

The Senate

Economics
Legislation Committee

Tax Laws Amendment (2009 Budget Measures
No. 2) Bill 2009 [Provisions]
&
Income Tax (TFN Withholding Tax (ESS)) Bill
2009

November 2009

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Senate Economics Legislation Committee

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Chapter 1

Introduction

1.1 The Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009, which will implement Government commitments in respect of employee share schemes (Schedule 1), non-commercial losses (Schedule 2) and lost superannuation (Schedule 3), was introduced into parliament on 21 October 2009. On 29 October, the Senate referred Schedule 2 of the bill to the Senate Economics Legislation Committee for inquiry and report by 16 November 2009.¹

1.2 Schedule 2 of the bill aims to improve the fairness and integrity of the tax system by tightening the rules regarding the use of non-commercial business losses by high wealth individuals. The measure it contains, more commonly known as the 'hobby farms' measure, forms part of a number of 2009-10 Federal Budget initiatives.

1.3 The measure, announced in a joint press release by the Treasurer and Assistant Treasurer on 12 May 2009, will achieve its intent by closing a 'tax loophole that allows a relatively small number – around 11,000 – of mostly high wealth individuals to exploit parts of the tax system to unfairly minimise or avoid their tax obligations.'²

1.4 The Government, through the Treasury, undertook extensive consultation on the exposure draft during June and July of 2009. The 16 submissions received by the Treasury during that period of consultation can be accessed at <http://www.treasury.gov.au/contentitem.asp?ContentID=1588&NavID=037>.

1.5 Following that consultation, the government agreed to three changes: carving out of investment allowances under Division 41 of the *Income Tax Assessment Act 1997* (ITAA1997), the grandfathering of the discretions that the Commissioner of Taxation (the Commissioner) has exercised in relation to the commerciality of businesses and provision for a formal application.

1.6 If passed the proposed amendments will take effect from the date of Royal Assent and will apply to the 2009-10 income year onwards.

1 The Selection of Bills Committee (in Report No. 16 of 2009) simultaneously recommended referring the Income Tax (TFN Withholding Tax (ESS)) Bill 2009, which is related to Schedule 1 of this bill. However, as the referral of this bill asked that the Economics Legislation Committee only consider Schedule 2, it has not been considered here. The Economics Legislation Committee tabled a report on *Employee Share Schemes* on 17 August 2009.

2 The Hon. Wayne Swan MP, Treasurer of the Commonwealth of Australia, the Hon. Chris Bowen MP, Assistant Treasurer and Minister for Competition Policy and Corporate Law of the Commonwealth of Australia, 'Improving fairness and integrity in the tax system' Media Release 067, 12 May 2009.

Financial impacts of the bill

1.7 The Treasury have forecast that by tightening the access to non-commercial losses ongoing revenue will be generated; the cumulative revenue across the forward estimates is expected to be \$700 million.³ These revenue expectations are considered in more detail in Chapter 3 of this report.

Conduct of the inquiry

1.8 The committee advertised the inquiry in the national press and contacted a number of organisations inviting submissions to be lodged by 6 November 2009. The six submissions received are listed in Appendix 1.

1.9 A public hearing into Schedule 2 of the bill was held in Melbourne on 9 November. The witnesses who appeared before the committee are listed in Appendix 2.

1.10 The committee would like to thank all those who participated in the inquiry.

3 The Treasury, Budget 2009-10: Budget Paper No. 2 – Budget measures 2009-10. Part 1: Revenue Measures, May 2009, p 20.

Chapter 2

Objects of the bill

Non-commercial losses (Schedule 2)

The existing provisions

2.1 Division 35 of the ITAA 1997 was introduced to prevent 'losses' of individuals from non-commercial business activities being offset against other assessable income in the year the loss was incurred. These provisions were introduced in 2000 following the 1999 Review of Business Taxation (the *Ralph Review*) which recommended that systemic changes were required to prevent 'revenue leakage from unprofitable activities carried out by taxpayers' as many of those activities were more like hobbies and/or lifestyle choices.¹

2.2 As a result of the changes, a series of tests were introduced to determine whether or not a business activity would be treated as being non-commercial and where the tests were not satisfied the losses were deferred. A discretion empowering the Commissioner to determine that in any particular year deferred losses could be offset against other income was also introduced. Other exceptions to protect start-up businesses and certain primary producers were also introduced.

2.3 In his Second Reading speech the then Treasurer explained of the four tests:

The tests look at the activity's level of turnover, history of profitability, the value of real property used in carrying on the business and the value of other assets used in carrying on the business. Only one of the tests needs to be passed to enable an individual's loss from a business activity in a year to be deducted against the individual's other assessable income, such as wages and salary.

