, or to defend a taxpayer in actions brought against him quite outside the question of the production of income.

CLAUSE 12, AMENDMENT (a)—*continued*

Persons carrying on business are—merchants, shopkeepers, professional persons, agents, manufacturers, producers, &c.

It is not at all clear, for example, why a grazier should be allowed a deduction of a subscription to a graziers' association and a doctor should not be allowed a deduction of a subscription to, for example, the British Medical Association, or a lawyer should not be allowed a deduction in respect of a subscription to the Law Institute.

It is considered that the doctrine of remoteness of the expenditure from the production of assessable income should operate in all such cases to prevent any deduction of such subscriptions unless it can be clearly demonstrated that a part or the whole of the subscription represents expenditure of the association which if incurred by the subscriber would be an allowable deduction in his assessment. Anything more than this will expose the revenue to ever-increasing losses.

In framing the amendment it was necessary to preserve existing rights of deductions expressly permitted by the law, e.g., deductions of contributions to any society registered under any Friendly Societies' Act of the Commonwealth or a State (section 23 (1) (*g*)). These rights are preserved by the terms of sub-paragraph (i) of new paragraph (*ea*) proposed to be inserted by amendment (*a*) under clause 12.

Sub-paragraph (ii) will cover the case of stock and share brokers who are obliged to pay an annual subscription to the Stock Exchange as a condition precedent to being permitted to exercise their calling.

Sub-paragraph (iii) provides in statutory form for the continuance of the present departmental practice of allowing a deduction to the taxpayer of so much of his subscription to the relevant association as bears to the whole of that subscription the same proportion as the expenditure incurred by the association in carrying out the activity specified in the provision bears to the total expenses of the association for the year. The activity specified in the provision is an activity of the association which if performed individually by the member would represent an activity the expenditure upon which would be a deduction in the assessment of that member, e.g., advertising, advising as to best buying and future market prospects, collection of debts, investigating customers' financial positions, engaging labour, and arranging transport.

CLAUSE 12, AMENDMENT (b).

This is consequential upon amendment (*n*), clause 11.

CLAUSE 12, AMENDMENT (c).

The first of the new provisos expressed in this amendment differs only slightly from the corresponding proviso which it is designed to replace in section 25 (*i*) of the Principal Act. The difference lies in the allowance, under the new proviso, of a deduction of the annual sinking fund required to recoup a payment made for the assignment or transfer of goodwill or of a licence associated with a lease.

The inclusion of this additional deduction is consequential upon the proposal stated in amendment (*f*) in clause 6 of the Bill, to cause assessable income to include payments made upon the sale, assignment, or transfer of goodwill or a licence associated with a lease which has been sold, assigned or transferred. The reasons stated in explanation of that amendment apply conversely with equal force in connexion with amendment (*c*) in clause 12.

CLAUSE 12, AMENDMENT (c)—*continued.*

The second proviso is new. It will remove an anomaly. At present there is no deduction of an annual sinking fund allowable in the assessment of a person who inherits a leasehold estate for which the person from whom he inherits it has paid an ingoing which was not entirely recouped during that person's life. The law allows a deduction in the assessment of the trustees of the deceased person as long as the lease remains in the hands of the trustees. In those circumstances the beneficiary entitled to an interest in the leasehold estate gets the benefit of the deduction of the annual sinking fund through the trustees' assessment, but no deduction would, at present, be allowable to him if the lease were transferred to him absolutely. Under the proposed amendment, the beneficiary will be entitled to the deduction when he takes over the lease.

Paragraph (*a*) of the last part of the amendment merely repeats the present words of the Principal Act in regard to the specified leases from the Commonwealth or a State.

Paragraph (*b*) of the last part of the amendment is new. It is the corollary to paragraph (i) of the second proviso to new section 16 (*d*) of the Principal Act as expressed in amendment (*f*) in clause 6 of the Bill. That paragraph excludes from assessable income shares taken in a company in consideration of the sale, assignment, or transfer of a lease granted to that company by the person taking the shares. Consequentially it is necessary to provide that the company shall not be entitled to a deduction of the annual sinking fund required to recoup the value of the shares so excluded from assessable income. This safeguard is most essential for the protection of the revenue in view of the ease with which an individual owner or a partnership owner of a property may form himself or themselves into a private company in which he or they hold the controlling interests, and may sell a lease to the company for shares of a face value in amount far above the real value of the lease.

Cases of this kind have actually occurred in several States of the Commonwealth with heavy loss to the revenue.

The provisos proposed to be inserted in the Act by this amendment are an exception to the general prohibition expressed in the first part of paragraph (i) of section 25 of the Principal Act against any deduction being allowed for any wastage or depreciation of lease or in respect of any loss occasioned by the expiration of any lease.

The exception is in reference to what may be termed commuted rent paid in advance as an ingoing to acquire a lease with or without goodwill or a licence associated with the lease. The reason for this exception is that in the accounts of the person paying the ingoing the ingoing must be written off out of the profit during the currency of the lease if the lease is held for its full unexpired period. This procedure in effect applies part of the annual profit towards the payment of the additional commuted rent represented by the ingoing.

