



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Budget Estimates)

THURSDAY, 2 JUNE 2005

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SENATE
ECONOMICS LEGISLATION COMMITTEE
Thursday, 2 June 2005

Members: Senator Brandis (*Chair*), Senator Stephens (*Deputy Chair*), Senators Chapman, Murray, Watson and Webber

Senators in attendance: Senators Brandis, George Campbell, Chapman, Conroy, Fifield, Lundy, Mason, Murray, Sherry, Stephens, Watson, Webber and Wong

Committee met at 9.02 am

TREASURY PORTFOLIO

Consideration resumed from 1 June.

In Attendance

Senator Abetz, Special Minister of State

Senator Kemp, Minister for the Arts and Sport

Department of the Treasury

Dr Ken Henry, Secretary

Outcome 1: Sound Macroeconomic Environment

Output Group 1.1: Macroeconomic Group

Dr Martin Parkinson, Executive Director

Mr David Parker, Alternate Executive Director

Dr David Gruen, Chief Adviser, Domestic,

Mr Roger Brake, General Manager, International Finance Division

Dr Steven Kennedy, General Manager, Domestic Economy Division

Ms Meghan Quinn, Principal Adviser, Forecasting, Domestic Economy Division

Dr Gordon de Brouwer, General Manager, G20 and APEC Secretariat

Mr Adam McKissack, Manager, Macroeconomic Policy Division

Mr Peter Downes, Specialist Adviser, International Economy Division

Mr Luke Yeaman, Acting Manager, International Economy Division

Mr Brian Thomas, Acting Manager, International Economy Division

Mr Phil Garton, Specialist Adviser, International Economy Division

Outcome 2: Effective Government Spending and Taxation Arrangements

Output Group 2.1: Fiscal Group

Mr David Tune, Executive Director

Mr David Martine, General Manager, Budget Policy Division

Mr Matthew Flavel, Manager, Budget Policy Division

Mr Jason McDonald, Manager, Budget Policy Division

Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division

Mr Rob Heferen, General Manager, Social Policy Division

Mr Michael Willcock, General Manager, Commonwealth-State Relations Division

Output Group 2.2: Revenue Group

Mr Mike Callaghan, Executive Director
Mr Bruce Paine, General Manager, Board of Taxation Secretariat
Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division
Mr Nigel Ray, General Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Tax Analysis Division
Mr Colin Brown, Manager, Tax Analysis Division
Mr Peter Greagg, Manager, Tax Analysis Division
Mr Neil Motteram, General Manager, International Tax and Treaties Division
Mr Patrick Colmer, General Manager, Indirect Tax Division
Mr Colin Johnson, Business Tax Division
Mr Tony Regan, Manager, Business Tax Division
Mr Mark O'Connor, Acting General Manager, Individuals and Exempt Tax Division
Ms Marisa Purvis-Smith, Manager, Individuals and Exempt Tax Division

Outcome 3: Well Functioning Markets**Output Group 3.1: Markets Group**

Mr Jim Murphy, Executive Director
Mr Chris Legg, General Manager, Financial System Division
Ms Kanwaljit Kaur, Manger, Financial System Division
Ms Vicki Wilkinson, Manager, Financial System Division
Mr Iain Scott, Manager, Financial System Division
Mr Trevor King, Manager, Financial System Division
Mr Damien White, Manager, Financial System Division
Ms Kathryn McCrea, Financial System Division
Mr Mike Rawstron, General Manager, Corporations and Financial Services Division
Mr Matt Brine, Manager, Corporations and Financial Services Division
Ms Kerstin Wijeyewardene, Manager, Corporations and Financial Services Division
Ms Ruth Smith, Manager, Corporations and Financial Services Division
Mr David Love, Manager, Corporations and Financial Services Division
Mr Steve French, General Manager, Competition and Consumer Policy Division
Ms Sandra Patch, Senior Adviser, Competition and Consumer Policy Division
Ms Louise Seeber, Senior Adviser, Competition and Consumer Policy Division
Mr David Hall, Competition and Consumer Policy Division
Ms Suzanne Howarth, Senior Adviser, Competition and Consumer Policy Division
Mr Simon Vickery, Competition and Consumer Policy Division
Ms Jacky Rowbotham, Senior Adviser, Competition and Consumer Policy Division
Mr Brad Archer, Competition and Consumer Policy Division
Mr Gerry Antioch, General Manager, Foreign Investment and Trade Policy Division
Mr John Hill, Manager, Foreign Investment and Trade Policy Division
Ms Susan Antcliff, Senior Adviser, Australian Government Actuary
Mr Peter McCray, General Manager, Financial Literacy Foundation
Ms Sally Webster, Manager, Financial Literacy Foundation
Ms Gillie Kirk, Senior Adviser, Financial Literacy Foundation
Mr Grahame Crough, Manager, Financial Literacy Foundation

Mr John Riley, Financial Literacy Foundation
Mr Scott Rogers, Competition and Consumer Policy Division
Ms Jane Benson, Competition and Consumer Policy Division
Mr Chris Lyon, Competition and Consumer Policy Division

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman
Mr Brian Cassidy, Chief Executive Officer
Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division
Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Branch
Ms Lee Hollis, General Manager, Criminal Enforcement and Cartel Branch
Ms Rose Webb, General Manager, Enforcement and Co-ordination Branch
Mr Tim Grimwade, General Manager, Mergers and Asset Sales
Mr Scott Gregson, General Manager, Adjudication Branch
Mr Robert Antich, General Manager, Policy and Liaison Branch
Mr Nigel Ridgway, General Manager, Compliance Strategies Branch
Mr Michael Cosgrave, General Manager, Telecommunications Group
Ms Helen Lu, General Manager, Corporate Management Branch
Mr John Bridge, Chief Finance Officer
Ms Lisa-Anne Ayres, Executive Branch
Mr Chris Steger, Executive Branch
Ms Colette Downie, Director, Enforcement and Co-ordination Branch
Mr Sam Ceravolo, Director, Finance and Services

Australian Bureau of Statistics

Mr Dennis Trewin, Australian Statistician
Ms Susan Linacre, Deputy Australian Statistician, Population Statistics Group
Mr Peter Harper, Deputy Australian Statistician, Economic Statistics Group
Ms Kerrie Duff, Acting First Assistant Statistician, Corporate Services Division
Mr Paul Williams, Assistant Statistician, Census & Geography Branch

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director

National Competition Council

Mr John Feil, Executive Director
Mr Alan Johnston, Director, Government Businesses and Regulation

Productivity Commission

Mr Ian Gibbs, Assistant Commissioner
Mr Garth Pitkethly, First Assistant Commissioner

Australian Prudential Regulation Authority

Mr Ross Jones, Deputy Chairman
Mr Stephen Somogyi, Member
Mr Charles Littrell, Executive General Manager, Policy, Research and Statistics
Mr Wayne Byres, Executive General Manager, Diversified Institutions
Dr Darryl Roberts, General Manager, Enforcement, Supervisory Support
Mr Stephen Glenfield, General Manager, South West Region, Specialised Institutions

Australian Securities and Investment Commission

Mr Jeffrey Lucy, Chairman

Mr Jeremy Cooper, Deputy Chairman

Ms Jan Redfern, Executive Director, Enforcement Mr Peter Clark, Senior Counsel

Australian Taxation Office

Mr Michael Carmody, Commissioner of Taxation

Mr Murray Crowe, Assistant Commissioner

Mr James O'Halloran, Assistant Commissioner

Mr Bill Gibson, Chief Information Officer

Mr Greg Farr, Second Commissioner

Ms Jan Farrell, Deputy Commissioner

Ms Erin Holland, Deputy Commissioner

Mr Mark Jackson, Deputy Commissioner

Mr Mark Konza, Deputy Commissioner

Mr Neil Mann, Deputy Commissioner

Ms Stephanie Martin, First Assistant Commissioner

Mr Michael Monaghan, Deputy Commissioner

Ms Donna Moody, Chief Finance Officer

Ms Tracey Nicholson, Assistant Commissioner

Mr Shane Reardon, Deputy Commissioner

Mr Greg Topping, Assistant Deputy Commissioner

Mr Graham Whyte, Assistant Commissioner

Ms Anne Ellison, First Assistant Commissioner

Inspector-General of Taxation

Mr David Vos, Inspector-General of Taxation

Mr Steve Chapman, Deputy Inspector-General of Taxation

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer

Mr Paul Power, Chief Operating Officer

Mr Pat Raccosta, Chief Finance Officer

Mr Michael Bath, Director, Financial Risk

Mr Gerald Dodgson, Head, Treasury Services

Department of the Treasury

CHAIR—I welcome to the table the Special Minister of State, Senator Abetz, and officers of the Treasury. We will resume this morning with questions to the Macroeconomic Group of Treasury.

Senator SHERRY—I want to turn to yesterday's current account deficit, which was \$15.6 billion for the first three months of 2005, which is 7.2 per cent of gross domestic product. How does this compare with Australia's historical experience?

Dr Gruen—I think I gave some of this answer yesterday. Australia has, over the past 20 years, run a current account deficit that has averaged about 4½ per cent of GDP and has cycled between about two per cent and a bit over six per cent on several occasions. The past two quarters are the first time since I think there was a very large current account deficit

associated with the Korean wool boom in the early fifties that we have had a current account deficit of the magnitude of 7.2 per cent of GDP.

Senator SHERRY—With respect to the percentage of GDP that has now been reached, 7.2 per cent, is it possible that it could go higher?

Dr Gruen—It is certainly possible.

Senator SHERRY—Has Treasury given any thought as to what it believes to be the percentage of gross domestic product at which the current account deficit is sustainable? Clearly, if it keeps going higher, there must be a point at which money markets internationally are going to say, ‘What is happening here? What are we going to do about it?’ and respond?

Dr Gruen—I guess at a theoretical level that is right. It is worth making the point I alluded to yesterday, which is that if you look at the savings-investment framework, which is a good fundamental way to think about the current account deficit, the current account deficit is very largely attributable to an excess of investment over savings in the household sector associated with the housing boom, and I think it is fair to say that the housing boom is subsiding. We have a range of evidence that confirms that, from house prices to dwelling investment and a range of other indicators. This suggests that the economic forces are in train that will tend to reduce the current account deficit over time.

It is also worth making the point that is looking at it from the savings-investment point of view. The other way one can look at it is of course from the external accounts. We have just had the March quarter current account deficit. On 1 April we know that there were very large increases in the contract prices for iron ore and coking and thermal coal. As a consequence of those very large increases, the value of exports is due to rise very significantly in the next quarter, and there is also already in the data a significant volume response for both iron ore and the two types of coal. Our forecasts are that the value of exports will rise very significantly in the next quarter, which will reduce the trade deficit quite considerably.

Senator SHERRY—Is that not also dependent on the value of imports?

Dr Gruen—Yes.

Senator SHERRY—What is your forecast and observations in respect of the value of imports?

Ms Quinn—We anticipate the price of imports to fall somewhat still on average over the course of 2005-06. That reflects a stable exchange rate, which is our usual technical forecasting assumption, and continued price falls for the goods that we import on the international market.

Senator SHERRY—What if the exchange rate does not remain stable? If the exchange rate drops, the price of imports goes up?

Ms Quinn—That is typically what happens, yes.

Senator SHERRY—So it is conditional on a stable exchange rate?

Ms Quinn—The forecast assumptions in the budget are conditional on a set of technical assumptions, one of which is the exchange rate staying constant over the forecast period.

Senator SHERRY—Has Treasury examined the scenario where the international money markets make an observation that they are not happy with Australia's current account deficit and obviously it is contingent for funding on imported capital? Has Treasury examined a scenario where the international money markets decide, 'We are not going to continue to fund this, certainly not at the current interest rates,' and then we have a rapidly declining value of the Australian dollar as a consequence? Have you looked at that scenario?

Dr Gruen—Again, as I alluded to yesterday, the current account deficit, as you would well know, is not a new phenomenon in Australia. We have had high current account deficits for a very long time. Over the period in which we have had them I think it is fair to say that most people, including the Treasury, have thought carefully about a range of possible scenarios. You would have to say that there have been over this period several occasions in which there have been sharp falls in the Australian dollar. I am sure you are aware of them—after the Asian crisis, the worldwide love affair with tech stocks. There have been a range of times when the Australian dollar has fallen sharply, and I think on those occasions what has been demonstrated is that that has helped to improve the current account, to reduce the current account deficit, at the times that has happened. All of the evidence that we have on those occasions is that the economic players are aware of the fact that the currency can fall and have in the broad arranged their affairs in such a way that they can take that on board without significant adverse impacts. I do not think anyone expected the Australian dollar to fall to below US50c, as it did in 2001. But the banking system and the corporate sector more generally has arranged its economic affairs in such a way that that does not have seriously adverse consequences for Australia. Precisely the opposite; we have very gradual pass through of exchange rate falls into inflation, and significant exchange rate falls have proven themselves to gradually improve the trade account, as you would hope they would.

Senator SHERRY—Just picking up on two points there: firstly, what if it is not a gradual fall but a very rapid fall?

Dr Gruen—There have been examples where there were significantly rapid falls. In the aftermath of the Asian crisis there was a time when the Reserve Bank was worried that international hedge funds were engaged in a campaign to drive down the Australian dollar and break the peg of the Hong Kong dollar with the US dollar. The Reserve Bank was worried that there was a concerted effort to generate in the market a feeling that the Australian dollar was a one-way bet and it only had one way to go, and we had some very rapid falls at that time.

Senator SHERRY—But those rapid falls at that time were not in isolation in the sense there were other countries that were experiencing or did experience very, very rapid, quick falls?

Dr Gruen—Indeed.

Senator SHERRY—Part of the Asian crisis. Do we not have a situation at the moment where money markets will be increasingly focused on Australia alone?

Dr Gruen—First of all, if you are looking at net external liabilities, then New Zealand has significantly higher net external liabilities than Australia as a proportion of GDP. Also, if you are looking at economic fundamentals, one of the pieces of advice that international agencies

are continually giving the United States with their very large current account deficit is that they should get their fiscal house in order. That is clearly something that we have got. We have almost no net debt, net government debt, and we have been running fiscal surpluses for many years now. As to the argument that international capital markets would single out Australia as unusually vulnerable, I do not accept that as a proposition.

Senator SHERRY—I note your observation about the US, but the US is a much, much larger economy and much more dominant in the world.

Dr Gruen—But in some ways that is a weakness.

Senator SHERRY—It is a two-edged sword.

Dr Gruen—Absolutely.

Senator SHERRY—But their current account deficit is not as high as ours now, is it?

Dr Gruen—Their current account deficit is currently around six per cent of GDP and they account for three-quarters of the current account surpluses of all the countries in the world.

Senator SHERRY—Just coming back to an earlier comment, you talked about the current account deficit not being a new phenomenon. But the peak we are now experiencing is a new phenomenon, is it not, except for that period you mentioned during the Korean War?

Dr Gruen—The peak we are now experiencing as a proportion of GDP is slightly higher than previous peaks. I think we had a previous peak of 6.6 per cent of GDP. So it is slightly higher, that is true.

Senator SHERRY—7.2 or slightly higher. But is it not true that once you start, as a percentage of GDP, reaching record highs and particularly compared to other countries, other comparable countries with advanced economies, there will be increasing focus on this as an issue by international money markets?

Ms Quinn—Can I just clarify that, while we had 7.2 per cent in the March quarter, the budget forecast for 2005-06 as a whole is for the current account to narrow to 5.25 per cent, and that is with an unchanged exchange rate. We are anticipating through increases in export prices, improvements in export volumes and moderation in import volumes in line with the moderation in consumption that the current account deficit will narrow over the forecast period. While we currently have 7.2 per cent, we are anticipating that to be a temporary peak, and that on average the current account deficit will improve over the next 12 months.

Senator SHERRY—Sure, that is your forecast, but when these figures literally come up on the screen internationally it is the figures that come up on the screen that the money markets will immediately focus on. I do not know to what extent the money markets and the money managers then say, ‘Well, I better go and have a look at the Australian Treasury budget forecast to reassure myself.’ I am sure some of them do. But it is the immediacy of the decisions they are required to make when those figures come up on the screen that is the most immediate impact, is it not?

Dr Parkinson—Revealed preference indicates that they took no notice.

Senator SHERRY—So far.

Dr Parkinson—That is true.

Senator SHERRY—So far.

Dr Parkinson—But that is always the case. People could wake up tomorrow and decide that there is a massive risk premium about any country in the world.

Senator SHERRY—Correct.

Dr Parkinson—Not necessarily around the current account. I again go back and draw your attention to this chart that was in the budget. I am happy to table it. It is on the terms of trade and goes back to the point that Dr Gruen was making earlier. This is the terms of trade improvement that we have seen. When we have had current account deficits of six per cent or thereabouts in the past it has not been associated with terms of trade shocks like this. It is a fallacy, but one that has some currency, that the terms of trade shock has actually helped hold the current account deficit down. In fact, it is the other way around. The terms of trade shock has provided an income stimulus to the economy which has spilled over into imports and basically contributed to a widening of the current account deficit. Were the terms of trade to fall tomorrow and that to lead to whatever reaction in the markets, you would expect that the pressure on the current account would be in the downward direction, not in the upward.

Senator SHERRY—The current level of the current account as a percentage of GDP is the highest in the world at the present time in comparable economies, advanced economies.

Dr Gruen—I am not aware of that.

Senator SHERRY—Is anyone aware of where we stand compared with other countries? Let us take OECD countries as a reasonable comparison. I understand it is the highest.

Dr Parkinson—It sounds plausible, yes.

Senator SHERRY—I noticed during the week there was some comparison with Bulgaria and Hungary.

Dr Parkinson—I think it was Bulgaria and Romania.

Senator SHERRY—Bulgaria and Romania.

Dr Parkinson—Two countries that I had never previously heard of as comparable to Australia in any economic fundamental or standard of living or anything else.

Senator SHERRY—I would have to correct you there, Mr Parkinson. We did hear a lot of these international comparisons in the context of the introduction of the GST.

Dr Parkinson—I said I had never heard any reference to Bulgaria or Romania and Australia being bracketed together.

Senator Abetz—But you are not rolling it back, are you? The wholesale sales tax was abolished.

Senator SHERRY—That is for the Revenue Group, Senator Abetz. What concerns me is that you are giving the impression of being—I do not want to overstate it—somewhat indifferent to this current account deficit or unconcerned about the potential consequences..

Dr Gruen—I go back to something Dr Parkinson said yesterday, which is that the current account deficit is the outcome of the decisions of the whole community and, for that matter, the decisions of people overseas. The current account deficit at the moment can be understood

as a situation where we have had a very strong housing boom, house prices have gone up a lot, and the proportion of investment in dwellings has gone up a couple of per cent of GDP compared with its long run average. We have had a long period of declining unemployment, low interest rates and real income growth, which has made people better off, and they have been consuming some of that. They have raised their level of consumption, so household savings are low by historical standards and household investment is high by historical standards, and the gap is the current account.

As I said, those developments from the savings-investment perspective do not look like they are continuing in that direction. It looks like a significant adjustment is under way, which leads us, going back to the point that Ms Quinn made, along with developments on the external sector, to a forecast that these current account deficits are a temporary peak. It is not as though we have just dreamed up the idea that we think the current account deficit is declining; we think there are sound economic reasons for coming to that conclusion.

Senator SHERRY—I would like to take you back to two years, Dr Gruen. I am not sure whether you were at that estimates two years ago, but Dr Parkinson was. When we discussed this on that occasion, Dr Parkinson, you talked about the CAD being a cyclical problem in the general context of an increase in the CAD. We are now two years down the track. Do you still believe it is a cyclical problem? The cycle just seems to be increasing each time.

Dr Parkinson—A couple of things have happened. I do still think it is partly a cyclical phenomenon. But I think the world is a little different from when we discussed things then. At that stage, I think what was driving my comments about the cyclicity of it was the sense there was a desynchronisation in growth rates between Australia and the rest of the world. Everything else being equal, constant terms of trade and everything else, that sort of current account would have diminished as the global economy picked up and as the growth rates in Australia vis-a-vis the rest of the world converged. However, at that stage you will also recall that we were anticipating the housing cycle beginning to come off. That carried on longer. As Dr Gruen said, that has added between 1½ per cent and two percentage points to gross national investment. In addition, the terms of trade—and I held this up earlier—accelerated in a way that I think caught us all by surprise.

The consequence of the terms of trade shock is an injection of income into the economy. The consequence of the continuing investment in the housing sector being above trend was to hold up the gap between household saving and investment. I point you to page 6 of our submission to the Senate Economics References Committee public inquiry into 'Possible links between household debt, demand for imported goods and Australia's current account deficit' where this chart highlights the point Dr Gruen has been making. If one looks at what has been happening to the public sector, the public sector is not contributing to the current account deficit. That is in sharp contrast to many previous periods when we have had high current accounts. Interestingly, the private corporates are not contributing—and that is in aggregate—and that is a consequence of high profit levels, in part due to the commodity price boom. But, if you look at households, households are in deficit; the saving-investment gap is in excess of five per cent of GDP. I am just eyeballing these figures. It looks like about 6½ to seven per cent of GDP. In fact, it has to be more than seven per cent. It has to be seven per

cent of GDP, because the other two are both positive. That is where the root cause of the current account deficit is.

Then the question is: how do you respond to this? If you are thinking about what you might do, you can run tighter fiscal policy. We are already running a public sector that is contributing to net lending. You could run tighter fiscal policy, but that means either cutting outlays or increasing taxes on households—that would decrease saving—or you could take, as Senator Murray was alluding to last night, direct measures to try to reduce household investment in the housing sector. That is the bit that is cyclically unusual. But, as we discussed last night, that has very significant consequences around it. We have said all along that when house prices flatten out you will see a reduction in the rate of growth of household consumption relative to household income.