...Where a test is not satisfied in an income year, the loss is deferred and can be offset in a future year against income from the activity or against other income if one of the tests is satisfied.²

The proposed amendments

2.4 In its 2009-10 Federal Budget the Government moved to tighten the rules of Division 35 through the introduction of another test – an income threshold. The

1 The Hon. Peter Costello, Treasurer of the Commonwealth of Australia, Second Reading Speech, House of Representatives, *New Business Tax System (Integrity Measures) Act 2000*, 2000, p 1.

2 Second Reading Speech, House of Representatives, *New Business Tax System (Integrity Measures) Act 2000*, 2000, p 1.

amendments propose that above this threshold amount, losses are required to be quarantined to be offset against future profits of the activity.

2.5 The introduction of new subsection 35-10(2E) will ensure that where the sum of:

- a) a person's taxable income for a year;
- b) reportable fringe benefits total for that year;
- c) reportable superannuation contributions for that year; and
- d) total net investment losses for that year

exceeds \$250,000, any amounts attributable to a business activity that could otherwise be deducted and which exceed the assessable income of the business activity to which they are attributed, are quarantined and carried forward to be deducted from the future assessable income of that business activity.

2.6 Below this threshold, the current rules will continue ie a person with an adjusted taxable income of less than \$250,000 may deduct expenses of a non-commercial business activity that exceed the assessable income of that business activity from their other income provided they satisfy one of the four objective tests (set out in sections 35-30, 35-35, 35-40 and 35-45 of the ITAA 1997).

2.7 Where a person exceeds the income threshold but is unable to satisfy one of the four tests, they are entitled to apply to the Commissioner, in the approved form, seeking that he exercise his discretion pursuant to section 35-55 and allow the excess amounts to be deducted.

The Commissioner's discretion

2.8 Under the current law, a person may apply to the Commissioner for exercise of his discretion pursuant to section 35-55 if they do not satisfy one of the four tests. This was the case for taxpayers at any income level, but under the proposed amendments those taxpayers with adjusted taxable income greater than \$250,000 will be subject to the following new rules.

2.9 Where a taxpayer's adjusted taxable income exceeds the \$250,000 threshold and the farm business is non-profitable (non-commercial), the taxpayer may apply to the Commissioner seeking that he exercise his discretion. Where the Commissioner is satisfied that, based on evidence from independent sources, the business will produce assessable income greater than the available deductions in a timeframe that is considered commercially viable for the industry concerned he can exercise his discretion and advise the taxpayer that the non-commercial loss provisions do not

apply to them.³ The taxpayer would then be able to deduct farm losses against other non-farm income.

2.10 The Explanatory Memorandum to the Bill further explains that the discretion is not intended to be available 'in cases where the failure to make a profit is for reasons other than the nature of the business, such as, a consequence of starting out small and needing to build up a client base, or business choices made by an individual that are not consistent with the ordinary or accepted practice in the industry concerned...'⁴

2.11 Over the past three years, on average, the Commissioner has received 237 requests to exercise his discretion under section 35-55; an average of 38 per cent of those requests being decided in favour of the taxpayer. Although the number of requests likely to be received in the initial year of the measure cannot be forecast, Treasury and the Commissioner have advised that in later years they expect around 350.⁵ As the Commissioner can exercise his discretion in respect of one or more income years, is required to make such decisions within 28 days of receiving all of the information, and has given a commitment to provide material concerning this measure to assist taxpayers with their applications, it is considered that mechanisms are in place to provide some certainty and enable affected taxpayers to make future investment decisions.⁶

Exceptions

2.12 Provision is made within the bill to ensure that deductions allowable pursuant to Division 41 of the ITAA 1997 - the Government's small business and general tax break are not inadvertently caught by the amendments.

2.13 Grandfathering provisions to protect taxpayers claiming deductions for excess non-commercial losses in circumstances where the Commissioner has previously exercised his section 35-55 discretion are also proposed including those relating to managed investment schemes.⁷

3 Explanatory Memorandum, p 107.

4 Explanatory Memorandum, p 108.

5 Department of the Treasury, answer to question on notice, 9 November 2009 (received 13 November 2009).

6 Department of the Treasury, answer to question on notice, 9 November 2009 (received 13 November 2009).

7 Explanatory Memorandum, p 111.

Chapter 3

Views on the bill

3.1 The proposed amendments do not require significant legislative change to achieve the Government's policy intent. However, there will be considerable administrative impacts for taxpayers who exceed the \$250,000 income test.