In section 23 (1) (*n*) of the Act there is a provision to allow a deduction in the cases specified in that section of the annual sum necessary to recoup the expenditure covenanted to be made on improvements on land by a lessee who has no tenant rights in the improvements. This section contains some necessary safeguard against loss of revenue

CLAUSE 12, AMENDMENT (c)—*continued.*

arising from more or less fictitious arrangements which would otherwise be made to secure deductions in respect of capital outlay not otherwise permissible.

The revised wording proposed in the amendment is similar, as far as is necessary, to the wording of amendment (*f*) in clause 6 of the Bill which introduces new paragraph (*d*) into section 16 of the Principal Act, so as to cause tax to be payable on amounts received by persons who have granted or sold the leases in the circumstances described.

The proviso operates in the following manner:—

	£
Assume A purchases a 20 years' lease, goodwill and license from B for payable £300 at the date of sale £100 per annum for seven years	1,000
The first assessment of the taxpayer making the payment would include a deduction of the sinking fund required to recoup £300 over the period of the lease —20 years .. .. — 300-20ths =	15
The second assessment would include a deduction of—	
in respect of £300 paid £15	
in respect of £100 paid .. .. .. — 100-19ths = 5 5-19ths	
	20
The third assessment would include—	
in respect of previous payments £20 5-19ths	
in respect of the next £100 .. .. — 100-18ths = 5 5-9ths	
	26

and so on up to and including the eighth assessment in which the last payment of £100 would be provided for.

Turning now to the assessment of the recipient of the ingoing (dealt with by clause 6 of the Bill which amends paragraph (*d*) of section 16 of the Principal Act) there would be included in his first assessment after the sale, the amount of £300 because that is the amount he would receive in the year of the granting or sale of the lease.

Against this amount there would be deductible an amount in respect of any ingoing which (if he were the lessee himself) he may have paid to secure the lease he has now disposed of. His subsequent assessments would respectively include as income the sum of £100 paid during each of the subsequent seven years. Against each of these payments there would be deducted an amount in respect of any ingoing which this person may have paid to secure the lease which he has sold. The first proviso to new paragraph (*d*) to section 16 of the Principal Act expressed in amendment (*f*) of clause 6 of the Bill describes how these deductions shall be calculated.

CLAUSE 12, AMENDMENT (d).

This amendment is essential in order to prevent loss of revenue which has recently been discovered in cases in which husbands and wives are evading the provisions of section 29 (2) of the Principal Act. Those provisions were inserted by the Acts of 1927 and 1928 for the purpose of preventing the losses of revenue that were being occasioned by the formation of partnerships between husband and wife for the purpose of having the income formerly assessed in total to either the husband or wife as the case required, divided between the two persons in order to be assessed separately to each of them at rates very much lower than that payable on the total income.

CLAUSE 12, AMENDMENT (d)—*continued.*

The provisions of section 29 (2) put a stop to the formation of further partnerships of the kind mentioned, but it would appear that early steps were taken by some of the persons interested to secure the former benefits by means of arrangements under which the business would be transferred entirely to the wife, and the husband would become an employee of the wife, receiving as remuneration a total amount which would be approximately the same as the former interest he had in the total profits as a member of a partnership. The profits of the business assessable to the wife would be the net amount remaining after deducting all "expenses". "Expenses" would include the remuneration paid to the husband.

It is obvious that the arrangements of the kind mentioned are entered into expressly for the purpose of relieving either the wife or the husband or both from a liability to tax which would have existed but for the arrangement. In such circumstances the total real profit from the business may only be assessed to the owner of the business by disallowing in that business assessment any deduction in respect of the payments made to the wife or husband as the case may be.

The amendment, as drafted, will secure the desired end.

CLAUSE 13, AMENDMENT (a).

It will be observed that this amendment omits the whole of section 26 (1) of the Principal Act, including the proviso, and substitutes a new sub-section (1) without a proviso. The object of the new sub-section is two-fold.

In the first place, it will permit of the deduction of a loss incurred in carrying on any business in Australia. At present a loss is not deductible if the Act provides for the exemption of the income of the business. The practical result of the amendment will be to entitle a taxpayer who is engaged in a business of primary production in the Northern Territory, or of gold-mining in any part of Australia, to a deduction from his assessable income of any loss made in carrying on that business.

In the second place, the new sub-section will provide, as a consequence of the provisions to tax ex-Australian income in certain circumstances, for the deduction of a loss made by a resident of Australia in carrying on a business outside Australia if the circumstances are such that income from that business (assuming income had been derived), would have been taxable in Australia. If the section stopped there, a business loss incurred outside Australia in such cases would be deductible in full irrespective of the extent to which the income of the business (if income had been derived) would have been taxable. In order to meet that position, "loss" has been so defined as to ensure that the extent of the allowability of the loss shall be proportionate to the extent of the taxability of the income. (*See* paragraph (ii) of the definition of "loss" inserted by amendment (*c*) of this clause.)

The omission of the proviso to section 26 (1) is consequential upon amendment (*b*), which aims at achieving the combined effect of that proviso and existing sub-section (2A), and, at the same time, remedying a defect in those enactments which at present prevents the original intention being given effect to.

CLAUSE 13, AMENDMENT (b).