We were talking about balance sheet consolidation of households. That is what we anticipate is occurring now. We think we are beginning to see that. In a sense, that cyclical component continues. Where there has been I think a structural shift—and by ‘structural’ I do not mean permanent in this case but I do mean potentially long-lived—is around the terms of trade, and that is around commodity prices. You mentioned last night that you wanted to go back and talk a bit about a speech I gave in December last year. The whole theme of that speech was directed at the fact that we have potentially seen a very long-lived shift in the relative attractiveness of different activities in the economy. But that means the terms of trade stays high and for some time provides an injection of income into the system that exceeds the rate of growth in GDP.

Saying all of that is not to say that we are indifferent to the current account deficit. If you want to trawl back through past estimates, you will see I have been asked whether I lie awake at night and worry about the current account, and my response has been that I worry about a lot of things.

Senator SHERRY—I am not sure that I have put it in those terms.

Dr Parkinson—I think our good friend Senator Conroy may have.

Senator SHERRY—It sounds like a Conroyism. On the issue of the interest rate level in Australia at the moment compared with those of other OECD economies, do the higher current account deficit and higher levels of foreign debt lead to any element of risk premium in those interest rates compared with those of other countries?

Dr Gruen—If you look at Australia’s real long-term interest rates over the past few years, they look a lot like the long-term real interest rates of the US or Europe. These things go up and down a bit, but there is very little in it.

Senator SHERRY—But over the last few years our level of real interest rates has been higher than comparable countries.

Dr Gruen—It is certainly true that our short-term interest rates have been higher, and that has been largely a consequence of economic success. If you recall, Japan has had zero interest rates for a very long time now because they have been trying to revive their economy from a decade-long slump. The US fell into recession in 2001 and cut their interest rates very quickly in response to that recession, and they have only in the last year or so been raising them back

up to more normal levels, whereas Australia of course avoided any such downturn. We are arguably closer to the economic productive capacity of the US or other countries and, therefore, you would expect to see a level of interest rates that was closer to neutral.

Senator SHERRY—But, going back to the issue of risk premium, are you saying there is no risk premium in the current level of interest rates as a result of the current account deficit and level of foreign debt—none at all?

Dr Gruen—Let us just remind ourselves of the history of this. Australia suffered a couple of downgrades by the major rating agencies in, I think, the 1980s, and then those downgrades were taken away and we were returned to a AAA credit rating. It is always difficult when you are looking at interest rates on Australian dollar liabilities to distinguish between the judgments about the currency that international investors are making and the judgments they are making with respect to risk premium on the country. If you look at the interest rates which the Australian government or Australian corporates can borrow in US dollars, they look very like comparably rated corporates in the United States. In other words, if an Australian corporate goes into the US capital markets to borrow in US dollars, the interest rates that they can raise debt at look very similar to comparably rated US companies. The reason I am making that point—

Senator SHERRY—Just before you go on making that point, they would have to be slightly higher, would they not?

Dr Gruen—There was very little in it the last time I looked. The point about that is that that is an attempt to actually ask the question about whether being an Australian company carries with it any excess risk as a consequence of Australia's particular economic circumstances rather than a judgment about the currency. So I think that is a cleaner way sometimes to try and see if there is a country risk premium associated with being an Australian entity. I must say I have not looked at these data carefully recently, but the last time I did look or at least the last time I talked to people who looked at this stuff carefully they assured me that there was almost nothing in it. In other words, a AAA rated Australian corporate could borrow in US dollars at roughly the same spread to US Treasuries that a US corporate could.

Dr Parkinson—Just to add to this point in relation to risk premia, risk premia can arise from a whole variety of different phenomena. It is true that it is possible they could arise because a country has a large current account deficit. Equally, it could be true that they could arise because a country has a very large fiscal deficit, even if it is not running a high current account, that is, people could fear that the high fiscal deficit portended future tax rises and, hence, a reduction in their future income stream. It could reflect a concern about future political instability. It could reflect concern about any one of a number of things. So it is very hard, as Dr Gruen said, to actually quantify the extent of a risk premium and then to be comfortable about where you might attribute the root cause of that premium.

Senator MURRAY—Dr Parkinson, it seems to me that the markets take a view on the three sectors as follows. They say that federal and state governments are in surplus and, therefore, they can regard them as responsibly managing their activities. The corporate balance sheets are good. They are not overgeared, which they were in the late eighties. And I

think the markets say there is an equity cushion in households, which therefore does not put them at risk. The consequence of those three is that the high current account deficit is therefore discounted. If there is a shift in any of those three, then I would assume the market would assess Australia as being at greater risk. The difficulty with markets is that the change can be quite quick once they take a judgment. I think behind Senator Sherry's questions—and I would like you to pursue that—is a concern that there might be at some stage a re-evaluation of Australia.

Dr Parkinson—I fully understand Senator Sherry's concern. I think it is a perfectly legitimate one—that, to the extent that things change the likelihood of a re-evaluation of Australia, you should be concerned about it. But that is an argument for pursuing a policy mix that takes you towards a medium-term approach to monetary policy that aims to run a responsible fiscal policy and actively pursue structural reforms to improve competitiveness and productivity. But your point is exactly right, which is that were there to be a dramatic change in the positions of any one of those sectors it could trigger a re-evaluation. But that would mean an environment where you have no Commonwealth government debt effectively. It would not be simply the running of a deficit; it would need to be in a sense the complete abandonment of any fiscal discipline. In the case of the household sector, you could imagine people might get concerned were there to be a precipitate decline in house prices—a dramatic decline, a huge decline—that removed the equity cushion.

In the case of the corporates, were they to have gone on a splurge that seriously weakened their balance sheets, then, yes, but none of those things are actually in prospect at the moment. None of that, the fact they are not in prospect, is to belittle in any way either your concern or Senator Sherry's concern. It is a perfectly legitimate concern. I fully agree with you, to the extent that if there is some exogenous shock that leads to a change in the way in which we are viewed it would have potential implications for people's willingness to invest in Australia. At the moment—and I go back to the terms of trade shock—we have no difficulty financing the current account deficit. In fact, in many ways it is the desire of foreigners to invest in Australia that actually drives the current account deficit rather than the current account driving the need for capital inflow.

Senator SHERRY—Dr Parkinson, I understand you had some additional figures in reference to a question from last night.

Dr Parkinson—Yes. We took on notice last night your request and Senator Murray's request that we pull together comparable data across countries on foreign debt by maturity. I just wanted to put on the record that, while we will be doing that work for you, as at March 2005 Australia had foreign debt of around \$690 billion. That is gross foreign debt, not net. So the foreign debt figures would have to be netted off. But, within that gross foreign debt, around about \$300 billion of it would be short term, so around \$400 billion would be long term. But again, going back to the point we are making last night, that is just about the maturity structure of the debt that we have issued. You really need to look at the whole balance sheet position. So you would need to think about what our net exposure was in terms of the short and long terms.

Senator SHERRY—Is that \$300 billion short term less than a year?

Dr Parkinson—Yes, that is less.

Senator SHERRY—Someone may have this figure as well. What is our current foreign exchange reserve situation like?

Dr Gruen—Off the top of my head, of the order of \$20 billion.

Dr Parkinson—\$20 to \$30 billion.

Dr Gruen—Yes, something like that. But do not hold us to that.

Senator SHERRY—I will take it as an approximate order of magnitude.

Dr Parkinson—And in a floating exchange rate environment it has considerably less importance. In fact, one could arguably say it has no importance other than for some testing and smoothing operations.

Dr Gruen—In principle, you could run a floating currency with no international reserves at all. And for a very long time the New Zealanders as a policy decision simply did not intervene in the foreign exchange market, so they might as well not have had any foreign reserves.

Senator SHERRY—But in a circumstance where international money markets decide to react strongly to the current account deficit, given the approximately \$300 billion in short-term borrowings, would that not place significant pressure on those foreign exchange reserves, the \$20 billion, and therefore the currency would drop quickly?

Dr Parkinson—I do not understand why it would affect how foreign holdings of Australian private sector issued debt would impact on the Commonwealth's foreign exchange reserves. The Commonwealth is not in the market providing foreign exchange for people who want to participate. People who want to participate in the market have to find other market participants to trade with.

Senator SHERRY—Of the short-term foreign debt, less than a year, in a circumstance where the money markets make a judgment that those borrowers should be paying more for that debt, when it is rewritten it is obviously rolled over and it would be rolled over at a high cost, would it not, if the money markets make a decision that there should be more paid for it?

Dr Gruen—If they make that decision, then I think that is the outcome.

Senator SHERRY—If they make that decision. What is the impact? Are you saying there is no impact on our foreign exchange reserves in those circumstances?

Dr Gruen—The foreign exchange reserves are held by the Reserve Bank and the Reserve Bank makes decisions about when and whether to intervene in the foreign exchange market. In principle, when they make those decisions they are well aware of the size of the flows in the foreign exchange market and they are well aware of the fact that they have a small stock of foreign exchange reserves, so they behave strategically with those reserves. I think the phrase that the governor has used is that you can think of the reserves as a small stick and their interest rate lever as a big stick. In principle, they use the reserves strategically, but the board determines monetary policy. In principle, exchange rate developments along with a lot of other things go into the determination of interest rates.

Senator SHERRY—In those circumstances, though, where the money markets have made a call that a higher price needs to be paid for that short-term debt, and accepting that the Reserve Bank has a small stick in terms of the foreign exchange reserves, the level to which it could intervene in those circumstances is quite limited, or even whether it would want to intervene.

Dr Gruen—I would take you back again to the situation that Australia faced in the aftermath of the Asian crisis, when the Australian dollar was under considerable downward pressure. That was a situation that obviously needed to be handled very carefully. But the Australian dollar did come down a considerable way. Again, the Australian economy demonstrated its resilience. Despite the dramatic events in the region, capital markets regarded Australia as a safe haven on that occasion. Despite the fact that there was very significant downward pressure on the Australian dollar, Australian bond yields through that period rallied.

Senator SHERRY—I note some comments by Standard and Poor's upon the release of the current account deficit figures. They were reported in the *Australian* as saying that 'the deficit was the biggest risk to Australia's AAA credit rating' and that, in regard to our record foreign debt, 'It is 50 to 60 per cent more than any other country with a AAA credit rating.' What is the view of Treasury on the current credit rating and a higher current account deficit?

Ms Quinn—It is the case that the most recent Standard and Poor's report card for Australia in February 2005 reaffirmed Australia's sovereign rating of AAA. This is the highest rating that Standard and Poor's applies to country debt. It is the case at the moment that Standard and Poor's continues to maintain a AAA credit rating. In the same newspaper article that you have quoted in the *Australian*, there was also a quote from market economists saying that the market cannot get enough of Australia's debt. There are conflicting views about the risk premium or lack of, related to the current account deficit. Standard and Poor's has also mentioned that it is important to note the composition of Australia's current account deficit. The issue in Australia compared with other countries, as has already been mentioned today and last night, is the fiscal positions: the public sector is in net surplus and most of the holdings of the foreign debt are related to the private sector. They note this is a significant implication for their assessment of the financial vulnerability of Australia. And it is positive for Australia.

Senator SHERRY—The concern I have about that theme is that it is almost as though you are saying that household debt does not matter—it is not even part of the equation. There is always the continual emphasis on government debt—there is not any, or virtually none—and household debt is almost something that is beyond any sort of influence by government; it is separate and of no consequence. But it is still part of the Australian economy.

Dr Parkinson—We have not set out to leave you with that view. I fully understand that our role here is to answer the questions, not ask the questions, but I would say that if you were concerned I think the question is: what do you think you could do about it? I think there are two issues. Firstly, should we be concerned? We have said numerous times that it is an issue that needs to be watched, that to the extent that people decide that Australia needs to be re-rated for some reason then obviously that would have implications. The question, though, in

my mind is: if you are concerned about the current account deficit, why are you concerned and what do you think you could do about it?

Senator SHERRY—Exactly, and that leads to a discussion about a whole range of policy responses in other areas outside Treasury, or its direct responsibility anyway.

Dr Parkinson—I am struggling to think about what any of those could be.

Senator SHERRY—There is a whole range of issues—savings issues, training issues, infrastructure issues.

Dr Parkinson—The training infrastructure issues are all about—I assume you are back to talking about what we were discussing last night—the need to improve international competitiveness.

Senator SHERRY—Yes.

Dr Parkinson—But you want to do that on a no-regrets basis. You should not be doing that just because you think you have a current account deficit. That is actually an important thing to be pursuing at all times.

Senator SHERRY—That is right. But the policy responses and whether the current policy responses are adequate is much more of a political debate—I know Treasury has an interest in everything—and a direct discussion about issues relating to infrastructure, education and training and a whole range of other social welfare issues. That is outside our remit and I am not going to go to that here.

Dr Parkinson—The timing is such that, were you to decide that from today, for example, you wanted to launch a whole new wave of structural reforms aimed at enhancing international competitiveness over and above what is already in train, it would take a very long time before you began to see the impact of those. So those are things that you do not do in response to a current account deficit. You want to do those things for other reasons.

Dr Gruen—Just to highlight the point that Dr Parkinson is making—and this harks back to a debate that was had in the early nineties—there are all sorts of structural reforms which you might well want to do on a no-regrets basis that might well stimulate private investment in the process and the current account could easily get larger. There was a debate started by Peter Forsyth from Monash University, who made the point when the case was being made for micro-economic reform that you would not want to make that case on what it would do for the current account because it might well make the current account deficit larger in the transition period. I think that just goes back to what Dr Parkinson was saying, which is that you do these things for wider reasons because you think they are going to enhance the wellbeing of the Australian people, because you think they are going to raise productivity, not because you think they are going to do something for the current account.

Senator MURRAY—I do not want to return to the discussion of last night, but it comes back to that issue of examining those policies that contribute to consumption in the household sector, which increases risk in the national sense—and we can debate what those are. But that was part of the debate last night. All of this is an assessment of risk—excessive, speculative or risky consumption that increases our risk of international market reappraisal. We have to

watch those policies that contribute to it, which is the nub of what we were discussing last night.

Dr Gruen—Yes.

Dr Parkinson—We have no disagreement with either you or Senator Sherry on the importance of watching all of those things. I fear that at times we might be in violent agreement about the need to focus on these issues.

Senator SHERRY—Yes, and there will be a political debate about whether the current government has focused on those issues to the degree required over the last 10 years. But that is a political debate to take place elsewhere.

Senator SHERRY—The net income component of Australia's current account deficit has been fairly stable. In 2001-02 it was about 2.7 per cent of GDP, but the March quarter shows it has increased significantly to 3.6 per cent. Why is that happening?

Ms Quinn—In recent quarters the net income deficit has increased. A large proportion of that increase has been related to profits being made to foreign entities, or profits earned in Australia by companies that are operated overseas. Payments go overseas in dividends and interest rates, but also if an entity owns more than 10 per cent of an Australian company any profits that continue to be held in Australia are measured in the net income deficit component as if they had gone over and come back.

Senator SHERRY—Is that in part a consequence of increasing foreign ownership?

Ms Quinn—I am not sure it is an increase in foreign ownership. It is reflected in the proportion of Australian companies that are foreign owned, but I am not aware of a significant increase in foreign ownership being the reason—certainly not the reason in the last few quarters. It is more a reflection of the strong profits in Australia, and that being relative to overseas profits and the amount of money being sent overseas rather than coming in—

Senator SHERRY—Do we know what the levels of foreign ownership are in Australia at the moment, say, compared with 10 or 20 years ago?

Ms Quinn—I am not aware of that comparison.

Senator SHERRY—The assumption is that it must have gone up, but I have not seen any recent figures.

Dr Parkinson—One would hope it had gone up.

Ms Quinn—It has certainly gone up in certain sectors that have been open to foreign investment, in the banking sector, for instance.

Mr Downes—There has been a worldwide phenomenon in that there was a huge amount of mergers and acquisition activity through the 1990s and, while investment in Australia has gone up, our investment overseas has gone up in proportion. BHP Billiton and companies like it are very diversified now.

Senator SHERRY—I accept that, but in terms of the issue of the net income component and the flow of dividends out of Australia—I accept the issue of the higher profit level—to some extent that must reflect increasing levels of foreign ownership.

Dr Parkinson—Or the profitability of firms that have foreign ownership.

Senator SHERRY—Yes.

Dr Parkinson—You have got in the mining sector, for example, reasonably high levels of foreign ownership, even in Australian domiciled firms. We get the terms of trade effect flowing through in the firm's profits, but even if it is reinvested in Australia—that is, it never leaves Australia—it shows up in the net income deficit. It is just an accounting phenomena in order to attribute income out to the appropriate owners.

Ms Quinn—Certainly for the December quarter the significant increase was reinvested earnings. It is money that did not actually leave Australia but is still being held here, and some proportion of that will be used to employ and invest in Australia.

Mr Downes—There is a diversification of the income streams. In terms of risk, it means that if our terms of trade fall—say, mining profits fall—then we have diversified into other overseas assets. So the income deficit in that situation might turn around.

Senator SHERRY—What is the current flow of dividends and the like into Australia versus the outflow?

Dr Parkinson—I do not know that we have the data in front of us. We can readily pull that out for you. It is publicly available. I am just not sure that any of us have that level of detail in front of us.

Senator SHERRY—Again, I would be interested in some sort of historical comparison for 5, 10 or 15 years back.

Dr Parkinson—We can go back and, in taking that one on notice, put together historical series showing foreign direct investment into Australia, foreign direct investment out of Australia and the portfolio components, and then the dividend flows as well. All of that data is available in the ABS's international investment releases.

Ms Quinn—And the balance of payments releases.

Senator SHERRY—Of the capital inflows coming into Australia, does Treasury have any data on the proportion that has flowed into financing the housing boom primarily through mortgage backed securities?

Dr Parkinson—Mortgage backed securities are issued after the mortgage is issued. They are mortgages that are then bundled together and sold off. In terms of the housing boom being fuelled—you did not use those words, but in terms of the causality—it is not the existence of mortgage backed securities that has driven an increased provision of mortgages. That is simply the way in which the mortgages have been bundled and then the risks have been diversified. We would not have data here, but I am sure some exists. Can we take that on notice?

Senator SHERRY—Yes. Overseas capital is flowing in to provide some financial underpinning of housing finance, whatever that level is, and it must be some level. Does Treasury regard capital inflows for housing investments as productive investment?

Dr Parkinson—I think it is important to keep in mind that capital is fungible. By that it means that it does not matter what it flows in for. One of the consequences can be that it adds

to the total pool of capital. If you think of it as a lake, the foreign capital is a river flowing in on one side and there are a series of rivers flowing out on the other side, one of which might be housing. But you cannot actually attribute what is happening in housing to the foreign capital inflow. A better way to think about it is the way we were talking about before, which is to say that the housing boom has been manifest by the fact that household investment is around 1.5 to two percentage points of GDP higher than its long-term trend. That has to have been funded out of the pool of capital available in Australia for all activities, and part of that pool of capital will be foreign sourced.

Senator SHERRY—Presumably that foreign sourced capital has gone into funding, to some extent at least, higher housing prices?

Dr Parkinson—Whether it is foreign or domestic capital, with a relatively fixed or slowly moving supply of assets and an increased demand, price rises. As we discussed last night, there are good reasons for prices to rise anyway in an environment where inflation and interest rates come down. You made a comment about whether some types of capital are unproductive. I might not get my economic history right, but I think it was in 1973 that we introduced the statutory reserve deposit ratios on foreign capital inflows. At the time the government was concerned that foreign capital inflows were stimulating the economy so it imposed what was effectively a tax by requiring a certain proportion of foreign inflows to be put on deposit. The experience in Australia was very similar to the experience in many other countries: that is a form of capital control, and capital controls can be got around and they are very blunt instruments. Because capital is fungible, putting on controls like that does not actually help you address a concern—if you are worried about excessive investment in the housing sector, for example. So putting it in terms of whether foreign capital is unproductive or domestic capital is unproductive does not help us get to grips with the issue.

Senator MURRAY—You are saying it is better to affect demand than supply, which gets you into behaviour.

Dr Parkinson—I think it is very hard to. The experience of capital controls all over the world is that the longer they are in place the more people are able to circumvent them. Going back to the discussion we were having about China last night, one of the challenges for the Chinese is to fix their banking system while they have capital controls that still have some degree of effectiveness. Otherwise they are going to be faced with the impossible trinity—you cannot have an open capital account, a fixed exchange rate and attempt to run an independent monetary policy. They need an independent monetary policy for their own domestic reasons. They clearly need, over time, greater exchange rate flexibility. They have very few capital controls on inward flows but the capital controls on outward flows will increasingly become untenable. That has been the case in every country that we have looked at around the world.

Senator SHERRY—You held up a graph earlier about the terms of trade. How robust do you believe the forecasts in the budget are on the terms of trade?

Ms Quinn—The terms of trade is the ratio of export prices to import prices. On the export price side, one of the reasons export prices are expected to increase or have increased significantly in the recent period is because of contract prices for our bulk commodities—iron ore and coal—whose prices are typically set each year at the start of the Japanese fiscal year

on 1 April for the entire year. Those prices—120 per cent increase for metallurgical coal and 70 per cent increase for iron ore—are fixed for 12 months. We have a very modest assumption for other commodity prices so we feel reasonably confident on the export price side.

The import price side is a function of world prices. We have made an assumption and examined the influences on the world prices of the goods that we import. There has been a downward trend in the prices of the commodities we import, reflecting ongoing productivity improvements in the countries that produce these goods. We also feel fairly confident on those import price assumptions.

The important thing to remember is that the forecasts in the budget are predicated on a technical assumption that the exchange rates remain constant. Obviously, if the exchange rate was to move then the Australian price of exports and the Australian price of imports would change. As noted in budget statement No. 3, in a box where we examine this issue, even if the exchange rate were to move the impact of those increases in export prices would still flow through to the Australian public. At the moment the increase in commodity prices goes into company profits and then back through investment into employment and stock market increases affecting people holding shares. But if the Australian dollar were to rise in response to high commodity prices then consumers would benefit from falling import prices. Even if the exchange rate were to move it is still not clear that the terms of trade would be thrown off balance.