3.2 In submissions received and evidence taken at the public hearing held on 9 November, five areas were consistently identified as areas of concern:

- (a) The \$250,000 threshold;
- (b) The Commissioner's discretion;
- (c) The retrospectivity of the proposed changes;
- (d) The impact on rural communities; and
- (e) The accuracy of the revenue projections.

The \$250,000 threshold

3.3 The introduction of the \$250,000 income test to Division 35 is the key element of this measure.

3.4 By introducing this threshold the government will limit access to tax deductions for non-commercial losses from a small sector of the community who could be regarded as high wealth individuals. (Treasury have advised that 'there are 11,000 taxpayers that will be affected by this measure'.¹)

3.5 The new test, which will be contained in Division 35 in new paragraph 35-10(2E) provides that:

(2E) You satisfy this subsection for an income year if the sum of the following is less than \$250,000:

- (a) your taxable income for that year;
- (b) your reportable fringe benefits total for that year;
- (c) your reportable superannuation contributions for that year;
- (d) your total net investment losses for that year.

3.6 Where the test is not met, the taxpayer will be required to quarantine any excess losses from their business activity and carry them forward to be offset against

1 Mr Christopher Leggett, Senior Adviser, Personal and Retirement Income Division, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p. 38.

assessable income of the activity in the future. They do not lose access to claiming these losses as deductions in future years.

Submissions tended to criticise the apparent arbitrary nature of the threshold amount of \$250,000. The Tax Institute of Australia, in noting that the \$250,000 threshold would probably only affect a small percentage of taxpayers, raised the possibility of complexity in situations where a taxpayer moves in and out of (over and under) the threshold.² This would suggest that averaging a taxpayer's adjusted taxable income over the preceding three years would provide more certainty to affected taxpayers. However it would add some complexity.

3.7 The National Farmers' Federation commented:

...an ongoing issue that the National Farmers' Federation has had with taxation related thresholds: the fact that there is no discussion either way of having any kind of indexation around that threshold. Sure, \$250,000 may seem like a high income now, but will it be in 10 years time? ...

If you are going to implement an arbitrary threshold ...you get into a situation where the threshold do not change and what might initially have been deemed to be an appropriate level becomes obsolete very quickly. All we are saying is that there are concerns about taking a threshold approach at any time. You have to think about that carefully to make sure you get those settings right. But, even if you do go down that path, you have to make sure they are relevant over time and that you do not have to go through a legislative process again to change them to make them more relevant.³

3.8 When questioned as to how this threshold amount was determined, the Treasury advised that it was a policy choice of government. They have since provided further information detailing that in the 2009-10 income year an estimated 130,000 taxpayers will have an adjusted taxable income of \$250,000 or more and that modelling suggests 8.5% (11,000) of those taxpayers would otherwise have claimed non-commercial losses against non-farm income in 2009-10.⁴

3.9 Treasury also noted that 'wherever one seeks to place a threshold in the tax transfer system and in any other arrangement where government decides to provide benefits or impose costs on people, there will always be arguments about the appropriateness of the fixed line in the sand that government chooses.'⁵

2 Ms Joan Roberts, President, Taxation Institute of Australia, *Proof Committee Hansard*, 9 November 2009, p. 10.

3 Mr Charles McElhone, Manager, Economics and Trade, National Farmers' Federation, *Proof Committee Hansard*, 9 November 2009, pp 15 and 17.

4 The Department of the Treasury, answer to question on notice, 9 November 2009 (received 13 November 2009).

5 Mr Michael Willcock, General Manager, Personal and Retirement Income Division, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p.40.

3.10 It is noted that although the seeming arbitrary nature of the threshold was criticised, no alternative approach to determining an appropriate income threshold was put forward. However, it was suggested that an alternative to the \$250,000 threshold would be the removal of the real property test, one of the four existing tests within Division 35.

We do have a solution ... a reasonably simple solution—that is, remove the \$500,000 real property test rather than introduce this arbitrary \$250,000 income test. The real property test is one of the existing four tests of the non-commercial loss provisions and is, in our view, the one that would be passed by, if you like, your Collins Street farmer or the individual that the government is looking to target in these proposed changes. So our No. 1 solution is to remove that \$500,000 test.⁶

3.11 In fact, the Treasury noted that this test is one that can be circumvented by high wealth individuals and that financial modelling associated with the removal of the test had not been undertaken:

Mr Willcock- ...Turning to the measure announced in this year's budget, the government is concerned that the current non-commercial losses rules are becoming less effective at identifying those business activities that are commercial in nature. This is because of the capacity for high-income individuals in particular to arrange their affairs to meet one of the four tests and use what is in reality a non-commercial business activity to reduce the tax payable on their other income. This could occur where the value of real property used in carrying on a business is greater than \$500,000—this would be the case for many hobby farms—or the plant and equipment is valued at more than \$100,000. High-income earners have the financial means to more readily meet these financial thresholds in the existing tax laws.⁷

CHAIR—Have you, as part of your consultation, had a look at other proposals—say, to remove the real property limit?