The existing proviso to sub-section (1.) operates, as was intended, to reduce the deduction, in respect of any loss, which would otherwise be allowable from assessable income of the year in which the loss was incurred by the amount of any exempt income derived by the taxpayer in that year.

Existing sub-section 2A was designed to achieve a similar result with respect to any unrecouped loss carried forward from a previous year, but the actual effect of that sub-section is that exempt income can only be set off against a carried-forward loss when that loss is added to a loss incurred in the year in which the income from which it is sought to be deducted was derived. Consequently, when no loss was incurred in the relevant income year, the carried-forward loss must be deducted in full (or at least to the extent of the net assessable income), notwithstanding that exempt income may have been derived in that year.

The Department has applied the existing provisions referred to in accordance with what was intended, but it now appears clear that the practice is not strictly in accord with the terms of the law.

The effect of new sub-section 2A, proposed to be inserted by amendment (*b*), will be to require the total amount which would otherwise be allowable as a deduction under this section (whether that amount consists of a current loss or of a carried-forward loss or of both) to be first set off against any exempt income derived by the taxpayer in the relevant year.

Amendment (*b*) will also have the effect of preventing the reduction of the amount of exempt income, against which a loss is required to be set off, by the amount of any extra-Australian loss which may be allowable as a deduction under the provisions of the section as proposed to be amended. This provision is a necessary consequence of the proposed amendment of sub-section (1.) to permit of the deduction of extra-Australian losses in certain cases. If the provision were not made, the anomalous position would arise under which, although an Australian loss might not be allowable because exempt income was derived, an extra-Australian loss would be allowable in full even though exempt income was derived. The remedy for the anomaly appears in the parenthesis following the word "Australia" in sub-paragraph (*a*) of proposed new sub-section 2A.

Example.

Assume that a taxpayer has income from the following sources:—

	£	£
(*a*) From taxable sources in Australia ..	5,000	
(*b*) From interest on State loans not liable to Federal tax	500	
(*c*) From ex-Australian sources taxed to him outside Australia	500	
	——	6,000

CLAUSE 13, AMENDMENT (b)—*continued.*

Assume, also, that the taxpayer has suffered the following business losses:—

(*d*) From an Australian business carried on by him	1,000	
(*e*) From an ex-Australian business carried on by him, any profit from which would be taxed outside Australia	800	
		1,800
Taxpayer's actual net income from all sources		4,200

The question to be decided is how much of item (*d*)—loss of £1,000—is deductible in the taxpayer's assessment.

	£
The deduction in this case is the excess of	1,000

over the income which is not liable to Federal tax—

(*b*)	£500
(*c*)	500
	£1,000

after deducting therefrom the ex-Australian loss which is not an allowable deduction under the section.

Item (*e*) shows that the ex-Australian business would be taxed outside Australia on any profits derived by it. Therefore those profits would not be taxable in Australia. Consequently a loss by that business is not an allowable deduction.

Therefore, in this case there must be set against

the income not liable to Federal tax	£1,000	
the ex-Australian non-deductible loss	800	
Net Australian non-taxable income to be set against deductible losses	200	
		200
Amount of Australian loss to be deducted in the assessment		800

Assessment.

	£	
(*a*) Australian assessable income	5,000	
Allowable deduction for loss	800	
Taxable income	4,200	

If the ex-Australian loss of £800 were entirely excluded from consideration the position would be—

	£	£
(*a*) Australian assessable income		5,000
(*b*) and (*c*) Income not liable to Federal tax	£1,000	
Deduct Australian loss	1,000	
Loss deductible in assessment		Nil.
Taxable income		5,000

CLAUSE 13, AMENDMENT (c).

Paragraph (i) of the definition proposed to be inserted by this amendment is necessitated by amendment (*a*), which is designed (as an incident of the proposal to tax residents in certain cases on income derived from sources outside Australia) to permit of the deduction of a loss, attributable to sources outside Australia, incurred by a resident in carrying on a business in such circumstances that, if income attributable to sources outside Australia had been derived therefrom, such income would have been taxable in Australia.

If the definition of "loss" in sub-section (6.) remains unaltered, it will stand in direct contradiction to sub-section (1.) (as proposed to be amended) in the case of such a resident carrying on a business of the nature defined in sub-section (6.). In other words, "loss" for the purposes of sub-section (1.) (as proposed to be amended) would include, in certain cases, a loss attributable to sources outside Australia, but "loss" for purposes of the present definition in sub-section (6.) excludes a loss attributable to sources outside Australia.

The words proposed to be inserted will remove this contradiction, and at the same time leave the definition of "loss" effective to achieve its original purpose in all cases other than that of a resident carrying on a business the proceeds of which, if any, would be assessable even if partly derived from sources outside Australia.

Paragraph (ii) of the proposed definition has been explained in the note on amendment (*a*) of this clause.

It will be observed that the definition of "loss" appearing in the Bill excludes any amount of Federal income tax paid or payable which would ordinarily enter into the accounts showing a business loss. This exclusion is necessary because, by the terms of section 23 (1.) (*a*) of the Principal Act, Federal income tax is excluded from the category of permissible deductions. Therefore, if this prohibition is to have full effect in all cases, Federal income tax which causes or increases a business loss, must be excluded from the amount of loss which, otherwise, would be a permissible deduction in full. It is not necessary to make any similar exclusion of State income tax or Federal and State land taxes, because each of these is a permissible deduction under the Act.