Senator SHERRY—There has been quite a bit of reference to those booming prices in coal and iron ore. What proportion of our total exports do coal and iron ore represent?

Ms Quinn—Roughly six per cent for coal and slightly less for iron ore.

Senator SHERRY—That is based on current export levels and prices?

Ms Quinn—Yes. It is obviously going to move when we get the new prices. That is not based on the latest historical information.

Senator SHERRY—Presumably, on the basis of your observation, the total export prices paid for coal and iron ore would go up as a proportion of exports, other things being equal.

Ms Quinn—That is right. The nominal share, of our exports, of coal and iron ore will rise in 2005-06 relative to in recent years.

Dr Parkinson—In addition, not only will the price effect mean that they will become more important, but the significant investment that has gone on in the last couple of years to increase production and transport capacity means that you will get a significant volume increase as well. So you will get the interaction of the two contributing to a rise in the share of total export values coming from coal and iron ore.

Senator SHERRY—I just want to have a look at non iron ore and coal exports. This is in the context of my comment about other things being equal. Has Treasury conducted research in recent times on the outlook for exports of the manufacturing sector?

Dr Parkinson—As you know, I gave a speech on the issue on 14 December last year at the Australian Business Economists Forecasting Conference which talked a little bit about the outlook for the manufacturing sector. So, yes, we have done work on this issue.

Senator SHERRY—Have you actually prepared a document on this? I am going to get to the speech in a minute; I am aware of it and I have a couple of extracts here I want to question you about. You have done research. What is the status of the research? Is there a document?

Dr Parkinson—There have been internal working documents and internal analysis.

Senator SHERRY—But that has not been published?

Dr Parkinson—We have not published anything other than what was referenced in my speech and to the extent that we said anything in the submission to the Senate inquiry.

Ms Quinn—And the reference in the budget statements.

Senator SHERRY—There are references, but have the research documents on this issue been referred to the Treasurer's office?

Dr Parkinson—We provide lots of material to the Treasurer's office and, yes, we have provided that material to the Treasurer's office.

Senator SHERRY—So the Treasurer's office has chosen not to publish it. I have not sighted it—that is all.

Dr Parkinson—No material has been sighted, but the working documents have been provided to the Treasurer's office.

Senator SHERRY—Could we go to that speech. I think it was given on 14 December at the ABE Forecasting Conference. On page 17 of the speech you note:

Developments in China, India and elsewhere also appear to be generating a significant, and potentially long-lived, shift in Australia's comparative advantage, in favour of resource exports and away from manufactured exports.

Can you explain what you mean by that statement?

Dr Parkinson—At its simplest, the global terms of trade increase caused by the growth in China and, to a lesser extent, India has basically been raising—at least for quite a long period—the price of resource exports. Given that there has been a broadly proximate relationship between movements in the terms of trade and the Australian exchange rate, that is suggestive that the exchange rate will remain higher than otherwise, and that therefore makes it harder for manufacturing exporters—everything else being equal—to export. Why? Because of a number of factors. The growth of China not only boosts demand for resource exports and pushes up the exchange rate but also manifests in increased competition for Australian manufacturers. If you look at something called an export similarity index, which attempts to say to what extent China's exports are like Australia's, you see that the export similarity index has increased over time. That means both that China is a more direct competitor to Australian manufacturers in some areas that it was, say, a decade ago and that its emergence is also putting pressure on resources, so there will be a set of incentives for Australian capital to be redirected towards resource exports rather than manufactured exports.

Senator SHERRY—So an increasing shift towards lower value adding and away from higher value adding?

Dr Parkinson—That is a presumption that manufacturing is necessarily high value adding.

Senator SHERRY—You do not think that is a reasonable presumption?

Dr Parkinson—There are simply transformed manufactures and there are elaborately transformed manufactures.

Senator SHERRY—Yes. But I cannot imagine much more simply transformed items than iron ore and coal. They are mined and cleaned, but not much more is done in Australia.

Dr Parkinson—Yes. But if you take bauxite and turn it into alumina, I will stand corrected but I think that would probably classify as STMs—simply transformed manufactures.

Senator SHERRY—I accept that. But the primary emphasis on export has been on iron ore and coal—we have heard that a number of times, not just here but over and over again in the political rhetoric outside these estimates—but they do not even reach the status of ‘simply transformed’.

Dr Parkinson—That is right. It is the same as tapping gas off the North West Shelf and exporting it directly.

Senator SHERRY—Based on the earlier comments about the income we earn, given the current price levels and contracts and increasing proportion of resources as our exports, we are becoming more reliant on resources in terms of our exports vis-a-vis manufacturing. That is a general observation.

Dr Parkinson—That is exactly right. As noted in the speech, the rise in world resource prices has contributed to the Australian dollar rising in real trade weighted terms by about 15 per cent over its average for the last five years. That has directly reduced the competitiveness of manufacturers. But, while we do not anticipate that resource prices will necessarily stay where they are indefinitely, I think it is pretty unambiguous that, everything else being equal, this development is going to make it harder for manufacturers to compete.

Senator SHERRY—That was my next point. If prices do not remain where they are and at some point in time they drop off—whatever that drop-off is—it is not necessarily going to be the case that the manufacturing sector, depending on what is left of the manufacturing sector, is going to pick up that loss in export income, is it? It does not automatically happen.

Dr Parkinson—That is true. It depends a lot on the behaviour of the manufacturers themselves. You can think very broadly of three types of manufacturers: those that have a dedicated export capacity, those that are opportunistic exporters and those that do not export at all. The opportunistic exporters are those that tend to have the capacity to divert their production from domestic to international markets or back to domestic markets, depending on where it is most profitable for them. The dedicated exporters obviously have a clear focus and are directly going to be affected, perhaps permanently, by changes in the real exchange rate.

Senator SHERRY—Why do you say ‘perhaps permanently’?

Dr Parkinson—It depends on the extent to which they are able to pursue improvements in things that make them more competitive, either because they have a design advantage or because they pursue productivity improvements that allow them to maintain their competitiveness as an individual firm even though the manufacturing sector as a whole may be less competitive.

Senator SHERRY—To the extent they cease to exist simply because they are no longer competitive despite whatever actions they take, it is not a simple process of re-establishment to take advantage of whatever the new export opportunities are as a consequence.

Dr Parkinson—That is exactly right. That is the sort of beachhead phenomenon too—that is, if you are one of these opportunistic exporters who tend to produce a fairly homogenous type of product, you can dip in and out of the market quite easily; but if you are producing a relatively specialised product or you have a relatively unique brand that you want to run with, if you pull out of a market then you generally experience quite significant entry costs when you go back in.

Dr Gruen—One of the advantages of having a flexible economy is that you can respond to changing comparative advantage. In a world where things happen that are not anticipated, like a huge increase in demand for some of the things you make which was largely unanticipated by everyone, you are going to benefit most if you are in a position to respond to that. But it will have implications for other parts of the economy, and to the extent that your economy is flexible and it is possible for factors of production to move from one sector to another you are going to do better than otherwise. That is going to mean that there are going to be times when some sectors are hurt. But, in principle, while it is true that there may be some manufacturing companies that will not be in a position to go on producing what they have been producing, if conditions improve for the manufacturing sectors you can have the birth of new firms. This is actually a success story, although there will clearly be parts of the economy which will not do so well out of these huge rises in Australia's terms of trade.

Senator SHERRY—But, conversely, if there is a significant fall-off in those prices we have been talking about that has an element of risk to it.

Dr Gruen—True. We were aware of the unusual nature of these very big increases in prices and so, whereas it is usually the case in the projection years in the budget that we assume a continuation of long-term trends, we have actually built into the projections the expectation that you will see declines in these prices. So we have built in slower growth in nominal GDP in the first two projection years than we would otherwise do for precisely the reason that you are talking about.

Dr Parkinson—The extent to which Australian firms disappear is one issue. The second issue though, as Dr Gruen said, is that Australian firms get born, and one of the interesting things is the birth and growth of firms and also the way in which, since we started opening up the economy, firms have become more interested in exporting. But there is another point that is not often remarked upon. A lot of Australian firms are manufacturers in many other countries. That is, they may manufacture part of their product, the things they sell, in Australia but they may also manufacture other parts elsewhere and import those back into Australia. So it is not clear that firms are necessarily under threat. They may shift their production base, and that may have implications for employment in particular geographic areas or particular industry subsectors, but to the extent that they are successful in that industry they are still generating income and profits and that keeps flowing back into the economy. It is true that you might no longer have people employed in producing woollen blankets, for example, in country Victoria but you may actually have higher living standards for everyone and those people are working in other parts of the economy.

Senator SHERRY—On page 17 of the speech, Dr Parkinson, you noted:

Disaggregated data suggest that manufactured export growth has been gradually slowing for quite some time.

Dr Parkinson—Senator, you have a different version of the speech. It is page 21 for us.

Senator SHERRY—Can I confirm that the data in this area shows that between the periods 1985-86 and 1993-04, 27 of 35 categories of manufactured exports were experiencing rapid growth, which is defined as in excess of 10 per cent per annum. During that period only one of 35 was in decline, defined as subzero. Can I confirm that the data also shows that between 2000-01 and 2003-04 only six of 35 categories of manufactured exports were experiencing rapid growth and almost half, or 17 of the 35 categories, were in decline?

Dr Parkinson—That is exactly right. That is chart 14 on page 22 of the version of the speech that is available on the Treasury web site. Let me add to that, though, that the speech then goes on and muses about what might be behind this. It notes:

One possibility is that manufacturers have been diverting sales away from export markets towards the booming domestic market.

It goes on to say:

If this were the case, export to output ratios in manufacturing sectors would be expected to stabilise or fall.

That is, output would still be growing. Then attachment 1 of this speech actually shows that the export to output ratios have actually stabilised over the first part of this decade. There are other reasons why that might be the case. Double-digit growth is in fact much easier off a very low base—that is, when you are a minuscule player in the global market—but once you are a bigger player it is much harder to maintain those sorts of double-digit growth rates. The other two factors are the ones we talked about earlier: the rise in direct competition from China to Australian manufactures and the exchange rate effect associated with the relative price shift towards resources from manufactures.

This is one of the quite interesting phenomena that are taking place here. If we think about it, in the past it has been the resource producers that have had no pricing power and the manufacturing producers that have had pricing power. One of the things about the emergence of China and, to a lesser extent, India is that in fact manufacturing has lost its pricing power while resource producers and service exporters have global pricing power. Service producers are predominantly developed countries—and we are one of them, but we also have the advantage that we are a major resource exporter. In a sense, the cards used to be held by those countries that were producers of manufactures but now manufactures are the new commodity and resource suppliers have market power in a way that historically they have not had.

Senator SHERRY—To conclude in this area, concerning the reference to 17 out of 35, what are those 17 categories that are in decline? I am sure that you do not have the full list, but what was the reference to?

Dr Parkinson—I do not have the full list, but it is very simple to get it. We will happily take that on notice.

Senator SHERRY—I note from the national account data it shows GDP growth of 0.7 per cent in the first quarter and 1.9 per cent in the year to the first quarter. Can I confirm that the increase in GDP in the first quarter could be entirely accounted for by a build-up in private inventories which, as the release notes say, contributed to 1.2 percentage points?

Ms Quinn—It is true that the contributions to growth in the March quarter from inventories was 1.2. Household consumption contributed 0.5 percentage points to GDP as well. So it was a combination of stocks and consumption with detractions from business investment and public final demand. Dwelling investment was flat. Net exports in aggregate detracted 0.3 percentage points from growth.

Senator SHERRY—What explains the build-up in inventory?

Ms Quinn—Our information is that it was largely in the wholesale sector and largely in machinery and equipment. The particular components that were mentioned were computers and cars. A large number of these are imported, so you can see that there was a significant increase in imports in the quarter and it appears that a large number of these have gone into stock building to be bought in a future period.

Senator SHERRY—Business investment fell by 2.6 per cent in the first quarter and 3.4 per cent over the year and that detracted 0.4 per cent to GDP growth. What is the reason for that decline?

Ms Quinn—The decline in business investment reflected a decline in machinery and equipment investment. That was partly coming off a very high growth rate in the December quarter. Some of that was related to planes. There were a large number of planes that were imported and went into investment in the December quarter which did not occur in the March quarter.

Senator SHERRY—Exports rose by 2.7 per cent over the year to the first quarter, while imports grew by 10 per cent over the same period. What is the explanation for that continued differential performance?

Ms Quinn—Exports grew, as you said, by 2.7 per cent over the year. Rural exports fell six per cent over the year, and that is reflecting the lower cereal crop last year relative to the year before. Non-rural goods exports rose two per cent. We have seen an increase in exports in many of the categories. As noted earlier, iron ore and coal exports grew 17 per cent through the year. Some of the other exports were weaker than expected. Imports grew strongly, reflecting strong growth in domestic investment and consumption over the course of the year.

Senator SHERRY—On page 10 ABS notes:

... average compensation per employee increased by 1.3%. This follows growth of 0.7% and 1.0% in the previous two quarters.

What accounts for the acceleration in compensation per employee in that last quarter?

Ms Quinn—I do not have the breakdown. It partly reflects the increase in wages more generally that occurred in the March quarter in terms of the wage price index. However, average non-farm compensation per employee is 3.5 per cent over the course of the year, so part of the increase reflects weakness in previous quarters—3.5 per cent is still weaker than other measures of wages or earnings in other ABS publications.

Senator SHERRY—But what accounts for that acceleration in compensation over that quarter? What are the factors that lie behind it?

Ms Quinn—I do not have a breakdown as to the different components of compensation, whether it be wages or other components.

Senator SHERRY—If it is wages, what accounts for that increase in wages? It must be largely wages.

Ms Quinn—Wages or other measures of compensation.

Senator SHERRY—Yes.

Ms Quinn—Wages have increased recently, reflecting the record unemployment rate, being at a 28-year low, although 3.5 per cent through the year is still a very modest increase in compensation per employee historically.

Senator SHERRY—And the issue we had so much discussion about, skill shortages in some sectors?

Ms Quinn—We have information that there are skill shortages in particular sectors and particular occupations and particular geographic locations but not widespread skill shortages. It is evident that there has been a significant increase in employment over the last 12 months, so employers have not found it in aggregate difficult to employ people, although they are finding it more difficult now compared to previous periods when the unemployment rate was high.

Dr Parkinson—Ms Quinn made the point that average non-farm compensation per employee, which grew by 3½ per cent over the year, is growing at a rate slower than the wage price index. The thing that is worth noting, when thinking about national accounts as against that price index, is that the national accounts are subject to compositional variation. If you have got 10 employees all earning \$10, the average compensation is \$10. But if you then go and add one more employee and that person is earning \$100, you will get a dramatic change in the average. Equally, if you have five employees earning \$5, five employees earning \$10 and one of the \$5 employees moves to \$10, that will also change the average even though the wages for individual skills or individual industries may not change. The wage price index corrects for that. It is a fixed weight. It is a fixed basket.

Senator SHERRY—Last night we touched on the household savings ratio. On page 10 it is given as negative 3.3 per cent, which continues the experience of the last two years at that level albeit a stabilisation, which I think was your reference. Does Treasury have any forecasts or projections on the household savings ratio?

Ms Quinn—We look at different measures of savings when we look at our forecast, just as we look at income, consumption and savings as a residual between those. As mentioned, we are expecting consumption to grow more slowly than income, so we are expecting the savings ratio and different measures of savings to improve modestly over the forecast period. It is very difficult to do a detailed forecast of the savings ratio as produced by the ABS because of the issues mentioned yesterday about depreciation of housing. There are many components that go into household income that are very difficult to forecast in isolation.

Senator SHERRY—When you say ‘improve modestly’, does that mean it will still be negative?

Dr Parkinson—Can I go back to the discussion we had last night? There are numerous ways to measure saving, and the household savings ratio in the national accounts is designed for the national accounts and is not necessarily the best measure of true saving in the economy from the perspective of individuals. Indeed, the bureau is now producing a separate measure called the net national savings ratio which in the March quarter was 4.1 per cent in seasonally adjusted terms. So that is positive, whereas the other one is negative.

Senator SHERRY—I understand that.

Dr Parkinson—Going back to my point from last night, we should not get too hung up on whether one is positive or negative; the interesting thing is the trend.

Senator SHERRY—But this is the one I am asking about. It has been in the ABS data for some time, and that is the one I am asking about.

Dr Parkinson—Yes, and, as I indicated last night, it is subject to revision, so all we can do at any point in time is to make forecasts around particular aspects of the economy. Things drop out.

Senator SHERRY—And all we can do at any one time is ask about the published figures and assume that they are accurate at this point in time, and they may or may not be revised.

Dr Parkinson—And all I am trying to do is to ensure that we have a discussion about something which we will all be comfortable about in terms of the credibility.

Senator SHERRY—Sure, and at least to some extent I am trying to ensure we have a discussion about the things I actually ask about, in this area particularly. Anyway, that concludes my questions.

Proceedings suspended from 10.42 am to 11.02 am

ACTING CHAIR—Order! The hearings of the committee will resume.

Senator SHERRY—There are two issues that I want to touch on: firstly, budget policy advice and coordination. On the revenue side, could you briefly explain whether there are regular revenue reports given to government on actual revenue being collected versus the budgeted revenue?

Mr Tune—It is probably best to ask the revenue group people about that. There are regular updates on the budget given to the Treasurer on a fairly ad hoc basis. At certain points in the year we do that and they would incorporate revenue.

Senator SHERRY—In terms of budget policy, if we just deal with revenue and expenditure, in the budget preparation in the lead-up to the finalisation of the budget are their regular reports flowing to the budget group from both the expenditure side and revenue?

Mr Tune—Yes, we do an update for the Treasurer prior to commencement of ERC, which is usually early March or something like that, and as we go through that budget period we are trying to keep a handle on both the expenditure side and the revenue side of budget.

Senator SHERRY—So you are receiving data from both the revenue side and expenditure side—presumably expenditure of finance.

Mr Tune—That is correct, yes.

Senator SHERRY—And each department is putting in program expenditure—

Mr Tune—They will enter data into AIMS, which is the finance system for monitoring expenditure. That then comes across to us and we try to keep a handle on that to the best of our ability. Our revenue people are obviously doing that material—

Senator SHERRY—So you have both sets of data coming in. There is a matching process on to the Treasurer?

Mr Tune—Not constantly but at various points along the way.

Senator SHERRY—When you say ‘various points along the way’, are you talking about weekly, fortnightly—

Mr Tune—In that last couple of weeks we would try and keep a handle on all decisions that are being made, for example, going through ERC both on the spending side and revenue side. We are trying to keep a fairly constant update on the position taking account of policy decisions as they are being made.

Senator SHERRY—So that inflow of information on expenditure and revenue is showing actual expenditure and actual revenue against the budgeted expenditure and revenue for the current financial year?

Mr Tune—We are focusing more on the out years: the forthcoming budget year and the forward estimate years.

Senator SHERRY—And then the impact further down the line?

Mr Tune—That is correct.

Senator SHERRY—That is a constant flow through to the Treasurer. It might be weekly; it might be daily?

Mr Tune—It is not daily, no.

Senator SHERRY—But it is constant?

Mr Tune—Through that budget period, yes. We are trying to keep a handle. But I should emphasise that it is about the future budget, not so much about—

Senator SHERRY—And you are inputting decisions that have been made at ERC, constantly updating that data and flowing it through?

Mr Tune—That is correct.

Senator SHERRY—Would the minister for finance not receive that cross-flow of information? He is obviously receiving it on the expenditure side. Does he receive the same revenue and matching data?

Mr Tune—The information that we have we provide to the Treasurer. What happens then, I cannot tell you. I do not know, quite frankly.

Senator SHERRY—Okay. So Treasury and your area do not cc it to the minister for finance?

Mr Tune—No, nor to the department of finance.

Senator SHERRY—So if it is cc'd, that is a flow via the Treasurer's office, not from Treasury itself.

Mr Tune—That is correct.

Senator SHERRY—Does that information flow through to the Prime Minister's office?

Mr Tune—Once again, I think that is a decision for the Treasurer to make.

Senator SHERRY—But it is not a direct flow?

Mr Tune—No, we do not provide the information to the department, for example.

Senator SHERRY—The only other issue I want to ask about is in the context of the financial system's superannuation choice, and competition and consumer issues.

Mr Tune—That is probably an issue for the markets group rather than us.

Senator SHERRY—Yes. Are they here?

Mr Tune—Is that it?

Senator SHERRY—That is all from me.

[11.08 am]

ACTING CHAIR—We now move to outcome 3, Well functioning markets.

Senator SHERRY—I have a couple of questions about markets, consumer policy advice and competition in the context of choice of superannuation funds. You are obviously aware of the policy of choice of superannuation funds?

Mr Murphy—Yes.

Senator SHERRY—The starting date is 1 July. Part of the consumer advice is the provision of what are called PDS: product disclosure statements. Are you aware that there has been considerable controversy around the size, complexity and difficulty of the PDSs to be provided to consumers?

Mr Murphy—Yes.

Senator SHERRY—Are you aware that there has been a revision—it has been termed 'enhancement'—of the provisions for PDSs?

Mr Murphy—The paper, termed 'refinements', released by the parliamentary secretary, Mr Pearce, was prepared for him by my group.

Senator SHERRY—What is the concluding date for the consultations on that paper?

Mr Murphy—I do not have the paper here. It is usually a three-month period for consultation.

Senator SHERRY—Then there will be some period of time before there is regulatory change—whatever that may be.

Mr Murphy—It depends. One of the strategies underlying the paper was to try to bring about an improvement in the financial services regulatory regime, without having to go back into the parliament to amend the law. So one of the strategies is to try to do things once there is agreement.

Senator SHERRY—One of the objectives is a more simplified PDS regime?