Mr Leggett—I guess the government considered a number of measures to address the problems that were identified. I assume that that was probably one of the issues—whether or not any particular test is more problematic than the others. I think everybody acknowledges that the real property test is perhaps one of the worst offenders in being circumvented, but that does not mean the other ones are not being circumvented as well. I guess there was a view that there was a need to protect smaller taxpayers from these changes. There was a focus on the upper end rather than changes across the board.

CHAIR—So you did not do any analysis of whether that would have produced the same result as the current proposal?

6 Mr Adam Tims, Thoroughbred Breeders Australia, *Proof Committee Hansard*, 9 November 2009, p. 26.

7 Mr Michael Willcock, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p. 37.

Mr Leggett—On a monetary basis?

CHAIR—Yes.

Mr Leggett—Not that I am aware of, no.⁸

3.12 Alternatively, the government might look to increase and then index the threshold amount to ensure that it remains relevant into the future.⁹

The Commissioner's discretion

3.13 In circumstances where a taxpayer's adjusted taxable income is greater than \$250,000 the default position under the proposed changes will require that excess losses be quarantined and carried forward to be offset against assessable income generated by the activity in future years. However, taxpayers in this situation will have the opportunity to seek relief from the non-commercial loss rules by requesting that the Commissioner exercise the discretion of section 35-55 of the ITAA 1997.

3.14 The bill sets out at item 11 of Schedule 2, that the Commissioner's discretion will be amended to address situations where taxpayers exceed the \$250,000 income test:

11 At the end of subsection 35-55(1)

Add:

; or (c) for an applicant who carries on the business activity who does not satisfy subsection 35-10(2E) (income requirement) for the most recent income year ending before the application is made—the business activity has started to be carried on and, for the excluded years:

(i) because of its nature, it has not produced, or will not produce, assessable income greater than the deductions attributable to it; and

(ii) there is an objective expectation, based on evidence from independent sources (where available) that, within a period that is commercially viable for the industry concerned, the activity will produce assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsections 35-10(2) and (2C)).

Note: Paragraphs (b) and (c) are intended to cover a business activity that has a lead time between the commencement of the activity and the production of any assessable income. For example, an activity involving the planting of hardwood trees for harvest, where many years would pass before the activity could reasonably be expected to produce income.

8 Mr Michael Willcock, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p. 38.

9 Mr Charles McElhone, National Farmers' Federation, *Proof Committee Hansard*, 9 November 2009, p15; Captain Kerry Dwyer (retired), Board Director, Australian Alpaca Association Ltd, *Proof Committee Hansard*, 9 November 2009, p. 22.

3.15 It is this requirement to provide objective evidence from independent sources that has caused considerable concern and uncertainty:

It will undoubtedly cause many taxpayers to go out and seek that advice, and I am sure that seeking that advice will come at a price. It not only imposes on taxpayers that headline cost of having to go out and seek that independent expert advice to justify the viability or otherwise of their particular business activity; it also imposes non-cash compliance costs, particularly in terms of the uncertainty that might be created for certain taxpayers, not knowing their tax position and what the commissioner may rule in respect of the exercising of discretion—which, in turn, could have consequential impacts on the taxpayer’s ability to predetermine their tax liability and be able to fund that liability on time, giving rise to debts and collection action down the track. So the potential consequences from a compliance perspective could be significant if these proposed changes are implemented in the fashion that is proposed at this point.¹⁰

...When you have a position where the commissioner is put in the position of exercising discretion with minimal skills themselves in the particular industries and no guidance as to how they are assessing these businesses, you are going to get to situations where more likely than not that discretion will not be exercised. It will be exercised, but in a negative sense.¹¹

What comes back to us is that there will be commissioner’s discretion but no-one is sure how that will work. ...you can take some comfort that there will be a process that you can go through to make sure your special circumstances are taken into account, but there is no guarantee that they will be.¹²

Senator BUSHBY—Are you talking about the lack of certainty about the prospect of this legislation or the lack of certainty as to how the ATO or the tax commissioner may deal with an application for an exemption?