CLAUSE 14, NEW SECTION 28A.

The object of this new section is to secure payment of income tax from film producers outside Australia who sell their products in Australia through Australian organizations controlled by them.

The maximum taxable income upon which it is proposed to levy tax is 30 per cent. of the amount which is derived from the sales in Australia by the film producers, but any producer will be entitled to satisfy the Commissioner (or the Income Tax Board of Review upon appeal from the Commissioner) that the taxable income should be reduced to some lesser amount or to nil.

The section provides that the Australian person or company through which the outside film producer sells films in Australia shall be the agent for the film producer for all purposes of the Act, and shall not make any payment to that producer unless and until arrangements for payment of tax on these payments have been made to the satisfaction of the Commissioner.

CLAUSE 14, NEW SECTION 28B.

This new sub-section is inserted specially to cause income tax to be payable by or on behalf of ex-Australian underwriters such as Lloyd's Insurance Association of London upon an assumed profit of 10 per cent. of all premiums on insurance effected in Australia by or on behalf of that underwriter.

For some time past considerable dissatisfaction has existed among insurance companies carrying on operations in Australia on account of the fact that Lloyd's Insurance Association of London has been securing large amounts of insurance business in Australia through resident insurance agents or brokers, and have not been taxable under Commonwealth or State law in respect of any profit arising to the Association from that business.

It has been pointed out to the Government that the locally-established companies, through their association and their own respective staffs, go to a lot of expense and employ skilled labour to frame rules for building and the storage of various inflammable goods and the control of dangerous volatile liquids and the control of hazardous processes, and of building up and fixing rates, &c., under Australian conditions of work and wages. "Lloyds" do none of these things, and base their quotations for business on the rates fixed by the companies mentioned, less varying percentages.

The locally-established companies have a large amount of capital invested in Australia in buildings, security to the Government for the proper conduct of their businesses, and mortgages. They pay land and income tax, municipal rates, &c. "Lloyds" avoid all of these requirements and charges.

It is understood that "Lloyds" is not a corporate body, and that policies of insurance are issued over the signatures of individual members of the London "Association", or their agents in Australia.

It is considered that special action is necessary to cause the profit accruing to the members of "Lloyds", London, to be subject to Commonwealth income tax.

The position appears to have been met by the New Zealand legislature. The proposed new section 28B is based upon the provision in the New Zealand law.

The precedent for the proposed action is to be found in section 27 of the Income Tax Assessment Act, which causes absentee ship-owners to be taxable in Australia upon an assumed taxable income of 7½ per cent. of the freights, passage moneys, &c., receivable by them in respect of goods, passengers, mails, &c., taken on board at any Australian port for transport to places beyond Australia.

It is considered that an assumed profit of 10 per cent. of the premiums received is not excessive.

CLAUSE 15.

This amendment is intended to prevent the loss of revenue which is still going on through the formation of family partnerships, notwithstanding the amendments made in 1927 and 1928 in the Principal Act to deal with such partnerships.

The conference of Deputy Commissioners of Taxation, which met in Sydney in May, 1929, strongly urged that the existing provisions of the Principal Act relating to partnerships between husband and wife which were, in the opinion of the Commissioner, formed for the purpose of avoidance of any liability to tax which would have existed if the partnership had not been formed, should be extended to similar partnerships formed between members of a family and to private companies in which the whole or the majority of the shares are held by some or all of the members of a family, or of families.

The Deputy Commissioners pointed out that it is becoming a very common practice for such partnerships and companies to be formed and that there is only one reason for the movement, viz., to avoid payment of income tax, or greatly to reduce the amount of tax which would otherwise be payable.

The present provisions of the Principal Act relating to husband and wife partnerships do not operate unless the Commissioner forms the opinion from evidence in his possession that the partnership has been formed for the purpose of avoidance of any liability to tax which would have existed if the partnership had not been formed.

The Commissioner's opinion is subject to review by the Board of Review, so that the interests of all parties concerned are amply protected. This protection would also exist with the additional cases which it is now sought to bring within the principle of the existing provisions of the law in this connexion.

The opportunity has been taken to cause the existing provisions to extend to partnerships not only between a husband and his wife, but between two or more husbands and any or all of their wives. There are cases where two or more husbands and their respective wives join together in one partnership. In the majority of such cases the partnerships are bona fide and the penal provisions of the section would not be applicable to them. But there are, unfortunately, some cases in which such partnerships are formed solely for the purpose of reducing income tax without substantially affecting the existing beneficial interests in the income. In this latter type of case there is usually some dominating personality who arranges all the details in order to create evidence which would, in law, support a contention that the partnership is bona fide. Special inquiry into these cases sometimes enables the Commissioner reasonably to form the opinion that the partnership has been created so that liabilities to tax, which would otherwise exist, might be avoided. The proposed amendment will cover these cases and will operate, in conjunction with a special rate of tax in a similar manner to that previously described in connexion with certain private companies dealt with by Clause 10 of the Bill.