Mr Murphy—The objective is to give greater guidance to people preparing PDSs so that they can meet the policy objectives of the financial services regime. Notwithstanding that there was a long gestation period and a long run-in period—there was a two-year run-in period—after the legislation was passed, we feel that it has not been interpreted as successfully as we would have liked.

Senator SHERRY—In other words, it is not as consumer-friendly as you would like?

Mr Murphy—That is one aspect of it. There are a number of reasons. It has not been as helpful to consumers as we would have liked. And it has been a burden on business, which we think is unwarranted.

Senator SHERRY—But, as far as consumers are concerned—and I suppose indirectly business—it is highly unlikely that new PDSs will be produced prior to 1 July, given the timetable? If the intention is to simplify the PDS regime and remove a level of complexity from business, how do the PDSs that have already been written—I have a high stack of them in my office—get rewritten by 1 July?

Mr Murphy—Some may be and some will not be.

Senator SHERRY—How will they be rewritten, given the timetable?

Mr Murphy—It depends on when the PDS is issued by the issuing company. The policy document that has been put out is putting forward a position of where the government thinks these things should be going. The current law is that a disclosure document is required. To some extent consumers are in a much better position than they would have been two or three years ago in terms of the new regulatory regime. There is no mistake about that. Some of the documentation is excessive but, that said, people are getting all the information they need to get to make an informed investment decision.

Senator SHERRY—If they read and understand it. Have you seen some of these PDSs?

Mr Murphy—Yes, I have looked at them.

Senator SHERRY—So have I.

Mr Murphy—I get them on my insurance renewal and all that, and to some extent they are not as bad as they are painted. Some are useful documents if you have the time—

Senator SHERRY—Exactly.

Mr Murphy—The reason that it is not as black and white as it would suggest is that many people want this information. In a PDS, it is more information; it is not incorrect information.

Senator SHERRY—Yes. Have you had the PDSs that are still out there road tested with consumer focus groups to find out to what extent they are read and understood?

Mr Murphy—We have had lengthy consultation with consumer groups on whether these things are being understood. One of the problems is that a lot of well-intentioned people feel the more information the better. That is the underlying problem with the whole area. I know that we might say it is too voluminous and possibly excessive, but a lot of people would say, ‘We’d prefer to have more information than less.’

Senator SHERRY—What is the response of the focus groups that I asked about.

Mr Murphy—I cannot speak for the focus groups. I would have to check on that.

Mr Rawstron—I understand that ASIC has been dealing with focus groups and looking at PDS issues. It is not a job that Treasury has undertaken. We see our role as designing the policy architecture, and ASIC has a key role in giving advice to the market about what the obligations of the PDS regime mean. ASIC has worked on developing model PDSs; it has consulted extensively with the market. The unfortunate development in respect of the financial services legislation is that a lot of industry is it is a compliance management tool. It has tried to address all possible risks in the document.

Senator SHERRY—I know all this. But I am particularly concerned that when you design this architecture, which is your responsibility, it is constructed—to use the comparison with architecture—such that people can find their way out of it.

Mr Murphy—As I said, a lot of people feel the more information the better. I suppose the underlying—

Senator SHERRY—You have said that. Where is your focus-group research to prove your assertion? Do you have any?

Mr Murphy—I do not.

Senator SHERRY—It is not a question to you personally but to the designer of the architecture: you and your division. Where is the focus-group research?

Mr Murphy—We have had numerous submissions in the long gestation period of the development of the financial services regulations.

Senator SHERRY—I did not ask about submissions.

Mr Murphy—As Mr Rawstron responded, ASIC looks at—

Senator SHERRY—Is there or is there not—

ACTING CHAIR—Senator Sherry, allow the witness to finish his answer.

Senator SHERRY—But he is not answering the question. Let us understand again what the question is: is there or is there not, in the design of this architecture, recent focus group research conducted in Treasury—in your divisions, under your auspices—on these PDSs? Yes or no? Is there or is there not? If there is not, tell me.

Mr Murphy—No.

Senator SHERRY—Is it true that it is unlikely that the revised PDSs—presumably simplified, less voluminous or whatever—that flow as a consequence of the enhancements are likely to be prepared in time for the 1 July start-up of super choice?

Mr Murphy—Some institutions may decide to provide new PDSs and some may not.

Senator SHERRY—The total fees data charged by corporate, public sector, industry and retail funds, at least at the individual firm or fund level, is readily available—after APRA’s evidence we now know it is not available in aggregate, at least for retail funds. In terms of a competitive market is it desirable that we have specific fees information in respect of small superannuation funds and RSAs? We do not have it.

Mr Murphy—The question of superannuation fees and charges is being addressed in various areas. Which are the ones that you feel—

Senator SHERRY—Where is the fee disclosure and aggregate data on small superannuation funds, which is a very significant section of the market, so that a consumer can make a comparison between that option—if they choose to take that option in respect of super choice—and other options? I submit to you that we do not have it.

Mr Murphy—I would have to check on that.

Senator SHERRY—Do you think it is desirable that information is available for consumers?

Mr Murphy—Do you mean self-managed funds?

Senator SHERRY—Yes.

Mr Murphy—There are other people who are involved in the regulation of self-managed super funds. Given the number that there are, it may be difficult to try to get fees. Are you talking about self-managed super funds?

Senator SHERRY—Yes. I accept that there may be difficulties but in a consumer choice world, isn’t it desirable that the pricing of the product options is available.

Mr Murphy—Yes, as a matter of principle.

Senator SHERRY—Yes. I accept there is a series of practical issues but I am not asking about the practical issues. I will go to the tax office to ask questions about that.

Mr Murphy—As a matter of principle it is desirable, but I would have to get back to you about whether it is viable to try to get fees data out of the self-managed super funds industry.

Senator SHERRY—I know the problem; that is an issue I will take up with the tax office. I am just asking you about the principle of competition and informing consumers choosing from a range of different types of product in superannuation. Do you accept that principle?

Mr Murphy—Yes. But in the area of self-managed super funds there are requirements on disclosure where, if a business with a self-managed super fund was advised that way by an accountant or whatever, there would be requirements on the persons steering people into these vehicles to provide certain information.

Senator SHERRY—You know that accountants are carved out of FSR?

Mr Murphy—Well, they are to a certain extent.

Senator SHERRY—Yes.

Mr Murphy—Once they start giving advice they have to be licensed but in terms of the exemption, they can.

Senator SHERRY—They are exempt.

Mr Rawstron—They are only exempt with respect to providing advice on self-managed funds but they do not have an exemption for giving advice on financial service products.

Senator SHERRY—Yes, but they are exempt in terms of the structure of self-managed funds. They were in originally, weren't they?

Mr Rawstron—Original they were in.

Senator SHERRY—And then they were carved out. I do not have any further questions.

[11.23 am]

ACTING CHAIR—I call back the previous witnesses for outcome 2.1, Fiscal group, for questioning by Senator Murray.

Senator MURRAY—There are three areas that I want to briefly cover. Before the decision was made to make substantial tax cuts, the surplus would have been well in excess of \$10 billion. The question is a straight one to the fiscal group: at what stage were the fiscal group aware that the surplus prior to the tax cuts would be in excess of \$10 billion?

Mr Tune—I do not think I can give you a definite answer on that. As I was explaining to Senator Sherry, there is a process of monitoring what is going on through the budget process. We try to look at the spends and the saves and try to keep tabs on those, but I think any advice we give to the government and directly to the Treasurer about when and how much is really internal to the budget processes.

Senator MURRAY—We have been given evidence that the fiscal group gets constant updates of revenue expenditure, trends and realities. That is true, isn't it?

Mr Tune—I do not think I said 'constant'; I said there were fairly regular ones throughout that budget process.

Senator MURRAY—Regular meaning what—weekly?

Mr Tune—More or less, yes.

Senator MURRAY—I wish to know whether you as an agency were aware that the budget surplus was in excess of \$10 billion before tax cuts before 13 March?

Mr Tune—Before 13 March? I could not tell you off the top of my head.

Senator MURRAY—Could you take it on notice?

Mr Tune—I could take the question on notice, yes.

Senator MURRAY—Thank you. If the answer is yes, could you add to your question on notice who you advised of that—which minister, in other words.

Mr Tune—Fine.

Senator MURRAY—My second question relates to the tsunami aid package. Budget Paper No. 2, on page 178 under the heading 'Australia-Indonesia Partnership for Reconstruction and Development', shows the forward estimates expenditure of \$115 million for the year 2005-06 and then \$125 million for each of the out-years after that, and the Department of Finance and Administration confirmed in evidence that that was an estimate of

when the money would actually be paid. The Treasurer stated on 28 January 2005 that in this budget:

... one of the biggest challenges is going to be funding the tsunami relief and seeing through the distribution of the very large sums that have been raised for relief ...

I cannot see why \$125 million in a year would be a big challenge within the scale of the budget. So my question to you is: when was the Treasury aware that this expenditure was likely to be phased in over a number of years and would be of this quantum?

Mr Tune—It was probably shortly after the announcement was made by the Prime Minister. I would have to confirm that, but I think it was the Prime Minister who made the statement. At that time, the government had committed \$1 billion: \$500 million in grants and \$500 million worth of loans. There was no view at that time about how that would be expended, particularly on the grant side of things. It was clear that it would be desirable to spend a fair proportion of that up front, but no allocation of the funds had been made at that particular point in time. It was probably a month or so—maybe a bit less than that—after the announcement that people started to get a grip on how those funds would be allocated over the financial years. As you stated, these are still estimates and they are subject to the agreement between the Indonesian and the Australian governments on the governance arrangements that surround the billion dollars. So those numbers may in fact change over time.

Senator MURRAY—Nevertheless, the Treasurer said that one of the biggest challenges was going to be funding the tsunami relief package. Given the scale of the budget, it has not worked out to have been a problem, in my view. \$125 million is neither here nor there in terms of the stress on the budget. Did anyone in Treasury advise the Treasurer that it was not going to be a big challenge?

Mr Tune—Not that I am aware of.

Senator MURRAY—My third set of questions relates to the item which is recorded as output 2.1.2, Commonwealth-state financial policy advice. I hope I am asking the right people.

Mr Tune—Yes, you are.

Senator MURRAY—We had evidence from the Commonwealth Grants Commission in estimates that they come to an assessment—I do not think they used the term ‘recommendation’; I forget the actual term—of what money should go to which states on what basis. It is then up to the government and the Treasurer in particular to confirm and agree with those. I recall the evidence as being that invariably their advice is accepted. The government insists, contrary to the Auditor-General’s and my own view, that the GST is a state tax. If that is so and the Commonwealth Grants Commission makes a recommendation for a certain amount of money to go, for instance, to Western Australia, what avenues are open to the Treasurer to adjust or change the package of moneys that go across?

Mr Tune—As you say, the CGC does a report called an assessment—I am not sure of the exact term myself. That then goes to the states prior to a meeting of the Commonwealth and state treasurers which is called the Ministerial Council on Commonwealth-State Financial Relations. That is where that issue gets discussed. A proposition is put to the state treasurers

as to generally what is in Commonwealth Grants Commission report and the Treasurer puts a motion for a resolution to that council. That provides the opportunity for the states or territories to say whether or not they agree to that. Certainly in relation to the last meeting, back in March or April, which I did attend, those recommendations made by the CGC were just accepted by the states and territories and by the Commonwealth, so that was the decision of the council. So the opportunity for debate largely rests within that council. On that occasion, there was no dispute or debate about that issue.

Senator MURRAY—I suppose anything is possible but I cannot foresee other states and territories wanting to whip Western Australia because the Treasurer is cross with it. So I return to that stage when the Treasurer receives the Commonwealth Grants Commission's assessment and I return to his view that the GST is a state tax, which to me means he should not and cannot touch it. What real opportunity is there for the Treasurer to punish Western Australia for not cutting some taxes that the Treasurer wants cut?

Mr Tune—That is an issue that the government has under consideration at the moment. You will be aware that the government made a proposal to the states around the abolition of the remaining state taxes that were listed in the intergovernmental agreement. Six states and territories have responded to that through letters to the Treasurer. Western Australia has not agreed to reduce their state taxes, nor has New South Wales, and the government currently has under consideration what might be the outcomes of that particular process. It is a live issue, still under policy consideration.

Senator MURRAY—I am not asking a policy question. The heart of my question is whether it is within the Treasurer's power to diminish the amount of money going to Western Australia that the Commonwealth Grants Commission has assessed as being their due.

Mr Tune—Yes, it is.

Senator MURRAY—Under what acts or considerations?

Mr Willcock—Section 9 of A New Tax System (Commonwealth-State Financial Relations) Act provides that the Treasurer will determine the relativity to be used to distribute the GST revenue. That provision also requires the Treasurer to consult with the states before making a determination.

Senator MURRAY—So it is an absolute discretion, because consultation is merely a courtesy not a power?

Mr Willcock—He is required to consult, but having consulted—

Senator MURRAY—He is not required to take into account their views.

Mr Willcock—he then has the discretion to determine the relativities.

Senator MURRAY—Sorry, I interrupted you. Just confirm this for me: he is not required to take into account the views of COAG?

Mr Tune—It is not COAG.

Mr Willcock—It is the ministerial council, which comprises state and territory treasurers. He is required to consult with them, which no doubt invariably means that he would indeed

take account of their views; but, having consulted, the Treasurer then has the discretion to determine the relativities.

Senator MURRAY—So if they disagreed with the view that Western Australia should be penalised, the Treasurer could still go ahead and penalise them according to the law.

Mr Willcock—Yes. As I said, section 9 of that legislation accords to the Treasurer the role of determining the relativities. Also within that legislation is the intergovernmental agreement, which provides that the GST revenue grants will be distributed amongst the states and territories in accordance with horizontal fiscal equalisation principles, which of course are the principles that guide the CGC's own advice in recommending relativities to the Treasurer.

Senator MURRAY—Yes, and we have gone through that process. So now he has received the advice relative to those principles from the Commonwealth Grants Commission. The point I want to be clear on is that it is within his power to diminish that amount.

Mr Willcock—It is within his power to determine the relativities. The change of relativities could obviously therefore affect the size of the GST revenues that flow to any particular state or territory.

Senator MURRAY—That is right, which could result in diminishing it.

Mr Willcock—Yes.

Senator MURRAY—Secondly, although he must consult within the ministerial council, would he still have discretion to make his determination even if they disagreed with him?

Mr Willcock—Yes, indeed. The legislation simply requires consultation; it does not require the agreement of any or all of the other members of the ministerial council.

Senator MURRAY—That is clear. Thank you very much.

ACTING CHAIR—I thank the witnesses.

Senator SHERRY—Senator Wong has some further questions on budget policy advice and coordination.

Senator WONG—We would prefer to deal with the ATO first and then come back for a short set of questions on budget policy and advice, if that is convenient.

ACTING CHAIR—I am happy to do Taxation now.

Mr Tune—Can you give me an idea of the questions so we will bring back the relevant officers?

Senator WONG—The Welfare to Work package.

Senator LUNDY—I also have some questions I would like to raise then on competition and consumer policy advice in output 3.1.3.

[11.41 am]

Australian Taxation Office

ACTING CHAIR—I welcome Mr Carmody and officers from the Australian Taxation Office.

Senator CONROY—Mr Carmody, I want to talk about the withholding schedules for personal income tax deductions. Would you detail your powers concerning setting the level of withholding that employers must make from their employees' pay packets?

Mr Carmody—My powers are to produce withholding rates for employers to deduct from employees' salary and wages. Those powers are generally exercised by our producing schedules of withholding rates. There is a large number of schedules, over 20, according to different circumstances, as simple as weekly or fortnightly pay and others such as whether people have HECS and other duties. Previously, until the proclamation of application of the Legislative Instruments Act, that was a power that I exercised and I produced formulae for software providers and the schedules that were mailed out to employers. With the implementation of the Legislative Instruments Act, those schedules are now legislative instruments. Once the schedules are made, I am required as soon as possible to have them registered on Attorney-General's register of legislative instruments and I believe they are required to table them in each house of parliament within six sitting days. Those legislative instruments are disallowable instruments by either house of parliament.

Senator CONROY—So that is the difference from what it was previously?

Mr Carmody—That is right. Previously it was under my authority that they were issued. They are still issued under my authority. However, if one house of parliament within the prescribed time frames passes a resolution to disallow the instruments then they are disallowed.

Senator CONROY—We are engaged in a quite unique process because they are now disallowable, which is the difference from what it was in previous years.

Mr Carmody—It is.

Senator CONROY—In the old days you made these withholding schedules in the same way, I presume, so it is just that they were not disallowable instruments?

Mr Carmody—It was very much a similar process except for the fact that now they need to be tabled in each house of parliament.

Senator CONROY—What precisely do you do when you 'make' a schedule? Take us through the steps.

Mr Carmody—Generally, the first schedules in effect are those provided to software providers. Generally we would provide them with formulae some time in late May. The effect of those formulae was effectively published—we used to put them up, again, in late May.

Senator CONROY—What status did the information you supplied—

Mr Carmody—They are now legislative instruments.

Senator CONROY—But, previously, what status did that information that you gave to software providers have?

Mr Carmody—We gave them that on the basis that we would then confirm the application of those from 1 July. They obviously needed a development time to produce the software. We would normally finalise the schedules and start printing them in early June. So as to enable time to get them out to employers, by mid-June we would commence the process of the mail-out to the employers.

Senator CONROY—I just want to get the sequence right because there are some technical terms that I was not familiar with until recently. I am hoping you will bear with me.

Mr Carmody—They have come into new prominence in my mind too.

Senator CONROY—Absolutely. I am not talking about the situation due to the changes; I am talking about the past. You make the schedule then you gazette it and send out copies to employers.

Mr Carmody—No, we would send out and then gazette.

Senator CONROY—When do they become legally binding—if that is the right phrase? Is it at the gazettal point where they become enforceable under the law? You can't just put out a press release and say, 'Here are the tax schedules.' You have to go through a formal process.

Mr Carmody—We would make them in the time frame and then they had effect from 1 July. Generally the *Gazette* notice notified to that effect.

Senator CONROY—I am trying to get an understanding of the term 'make the schedule' and what that actually entails.

Mr Carmody—There is a physical process and an intellectual process. In my language, making the schedules is when we sign off that these are the schedules that we are producing. Under the Legislative Instruments Act the signing off of those is, in my understanding, the making of the schedule, of the legislative instrument.

Senator CONROY—What part of the process is the gazetting?

Mr Carmody—That was under the old system, when you did not have to table them as a legislative instrument. There was a formal process of gazettal. That notified people formally that from 1 July they had effect.

Senator CONROY—As opposed to your informal notice. How many days are there in between—do you make them in January, in February?

Mr Carmody—I just explained. In late May we make the schedules that we provide for software providers. In early June we have started producing the schedules, printing them. In my terms, they are made at the point when we sign off on them.

Senator CONROY—When you print them?

Mr Carmody—No, when they are formally signed off as being the schedules that reflect what we are going to require as withholding.

Senator CONROY—As opposed to gazetting.

Mr Carmody—Yes.

Senator CONROY—I am trying to get an understanding of the difference between the making, the formally signing off and the gazetting. I am just trying to understand the difference. As you say, it is an arcane area which I am sure you have never had to discuss in public before.

Mr Carmody—I never have, and was not aware of a lot of it before, to tell you the truth. Based on my becoming aware of it now, as I said, the term ‘making’ is a defined term in the Legislative Instruments Act and it is when they are signed off. So in my terms it is when we signed off to allow production and printing.

Senator CONROY—So it is not the printing; you have signed them off the day before they go to the print shop.

Mr Carmody—Obviously there is a process in which someone approves that they are the schedules that can go off to be printed.

Senator CONROY—Okay. And then the gazettal comes and that is formal public notification.

Mr Carmody—That is formal public notification of the date of effect—1 July.

Senator CONROY—In the legal sense, what is the difference between a making of a schedule and the gazetting of the schedule?

Mr Carmody—They are two different concepts. One is now a legal sense under the Legislative Instruments Act—

Senator CONROY—I am talking about previously.

Mr Carmody—There was not such a term in the legislation as ‘making’. It is only when the Legislative Instruments Act came in that there was a statement. It all hinges on when they are made and under the new legislation making is designed as when the person with the authority signs off on—

Senator CONROY—So previously there was not a concept of making. You just went through the process and gazetted them on X day?

Mr Carmody—There was not a legal concept of making. We did make them, but it was not a legal concept.

Senator CONROY—If your schedules previously—and I am trying to talk about past practice—were not gazetted, what did that mean for them?

Mr Carmody—Under the tax law, gazettal was like a lot of other things and required notification so that the community knew that something came into effect from a particular date. So under the existing tax law there was a requirement for us to gazette them. Now that we have the Legislative Instruments Act we do not have to gazette them.

Senator CONROY—They are tabled in parliament or tabled with the A-G—

Mr Carmody—We have to register them as soon as possible after the making with the Attorney-General, who has a register of legislative instruments. The Attorney-General—

Senator CONROY—Six days, isn’t it?

Mr Carmody—Having registered or arranged for it to be tabled within each House within six sitting days.

Senator CONROY—Where in the legislation does it say ‘as soon as possible’?

Mr Carmody—Under the Legislative Instruments Act.

Senator CONROY—Could you point me to the section?

Mr Carmody—It is not an act that I am familiar with, so it could take quite a long time.

Senator CONROY—I understand that entirely, Mr Carmody.

Mr Carmody—Under the definition, ‘making’ in relation to an instrument that will become or that is a legislative instrument means a signing by the person in authority.

Senator Abetz—Section 38, from memory.

Senator MURRAY—That is what rugby union people call ‘seagulling’!

Mr Carmody—Section 38 is the requirement that the department deliver to each House within six sitting days. Section 25 says:

If a legislative instrument is required to be registered under this Division, the rule-maker must, as soon as practicable after making that legislative instrument, lodge the instrument ... with the Department for registration.

Senator CONROY—As soon as practicable?

Mr Carmody—Yes.