Mr Tims—I think it is probably more about how the ATO commissioner will deal with an application.¹³

3.16 A number of witnesses advised that they take the view that the obligation the discretion imposes on the Commissioner is onerous and fraught with risk as it requires the taxpayer to expend money sourcing independent advice before presenting that advice to the Commissioner for his consideration and ultimate decision as to whether

10 Mr Yasser El-Ansary, Tax counsel, Institute of Chartered Accountants, *Proof Committee Hansard*, 9 November 2009, p. 9.

11 Mr Peter Murray, National Councillor, Tax Institute of Australia, *Proof Committee Hansard*, p. 13.

12 Mr Charles McElhone, Manager, Economics and Trade, National Farmers' Federation, *Proof Committee Hansard*, 9 November 2009, p. 17.

13 Mr Adam Tims, Thoroughbred Breeders Australia, *Proof Committee Hansard*, 9 November 2009, p. 34.

or not the business arrangements into which they have entered are commercial despite not being an expert on the industries involved.¹⁴

Retrospectivity of the proposed changes

3.17 In their joint media release on 12 May 2009 when announcing the measure, the Treasurer and Assistant Treasurer detailed that the proposed changes would apply from 1 July 2009, the current income year.¹⁵

3.18 The Institute of Chartered Accountants commented on this feature of the proposed changes noting that:

... introducing these proposed new laws from 1 July 2009 for the 2009-10 income year will mean that certain taxpayers who have taken positions based on the law as it stood prior to the budget announcement this year may potentially be disadvantaged in an adverse way by virtue of the fact that they are claiming what are referred to as division 40 and 43 capital allowance deductions on an ongoing basis because they are depreciation non-cash items that are deducted on a cyclical program over the effective life of an asset. The taxpayers who are claiming division 40 and 43 capital allowance deductions will find themselves ... in a position where they are generating tax losses and therefore are not able to satisfy the non-commercial loss rural tests and therefore be denied access to their losses simply by virtue of them claiming depreciation deductions. I think that is a significant issue which should not be dismissed or underestimated.

... The other point, on a related issue to that, is that for those taxpayers who have generated losses before the commencement of the 1 July 2009 changes and who will now potentially be subject to the changed taxation laws that apply in this area, they may be disadvantaged in adverse way as well by virtue of in effect the goalposts having been shifted on them from 1 July 2009. I think it would be appropriate for those taxpayers in those situations who have generated losses before the commencement of this current income year to be also given some transitional relief...¹⁶

3.19 The committee, through the Chair, sought clarification from Treasury in respect of the Commissioner's discretion:

CHAIR—A theme that was coming through in a number of submissions here today was the uncertainty and the desirability of the tax commissioner making rulings on the basis that people could not make investment without some more certainty about what the tax commissioner would decide. There

14 Mr Yasser El-Ansary, Institute of Chartered Accountants, *Proof Committee Hansard*, 9 November 2009, p. 3; Ms Roberts and Mr Murray, Tax Institute Australia, *Proof Committee Hansard*, 9 November 2009, p. 12.

15 Media release 67, 12 May 2009.

16 Mr Yasser El-Ansary, Tax counsel, Institute of Chartered Accountants, *Proof Committee Hansard*, 9 November 2009, pp 8 – 9.

was a view that perhaps people would not be able even to apply until July 2010.

Mr Leggett—That is not true. You can apply for the exercise of the commissioner's discretion at any time. It can be before you make the investment or after you make the investment. If you are profitable in the first couple of years even though the viability period has not happened, and you later become unprofitable, you can apply at that time as well. There is no limitation as to when you ask the commissioner for the exercise of that discretion.

Of course, until the law is enacted he cannot exercise his discretion, but his discretions have been exercised under the existing law and are being grandfathered into the new system, so people could apply for the exercise now. In effect, like managed investment schemes, the commissioner exercises discretion always in advance of the scheme being started. So he exercises his discretion in regard to the product rulings.¹⁷

3.20 It is suggested that these features of the amendments, ie the honouring of decisions made by the Commissioner to exercise his discretion under the existing provisions and the ability of taxpayers to seek a ruling at any time in the process of establishing their business activity will provide adequate protection to taxpayers and enable them to make decisions.