The rates of tax must be separately specified in the Income Tax Rates Act, as it is not permissible to prescribe rates in the Income Tax Assessment Act.

CLAUSE 15—*continued.*

Examples:

A owns a business yielding a taxable income of £10,000. This is his only income. He forms a partnership with his wife and the members of his family as nominal partners, and claims that the £10,000 should be assessed to the several partners *pro rata* to their stated interests in the partnership.

If the Commissioner considers the partnership was formed to relieve A of part of his liability to tax on £10,000, he would assess the partnership as a single individual on £10,000. The rate of tax payable by the partnership would be the rate which would have been payable by A if the £10,000 had been assessed to A = £2,070 7s. 2d., the rate being 49.6886d. in the £1.

If A had separate income in severalty, say £1,000, he would be assessed separately upon £1,000 as if he had no other income. The partnership would be assessed upon £10,000 at a rate to be ascertained by the following steps:—From the total amount of tax which would be payable by A if the taxable income of the partnership were added to his own taxable income subtract the amount of tax payable by him in respect of his own taxable income and divide the resulting difference by the number of pounds in the taxable income of the partnership. The quotient will represent the rate of tax to be paid by the partnership upon its taxable income of £10,000.

Example—

	£	s.	d.	£	s.	d.
A's severalty income ..	1,000	0	0			
Partnership income ..	10,000	0	0			
				11,000	0	0
Tax on £11,000 = ...	..			2,178	18	0
Deduct A's tax on £1,000 ..	..			33	8	3
				2,145	9	9

Rate of partnership tax, £2,145 9s. 9d. ÷ £10,000 = 51.4917d.
Tax payable by the partnership is £2,145 9s. 9d.
The tax which would otherwise be payable by the partnership would be considerably less than £2,145 9s. 9d.

The actual amount which would be payable depends upon the number of members of the partnership and their respective interests in the profits.

A corresponding position to the above will exist in the case of the individually-owned private companies dealt with by Clause 10 of the Bill.

B, C and D have individual incomes from individually conducted businesses, yielding them in the aggregate, £10,000 per annum. They decide to form themselves into a partnership in respect of the assets producing this income, and to take in as partners their respective wives, and, perhaps, some or all of their respective children. (It may be mentioned that such partnerships are increasing in numbers.)

If the Commissioner applies the section to this partnership, the partnership will be assessed and liable to pay tax on £10,000. The amount of tax to be paid by this partnership will not be as great as in the case of the partnership formed by A in ordinary circumstances,

because in that case A was the only person originally interested in the total income, and therefore the rate is the rate applicable to £10,000 in A's personal assessment.

The rate of tax to be paid by the partnership will be ascertained as follows:—

Compute the total of the amounts of tax that would be payable by B, C and D if the partnership were a partnership between them with equal interests, and divide that total by the number of pounds in the taxable income of the partnership.

In this case B, C and D would have paid a total amount of tax between them of £836 17s.

The partnership would thus pay at a rate of 20.0844d., being £836 17s. divided by £10,000.

If B, C and D had severalty incomes apart from the partnership the partnership rate would be ascertained as follows:—

Calculate the total amount of tax which would have been payable by each of B, C and D if the partnership had been a partnership between them and they had equal interests. From the aggregate of those taxes deduct the aggregate of the amounts of tax payable by each of those persons on his income, if any, apart from the partnership. Divide the difference by the number of pounds of taxable income of the partnership and the result will be the rate of tax payable by the partnership.

The effect of this provision will be that the total amount of income taxes payable by the partnership and the persons who are deemed to be the real owners of it will equal the total amount of taxes which would have been payable by those persons if the partnership had not been formed.

Example—

B has, say, £2,000 income from personal exertion in severalty.
C has, say, £1,500 income from personal exertion in severalty.
D has, say, £3,000 income from personal exertion in severalty.

The first step is to find the tax which each of B, C and D would pay in his individual assessment if the partnership had not been formed.

	£	£	£	*s.*	*d.*
B. Severalty income ..	2,000				
Interest in partnership ..	3,333				
		5,333			
Rate of tax 29.8063.—Tax ..			662	6	5
C. Severalty income ..	1,500				
Interest in partnership income	3,333				
		4,833			
Rate of tax 27.3763.—Tax ..			551	5	9
D. Severalty income ..	3,000				
Interest in partnership income	3,333				
		6,333			
Rate of tax 34.6663.—Tax ..			914	15	2
Aggregate of taxes			2,128	7	4

CLAUSE 15—*continued.*

	£	s.	d.	£	s.	d.
Carried forward				2,128	7	4
B. Tax on severalty income of	2,000					
Rate 13.041d.—Tax ..	108	13	6			
C. Tax on severalty income of	1,500					
Rate 10.2465d.—Tax ..	64	0	9			
D. Tax on severalty income of	3,000					
Rate 17.6985d.—Tax ..	221	4	7	393	18	10
Difference				1,734	8	6
£1,734 8 6 / 10,000 = 41.6262d.—Tax ..				1,734	8	6

A corresponding position to the above will exist in the case of the severally owned private companies dealt with by Clause 10 of the Bill.

The loss of revenue arising under present conditions cannot readily be ascertained, but Deputy Commissioners consider that it is a substantial annual amount.