Senator CONROY—Going back to what happened previously, in the old days if your schedules were not gazetted, were they valid?

Mr Carmody—No, I do not believe they were.

Senator CONROY—The gazetted document has a signed date on it. Is that the date the schedules used to be legally created on?

Mr Carmody—No, that was just the date we prepared the gazettal notice. The concept of making came in under the Legislative Instruments Act.

Senator CONROY—But some process of creating—I will avoid the word ‘make’ so that we do not—

Mr Carmody—Previously we finalised the schedules and then they were printed and then they were sent out—

Senator CONROY—But they did not exist in any legal sense, even though you had done all that previously, until they were gazetted?

Mr Carmody—They came into effect with the gazettal notice.

Senator CONROY—The reason I ask about the previous approach is that there were tax cuts delivered from 1 July 2004 which necessitated new withholdings schedules.

Mr Carmody—Yes.

Senator CONROY—I have a copy of special *Gazette* No. S232. That was gazetted on 28 June 2004—

Mr Carmody—That would be in accordance with our normal practices.

Senator CONROY—and the document is dated 25 June 2004.

Mr Carmody—I am sure that is right.

Senator CONROY—I am sure you have seen it before, even though, to be fair to you, you did not sign it.

Mr Carmody—I did not sign it.

Senator CONROY—So last year you changed the schedules just before 30 June and there was no complaint about compliance even though gazettal was on 30 June?

Mr Carmody—We had sent them all out before then. All employees had them, and our act required that, for the operative date to come into effect, they be publicly notified by gazette notice. That was the old system.

Senator CONROY—We are talking about the old system. I am happily going to come to the new system, but I am trying to clarify the previous practice. So gazettal took place on 28 June, but you had circulated material—

Mr Carmody—We had started printing them probably in early June. The software ones we published in late May. We started distributing them probably in mid-June.

Senator CONROY—It says:

I made the schedules under section 15-25 for the purposes of collecting income tax, Medicare levy and amounts of liabilities to the Commonwealth under Chapter 5A of the Higher Education Act 1988.

Unfortunately, back on 28 June 2004 you used the phrase, ‘I made the schedules’.

Mr Carmody—It did not have it as ‘defined’. All it was stating was the matter of fact that they had been made. And the gazettal notice was about the date of effect.

Senator CONROY—I wondered whether it was just an isolated incident or a fluke that last year’s schedules came out later than previously, so I went back and checked.

Mr Carmody—No. Typically, we put the gazette notice out close to 30 June because employers have been notified in advance and we are telling them at or about the time they come into effect.

Senator CONROY—Monday, 28 June was the gazettal date last year, so I went back to the previous year—

Mr Carmody—Good.

Senator CONROY—and checked on those infamous tax cuts from 1 July 2003, often referred to as the ‘sandwich and milkshake’ tax cuts.

Mr Carmody—Not in my gazette notices!

Senator CONROY—Not in your gazette notice, that is true, though it might have been appropriate at the time.

Senator Abetz—Did you vote for those, Senator, or not?

Senator FIFIELD—They pick every other one except that.

Senator CONROY—I discovered that the withholding schedules for the tax cuts that commenced on 1 July 2003 were gazetted on 27 June 2003 in special *Gazette* No. S241. There was also some extra information in special *Gazette* No S242 on Friday, 27 June, which would have been the last working day before 1 July, I presume, because you do not work on weekends. Let me rephrase that: you do not get paid to work on the weekends, but I know from previous discussions that you get phone calls in supermarkets at strange hours of the night and day. The instrument was dated 26 June. As I said, 27 June was the date it was gazetted. That seems consistent with past practice.

Mr Carmody—I acknowledge that that was the procedure we had under the previous system.

Senator CONROY—How do you define ‘as soon as practicable’, because that is your decision?

Mr Carmody—Given that these were new legislative instruments to go to parliament, I obviously made arrangements for them to be transmitted on the day or the day after. They were ready and they had been signed off, so they were sent on.

Senator CONROY—What date was that? When did you make them?

Mr Carmody—I think it was about 25 June, or something like that.

Senator CONROY—It would not have been in June.

Mr Carmody—It would have been May, around that time.

Senator CONROY—So they were made, as in signed off, on 25 May?

Mr Carmody—I believe that was the date. Anyway, it was around that time in May.

Senator CONROY—You may not actually know the answer to this. Do you know when they were gazetted?

Mr Carmody—They are not gazetted any more.

Senator CONROY—That is right. When were they registered and promulgated by AG’s. You have to go to them and register them, don’t you?

Mr Carmody—I think that was done fairly quickly.

Senator CONROY—Do you know off the top of your head? I actually do not know the answer and I was just wondering.

Mr Carmody—It was done very quickly because I think they were tabled in the House of Representatives on 26 May.

Senator CONROY—Do you think that the tax rates announced in the 2005 budget will actually apply to the 2005-06 year?

Senator Abetz—I suppose that depends on whether it gets through the parliament, and we can get rid of that uncertainty by your support.

Senator CONROY—Thank you for interrupting the independent Commissioner of Taxation, Senator Abetz!

Mr Carmody—Yes, I believe they will.

Senator CONROY—The Treasurer has stated as much. He said in question time on 12 May 2005:

I am very confident that, when the new Senate assembles after 1 July, the new Senate will pass this law.

On 26 May 2005, he said:

The bill will ultimately pass the Senate and become law.

I am just repeating the Treasurer's comments. I am not passing any judgment on them.

Senator FIFIELD—You could just let the bills through.

Senator CONROY—The Treasurer is saying that they will pass. You have indicated that you believe they will pass.

Mr Carmody—Yes.

Senator CONROY—Is that because the government will have the majority in the Senate on 1 July?

Mr Carmody—That is the reason.

Senator CONROY—You anticipate outcomes in parliament when you make these schedules?

Mr Cooper—I am entitled to do that.

Senator CONROY—Under the law you are. I wanted to come to that very issue. Under the law you are entitled to anticipate parliamentary outcomes in promulgating—

Mr Carmody—The law actually refers to a requirement to make sure that I have regard to the enacted rates but, yes, I am entitled, for the purposes of administrative ease of business and other things, in determining the schedules to anticipate.

Senator CONROY—You are entitled to anticipate that the government's preferred tax schedules, which were announced in the budget, will become law.

Mr WAKELIN—I am entitled in determining withholding schedules to take into account my understanding or belief as to what rates will apply, yes.

Senator CONROY—And you are confident that the tax rates announced in the 2005 budget will actually apply in the 2005-06 year?

Mr Carmody—I believe they will, yes.

Senator CONROY—That being the case, can you not simply tell employers to withhold the amounts in the withholding schedule irrespective of whether the parliament disallows it?

Mr Carmody—No, I cannot.

Senator CONROY—So you can only anticipate a few days in advance or you can anticipate six or seven weeks in advance?

Mr Carmody—No, the Legislative Instruments Act—I think it is section 47—says that if they have been tabled and there is a notice of motion to disallow that has not been dealt with then I cannot make another instrument.

Senator CONROY—That was not what I was asking you.

Mr Carmody—I think it goes to the effect of that.

Senator CONROY—I disagree with you. You could anticipate that the parliament, as you have said and as you believe will be the case, will pass the government's schedules.

Mr Carmody—I can anticipate that. I will help you out. If the Legislative Instruments Act had not been in place, that is what I would have done. I would have advised employers in the normal way and I would have gazetted that.

Senator CONROY—And you could do that now.

Mr Carmody—No, I cannot because I am required now to table the legislative instrument.

Senator CONROY—It is a question of what you table. You tabled two for a start.

Mr Carmody—I did because of the uncertainty—

Senator CONROY—You were not required to table two.

Mr Carmody—I was because under the legislation that was enacted with the 2004 tax rate cuts they would normally require new schedules. Under the Legislative Instruments Act those new schedules, to take effect from 1 July in respect of the 2004 budget cuts, are a legislative instrument. Secondly, I have an announcement about 2005 budget cuts and, based on what I said to you about anticipating, if they are to have effect they have to be tabled as a legislative instrument. So we now have a legislative instrument that has been tabled that allows—according to whether one is disallowed or not—either for the 2004 second stage of tax cuts to be reflected in the schedules or, if they are not disallowed, for the 2005 cuts to be reflected in the schedule.

Senator CONROY—My point being that you anticipate that the government's 2005 tax cuts will be legislated.

Mr Carmody—Yes.

Senator CONROY—And you could, if you chose, anticipate solely that?

Mr Carmody—Yes, I could, but then I would be in a situation, if I were to have arranged for the tabling of the legislative instrument based solely on the 2005 tax cuts and if that were to be disallowed, where employers would not be entitled to apply the 2004 tax cuts; so I have to provide for both possibilities.

Senator Abetz—H-e-l-p!

Senator CONROY—Can I just confirm that it is perfectly legal for the parliament to pass retrospective legislation, say in August, cutting income tax rates from 1 July.

Mr Carmody—It is my understanding that parliament could do that, yes.

Senator CONROY—This means that the tax liabilities that individuals face for that year are the same, irrespective of when the bill implementing the rates is passed on by the parliament. Is that correct?

Mr Carmody—The ultimate rates of tax applied on assessments would be, if the 2005 rates were in the course of events to be passed in August with effect from 1 July, the actual end of year liability would be based on those tax rates.

Senator CONROY—The actual liability for tax is not in any way connected to the withholding schedules?

Mr Carmody—Obviously, I have to have regard to the rates of tax in applying the withholding schedules. However, if the legislation, the bill, to enact the 2005 budget tax cuts were not to be passed by 30 June but the legislative instrument was not disallowed, then the schedule would come into effect from 1 July.

ACTING CHAIR—What would happen if the instrument was disallowed?

Mr Carmody—If that instrument was disallowed, the 2004 schedules would come into effect, unless that instrument was also disallowed. They are both instruments.

ACTING CHAIR—That would cause an awful lot of confusion in the business community, wouldn't it?

Mr Carmody—I am just stating factually what can occur under the process.

Senator FIFIELD—When would people actually get their money back? These are the tax cuts they otherwise would have received. Would they have to wait until they filed their tax return at the end of the financial year?

Mr Carmody—Is this on the assumption that the instrument was disallowed?

Senator FIFIELD—Yes.

Mr Carmody—Presumably a new instrument would be allowed to come into the parliament and would take effect from some time in August or September. That would apply the new tax rates. There would be a gap during which tax had been withheld at a higher rate. Generally, I would expect people to get it as part of their refund, but there are variations available. They can apply to the Taxation Office for variations where they believe their ultimate tax would be lower.

Senator FIFIELD—But, essentially, people would have to wait?

Mr Carmody—They would have the entitlement to apply to the Taxation Office for a variation and at some point get that variation earlier in the year.

Senator CONROY—I wonder whether I might go back to when you made the schedule. I appreciate Senator Fifield's excitement at getting himself a \$6 tax cut.

Senator FIFIELD—You are not donating your's to charity, Senator Conroy?

Senator CONROY—We ask officials questions at estimates, Senator Fifield.

ACTING CHAIR—What is your question, Senator Conroy?

Senator CONROY—In the past, as we have indicated, you have created, to avoid the use of 'made', schedules even though you have described it in your own documents as 'making' schedules. So you have made the schedules as late as 25 June?

Mr Carmody—No. That was the gazette notice stating that they had been made. The gazette notice was required under the legislation to allow—

Senator CONROY—So they had no legal force, as we have agreed, until they were gazetted.

Mr Carmody—That is right.

Senator CONROY—So you gazetted them and gave them legal force as late as 28 June in 2004.

Mr Carmody—It was typical to put the gazette notice in as close as possible to when the cuts would come in.

Senator CONROY—So this was your typical approach?

Mr Carmody—Yes.

Senator CONROY—In the previous years, as we have discussed, on Friday, 27 June 2003 you gazetted?

Mr Carmody—Yes.

Senator CONROY—On that day you said you ‘made’ the schedules under section 15-25, and I appreciate that ‘made’ had a less formal context back then.

Mr Carmody—It did not have a formal context. I do not know the terms of the gazette and I am not even sure that it says what date they were made, but the term had no particular legal effect.

Senator CONROY—The legal effect was the gazetting, which, as I have said, was on Friday, 27 June, the last working day prior to them coming into force.

Mr Carmody—Under the legislative regime that applied before the Legislative Instruments Act came in, that was the procedure.

Senator CONROY—But the Legislative Instruments Act says as soon as possible after you have made them. The issue of when you make them is the question.

Mr Carmody—Yes, and they are signed off.

Senator CONROY—So previously you have issued them, gazetted them and made the schedules on the last couple of days in June?

Mr Carmody—I have been through that. That was the previous legislative scheme. But I also pointed out that we actually produced the schedules—produced the things—in late May to early June.

Senator CONROY—And I am presuming you did all of that at the same time as you made the schedule under this new system. So nothing changed administratively for you in circulating the information to the people that we have discussed at length.

Mr Carmody—As required under the Legislative Instruments Act, nothing in particular changes in the process. However, there is now a defined requirement that once they are made they are registered.

Senator CONROY—But this is about when they are made. I am accepting the point you have made about once they are made, but under past practice you have been able to circulate all of the documentation necessary previous to your gazetting them and giving them legal force.

Mr Carmody—That is true, but it was a different system. The gazettal was simply a means required to notify the population and employers—

Senator CONROY—It was a required act of law.

Mr Carmody—Yes, to notify, as with a lot of things. When something is coming into effect, there is a requirement that the public be notified. Typically, we notify it close to the date that something is coming into effect because then it is in people's minds.

Senator CONROY—I am not arguing any of that with you. I am simply making the point that your past practice, which worked and served the country quite well for about 104 years, was that you gazetted the information but that you had circulated all of the other information necessary prior to that. But in these two cases you did not feel the need to rush to a gazettal earlier than the last working day.

Mr Carmody—No. I have explained that.

Senator CONROY—No, you have explained that was your normal practice.

Mr Carmody—Yes, because that was a requirement to notify by gazette. All that system changed—

Senator CONROY—Of course, you had to gazette prior to 1 July for them to be in force from 1 July.

Mr Carmody—From 1 July—that is right.

Senator CONROY—And in past practice the gazettal took place in the last few days of June, and in one case on the last working day before 1 July.

Mr Carmody—That is true.

Senator CONROY—And the country seemed to bowl along merrily and you did not have any confusion or compliance issues.

Mr Carmody—But the issue this year is not to do with that. The issue is simply that there is now new legislation in place that requires a different process.

Senator CONROY—No, the issue is about when the legislation kicks. It is from the moment that you decide to make—that is, sign off. At that point, that is when it kicks in.

Mr Carmody—That is right. I do not understand the suggestion, Senator. We had to finalise the schedules and the formula for software providers in late May or early June. At that point they were finalised, by definition. What else would you do?

Senator CONROY—You finalised things a long time before you gazetted legally tax schedules in the past.

Mr Carmody—Can I just help you, Senator. Under that regime, yes, we did produce the formulas and produce the schedules in late May or early June.

Senator CONROY—And circulated them.

Mr Carmody—And sent them out. At that stage, so that people would know the date of effect, there was a legislative requirement for a *Gazette* notice. That is one legislative regime. The new legislative regime does not operate on the basis of the *Gazette* notice; it introduces

different points and different accountabilities. It says that if you make a legislative instrument—in this case, if you sign off these schedules as being the schedules we are going to notify employers of, and it specifically refers to schedules or instruments that are to come into effect in the future—it is at the point that you finalise those and sign them off.

Senator CONROY—No, it is at the point where you make them. Other things are then triggered at the point under the new legislation—

Mr Carmody—Let me approach it a different way. At the point when we finalised the schedules and said, ‘These are the schedules; we are issuing them,’ I saw my responsibilities under the Legislative Instruments Act as saying, ‘At that point they were made.’ And it was at that point—

Senator CONROY—At what point?

Mr Carmody—We signed them off as being the schedules that we will be notifying employers to withhold tax on.

Senator CONROY—But you have not needed in the past—

Mr Carmody—No, because I did not have the Legislative Instruments Act.

Senator CONROY—Can I finish my question?

Mr Carmody—I am just so eager.

Senator CONROY—I appreciate your anticipation, which is what this debate is largely about, and you are showing a keen sense of it, but I would like to finish my question.

Mr Carmody—Please.

Senator CONROY—Thank you. The issue is: at what point in the past did you need to circulate, for practical administrative purposes, the information necessary to any software company—

Mr Carmody—In late May we notified software companies.

Senator CONROY—And in early June you sent it all out?

Mr Carmody—We started producing the schedules in early June, and in mid-June we started sending them out.

Senator CONROY—It did not require for you to do any of those things, and I suspect even now it does not require you to do that. You could circulate them earlier than that. The budget comes out on 11 May or something. You could circulate things earlier than that if you were physically able to print the schedules and send them out to people.

Mr Carmody—We have to produce the schedules first.

Senator CONROY—Yes, but you could send them out earlier than 25 May. There is nothing in this new regime that is the trigger for you to start sending information out to employers and software companies.

Mr Carmody—No, it is a practical administrative requirement to enable employers to withhold taxes. That requires that we produce schedules at around the end of May or early June.

Senator CONROY—In the past, you have happily chosen to gazette in the last few days of June. Is that right?

Mr Carmody—Yes—under the legislation as it applied then, that is correct.

Senator CONROY—There is nothing in the new regime that says you must do it by 25 May, is there?

Mr Carmody—There is a requirement that I table them as soon as practicable after the legislative instruments are made.

Senator CONROY—No, I am not talking about that. I understand that, and we have agreed on what happens after you make the schedule. The question I am asking is: is there a requirement in law for you to make the schedule by 25 May?

Mr Carmody—No. The requirement—

Senator CONROY—26 May?

Mr Carmody—There is not a date in the law—

Senator CONROY—27 May?

Mr Carmody—but there is a practical administrative requirement to make the schedules so that they can then be notified, produced and sent out to employers.

Senator CONROY—No, that is not the requirement of the legislation. That is not in the legislation—unless you can point out to me where in that piece of legislation it says you have to circulate it to employers by X date. We have agreed it is a practical administrative issue of when you circulate the information to employers.

Mr Carmody—That is true.

Senator CONROY—It is not a legislative requirement, so please do not suggest that it is.

Mr Carmody—No, but can I just say I have clearly accepted that it administratively puts a time line on when we need to produce and put them out. Then I come to the Legislative Instruments Act and it says, ‘When you make them.’ You make them when you determine that these are the schedules we are going to produce so that we can send them out. So just in terms of that practical time frame, it is at the point that we sign off: ‘Yes, these are the schedules that we are satisfied will need to apply from 1 July and we need now to publish them and mail them out.’ So it is a requirement—

Senator CONROY—The points you are making now are not required by the legislation. There is nothing that says you must make them by 25 May. There is nothing that says you must make them by 26 May. If you chose to make them on 26 June rather than 25 May, you could still have circulated to employers and software companies all of the information prior to 26 June.

Mr Carmody—I think I am in a parallel universe.

Senator FIFIELD—I think we all are, Commissioner.

Mr Carmody—I am not being flippant. It seems to me that what is being suggested is that we finalise what the schedules should be, actually produce them and mail them out to people

but artificially not sign off that they are the schedules we have determined until 28 June. That is a manipulation of the system that I would be very upset about if taxpayers did it.

Senator CONROY—The budget actually decides the tax schedules. The government announces what its tax schedule will be. You do not actually make any decisions other than to comply with what the government has announced it is going to do. The schedules are actually available on 11 May.

Mr Carmody—I make a decision based on things including the rates of tax that are expected to apply. But the actual schedules are made under my authority. As I have already pointed out, if the schedules presently being tabled were not to be disallowed then those schedules of withholding would apply irrespective of the fact that the actual budget tax bill had not been passed.

Senator CONROY—We have not had a discussion about that but I am not arguing that point.

Mr Carmody—You are making the point that these were made by the budget. They are in fact made under my authority and I take into account those rates—but they operate independently of the budget.

Senator CONROY—Did you enjoy living in a parallel universe in previous years when you circulated all the information to employers and then gazetted it on 27 or 28 June? How was that parallel universe?

Mr Carmody—I seem to be having difficulty getting my point across. They are two different systems. The old system was not about when you make or when you sign off the schedules. Under the old system we still did that. We determined the schedules, produced them—

Senator CONROY—And circulated them without gazetting them.

Mr Carmody—And the requirement under that act was to notify when they would come into effect. And we did that, typically, close to the date they came into effect. That system does not apply now. We do not have to gazette. I was faced with the situation that required I sign a legislative instrument—

Senator CONROY—You are not required to sign it on 25 May.

Mr Carmody—I was just going on to say—

Senator CONROY—How many more times do we have to have this discussion? You made the decision to make them on 25 May. You could have chosen to make them on 25 June if you had decided.

Mr Carmody—In my terms and given my responsibilities that is just not true.

Senator CONROY—You could have anticipated that there would be no confusion whatsoever if you made them on 26 June.

Mr Carmody—Again, what that would require—

Senator CONROY—You could have anticipated that. The bleeding obvious would suggest that that was an alternative for you.

Mr Carmody—I think that would require me to thumb my nose at parliament, to be frank.

Senator CONROY—You can anticipate, as you have said, that the tax schedules will apply from 1 July.

Mr Carmody—Absolutely. And under the arrangements that I have described to you, we actually have to produce the schedules in late May or June. For me to have said, ‘Yes, they’re—

Senator CONROY—To circulate them just like you did every other year?

Mr Carmody—I allowed you the courtesy to finish speaking. Please allow me the courtesy of finishing.

CHAIR—Senator Conroy, can Mr Carmody finish?

Mr Carmody—We have to determine what the schedule rates will be, we have to produce the schedules and we have to mail them out, all around this time and the next few weeks. What you are suggesting to me is that, having determined that they are the withholding schedules, I artificially hold off on signing them off until after parliament has risen. I would consider that to be, as I said, thumbing my nose at parliament and completely inappropriate for me as a statutory officer.