The impact on rural communities

3.21 Some witnesses suggested that the bill would have the effect of leading to hobby farms being abandoned with a subsequent loss of employment in rural areas:

...the losses being incurred by high-income earners are providing a vital injection of funds to rural and regional communities through things such as the wages being paid to farm managers, to contract suppliers and other equipment purchased from local rural trading shops. The NFF believes that the proposal to impose an income threshold to the non-commercial loss rules will act to reduce expenditure by these high-income individuals in regional Australia...¹⁸

...our farming business spends a considerable amount of money each year in our local community, through farm contractors and local businesses delivering products and services ... in all likelihood many working/farming families like ours will be forced to re-evaluate our businesses and take this expenditure out of the local community.¹⁹

17 Mr Chris Leggett, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p. 38.

18 Mr Charles McElhone, National Farmers' Federation, *Proof Committee Hansard*, 9 November 2009, pp 14-15.

19 Ballycastle Pastoral Company, *Submission 6*, p 3.

3.22 However, such concerns appear misplaced. Firstly, they ignore the protection in the discretion provisions for 'serious' farming operations. As Treasury point out:

...as to the extent that the businesses are legitimate and genuine, they are unlikely to be affected by this measure because they will get the commissioner to exercise his discretion.²⁰

3.23 Secondly, the measures only affect people on high incomes who may well be able to organise their affairs to cope with some additional taxation. The measures may also encourage adjustment to the business plan to improve the profitability of their farms.

3.24 Finally, even if the measures do lead to some hobby farmers leaving, the farms may be sold, either to existing farmers who may very well operate them more efficiently, or to new farmers who may have found themselves priced out of the farming industry by the hobby farmers. There would therefore be no reason to expect any significant adverse 'multiplier' effects on rural communities.

The revenue projections

3.25 In announcing these proposed changes the Government has forecast ongoing revenue gains – expecting that over the forward estimates \$700 million will be collected.²¹

3.26 These forecasts were identified by a number of submissions as being higher than they would have expected given the potential flow-on effects of the movement of investment dollars from rural areas to other tax effective investment vehicles.

3.27 The Committee sought to clarify the extent to which revenue forecasts had factored in second and third round impacts. In response, the Treasury replied:

...the secondary impacts are not normally costed for the reason that it is just too difficult to come up with those sorts of figures. We do not know whether money will be reinvested in other areas or whether people will drop out of the particular industry concerned, so it is normally too difficult to calculate flow-on effects.²²

3.28 Senator Bushby sought to further clarify the extent to which the revenue from tightening up on deductions for losses on hobby farms would be offset by increased losses of revenue from greater use of other tax shelters:

I tested this this morning with other witnesses and they thought this was true—including the tax institute and chartered accountants. By making this change you will make investing in these types of enterprises less attractive

20 Mr Chris Leggett, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p 41.

21 Budget 2009-10, p. 20.

22 Mr Leggett, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p 41.

in terms of tax minimisation for some of the people who will be affected than other forms of investment which might also have tax minimisation benefit. I asked them whether they thought it would be significant or marginal. They said that ... it would be real and there would be a move from people, when they receive their tax advice, into areas other than this. I am interested in knowing whether any consideration of that likely impact was taken into account in the \$700 million.²³

3.29 The Treasury confirmed that although their estimates included an assumption that people would move into different investment types, they were not in a position to provide further detail and took on notice a request to provide more information around the exact costing method.²⁴

Conclusion and recommendation

3.30 The Committee supports the intention of tightening the non-commercial losses regime of Division 35.

Recommendation 1

3.31 The Committee recommends the Senate pass the bill.

Senator Annette Hurley

Chair

23 *Proof Committee Hansard*, 9 November 2009, p. 45.

24 *Proof Committee Hansard*, 9 November 2009, p. 45.

ADDITIONAL COMMENTS FROM COALITION SENATORS

While the Coalition is not opposing this legislation, there are a number of technical issues that the Coalition wishes to raise.

\$250,000 income threshold

It was pointed out during the hearings that while \$250,000 sounds like a high annual income, it should be indexed to ensure that farmers who were successful in generating off-farm income were not excessively penalised.

While it may appear that imposing a \$250,000 threshold will avoid any impact on genuine farming operations, the NFF is aware of a number of instances where this is not the case. The NFF therefore questions why these farmers, who have been more successful than most at generating off-farm income (even for a temporary period) should be penalised.¹

Similarly, many of the operations that currently do not fit under the \$250,000 threshold could squeeze over the line, because over ten years that threshold would become comparatively lower.

I thought that there might have been some adjustments to the thresholds, the existing tests, rather than this \$250,000 income figure. That was probably the expectation.

Essentially, you thought there might have been a little bit more of a sophisticated approach to trying to target the people who the government want to get in terms of higher net income – for example, higher net income people out there who might go and buy themselves a nice country property as a holiday home, run a few horses on it and claim that as a loss against their income, and so basically they get a holiday home in before-tax dollars.