CLAUSE 16.

This amendment is necessary in order to remove an anomaly which is causing unnecessary loss of revenue in a number of cases.

The anomaly arises in connexion with life tenant beneficiaries of trust estates who are entitled to and do receive all the annual income which may be derived by the trustees of the estate, notwithstanding that the trustees may have suffered estate losses in previous years. The anomaly is a result of the present joint operation of section 26 (deduction of losses from profits) and 31 (assessment of trust estates).

Section 31 provides that a trustee shall not be taxable as a trustee except in certain circumstances which are not at present material, but that each beneficiary who is not under a legal disability, and who is presently entitled to a share in the income of the trust estate shall be assessed in his individual capacity in respect of—

(*a*) his individual interest in the income of the trust estate which, if the trustee were liable to pay the tax in respect of the income of the trust estate, would have been the income of the trust estate remaining after allowing all the deductions under the Act except the general exemption of £300; and

(*b*) any other income derived by him separately; and

(*c*) his individual interests in the income derived from any other source.

In ascertaining the income which would be the taxable income of the trustee if he were a taxpayer, it is necessary to carry forward as a deduction any trading loss of a previous year which has not yet been recouped by subsequent profits.

When, as is frequently the case, it becomes necessary to assess a life tenant who is entitled to the whole or part of the income of a trust estate, the amount upon which the life tenant is legally assessable will

CLAUSE 16—*continued.*

be his interest in the taxable income, if any, of the trust estate calculated as stated. It has happened in several cases that this technical calculation leaves no statutory amount of income of the trust estate upon which the life tenant may be assessed, notwithstanding that the life tenant has actually received the whole or a part of the income, and notwithstanding also that the trading loss of the previous year sustained by the estate will, in the circumstances, have been charged against the corpus of the estate.

In such a case the life tenant escapes tax, although actually in receipt of income from the estate.

The amendment contained in this clause will remedy this defect without injustice to the life tenant.

CLAUSE 17.

This amendment is consequential upon the amendments being made to cause residents of Australia to be taxable on extra-Australian income in certain cases.

CLAUSE 18.

The object of this amendment is to extend the present powers of the Commissioner to make alterations in or additions to assessments so as to ensure their completeness and accuracy. This power is absolute if the relevant assessment is not three years old, but the power may only be exercised in cases in which the assessment is more than three years old, if, in the opinion of the Commissioner, there has been an avoidance of tax owing to fraud or evasion. The power does not extend to cases where tax has been underpaid owing to the failure or omission of the taxpayer to keep books, accounts, or records which would reasonably show his income if there is not sufficient evidence to cause the Commissioner to form the opinion that the avoidance of tax has been due to fraud or evasion.

The conference of Deputy Commissioners of Taxation which met in Sydney in May, 1929, resolved that the attention of the Commonwealth Government should be drawn to the fact that large sums of income tax are being lost annually to the Commonwealth owing to the absence from the Income Tax Assessment Act of authority to amend assessments after the expiration of three years in cases where the taxpayers have failed to include assessable income and the failure has been due to lack of business accounts and fraud or evasion could not be proved.

There are large numbers of such cases, and the Department's invariable experience is that the income returned is much less than the correct income.

The cases aimed at are those which cannot be discovered expeditiously by the Department owing to unavoidable lack of staff.

There are three classes of case where revenue is lost through inaccurate returns being lodged—

(1) Those in which, as the investigation develops, there is more or less indication of fraud or attempted evasion. These are fully covered by the present law.

(2) Those where the understatement of income has arisen through ignorance or inadvertence on the taxpayer's part. These are fully protected by the law.

(It is not proposed that any alteration should be made in the law in regard to these cases.)

CLAUSE 18—*continued.*

(3) Those where the understatement of income is due to the entire absence of business accounts or to such accounts as may have been kept being incomplete and misleading.

This class is not covered by the law and tax short-paid cannot be recovered in respect of assessments which are more than three years old at the date of discovery of their inaccuracy, notwithstanding the fact that the taxpayers concerned have been guilty of culpable neglect in the matter of keeping records of their income and expenditure as would enable them reasonably to determine their correct income and correct expenditure.

In the great bulk of such cases the facts do not warrant the Commissioner in forming an opinion that there has been avoidance of tax through fraud or evasion.

The Deputy Commissioners' Conference strongly urged that taxpayers' neglect to keep reasonably correct records of income and expenditure in relation to their businesses, should not be condoned by allowing them to continue to escape payment of tax shortpaid in past years. The persons concerned are always well aware of their responsibility to keep proper records, because they know of the liability, in case of bankruptcy, that their certificate of discharge will be refused if they have failed to keep proper accounts.

The Deputy Commissioners accordingly urged that there should be an analogous penalty under the Income Tax Assessment Act for the same neglect, and that that penalty should be a liability to pay all income tax short-paid in previous years. This liability exists under all the State Income Tax Assessment Acts except New South Wales.

The experience of the Department is that at least 80 per cent. of taxpayers make honest attempts to lodge correct returns. The balance of 20 per cent. consists of classes 1 and 3 mentioned above.