CHAIR—Senator Conroy?

Senator CONROY—Thanks. Good to see that you have arrived, Senator Brandis.

CHAIR—Just trying to make sure everybody behaves courteously, Senator Conroy.

Senator CONROY—Actually, I do not think anyone has suggested that anyone has behaved discourteously, other than your overbearing interventions from the chair, but we do welcome you back. Mr Carmody, I just got some correspondence from Mr Evans, the Clerk of the Senate. He makes the point:

The rejection or deferral of the bill, however, would not prevent the re-presentation of the bill any time after 1 July with a clause making it effective from 1 July.

No argument?

Mr Carmody—No argument. You would know that better than me.

Senator CONROY—Mr Evans writes that, if the withholding schedules were to be disallowed before 1 July, it is understood that it would be six months before they could be re-presented, unless the legislation—

Mr Carmody—This is the withholding instruments?

Senator CONROY—Yes.

Mr Carmody—If they are disallowed then, yes, they cannot be re-presented for six months unless the particular house passes a motion to allow them to come forward earlier.

Senator CONROY—So the Senate could be summoned to meet on or after 1 July to approve the remaking of the schedules with effect from 1 July.

Mr Carmody—That could be a parliamentary process.

Senator CONROY—It could be or it is a parliamentary process?

Mr Carmody—You would understand parliamentary processes better than me.

Senator CONROY—All of a sudden you are not able to anticipate a parliamentary process?

Mr Carmody—Sorry?

Senator CONROY—The Clerk is advising publicly that—

Senator Abetz—Who else has this letter? I do not have it, and I do not think the commissioner has.

Senator CONROY—I am happy to table it; there are no great dramas.

Senator Abetz—It is not public. Just for the record—

Senator CONROY—But I am sure Mr Carmody's officers have been in discussions with the parliament.

CHAIR—Senator Conroy—

Senator Abetz—Just for the record, this has not been made publicly available.

CHAIR—Hang on a minute, Senator Abetz. Senator Conroy, if you are going to ask questions about a letter, the commissioner should be shown the letter and so should the other members of the committee.

Senator CONROY—Thanks for your opinion.

CHAIR—That is not my opinion; that is my ruling.

Senator CONROY—It is a pleasure to have you back, Senator Brandis, as always.

CHAIR—If you want to ask him about a letter from which you are quoting selectively, you must show it to him otherwise I will not allow the question.

Senator CONROY—No, I must not. You will not find that the Clerk of the Senate supports that ruling. As always, Senator Brandis, you make your rulings as you go without any support—

CHAIR—I make my rulings on the basis of fairness to the witnesses.

Senator CONROY—You are the most successfully overturned—

CHAIR—Do you wish to proceed with questions about that letter?

Senator CONROY—If I can ask my questions my way, thanks—

CHAIR—No, I am not going to permit questions to—

Senator CONROY—Senator Brandis, you are the most successfully overturned chair of any parliamentary inquiry—

CHAIR—I pass the call to Senator Fifield.

Senator FIFIELD—Thank you, Chair.

Senator CONROY—No, I am going to keep talking. Don't play this game, Senator Fifield.

CHAIR—Order! Senator Conroy, you are out of order. Senator Fifield has the call.

Senator FIFIELD—Commissioner, I hope to take you out of this parallel universe.

Senator CONROY—Mr Carmody, if you did not want to thumb your nose at parliament, why did you wait until after the legislative debate?

Mr Carmody—Because I had to—

CHAIR—Senator Conroy, you are out of order. Mr Carmody, do not answer any questions from Senator Conroy. Senator Fifield has the call.

Senator CONROY—It will not do you any good. John Howard is not going to promote you.

CHAIR—Disregard Senator Conroy's interjections. Senator Fifield has the call.

Senator CONROY—It doesn't matter; neither of you are going to make the front bench, fellas, so give it up—it won't matter.

Senator FIFIELD—Commissioner, I hope to take you out Senator Conroy's parallel universe. It is quite clear that Senator Conroy is trying to blame the current uncertainty over the schedules on the administration of the tax office rather than on the activities of the Australian Labor Party.

Senator CONROY—No, that is an assertion, Senator Carmody, that you don't have to respond to.

Mr Carmody—Senator Carmody?

Senator CONROY—Sorry, Mr Carmody. That is a complete assertion and a bit of editorialising by Senator Fifield.

Senator FIFIELD—Commissioner, I would simply like to ask questions about the withholding schedules for the pay as you go system and the uncertainty necessitated by your having to produce two schedules. When people hear that two schedules have been tabled in the House, they have in mind two sheets of paper with different tax scales. The schedules are in fact 100 pages or more each.

Mr Carmody—Yes, there are 22—

Senator LUNDY—Chair, I have a point of order. Senator Conroy challenged your ruling on the treatment of the letter and his asking questions and you responded by taking the call away from him. I ask you to respond to the challenge to your ruling by Senator Conroy.

CHAIR—In fact, there was not a challenge to my ruling. I am told by Senator Watson that, by arrangements that were made when he was in the chair, the call was to go to Senator Fifield at 12.30 in any event.

Senator LUNDY—That is not the basis upon which you transferred the call to Senator Fifield. I believe that Senator Conroy has a right to finish his line of questioning.

Senator CONROY—I accept Senator Watson's recollections in that sense, but Senator Lundy is completely right about your—as always—outrageous and overbearing chairing of committees.

CHAIR—Senator Lundy, if you want to raise the matter at a private meeting of the committee when we adjourn, you are, of course, at liberty to do so. Senator Fifield has the call.

Senator CONROY—Can I confirm with Senator Watson when we were going to adjourn?

CHAIR—My understanding, from Senator Watson, is that we adjourn at quarter to one, after Senator Fifield has had 15 minutes of uninterrupted questions.

Senator LUNDY—I still think you need to respond to my question about your formal response to Senator Conroy's challenge to your ruling on the letter.

CHAIR—I have responded.

Senator CONROY—He is going red with embarrassment, Kate. Do not do it; you will make him even more embarrassed.

CHAIR—If you want to have a private meeting at 12.45 we will of course have one. Senator Fifield.

Senator LUNDY—The record will note, then, that no explanation was provided by the chair.

Senator FIFIELD—Commissioner, how many schedules are there?

Mr Carmody—We have schedules reflecting the second round of 2004 budget tax cuts and schedules reflecting the 2005 budget tax cuts. As I have explained, they are both presented to give the alternative. My understanding is that there are 22 schedules for each.

Senator FIFIELD—So there are 44 schedules?

Mr Carmody—There are 44 schedules. We produce schedules so that employers can go to the convenient withholding rate for a particular employee. So there are schedules for weekly, fortnightly, those with HECS, those without HECS and so on. I recently discovered that there are 22 of them.

Senator FIFIELD—They include: statement of formulas for calculating amounts to be withheld; weekly tax table incorporating Medicare levy with and without leave loading; fortnightly tax table incorporating Medicare levy with and without leave loading; monthly tax table incorporating Medicare levy with and without leave loading; special tax table for actors, variety artists and other entertainers—

Senator Abetz—It sounds very simple!

Senator FIFIELD—There are 44 in all. So when we talk about two schedules, we are not talking about two bits of paper with tax scales; we are talking about 44 schedules; we are talking about something that is very complex, very involved, very detailed.

Mr Carmody—We have produced 22 schedules so that employers can relate it to the circumstances of particular employees.

Senator FIFIELD—How many employers who pay salary and wages are affected by this uncertainty?

Mr Carmody—I understand that our mailing program has about 850,000 employers.

Senator FIFIELD—So 850,000 employers are affected by this?

Mr Carmody—Yes.

Senator FIFIELD—When making withholding schedules, the ATO, I presume, consults with software providers.

Mr Carmody—Yes, we did, because they obviously need lead time to produce their software products to provide to employers so that they can have them installed ready to operate from 1 July.

Senator FIFIELD—What was the advice of the software providers? What were they hoping would be the outcome? Were they hoping you would produce two schedules or were they hoping you would produce one schedule?

Mr Carmody—They obviously advised us that it would be simpler for them and for business if one set of schedules were produced.

Senator FIFIELD—Are you aware of the situation of the software provider MYOB?

Mr Carmody—I understand broadly that we had consultations with them and a range of—

Senator CONROY—You might find if you check the parliamentary history that they know how to rip-off and rot—

CHAIR—Order! Senator Conroy!

Senator CONROY—using disallowable instruments extensively. I refer you to a couple of speeches I have done on MYOB.

Senator FIFIELD—Chair, can I pass to the commissioner a letter from MYOB to Wayne Swan, the shadow Treasurer?

CHAIR—Yes, certainly.

Senator SHERRY—Can we have copies, too, as a matter of courtesy?

CHAIR—Are there copies for the committee please, Senator Fifield?

Senator Abetz—Funny you should suggest that that would be a matter of courtesy, Senator Sherry.

Senator SHERRY—It is not funny at all. I always provide them to all committee members.

Senator Abetz—Unlike Senator Conroy.

Senator CONROY—Unlike the Prime Minister, who regularly quotes from letters that he does not table. It is just an outrageous ruling.

CHAIR—Senator Abetz, that was not helpful. Mr Carmody, do you have the letter in front of you?

Mr Carmody—No, I do not.

Senator MURRAY—On a point of order: I thoroughly agree that in all instances letters or documents being quoted from should be provided to the witness if required, but I am aware of a previous ruling by the chair which was contrary to that. During a committee hearing in

Brisbane with respect to a tax bill, Senator Watson quoted from a document and I specifically asked that that reference be advised to both the witness and the chair. My point of order is whether the chair will refer those contradictory rulings to the Clerk so that we can get some kind of permanent ruling on this matter.

Senator CONROY—On the point of order: thank you, Senator Murray—as I indicated earlier, Senator Brandis is the most successfully overturned chair in the business. I actually had no trouble tabling the document; I was just not given an opportunity. I was told that I had to, under a ruling; and then, before I even had a chance to say that I was happy to table it, Senator Brandis chose to take the questions away from me. I do appreciate your drawing to the chair's attention that once again he has made a totally fallacious ruling.

Senator MURRAY—I agree with the ruling. It is just that it contradicts a previous ruling.

CHAIR—Senator Murray, on your point of order: I have a vague recollection of a debate between Senator Watson and me. I will have a look at the *Hansard* and I will come back to you later in the day.

Senator FIFIELD—Commissioner, I draw your attention to the letter, from MYOB to Mr Swan, headed 'Looming crisis for small business—deadline for tax table decision: 06/06/05'. The second paragraph of that letter states:

The fact remains that releasing two schedules to the business community is far from ideal. As currently designed, businesses who insert the MYOB payroll upgrade will automatically install the tax tables approved from the 2004 budget. They will then need to manually override this automatic process and insert a password to access the 2005 tables should they be approved. I must emphasise that this is a solution of last resort for our customers. The limited technical capacity of the average small business renders any manual activity of this kind a recipe for confusion, error and ultimately potential miscalculation.

... ..

MYOB begins producing upgrade CDs for our customers on 6 June. So unless the ATO is in a position to authorise delivery by this date we cannot make the 2005 tax tables the default option. This is, therefore, the last chance for all involved to eliminate imminent confusion for small business owners around the nation. I implore you to take the required steps to avert an unnecessary and far reaching quandary.

Commissioner, are you aware that the 6th of this month—four days away—is the effective deadline for businesses like MYOB to produce this material?

Mr Carmody—I was informed that MYOB had advised that position.

Senator FIFIELD—It would be fair to say that the confusion created would be something of a crisis for the businesses concerned.

Mr Carmody—They have pointed to their experiences with businesses as saying that it would cause some confusion for them.

Senator FIFIELD—We were discussing briefly before how the ATO could implement the tax cuts without inconvenience and without confusion. There is no way.

Mr Carmody—I am required by an act of the parliament to arrange for these legislative instruments to be tabled and, until there is certainty as to whether they will be allowed or not,

I cannot do anymore. We can do our best to minimise the difficulty and confusion, but I cannot do anymore than that.

Senator FIFIELD—There is nothing you can do as commissioner to avoid confusion and complexity at this point. All you can do is—

Mr Carmody—I cannot give the certainty that they are asking for.

Senator FIFIELD—This uncertainty is in no way being created by the administrative efforts of the tax office; it is entirely the result of the uncertainty of the parliamentary process.

Mr Carmody—I believe we have done everything in a responsible way to address the current situation.

Senator FIFIELD—If the tax cuts were not delivered on time as we were discussing before—let us say they did not take effect until September—and a catch-up were proposed, taxpayers would have the option of getting the tax cuts that they were denied in their tax return. You mentioned that taxpayers could make application to the tax office.

Mr Carmody—There is an entitlement under the law to apply to the tax office for a variation from their withholding, which they could seek to catch up the difference—

Senator FIFIELD—But that is something that has to be initiated by the taxpayer.

Mr Carmody—It is.

Senator FIFIELD—It is not something that they will automatically get.

Mr Carmody—No, and if all of them were to do it it would certainly be a large administrative workload for us and employers.

Senator FIFIELD—So if people did take that up it would be a huge administrative workload on you and on employers? In your experience do people tend to do that?

Mr Carmody—We have not quite had an experience like this so I cannot estimate. Our gut feeling is that most would wait to get it in their tax return.

Senator FIFIELD—So that means, from your professional experience, that most people would have to wait until they filed their tax return and got their tax refund to get that.

Mr Carmody—I would not put it at professional experience because I have not had experience in this before. I was just giving you a gut feeling.

Senator FIFIELD—The effect is that people would have to wait longer. People can talk about retrospectivity, about passing legislation to give effect to the tax cuts so that people would not miss out, but people would miss out because they would have to wait in most cases until they completed their tax return.

Senator WATSON—They could apply for adjustment.

Mr Carmody—By definition they would have to wait for the period of the first few months. After that it is whether they apply for a variation or not.

Senator FIFIELD—So when other senators say that it is okay, that people will ultimately get their money, they may but most people will have to wait.

Senator CONROY—That is not what you said.

Mr Carmody—I said that by definition they would have to wait—

Senator CONROY—Senator Brandis might allow Senator Fifield to verbal you there, but that is not what you said.

CHAIR—You put it in your own words, Mr Carmody.

Mr Carmody—I said, by definition, if the instrument were to be disallowed then they would not receive the benefit of the additional 2005 tax cuts for the period at least up until—

Senator CONROY—That is only if you choose to act in the way that you are currently acting.

CHAIR—Senator Conroy, let him finish.

Senator Abetz—You are trying to verbal him.

Mr Carmody—By definition, if the instrument were to be disallowed, for the period until a new instrument could be made, which requires—

Senator CONROY—That is not correct, Mr Carmody.

CHAIR—Senator Conroy, order always descends on these meetings when you fall silent.

Senator CONROY—When you are not in the chair then we actually proceed along quite nicely.

CHAIR—Mr Carmody has the call to finish his answer. Please do not interrupt him.

Mr Carmody—By operation of the Legislative Instruments Act, if the legislative instrument reflecting the 2005 budget schedules were to be disallowed then a new instrument could be made. That would require the house—the Senate in this case—to pass a motion to allow it to be made, and presumably that would be in August or September. So, by definition, for that period they would not get the additional tax cuts. Then at that point in time, some three months into the year, they would have the choice either of waiting to catch up on that three-month differential when—up to 12 months later—they lodge their tax return and get a refund, or of applying to the tax office for a variation in their instalments. We would then have to approve them and we would have to notify employers to vary, and they would get it then.

Senator CONROY—Or you could anticipate the outcome of a second parliamentary vote.

Mr Carmody—But I have anticipated the possibility of the 2005 tax rate cuts coming in from 1 July. That is why you have an instrument that has been tabled in the House and that will be tabled in the Senate. I have anticipated that.

Senator CONROY—You have chosen to be selective in your anticipation.

CHAIR—Let him finish!

Mr Carmody—What happens depends on whether that instrument is allowed to stand.

Senator FIFIELD—In relation to the schedules, for you to have the certainty to communicate with employers that the 2005 schedules will apply—we know that the schedules have been tabled in the House and they will be tabled in the Senate—what would be sufficient for you to have that certainty? Would it be sufficient for the Leader of the Opposition to stand

up in the House today and say that the opposition will not disallow the 2005 schedules? Would that be sufficient certainty for you?

Mr Carmody—If that were to occur I would feel comfortable advising employers to proceed on the basis that the 2005 schedules would apply from 1 July.

Senator FIFIELD—So if Mr Beazley did that today, which would also provide certainty—

Senator CONROY—So the Treasurer's saying that they are going to pass ultimately does not give you confidence?

Senator FIFIELD—for the business, MYOB—

Mr Carmody—I have answered—

CHAIR—One question at a time. Senator Fifield has the call.

Senator SHERRY—Chair, on a point of order: I want to clarify our program. We have extended questions for 15 minutes.

CHAIR—We have.

Senator SHERRY—The program is under considerable pressure. If we are going on—I am not advocating we should—what is the situation?

CHAIR—I was going to extend to Senator Fifield the same courtesy I extended to you at 11 o'clock last night and let him finish his line of questioning as long as it does not take too much longer. Senator Fifield, you may continue on that basis.

Senator FIFIELD—Commissioner, if Mr Beazley were to stand up in the House today and say that the opposition would not disallow the 2005 schedules would that provide certainty for a business such as MYOB, whose deadline is 6 June? Today is the last sitting day before MYOB's deadline. Would it also be adequate for you if Senator Conroy, in this forum today, indicated on behalf of the opposition that Labor would not block the 2005 schedules?

Senator CONROY—Can you answer hypothetical questions?

Senator FIFIELD—It is not a hypothetical question.

Senator CONROY—It is an entirely hypothetical question.

Senator FIFIELD—It goes to the heart of tax administration, as to what would be sufficient for the tax commissioner to have certainty.

Mr Carmody—If there were to be such an announcement, I think it would be a reasonable judgment for people to make to work towards the 2005 schedules.

Senator CONROY—So the Treasurer stating that the 2005 tax cuts will be law isn't enough?

Mr Carmody—It is enough for me to produce a legislative instrument reflecting those. I have said to you, Senator, that I am entitled to take into account a belief that the rates will change in the future. I have done that and that is why I have produced schedules reflecting those. And, as required by the Legislative Instruments Act, I have arranged for those schedules to be tabled. I have done exactly as you asked, Senator.

Senator CONROY—Don't verbal me, Mr Carmody.

Senator FIFIELD—Commissioner, I am endeavouring to help you in the administration of the tax law here and to provide certainty for Australian taxpayers. Rather than blaming the confusion on you, Commissioner, which is in no way your fault, I am seeking to help clarify that confusion. If Senator Conroy or Senator Sherry would like to declare here and now that Labor will not disallow the 2005 schedules that would be helpful for this committee and the Australian people.

Senator CONROY—Is this a question to the tax commissioner or to me, Chair?

Senator FIFIELD—The record will show that—

CHAIR—Senator Fifield, I do not think that was a question. Do you have a question?

Senator FIFIELD—Would it be sufficient for the commissioner to provide certainty if that declaration were made by Senators Conroy or Sherry?

Mr Carmody—As I have indicated, I think employers would be entitled, if that were to occur, to proceed on the basis of preparing for the 2005 budget schedules to apply from 1 July, and that is what we would do.

Proceedings suspended from 12.48 pm to 1.35 pm

CHAIR—Before the luncheon suspension there was a procedural debate in which Senator Conroy moved a point of order and Senator Murray also moved a point of order. Senator Conroy has indicated to me that he wants to say something more about that.

Senator CONROY—I have spoken with the clerk, who has advised me verbally—and will provide a letter to the committee to indicate this—that in his view there is no basis whatsoever for Senator Brandis's ruling that you cannot ask a question unless you are prepared to table the letter you are reading from. I want to put on the record that the letter is coming and that the clerk has said that there is no basis whatsoever for Senator Brandis's earlier ruling.

CHAIR—Thank you, Senator Conroy. Senator Murray also took a point of order in which he said—if I may summarise this, and Senator Murray may correct me if I get this wrong—that my ruling that Senator Conroy should not ask a question of Mr Carmody in which he was quoting from a document without putting the document before Mr Carmody was inconsistent with a ruling I had given in proceedings of this committee in Brisbane. I told Senator Murray that I would get back to him after having consulted the transcript of the *Hansard*. I have done that. The ruling that Senator Murray was referring to took place on 26 April at hearings of this committee into the Tax Laws Amendment (2005 Measures No. 1) Bill 2005. The relevant portion of the *Hansard* is page E4. Senator Murray, in taking a point of order, said relevantly:

Senator MURRAY—Chair, I raise a point of order: I wonder, for the benefit of the committee and for *Hansard*, if Senator Watson could give us the source of that information so that we can reference it, please.

CHAIR—There is no point of order, but if Senator Watson wants to give the source of that information that is a matter for him.

I have read the *Hansard*. I have also discussed the matter with Senator Watson. It is perfectly clear that what Senator Watson was doing was putting certain propositions and questions to a witness on the basis of private notes of his own. He was not asking the witness questions

about a document, nor was he quoting from a document. Therefore I can see no inconsistency between that ruling and the ruling I made earlier today.

Senator Conroy, in relation to your observation, I simply say that there is an overriding obligation on a chair to keep order. There is also an overriding obligation on a chair of proceedings in which questions are asked of witnesses to ensure that all people asking questions of witnesses treat the witnesses fairly. I take the view, which I regard as a commonplace view, that if a witness is being asked questions on the basis of selective quotation from a document it is a matter of fairness that the witness sees the document which is being selectively quoted from when being questioned upon it. I adhere to my earlier view.

Senator CONROY—Mr Carmody, let us come back to anticipating parliament. You are aware of the power of either house of parliament to reverse a previous disallowance motion, aren't you?

Mr Carmody—To reverse a disallowance motion under the Legislative Instruments Act?