MR TIMS: And that is not fair.²

...the fact that there is no discussion either way of having any kind of indexation around the threshold. Sure, \$250,000 may seem like a high income now, but will it be in 10 years time? Do we have to go through another legislative process to ensure that it meets an intended level for all time into the future?³

1 National Farmers' Federation, *Submission 2*, p.7.

2 Mr Adam Tims, Thoroughbred Breeders Australia, *Proof Committee Hansard*, 9 November 2009, p. 33.

3 Mr Charles McElhone, Manager, Economics and Trade, National Farmers Federation, *Proof Committee Hansard*, 9 November 2009, p. 15.

It was suggested that a solution to this problem was the removal of the \$500,000 real property test rather than introducing the arbitrary \$250,000 income test which would seem appropriate to adjust in future.

We do have a solution... a reasonably simple solution – that is, remove the \$500,000 real property test rather than introduce this arbitrary \$250,000 income test. The real property test is one of the existing four tests of the non-commercial loss provisions and is, in our view, the one that would be passed by, if you like, your Collins Street farmer or the individual that the government is looking to target in these proposed changes. So our No. 1 solution is to remove that \$500,000 test.⁴

Additionally, it was accepted that Treasury had not done any financial modelling as to the impact of removing of the real property test.⁵

Commissioner's discretion

While there is no doubt that the Commissioner acts with the utmost propriety, the questions needs to be asked as to what advice the Commissioner will take on board. For example, a number of industries have developed out of hobby farms that otherwise would not have occurred if this option was not available to them.

The wine sector is a clear example. You mentioned the Margaret River wine industry earlier. Clearly, that has generated a lot of benefit from the non-commercial loss provisions and has developed in its own right to make a very genuine and positive contribution to the Australian economy broadly. There are a whole range of examples and I do not think they are limited to the wine sector. Particularly in some farming operation in some of the peri-urban areas, there are a whole raft of examples...⁶

We are concerned that already strong tax disincentives to investment in our industry will be escalated by the imposition of the new measures proposed, which will disadvantage genuine farming operations.⁷

The long lead times in areas such as alpaca farming, where the genetic improvements of the herd needs to occur to produce higher wool yields, and other new industries require assistance in this area.

That has been our challenge – to get our genetic development to that stage – but we are getting closer.⁸

4 Captain Kerry Dwyer, PSM (Retired), Board Director, Australian Alpaca Association Ltd, *Proof Committee Hansard*, 9 November 2009, p. 26.

5 Mr Chris Leggett, Senior Adviser, Personal and Retirement Income Division, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p. 38.

6 Mr Charles McElhone, National Farmers' Federation, *Proof Committee Hansard*, 9 November 2009, p. 19.

7 Captain Kerry Dwyer, PSM (Retired), *Proof Committee Hansard*, 9 November 2009, p. 22.

8 *Proof Committee Hansard*, 9 November 2009, p. 22.

Retrospectivity

Coalition Senators in principle believe that it is unfair to impose tax changes retrospectively. Some evidence was given that there should be time for industries and individuals to get their affairs in order.

The point here is that introducing these proposed new laws from 1 July 2009 for the 2009-10 income year will mean that certain taxpayers who have taken positions based on the law as it stood prior to the budget announcement this year may be potentially disadvantaged in an adverse way...⁹

Impost on rural communities

While there may be an ideological view that these operations are merely tax dodges for the wealthy, the fact of the matter is that most of these enterprises employ people in the local area and are legitimate businesses. By their operation, the employment of local people means that money is spent in the local community on local goods and services.

The third area of focus is on the social considerations of this legislation. I guess what the Taxation Institute would do here is to make sure that there is a question on the table as to whether all of the social implications of the proposed changes have been considered... There may be effects in local communities when you take money out of local communities that would otherwise be there to build up the wealth of the community. Investment decisions may be affected and that has flow-on social implications. Also, there are productivity issues. Sometimes when people are comfortable enough to be in a situation where they follow their passion – whether it is some sort of farming venture, or art – the community ultimately benefits. Some of the examples given in the guidelines show how the current vision of how this might work can really narrow that scope for advances in productivity and innovation.¹⁰

Revenue projections

It has been projected that this measure would raise an additional \$700 million. During the hearings, Treasury did state that there was an assumption about the behaviour of people that it may affect.

9 Mr Yasser El-Ansary, Tax Counsel, Institute of Chartered Accountants in Australia, *Proof Committee Hansard*, 9 November 2009, p. 8.