By reason of the escape of the many offenders through gross carelessness or neglect, the general community had suffered a shortage of national revenue through causes which should have been avoided, and which deserve to be met by the liability to pay the whole of the tax short-paid in past years.

State Commissioners (who are Deputy Federal Commissioners) advised that for a number of years past, their recoveries of State tax in such cases have amounted to between £50,000 and £100,000 per annum.

Equal results would be secured by the Commonwealth Treasury under similar circumstances.

It is also certain that if all those cases could be made public—it is not possible under the law—there would be an outcry from honest taxpayers against the present freedom from liability to surcharge for past years now enjoyed by the careless and culpable taxpayers mentioned.

The expression of the proposed amendment in the form of an addition to the existing second proviso of sub-section (1) would have been a very awkward form of an amendment. For this reason advantage has been taken of this opportunity to re-arrange the earlier part of the existing section, so that what is now expressed as a second proviso to sub-section (1.) will be more suitably and logically expressed in the form of a new sub-section, shown in the Bill as sub-section (1A).

CLAUSE 19.

The amendment here proposed was recommended because it was considered possible to reduce departmental expenditure in connexion with litigation connected with the Taxation Acts by cutting out all appeals to a State Supreme Court, and causing all appeals to a Court to be made direct to the High Court.

Since the Federal taxation laws were enacted, they have permitted a taxpayer who is dissatisfied with a decision of the Commissioner on his objection to an assessment, and who is desirous of appealing to a Court, to elect the High Court or the Supreme Court of the State in which his assessment has been made.

It has been observed recently that some taxpayers, and the legal advisers of other taxpayers, are showing a preference for an appeal to a State Supreme Court. This preference has always been very marked in South Australia.

There have been several appeals listed for hearing by the Supreme Court of one State, but owing to congestion in the work of that Court, they could not be reached, in some cases, for over twelve months.

The High Court sits in each State once at least each year, and can very readily deal with all appeals that are ready for submission to a Court.

Decisions by a State Supreme Court are frequently carried to the Full High Court on appeal, since it is the High Court which should have the last word in respect of the interpretation of a Commonwealth law. But these appeals to the High Court involve added expense to that already incurred before the State Courts. This latter expense already incurred would have been avoided if the original appeal had been made direct to the High Court.

The difficulties and unnecessary expense are well illustrated by recent happenings as regards the appeal of the British Imperial Oil Company against its assessments. The appeals were made to a judge of the Victorian Supreme Court, although it was recognized that a judge of that Court would feel himself bound by the prior decision of the Full Bench of the High Court upon the company's appeals against assessments for previous years.

It was also practically understood that neither party would accept an adverse judgment by that Supreme Court Judge, but would carry the matter further on appeal. It was understood that the company would carry the case to the Privy Council, because that course would have been without difficulty, seeing that the appeal to the Privy Council would have been against a decision of the State Supreme Court. The company might have experienced difficulty in appealing to the Privy council if it had gone before the High Court in the first instance.

In order, therefore, to render it easily possible to appeal to the Privy Council, the company caused the Commonwealth to incur heavy legal costs which were involved in its appeal to the judge of the State Supreme Court, in addition to the costs subsequently involved by the reference of the case to the Full High Court.

There is no necessity for a State tribunal to adjudicate on a Commonwealth taxation law, seeing that the taxpayer now has a choice between the inexpensive Commonwealth Income Tax Board of Review and the High Court.

It is considered that the present necessity for the curtailment of expenditure in every possible way requires adoption of the present proposal.

CLAUSE 20.

This amendment is consequential upon that contained in Clause 19.

CLAUSE 21.

This amendment is designed to make more effective arrangements for collecting income tax from persons who are about to leave Australia.

Under the present form of the law, Parliament has provided that a passport may be withheld from a person applying for it until that person produces at the passport offices a clearance for income tax from the Taxation Department.

This arrangement is inadequate to enable the Department to secure payment of tax from all persons about to leave Australia. It does not enable the Commonwealth to withhold passports issued in Great Britain, or any other country outside Australia which have merely to be vised by the passport office, in the case of British passports, or by the relevant foreign consul in other cases.

One or two foreign consuls insist upon their nationals satisfying the requirements of the Commonwealth Income Tax Assessment Act, but the great majority do not so insist.

The conference of Deputy Commissioners of Taxation which met in Sydney in May, 1929, urged that the law should be amended in this connexion so as to require all shipowners whose vessels trade between Australia and overseas ports, to refrain, under penalty, from issuing a passage ticket until the passenger produces a clearance for income tax from the Taxation Department.

A similar amendment had been submitted in 1928 by the then Minister for Home Affairs to the then Treasurer. The Government approved it for adoption.

Whilst the existing provision in the law has proved of the greatest assistance to the Department in collecting income tax from persons who are undoubtedly liable to pay it, especially persons entering Australia from abroad for the purpose of engaging in profit-making schemes, it is known that many persons similarly liable have been able to leave Australia without payment of tax, for the reasons already stated.

The present system in connexion with passports causes all overseas shipping companies to ask intending passengers to produce their passports before issuing an authority to them to travel by a ship. The proposed system will not cause any additional work to the shipping companies, except to ask more persons than formerly to produce their taxation clearances.