Senator CONROY—No, under the powers of the parliament. I think you actually indicated that you believed that was the case in earlier discussions. I want to confirm that you understand that it is possible and that it was actually around—

Mr Carmody—Under the Legislative Instruments Act my understanding of how the system operates is that if an instrument is disallowed then normally a replacement instrument cannot be tabled until six months after.

Senator CONROY—That is correct but I am not talking about a replacement instrument; I am talking about the capacity for either chamber of parliament to reverse a disallowance.

Mr Carmody—I am only looking at the Legislative Instruments Act, which is the one I have been operating on.

Senator CONROY—I will dig out the transcript. I understood that either chamber can reverse a disallowance position. In other words, it can overturn a previous decision of the Senate.

Mr Carmody—We are looking, here, at legislative instruments. I am assuming the terms of the Legislative Instruments Act apply in relation to these instruments. It has specific provisions about the effect of a disallowance.

Senator CONROY—So you are saying that you are not aware that—

Mr Carmody—I am operating on the Legislative Instruments Act.

Senator CONROY—There are more than the one act involved here. Are you aware that the Senate, for instance, can reverse a disallowance?

Mr Carmody—I am only aware of the Legislative Instruments Act.

Senator CONROY—Can I take it that means you are not aware?

Mr Carmody—I do not know the detail of how that applies.

Senator CONROY—If I could adopt the procedure of my colleague Senator Fifield: would you be satisfied if the Treasurer announced that the government would reverse a Senate

disallowance of the withholding schedules, that those withholding schedules could apply from 1 July 2005?

Mr Carmody—I could not be satisfied because I cannot reconcile how that rests with the operation of the Legislative Instruments Act.

Senator CONROY—Have you taken any legal advice on this?

Mr Carmody—Not on that, because I have taken legal advice on the Legislative Instruments Act.

Senator CONROY—If the Treasurer stood up and said that no matter what happens in the next few weeks of parliament, he would reverse the disallowable instrument decision—if that is what the decision was—would you then be in a position to advise people that they can go ahead from 1 July?

Mr Carmody—I would need to take advice on the effect of that statement and the ability to reverse retrospectively, because I am operating on the basis of advice and the operation of the Legislative Instruments Act which seems to be quite specific in its terms. I cannot see how it would operate.

Senator CONROY—Before Senator Brandis decided to overturn Senate procedure I was quoting to you from a letter from Harry Evans which I am—and always was—perfectly happy to table. I have a copy here. He was discussing Senate procedure and said:

Alternatively, the Senate could be summoned to meet on or after 1 July to approve the remaking—

CHAIR—Senator Conroy, I do not want to constrain you. Do you have the letter there?

Mr Carmody—I do now.

CHAIR—Read it for yourself. Familiarise yourself with it and then Senator Conroy can direct you to the part that he wants to ask you a question about. That is what you should have done before lunch.

Senator CONROY—In your opinion.

CHAIR—That is right.

Mr Carmody—I have read that now.

Senator CONROY—On the second page he talks about the withholding schedules being disallowed. There is no argument about that. In that last sentence he goes on to say:

Alternatively, the Senate could be summoned to meet on or after 1 July to approve the remaking of the schedules with effect from 1 July.

In other words that would overturn the disallowance.

Mr Carmody—That is what I said applied. Under the Legislative Instruments Act, if it is disallowed the provisions say a new schedule is not allowed to be put in for six months. However, as I indicated, a house of parliament can say, ‘No, we override that requirement to allow a new schedule to come in at an earlier date.’ That is the Legislative Instruments Act.

Senator CONROY—Going back: would you be satisfied if the Treasurer announced that the government would reverse, remake, the schedules so that those withholding schedules

could apply from 1 July 2005 no matter what happened in the next few weeks? Would that give you confidence?

Mr Carmody—I do not think the provisions would allow them in, say, August to remake with effect from 1 July.

Senator CONROY—Why do you think that?

Mr Carmody—That is my reading of the operation of the law.

Senator CONROY—Have you got legal advice on that?

Mr Carmody—I have not been given legal advice on that specific. The Clerk of the Senate, Mr Evans, seems to be operating on the basis that the Senate is recalled on 1 July.

Senator CONROY—No. He says, ‘on or after 1 July’, and that can be on 7 August, 10 August or whenever the Senate sits. It does not have to come back on 1 July. According to the Clerk of the Senate, whenever the parliament resumes—whether it is called back early or on its normal resuming date—the government, as we have agreed previously, which will then have a majority, can remake the schedules.

Mr Carmody—It is a question of the date of effect.

CHAIR—Senator Conroy, have you finished your questions on the letter?

Senator CONROY—Yes.

CHAIR—Can we have that copied so that other members of the committee can see it?

Senator CONROY—You have me at a disadvantage now, Mr Carmody. I do not have a copy of the letter.

Mr Carmody—I will read it to you if you like.

Senator CONROY—So the Clerk of the Senate is clearly indicating that the schedules can be remade and applied from 1 July under the powers of the parliament, under the act.

CHAIR—Do you agree with that, Mr Carmody? Is that your interpretation of the letter?

Mr Carmody—He says, ‘however, would not prevent the re-presentation of the bill’—

Senator CONROY—No. He then goes on to talk about something he has talked about earlier when he is talking about the bill. He is saying that that paragraph is a paragraph about—

Mr Carmody—It says:

Alternatively, the Senate could be summoned to meet on or after 1 July to approve the remaking of the schedules with effect from 1 July.’

Senator FIFIELD—Chair, in relation to the document that Senator Conroy has given to the commissioner, I am wondering whether I am able to table a version of that document with some additional comments from the Clerk of the Senate.

Senator CONROY—If he wants to table a document, I am happy for him to table a document.

CHAIR—That is a procedural point. Is it the wish of the committee that Senator Fifield table that document? There being no objection, you may do so, Senator Fifield.

Senator FIFIELD—A section of the document says:

The advice dealt with what was possible, not what was ethical or proper.

Senator WONG—That is a killer blow!

CHAIR—Are you tabling that?

Senator FIFIELD—I just thought it may be of assistance to the committee—

Senator Kemp—I think that is quite an important point, Senator Fifield.

Senator FIFIELD—that the advice the Clerk of the Senate provided deals with what is possible.

Senator CONROY—Before he keeps reading from it he should table it, to be consistent.

CHAIR—I think he just did.

Senator Kemp—I think that is what he wanted to do.

Senator CONROY—We asked him to, and he kept reading from it. But coming back to the discussions—

CHAIR—Let us get some order here. Senator Fifield, is that all you wanted to say?

Senator FIFIELD—I think the words of the Clerk speak for themselves.

CHAIR—So that is all you wanted to say. Can we have that circulated, please. Senator Conroy, are you able to proceed without a copy of the letter? It is being photocopied right at the minute.

Senator CONROY—I understand that. Mr Carmody, I was not sure whether there is anything you want to add, given that you are getting advice from one of your officials.

Mr Carmody—He cannot give me any advice on this particular point.

Senator CONROY—The Clerk is indicating that this is a course of action that is possible. So, if the Treasurer stands up and says, ‘Irrespective of anything that happens, if the Senate were to disallow it, we will remake the schedules using the Senate,’ would that give you the confidence to proceed?

Mr Carmody—If I understood that they could be made with retrospective effect back to 1 July.

Senator CONROY—Would that give you the confidence to proceed, as you have previously described, with Mr Beazley’s alleged—

Mr Carmody—If the operation of the law were such that a legislative instrument could be passed retrospectively to have effect from 1 July 2005, I would need to think through what I would be saying to people.

CHAIR—Do you want to consider that or take some advice?

Mr Carmody—I need to get advice. That is not my understanding of how the instruments operate, but I am happy to get advice on that.

Senator CONROY—My follow-up question is dependent on your answer, so I am a bit stuck.

CHAIR—Are there questions to officers other than Mr Carmody for which he does not need to be here while he considers this? Why don't we stand the proceedings down for a few minutes? Does that suit you, Senator Conroy?

Senator CONROY—No, Senator Wong has some questions for one of the other sections.

CHAIR—Mr Carmody, I will excuse you momentarily for you to consider—

Mr Carmody—I need to get advice.

CHAIR—Perhaps you might take Senator Fifield's letter too, and let us know when you are in a position to give a considered response. We will move on to outcome 2.

[1.52pm]

Department of the Treasury

Senator WONG—Mr Tune, I have some questions regarding Treasury's involvement in the preparation of the Welfare to Work package.

Mr Tune—Yes, I am the right person.

Senator WONG—How many officials do Treasury have on the task force?

Mr Tune—One.

Senator WONG—Can I ask who that was?

Mr Tune—It was an EL2 officer; not an SES officer. It was not me or Mr Heferen. It was a member of Mr Heferen's division, though.

Senator WONG—I understand from the answers given by both Finance and DEWR in estimates that the modelling of the number of people under the government's package would be work performed by Treasury.

Mr Tune—As Senator Sherry asked me last night, Treasury did some modelling of the participation impacts of the various options that were being looked at. One of the figures released from that modelling was done for cabinet. One of the figures that was released was an estimate of 190,000 people extra participating in the work force.

Senator WONG—When was that released?

Mr Tune—The Treasurer announced that on the day of the budget.

Senator WONG—I have his budget lock-up transcript. Is that predicated on Treasury's modelling?

Mr Tune—It basically comes from work done within the task force around the costing of the package. It is an estimate of the number of people who are likely to take up services as a result of the package.

Senator WONG—Is 190,000 the number of people who will need services—that is, training and other support mechanisms—

Mr Tune—Or child-care or something like that.

Senator WONG—or is it the number of people who will move into work as a result of the package?

Mr Tune—The best data we could find was that 190,000 people are likely to require services. That was the best proxy we could find for the number of people who are likely to participate for the first time in the labour force.

Senator WONG—I am a bit confused. Does the number of people requiring services equal the number of people who will move into employment?

Mr Tune—Not employment—participation.

Senator WONG—Sorry, participation in the labour force?

Mr Tune—Yes.

Senator WONG—That is your assumption?

Mr Tune—That is the data we took.

Senator WONG—Can you explain why the Prime Minister has, on the public record, given the lower figure of 100,000?

Mr Tune—No, I cannot. I am not aware of the Prime Minister making statements to that effect.

Senator WONG—So 190,000 is your estimate?

Mr Tune—That is the figure that we have used.

Senator WONG—How many people did Treasury model as moving onto the enhanced newstart income support mechanism as opposed to the disability support pension?

Mr Tune—We did not do any modelling of that at all. That was all done within the work that the task force would have done through DEWR and DOFA costing the package.

Senator WONG—I understood from previous estimates that Treasury was the department who dealt with the modelling of that aspect of it.

Mr Tune—No, that is not correct. The only modelling we did was the modelling I mentioned to you initially and, as I mentioned to Senator Sherry last night, there was some modelling done on the impact of various options on effective marginal tax rates. We did not do any costing of the proposals and, hence, we did not do any work on the number of people who had moved from one payment to another.

Senator WONG—Who did that?

Mr Tune—DEWR and Finance. It is part of the costing process.

Senator WONG—That is right.

Mr Tune—We did not do the costing.

Senator WONG—No, and Finance refuses to answer how many will move onto different repayments. Of the 190,000, are you able to give us an indication of how many of those are sole parents and how many are disability support pensioners?

Mr Tune—Yes, I might be able to give you a small amount of information. Around 74,000 are people with disabilities and around 117,000 are parents.

Senator WONG—Over what time frame?

Mr Tune—Over the three years.

Senator WONG—Commencing 2006-07?

Mr Tune—Commencing 1 July 2006, yes.

Senator WONG—Over three years.

Mr Tune—Yes, over the ensuing three years.

Senator WONG—Can you break that up and tell me about the figures over the three years? Let us deal with people with disabilities first.

Mr Tune—I have the information here; I just have to add a couple of numbers.

Senator WONG—I am happy to wait. I think other things are happening while you are doing that, so I am sure no-one will mind.

Mr Tune—Of people with disabilities, in 2006-07 there are 38,000; in 2007-08, 18,000; in 2008-09, 18,000. Those numbers are rounded to the thousand. The residual is the parents, and there are 43,000 for 2006-07; 60,000-odd for 2007-08; and 14,000-odd for 2008-09.

Senator WONG—I am a bit confused. Why is the figure for the first year over double those of the later years? Let us start from the beginning. I assume your modelling was predicated on projected inflows into the DSP.

Mr Tune—It is also a stock of people, because you have a stock of people who, for example, are already on DSP who are not participating at the moment—

Senator WONG—About 700,000.

Mr Tune—but who, under the new regime, may require services, seek services or be required to take up those services.

Senator WONG—How many of the 38,000 were existing stock?

Mr Tune—About 29,000.

Senator WONG—So 29,000 in the first year were existing stock.

Mr Tune—Yes.

Senator WONG—And in 2007-08?

Mr Tune—46,000.

Senator WONG—Sorry, I was talking about people with disabilities. I thought 38,000, 18,000 and 18,000 were the numbers you gave me.

Mr Tune—Yes, sorry.

Senator WONG—Shall we start from the beginning again?

Mr Tune—Yes. Ignore the 29,000.

Senator WONG—How many of the 38,000—

Mr Tune—It is all flows with the people with disabilities.

Senator WONG—How many of the 38,000 were from the existing stock?

Mr Tune—It is a flow, so it is the new flow of people.

Senator WONG—This is inflows only?

Mr Tune—For the people with disabilities it is, yes.

Senator WONG—So, for the 74,000 for DSP, there is no assumption that anyone currently on the payment will move into work?

Mr Tune—Not according to these figures, no.

Senator WONG—What does that mean?

Mr Tune—The figures in front of me do not show any stock.

Senator WONG—So you are affirming for me that the government's modelling of 74,000 people with disabilities moving into the work force is not predicated on any of the existing DSP recipients moving into the work force?

Mr Tune—Yes, that is correct—taking up services and, hence, our assumption that they would move into work force.

Senator WONG—Thank you. Shall we move on to parents then? Of the 43,000 in 2006-07, how many are existing?

Mr Tune—About 29,000. And in 2007-08, 46,000.

Senator WONG—And the 46,000 of the 60,000?

Mr Tune—Sorry, I am missing something.

Senator WONG—I thought the figures for parents, broken up over the three years from 2006-07, were 43,000; 60,000; and 14,000. Did I not annotate those correctly?

Mr Tune—No, you got those right.

Senator WONG—So, of the 60,000 in 2007-08, are 46,000 the existing stock?

Mr Tune—That is correct. Then the figure of about 14,000 is the flow—the new people. 46,000 and 14,000 should come to 60,000.

Senator WONG—Yes, okay. And then in 2007-08 and 2008-09?

Mr Tune—All of it is flow. The 14,000 is all flow. None of it is stock.

Senator WONG—Is the assumption, therefore, that all the people who are currently on the parenting payment who will be required under the new arrangements to engage in work have done so by 2007-08?

Mr Tune—In relation only to those who are voluntarily taking up work. I am sorry, there is a group there who, if a child turns six, have a year to take up work. So you are assuming most of that is going to occur in 2007-08, yes. That would be the basis for coming to that view.

Senator WONG—So can I just confirm those. People with a disability: a total of 74,000, all of it assumed to be inflows?

Mr Tune—Yes.

Senator WONG—And with parents: a total of 117,000, with existing stock—for want of a better term—being 29,000 in 2006-07 and 46,000 in 2007-08?

Mr Tune—Yes.

Senator WONG—With the remainder all being inflows?

Mr Tune—Correct.

Senator WONG—When were those figures provided to government?

Mr Tune—To government?

Senator WONG—Yes; the modelling and the inflows.

Mr Tune—The modelling was done around particular options two to three weeks before the budget, probably.

Senator WONG—What is the assumption underpinning the number of people with a disability entering enhanced Newstart in your figures?

Mr Tune—No, we did not have those data. As I mentioned earlier, that would have come out of the costing process. We do not have that information.

Senator WONG—I am trying to work out what your base inflow for people with a disability was.

Mr Tune—I do not know.

Senator WONG—You must have, because you have costed only base inflows, you have said.

Mr Tune—No, we were given this information. We did not derive this. This is information that we input into the model.

Senator WONG—So you were just provided with data that said, ‘This is the number of people who will’—what?

Mr Tune—Require services or are likely to receive services. So they were costing the services side of the package, and these were the numbers that they were inputting into that model to determine that.

Senator WONG—Who provided you with that data?

Mr Tune—Department of finance.

Senator WONG—Finance or DEWR?

Mr Heferen—That is correct. It is an agreed costing between the department of finance and DEWR. They go through the process. They discuss the assumptions and they come up with what they can both agree will be the basis for doing the costings. We do not really input into that; we take that as a given and, as Mr Tune said, that feeds into the modelling process.

Senator WONG—I am not clear. What was the nature of the data they gave you?

Mr Tune—They gave me the data I have just read out to you.

Senator WONG—That is what they gave you?

Mr Tune—Yes.

Senator WONG—So they give you the data that says, ‘Assume this many people were moving into work,’ from each of those cohorts?

Mr Tune—Yes. We were asked to try to work through the participation index. We needed some data out of the costing process to try to come to a view of where to start that process, so that is why we asked for that information. Then we plugged that into our models, in essence, and out came the results.

Mr Heferen—As Mr Tune has noted, it is a proxy for the participation, but it was the best proxy we could get.

Senator WONG—Why is that?

Mr Tune—The impact on participation could be from a whole range of things. You are talking about an ABS type concept of participation in the work force, and it can encompass a person working or looking for work for an hour a week or more. So it is a different concept to measuring numbers of people on newstart, for example. Even though they both might have a person unemployed under the ABS definition receiving newstart, there are lots and lots of differences between the two things. So trying to get to the economic concept of participation is not the same thing as working with people who are on income support.

Senator WONG—Yes, I understand that. You also said at the outset, Mr Tune, that you had done some work on modelling effective marginal of tax rates, I suppose.

Mr Tune—Yes.

Senator WONG—It is the case, isn't it, that the enhanced Newstart actually has a higher taper rate than the DSP and the parenting payment, even with the changes the government has put in place?

Mr Tune—Yes.

Senator WONG—And the free area is more generous in relation to earnings if you are on the pension or the parenting payment?

Mr Tune—Yes, that is correct.

Senator WONG—So in fact it is the case, isn't it, that the enhanced newstart payment is a payment on which people would actually retain less of income earned than they would if they were on the parenting payment or the DSP?

Mr Tune—Not really, because no existing recipient is being transferred to the enhanced Newstart. It depends on what you want to compare it against. I would compare it against those who are existing recipients, where there is no change. A new recipient who applies after 1 July next year has never received DSP or never received parenting payment single, so there is no counterfactual in essence.

Senator WONG—That is not the case, because the government's policy is that those who apply after 11 May will be reviewed against new criteria. But let's leave that to one side. We have person X who is on the DSP and earns a certain amount. I am putting to you that, given the answers you have given about the free area and the taper rate, they would actually retain more of their income earned than a similar person on the enhanced newstart payment?

Mr Tune—If you compare a person who applies for DSP after 1 July and is not able to work 15 hours or more a week and hence is eligible for DSP, and then they have income from somewhere, presumably not work—it might be investment income, I assume—yes, you are

correct, vis-a-vis someone who applies after 1 July 2006 and is not eligible for DSP. That is obvious.

Senator WONG—The effective marginal tax rate for enhanced Newstart is higher than is currently the case on the parenting payment?

Mr Tune—No. You need to be very careful about saying that. Effective marginal tax rates are not only the product of the withdrawal rates but also a function of the tax payment.

Senator WONG—And the free area.

Mr Tune—And the free area, or the free area exempts you from—

Senator WONG—Correct.

Mr Tune—Well, it does not totally exempt you from an MTR.

Senator WONG—Up to a certain point it does, I suppose.

Mr Tune—But, in the way the MTRs work, you do not just add the tax rate to the withdrawal rate. You can end up in a situation where a person on DSP, for example, has a higher effective marginal tax rate than someone who is on a taxable payment. That occurs because the DSP is non-taxable.

Senator WONG—I am asking you to compare DSP and parenting with the enhanced Newstart. It is the case that if you earned a certain amount whilst on DSP or parenting payment, given the higher free area and the lower taper rate, you would retain more of the income earned than you would if you were on the enhanced Newstart?

Mr Tune—Under the assumptions I mentioned, yes. But it is the counterfactual. You have to be careful that you compare the right sorts of things.

Senator WONG—It is a policy issue about what payment people are moved onto and to what extent it is a disincentive to work.

Mr Tune—I guess my point is they are not being moved onto anything; they are applying for a payment after 1 July.

Senator WONG—That is a different issue. Thank you very much.

[2.07 pm]

Australian Taxation Office

CHAIR—Mr Carmody is back, but Senator Conroy is not. Senator Watson, we will go to you for the time being.

Senator WATSON—Mr Carmody, in the letter to Senator Evans from Harry Evans—this document has now been tabled—the Clerk refers to your powers ‘of withholding schedules made under section 15-25 of Schedule 1 of the Taxation Administration Act’. Earlier today I understood that your powers were now under the Legislative Instruments Act. Which is correct?

Mr Carmody—I make a schedule under the tax act, but under the Legislative Instruments Act that becomes a legislative instrument, which has to be tabled. So it is still made under my powers under the tax act.

CHAIR—Are there any other questions to Mr Carmody? We have left some other questions pending, so I will take some of those at the moment if they are brief.

Senator MURRAY—I have some questions on a different topic, Chair, and I am happy to be cut off when you want to return to the tax issue. Mr Carmody, I was both very pleased and not pleased by the answer you gave me to my lengthy written question on the superannuation co-contribution. You answered:

The information requested will be presented to the Parliament by the Minister for Revenue and Assistant Treasurer as part of the requirements of the Superannuation (Government Co-contribution for Low Income Earners) Act 2003.

I was pleased with that response because a considerable amount of information had been asked for. But you then said:

The report will be presented after the end of the financial year.

I did not think that was satisfactory if you had the information already available. Is there a reason for refusing to give information which obviously is available?