10 Ms Joan Roberts, President, Taxation Institute of Australia, *Proof Committee Hansard*, 9 November 2009, p. 11.

I can confirm that the \$700 million includes a behavioural assumption of people moving into different investment types as a result of this...¹¹

However, other witnesses felt that this was an unusually high amount of revenue.

I must confess that I found the number of \$700 million to be a significantly high number, in my estimation.¹²

What we are suggesting there is that, for high-income earners, there are a range of tax-effective options available, the major one being negative gearing in metropolitan areas. So if it is the sole purpose of a high-income earner to minimise their taxation through non-commercial loss provisions through hobby farming, we would argue that, sure, the savings might be there in the first year of operation, only for long enough for those investors to shift their investment into other areas such as negative gearing, where they will continue to make equivalent savings.¹³

The question that needs to be asked is whether the \$700 million that has been projected as revenue from this will actually be realised, as the legislation could result in more people moving away from such investments as may be captured by this legislation than expected. This would have dramatic impacts on not only the expected revenue but on local communities as well.

It is not known what proportion of those individuals will apply for the Commissioner's discretion, or what proportion will actually receive relief from the rules.¹⁴

Additionally, evidence was given that new and innovative forms of agricultural enterprises would have difficulty in being approved. The failure of development of the Margaret River wine industry is just one scenario where this measure could have impacted on investment in a local community.

Conclusion

In conclusion, the Coalition Senators are concerned that this measure may inhibit the growth of new industries, such as the development of the Margaret River wine region, alpaca breeding and blood stock breeders, from developing into the future and consideration must be given as to the effectiveness of this measure by comparing the projected revenue against the potential economic and social costs of such a measure.

11 Mr Michael Willcock, General Manager, Personal and Retirement Income Division, Department of the Treasury, *Proof Committee Hansard*, 9 November 2009, p. 45.

12 Mr Yasser El-Ansary, Institute of Chartered Accountants in Australia, *Proof Committee Hansard*, 9 November 2009, *Proof Committee Hansard*, 9 November 2009, p. 7.

13 Mr Charles McElhone, National Farmers' Federation, *Proof Committee Hansard*, 9 November 2009, p. 16.

14 Department of the Treasury, responses to questions on notice - question 3, 9 November 2009 (received 13 November 2009).

Senator Alan Eggleston

Deputy Chair

Senator David Bushby

Senator Barnaby Joyce

APPENDIX 1

Submissions Received

Submission Number	Submitter
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- | | |
|---|---|
| 1 | Thoroughbred Breeders Australia |
| 2 | National Farmers' Federation |
| 3 | Mrs Marlene Ciganovic |
| 4 | Institute of Chartered Accountants in Australia |
| 5 | National Association of Forest Industries |
| 6 | Ballycastle Pastoral Company |

Additional Information Received

Received 11 November, 2009 from the Australian Alpaca Association:
'Commercial Viability of the Australian Alpaca Industry'
Report to the Australian Alpaca Association 7 May 2001

Received 11 November, 2009 from Taxation Institute of Australia. Answers to Questions on Notice, taken on notice from the public hearing held in Melbourne, Monday 9 November 2009.

Received 12 November, 2009 from The Institute of Chartered Accountants in Australia. Answers to Questions on Notice, taken on notice from the public hearing held in Melbourne, Monday 9 November 2009.

Received 12 November, 2009 from the National Farmers' Federation. Answers to Questions on Notice, taken on notice from the public hearing held in Melbourne, Monday 9 November 2009.

Received 13 November, 2009 from Treasury. Answers to Questions on Notice, taken on notice from the public hearing held in Melbourne, Monday 9 November 2009.

APPENDIX 2

Public Hearing and Witnesses

MELBOURNE, MONDAY 9 NOVEMBER 2009

DWYER, Captain Kerry, PSM (Retired), Board Director
Australian Alpaca Association Ltd

EL-ANSARY, Mr Yasser, Tax Counsel
Institute of Chartered Accountants in Australia

JOHNSON, Mr Tim, Vice President
Thoroughbred Breeders Australia

LEGGETT, Mr Christopher, Senior Adviser, Personal and Retirement Income Division
Department of the Treasury

McELHONE, Mr Charles, Manager, Economics and Trade
National Farmers' Federation

MURRAY, Mr Peter, National Councillor
Taxation Institute of Australia

ROBERTS, Ms Joan, President
Taxation Institute of Australia

TIMS, Mr Adam, Director, Thoroughbred Breeders Victoria, Thoroughbred Breeders
Australia; and Director, Stable Financial

WILLCOCK, Mr Michael, General Manager, Personal and Retirement Income Division
Department of the Treasury