The new provision will affect intending travellers more than it will affect anybody else. If the intending traveller fails to secure the taxation clearance before applying for his steamer ticket he will be obliged to visit the Taxation Department to secure the clearance.

CLAUSE 22.

This amendment was recommended in consequence of the difficulties that were encountered in carrying out successful prosecution of certain taxpayers.

If the present suggestion had been in the law, it would have been possible to have secured some effective punishment by imprisonment of the parties concerned.

The proposal now made is copied from the Victorian Income Tax Assessment Act.

CLAUSE 22—*continued.*

The present provision in the Federal Income Tax Assessment Act for punishment for false returns is contained in sections 66, 67, 68 and 69 of that Act. Sections 66 and 67 deal with the simpler cases. Sections 68 and 69 involve proof to the Court of wilful intent to defraud.

Practically all cases which are dealt with by Courts are dealt with under section 66 because of the lack of evidence which would prove to the satisfaction of a Court that fraud exists, as fraud is understood in law. In the vast majority of cases the relatively heavy automatic penalty provided by section 67 is collected without taking the taxpayer before the Court where the maximum penalty which may be imposed is £100. The maximum automatic penalty under section 67 is double the amount of tax short-paid. It was by means of this section that the enormous penalties paid by the Abrahams Brothers were made possible.

There are very many cases in which a taxpayer seeks to shelter himself behind the acts of an employee or agent when confronted with a charge of having lodged a false return. They admit that they should have read the return carefully before signing it, but plead absence of intent to defraud. A little judicious carelessness of this kind very frequently means considerable loss to the revenue and corresponding gain to the taxpayer, with the opportunity of entirely escaping penalty in a prosecution by pleading inadvertence which the law makes a sufficient defence. The relatively high number of persons who take advantage of this provision would be reduced to a minimum if the law exposed them to a successful prosecution for wilful and corrupt perjury with its attendant risk of imprisonment.

CLAUSE 23.

This clause is designed to provide more effective means than exist at present for the prosecution of companies for offences under the law.

The law requires every company to be represented by a public officer. It is a common practice for a company to appoint an outside taxation expert, as its public officer. Quite as frequently, perhaps more so, an employee of lower status than the manager is appointed as public officer.

By relying upon the public officers as appointed, companies seek to be excused for whatever inaccuracies may appear in their returns. Most public officers of companies carry out the requirements of the law in proper and full fashion but there are some companies which are open to doubt in this regard.

It was noticed in the Abrahams Brothers' case that the public officer of the private companies formed by these persons was the secretary to the main company formed by these people. That public officer is a man of straw and no good result would have followed his prosecution. What is needed is a power to select one of the real owners, or the principal executive officer of the company as the person who is to be liable to all the penalties of the law for breaches of the act committed by the nominal public officer.

The previous Government decided to ask Parliament to amend the Act to meet the position as explained in the manner suggested.

CLAUSE 24.

This clause fixes the dates for commencement of the various amendments in the Principal Act made by the Bill.

Sub-section (1) deals with—

(*a*) Taxation of profit from isolated transactions which were entered into for profit-making; and

(*b*) The limitation of the deduction for rates and taxes to those which are assessed and charged annually.

In the case of (*a*)—The retrospective operation of the amendment is necessary to prevent loss of revenue at present outstanding upon assessments for past years back to 1922-23, against which objections have been lodged on the ground that the transactions are not businesses. These objections would, but for the very recent judgment of the House of Lords mentioned in the explanatory notes on the amendment, have been disallowed upon the authority of existing judgments by Judges of the High Court, also referred to in the explanatory notes, but it is thought that those Courts might consider it necessary to review their decisions. It is considered by the Government that all profit arising from any scheme entered into with the intention of making profit, should be subject to Income Tax, and that as the Department has been acting upon judicial authority which secured this end in the past, all past assessments should now be made secure in this respect by the retrospective operation of these particular amendments.

In the case of (*b*):—The retrospective operation of this amendment is necessary in order to prevent the allowance of claims for deduction of State Stamp Duties and Commonwealth Death Duties, which have no relation whatever to assessable income, either in regard to its production or as being payments made out of assessable income. The Department now has a number of these claims before it relating to assessments back to the assessment year 1922-23. The retrospective operation of this amendment will validate all past assessments in which the deductions allowed have been limited to annual rates and taxes. This is obviously the original intention of Parliament.

Sub-section (2).

This sub-section deals with the exemption granted by the Amending Bill in respect of the official remuneration of the members of the staffs of official representatives in Australia of foreign countries, when the members of the staffs are nationals of that country and are temporarily resident in Australia for the performance of their duties.

The retrospective operation of the amendment is desirable in order to meet the cases of several expert attaches to foreign consulates who have not paid the taxes assessed to them on the ground that they should receive equal treatment from the Commonwealth to that accorded to corresponding representatives of the Commonwealth in their countries. It has been demonstrated that the foreign countries represented by these persons have always granted similar exemption to Australian official representatives located in those countries.

A few of these cases represent assessments made for the assessment years 1923-24 *et seq.*

These two sub-sections represent the only provisions in the Bill for the retrospective operation of any of the amendments in the Bill.

By Authority: H. J. GREEN, Government Printer, Canberra.