Mr Jackson—The information is not yet complete. We have not had the full cycle of the co-contributions year, and there is a requirement by the parliament to report on certain things at the conclusion of the year. It would have been pre-emptive of that report to provide this information which is not entirely complete and will be reported shortly anyway.

Senator MURRAY—That is reasonable, Mr Jackson. Because this is a question from the committee, by virtue of the estimates process, can I ask that when the report is tabled the information is also be provided to the committee?

Mr Jackson—Certainly; no problem.

Senator MURRAY—Thank you very much; I appreciate that.

Senator SHERRY—To date what is the total number of individuals who receive the co-contribution and the total quantum of money?

Mr Jackson—Our most recent report was tabled in, I think, early May—I forget the exact date—and there were 516,000 people had received their co-contribution payment and the amount that had been paid over was about \$275 million.

Senator SHERRY—What was the original estimate?

Mr Jackson—I forget. I think—

Senator SHERRY—I can see Mr Gallagher leaping to his feet.

Mr Jackson—Very anxious to come and join our discussion, I am sure. There were some original numbers in the EM which were subsequently revised and I am not sure they were publicly announced.

Mr Gallagher—The amount to date is slightly in excess of the estimate as we had it. We had an estimate of \$275 million, and the amount paid is now in excess of that amount.

Senator SHERRY—What was the original base number, Mr Gallagher?

Mr Gallagher—I am not sure of the variation in those estimates. This happens with a considerable lag. It might have been there. An important point is that the co-contribution is

slightly ahead of estimates. The other important point is that there was a very significant change in the costing for behaviour in the subsequent years when the co-contribution goes to 1.5 to one.

Senator SHERRY—Can I get to that in a second. Can I just come back to you, Mr Jackson. Do you have any estimate of both the number of individuals and the quantum that is outstanding at this time?

Mr Jackson—No, I do not have that.

Senator SHERRY—At the last Senate estimates with respect to questions to Mr Carmody on originally the surcharge issue—

Mr Jackson—I recall.

Senator SHERRY—and then the co-contribution and SG back payments, it was acknowledged that there were some difficulties with the computer system and that was impacting on the co-contribution payments at that time. Have those difficulties been overcome with respect to the co-contribution?

Mr Jackson—The exact difficulties that related to the super surcharge system were not quite the same. Essentially, there are still cases of co-contribution where no TFNs are provided by funds in the member contribution reporting because the funds do not have those TFNs. But, in dealing with the superannuation surcharge problems, we have developed some systems to handle those and we are currently progressing those systems. There are no cases, in that sense, held up by that process. I guess there are situations where we have a member contribution reported to us where we believe, based on the level of contribution made, that there may be a possibility of a co-contribution payment arising that we are in the process of endeavouring to match. If I could just recall some numbers from last time, I think out of the 16.5 million or so member contribution statements we get each year we get down to about one million that we have difficulties matching. My recollection at the moment is that there are in the order of 60,000 cases where there may be a co-contribution arising when the match is done. That is not to say there will be.

Senator SHERRY—So that is 60,000, question mark.

Mr Jackson—Yes.

Senator SHERRY—In what time frame will that match be done?

Mr Jackson—We are in the process of working on that now. I cannot give you an exact time.

Senator SHERRY—Do you have any indicative date for when that match will be concluded?

Mr Jackson—I do not at the moment, no.

Senator SHERRY—In a case where a match cannot be made, is there any ongoing liability on the government to pay the co-contribution if the individual comes back and says, ‘Where is my co-contribution?’

Mr Jackson—There is an obligation to pay where the information was available to the government to produce the match and it has not been done in 60 days. In cases where we do

not have the information to make that match, though, no liability will arise, as I understand it, until we have sufficient information to make the match. So if we do not have the TFN that allows us to make that match, there would be no liability, as I understand it.

Senator SHERRY—It is over budget to date, and therefore the additional payment, if you like, by the end of the financial year is certainly going to grow more. We do not have that precise figure yet; I understand that. Mr Gallagher, has that led you to revise the costings of this measure going forward?

Mr Gallagher—It is something that we will be monitoring to see whether we should. But at this point we have not revised because there is a very significant behavioural change allowed for in the next year's estimates.

Senator SHERRY—That is because of the extra—

Mr Gallagher—Yes, the 1.5 to one: \$1.50 for a dollar contribution.

Senator SHERRY—Do you have the 2008-09 figure for the co-contribution?

Mr Gallagher—The basis for accounting for the co-contribution has changed from the tax liability method to an economic transactions method, which has brought forward some of the numbers, and that is apparent in the portfolio budget statement. On an ETM, economic transactions method, basis, which looks at the income year and allows for the expenditure in relation to an income year, I have a number of 1.15 in 2008-09.

Senator SHERRY—What is the number in 2007-08?

Mr Gallagher—1.11.

Senator SHERRY—And 2006-07?

Mr Gallagher—1.06.

Senator SHERRY—So that is on the basis of the change in the treatment; but, at this point in time, there is no revision of the estimate because there may be a higher take-up?

Mr Gallagher—The estimate has been revised. The TLM estimate for 2004-05 has been revised up.

Senator SHERRY—What is the revision?

Mr Gallagher—My understanding is that that estimate has been revised up from \$305 million to \$335 million.

Senator SHERRY—That is because of the TLM revision? That is the basis of that change?

Mr Gallagher—No, it is an allowance in the forward estimates. On page 221 of the portfolio budget statement for the Treasury portfolio you will see that in 2004-05 there is an amount of \$1.285 billion allowed for, which is the confluence of two years. It is the \$335 million TLM estimate and the new ETM estimate of \$950 million for the next year.

Senator SHERRY—Mr Jackson, you may be able to answer this. I got a response to a question on notice relating to co-contributions. I had asked for anyone who received payment of the super co-contribution with a taxable income of zero or less than zero up to the period, and I am informed that as at 18 February there were 1,245 individuals.

Mr Jackson—That sounds right.

Senator SHERRY—How can a co-contribution payment be made to a person who is on a zero or less than zero income? If you do not have any money, how can you put in \$1,000 or up to \$1,000?

Mr Jackson—I would have to look at the cases. I would hate to speculate on that just at the moment.

Mr Gallagher—I have no knowledge of the cases. Theoretically it is possible with deductions. A person can have employment income, and therefore qualify for the co-contribution because of employment income, but have deductions.

Senator SHERRY—I do not have any further questions on the co-contribution.

CHAIR—I think it is convenient to return to the topic we left a little while ago.

Senator CONROY—We were waiting on the ponderings and thoughts of Mr Carmody.

Mr Carmody—In the time available to me I have had a look at the provisions. On the basis of that, I do not believe that I could anticipate in the way you suggested, Senator Conroy. As I have indicated to you before, I can anticipate the passage of legislation in determining the amount to include in schedules for withholding. If those schedules and the instrument were to be disallowed before 1 July, or by 30 June, then the Legislative Instruments Act says that I cannot make another instrument. You have pointed out that, let us say, the Treasurer were to say that somehow by an amendment in the future, say in August—

Senator CONROY—It is called remaking.

Mr Carmody—they would give me the power to remake it. The problem is: for me to advise employers to withhold at a particular rate I have to make a schedule, and as at 1 July the law would say I am not allowed to make that schedule. So I cannot make a schedule to allow employers to withhold at those rates.

Senator CONROY—You indicated earlier you were not sure whether or not a legislative instrument could be retrospective. Have you sought any advice on that?

Mr Carmody—I do not think that makes any difference. Say they could put in an amendment to the Legislative Instruments Act to allow that to happen—let us just say they could do it or they could not—

Senator CONROY—No, I am not suggesting that the Legislative Instruments Act be amended. Any legislative instruments can be retrospective. Do we agree on that?

Mr Carmody—I will assume that; I will take that as a given. The problem for me is: to allow employers, authorise employers, to withdraw tax at a particular rate I have to, by law, make an instrument. The law as it would stand at 1 July would say, ‘Commissioner, you are not entitled by law to make an instrument.’ So I just could not make an instrument to allow employers to withdraw tax at that rate.

Senator CONROY—You have wide anticipatory powers, we have agreed.

Mr Carmody—I do. But it is a question of law. The anticipation that I can do is that, in making the amounts within the schedules that I make, I can anticipate what the rates will be.

That is a different question. But when the law says, ‘Commissioner, you cannot make an instrument,’ even if it is said that there will be in the future retrospective law to change that, I cannot make that instrument under the law.

Senator CONROY—But you have made an instrument based on legislation that is likely to be defeated in the parliament now.

Mr Carmody—Yes, but what I am anticipating there is the amounts included in the schedule. That is a different—

Senator CONROY—No, you are anticipating the successful passage ultimately in August.

Mr Carmody—The practical effect of that is that I am anticipating, yes, that the law will pass and therefore—

Senator CONROY—Yes, in August.

CHAIR—Let him finish. Go on, Mr Carmody: therefore—

Mr Carmody—Therefore, I can anticipate in the rates that I include in the schedule, the instrument, that fact or that anticipation. That is different to: if the law says, ‘Commissioner, you are not allowed to make an instrument’—that is, not ‘what is in an instrument’ but ‘you are not allowed to make an instrument’. I do not have the power to do that, even though someone says, ‘In the future I will retrospectively give you that power.’

Senator CONROY—Senator Brandis, he is not allowed to jump in if you have told me to shut up and wait.

CHAIR—You have the call generally at the moment, Senator Conroy.

Senator CONROY—I do have the call, and I appreciate that.

CHAIR—I do generally allow discussion, but you go ahead, Senator Conroy.

Senator CONROY—Thank you. So you can anticipate that legislation which is going to be defeated between now and 1 July will ultimately be passed, but you cannot anticipate that the Treasurer will stand up and say, ‘If the Senate disallows the instrument, then when the Senate reconvenes it will remake the schedule effective from 1 July’? You can anticipate one but you cannot anticipate the other?

Mr Carmody—I will try and explain again.

CHAIR—Let me make it perfectly clear to everybody: Mr Carmody, you explain in your own words and you take as long as you need to and nobody is going to interrupt.

Mr Carmody—Thank you. To authorise employers to withhold tax at a particular rate I have to make a schedule; that is a legislative instrument. Under the tax law, in making a schedule I have advice that I can anticipate that particular rates of a tax will apply in the future year, even though the bill has not been passed yet. So by law I can make a schedule, and in terms of the amounts included in the schedule I can anticipate something.

You are putting the proposition that the legislative instrument has been disallowed. By the operation of the law as it is presently on the books, I am not entitled to make a schedule—not anticipate what might be in a schedule but not entitled to make a schedule. The fact someone

says that in the future that will somehow be changed does not alter the fact that the law as it stands at the time says, ‘You cannot make a schedule.’

Senator CONROY—Commissioner, what about your powers to vary withholdings based on existing—

CHAIR—Are you going on to a different point now, Senator Conroy?

Senator CONROY—No, this is the same point: section 15-15. Would that variation be a disallowable instrument? Will any variation of the schedule even for an individual taxpayer be disallowable?

Mr Carmody—That is an interesting question. It will certainly be interesting if we have to put in legislative instruments for particular variations, but I have not pursued that question.

CHAIR—Mr Carmody, listening to your earlier answer, because this is a slightly different point, I have just been looking at section 48 of the Legislative Instruments Act and it seems to me that what you said, from my point of view, is plainly correct.

Mr Carmody—Thank you, Senator.

Senator CONROY—Thank you for your esteemed political and legal commentary.

CHAIR—You should read the statute before you venture erroneous views about the law, Senator Conroy.

Senator CONROY—I am glad to see you are impartially chairing the meeting, as always.

CHAIR—I am trying to be as much within the limits of provocation as I may.

Mr Carmody—Can I perhaps anticipate—

Senator CONROY—Anticipation is something that you are very selective in, Mr Carmody, but feel free.

Mr Carmody—I anticipate within my authority under the law, Senator, and that is what I am trying to do. We had a discussion earlier in which you pointed out that, in terms of the then existing operation of the law, we made and gazetted instruments near the end of June.

I pointed out to you that because of the operation of the Legislative Instruments Act, it seemed to me the ethical and appropriate way to act when, in the new environment, as soon as we have determined what the schedule should be, that should be the point at which I make them, and I think Mr Evans had said that in theory I could have continued the practice of making them at 23 June. I took the view that under the new environment with the Legislative Instruments Act it would be inappropriate for me to do so.

Senator CONROY—It does give you as soon as practicable or 28 days?

Mr Carmody—It does not say 28 days, no. The only point I was going to make is that I notice in the exchange tabled by Senator Fifield—

Senator CONROY—That would be where the Treasurer was trying to monster the clerk.

Mr Carmody—Mr Evans said that the advice dealt with what was possible, not what was ethical or proper. So I take some comfort from that.

CHAIR—Implying that the alternative course would not be ethical or proper?

Mr Carmody—It could be. But I just say that I took a particular view that it was ethical and proper for me to do it in the new environment at the time we determined it. I guess if your question was leading to whether I could use some other mechanism to do a variation for everybody to try to overcome the impact of the operation of the law, I would certainly view that as unethical and improper.

Senator CONROY—Thank you for anticipating my question or even asking yourself questions. Are there any other questions you would like to ask yourself? You can just keep asking yourself questions.

CHAIR—Senator Conroy, do you have any other topics you want to canvass?

Senator CONROY—I am happy to pass to Senator Fifield.

Senator FIFIELD—Commissioner, I wish to follow up the points that Senator Conroy was making in terms of the extent to which you can anticipate, you can really only anticipate on the basis of the government's original stated intention to introduce a bill to introduce tax; you cannot anticipate further stages down the track once something has been disallowed?

Senator CONROY—Selective anticipation.

Mr Carmody—No, as I tried to explain, there were two very different things. I can anticipate in terms of specifying the amount within schedules. I cannot anticipate as to my power to make a schedule.

Senator FIFIELD—That clarifies it. Thank you very much. Going back to the letter that Senator Conroy tabled from the Clerk of the Senate, another impediment obviously for you, if the schedules were disallowed is, as Mr Evans says, that you would have to wait six months before you could again introduce those schedules. That is another clear impediment for Australian taxpayers—a delay in their getting their tax cuts. He went on to say:

This problem could be avoided by making the withholding schedules different in some way (and, given their nature, virtually any difference would be a substantial difference).

To me that sounds like making a difference of a full stop, a comma or a word here or there.

Mr Carmody—I have difficulty with that position. I just need to go back to when you said six months. That can be shortened by the House changing that.

Senator FIFIELD—Sure.

Mr Carmody—These schedules are specifying rates. The rates would not change if I reissued them. To me, they are materially the same.

Senator FIFIELD—It would be almost legislative fraud to do so.

Mr Carmody—As I said before, I suspect it would be the sort of behaviour that, if taxpayers were to employ in their tax affairs I would take exemption to.

Senator FIFIELD—Indeed. So you would be wholeheartedly in agreement with the Clerk of the Senate that, although that may well be possible, it is not necessarily ethical or proper to do so.

Mr Carmody—I have made my position clear, that I view that as improper.

Senator FIFIELD—I wanted to confirm that. Going back to the issue of certainty, if we did have the opposition today making it clear that they would not disallow, you could solve everything today, you could solve the uncertainty today?

Mr Carmody—I think employers would be entitled to operate on the basis that the 2005 schedules would apply, and I would certainly operate on that in terms of my preparation.

Senator FIFIELD—Thank you, Commissioner.

Senator SHERRY—Mr Carmody, the surcharge tax on superannuation is not in the same group? The same circumstances do not apply?

Mr Carmody—No, that is different. They are not legislative instrument issues.

Senator SHERRY—Yes, I just wanted to make that clearly understood. Thank you.

CHAIR—On the topic we have just been debating do you still have questions?

Senator CONROY—I want to go over a couple of points. I am intrigued by your capacity to anticipate—and maybe you are going to have to explain it again more slowly for me this time—making a schedule based on legislation that is likely to be defeated. It is not that you are able to anticipate making a schedule on the basis of a disallowance instrument that may or may not be a future activity?.

Mr Carmody—I am not sure how differently I can explain it. Under the law—

Senator Kemp—That question has been asked before.

Senator CONROY—I just said I want to go back over something.

Senator Kemp—It was carefully responded to. It does seem unfortunate that the same question is occurring time and time again.

CHAIR—I think the problem is that it was not a question, it was a statement. Nevertheless, I think Senator Conroy is entitled to re-put a proposition and invite the witness to explain further what he said in the past.

Mr Carmody—I have the power at the moment to make schedules for 2005 withholding. I have legal advice that in determining what rates to include in those schedules I can anticipate passage of legislation. That is one proposition. But recall that is on the basis that I have a power to make the schedule. If those instruments/schedules are disallowed, then as the law would stand at 1 July I do not have the power to make the schedule or the instrument. So one is a question of what I can include in an instrument that I have the power to make. The second proposition, once that instrument is disallowed, is simply that I do not have the power to make that schedule, because the Legislative Instruments Act says that that is the case and that is the position that would be under the law as at 1 July. So by law I could not make an instrument, even if someone said in the future—

Senator CONROY—You can anticipate that the Senate—

Mr Carmody—No, I cannot anticipate—

CHAIR—You do not have the jurisdictional foundation to make the law; that is your point, is it?

Mr Carmody—At one point I have a power to make a schedule under the law. Then there are questions of what I can anticipate in terms of the rates that I include in that schedule. The position I get till 1 July if they have been disallowed is that I do not get past first base. I do not have the power to make the instrument. Full stop. That is the law as it would be.

Senator CONROY—Coming back again to one of the points that we have already discussed, I notice that the LIA does not specify what ‘as soon as practicable after’ means.

Mr Carmody—No, it does not.

Senator CONROY—Although there may be an argument that the LIA seems to suggest that the maximum amount of time available to register an instrument should be no more than 28 days.

Mr Carmody—I do not know where the 28 days—

Senator CONROY—Subsection 29(4) considers that period to be the longest possible period from the registration of a legislative instrument.

Mr Carmody—If it is. But as I have said, under the previous system, when there was not a legislative instrument and it was all in our power, there was nothing wrong because we were going to publish the gazette near to the start of the year informally doing it then. Once we had the Legislative Instruments Act in, which contemplates parliament having the power to disallow the instrument, in that environment I felt it was proper and required of me to make it consistent with that at the earliest possible time, which in my view was as soon as we had determined what the schedules were. I felt that was the ethical and appropriate approach under the new legislative regime.

Senator CONROY—The Treasurer has publicly stated that he was awaiting advice from you over the issue of the schedules and the tax cuts.

Mr Carmody—Yes, he did.

Senator CONROY—He stated that publicly.

Mr Carmody—Yes.

Senator CONROY—What were your dealings with the Treasurer and his office over this issue?

Mr Carmody—At one point I was asked about legal advice. I provided the first set of legal advice and noted that there was a second set of legal advice.

Senator CONROY—What date was that?

Senator CONROY—I am not sure. It is somewhere close to when I made my announcement, not far from then.

Senator CONROY—Obviously prior to it?

Mr Carmody—Yes. And then I got to the point of the formal advice on the legislative instruments, and so that we can be very clear about this—

Senator CONROY—Why did you need legal advice at this point?

Mr Carmody—Because it had been brought to my attention that these were now legislative instruments or were potentially.

Senator CONROY—Just out of interest, who brought it to your attention?

Mr Carmody—One of my wise staff members.

Senator CONROY—Who is the lucky bunny? Who was causing this torture?

CHAIR—Mr Carmody, you were in the middle of saying, ‘so that we can be clear about this’, and you were interrupted.

Mr Carmody—Given this train of questioning, I want to be clear on this. Once I satisfied myself on the basis of the advice that this was a legislative instrument, I then determined that the only course available for me was to do what I did, make the legislative instrument at the time that they were produced and, on the basis of uncertainty as to whether the legislative instrument would be allowed to stand, to produce two schedules. Having determined that, I advised the Treasurer’s staff that that is what I was doing. I will be open with you and say that during the course of preparation of that, given what you have raised, the fact that we only gazetted them in previous circumstances near the end, it was raised whether I should hold off the making/signing until that time that we had employed in the previous. But I took the decision, as I have explained to you, that having produced the schedules and instruments, given the new legislative environment, it was appropriate for me to sign off and make them an instrument then. In advising the Treasurer’s office I did not even canvass the possibility that I would hold off making the legislative instruments. I advised them what I was going to do.

Senator CONROY—But you were happy enough to make legislative instruments based on legislation that was likely to fail?

Mr Carmody—The first set of legal advice was that in determining what amounts to include in the schedules, and therefore the legislative instrument, I was allowed to take into account the fact that, to put it bluntly, around August the bill would be passed. And if I had a belief that that was to occur, then I was entitled in determining the amounts to include in the schedule that belief, and that is what I did. That is why you have got the 2005 schedules and legislative instrument.

Senator CONROY—So even though the legislation authorising those rates was going to be passed in August, it would be deemed to be retrospective to 1 July?

Mr Carmody—That is true, yes.

Senator CONROY—So you accept that the Treasurer could stand up in parliament today and say, ‘I want to make it clear to all Australians that when the parliament returns after 1 July we can repeal and remake the disallowance and we will pass the legislation, that the tax cuts are from 1 July?’ Do you accept the Treasurer can stand up and say that?

Mr Carmody—He can say that, but that does not alter the fact that, if the instrument is disallowed, at 1 July I would need to make an instrument scheduled to allow employers to deduct at a particular rate, and the law as it would stand then does not enable me to get past first base. I am not empowered to make the legislative instrument—

CHAIR—The Treasurer cannot confer legislative power on you.

Senator LUNDY—Don't interrupt!

Senator CONROY—He is doing fine. I would not have thought he needed your commentary along the way.

CHAIR—Just making an observation, Senator Conroy.

Senator CONROY—I think Mr Carmody is doing fine. He does not need your help.

Mr Carmody—Given the time available to me and given your question, that is my understanding of the law.

Senator CONROY—But you accept the Treasurer can make it clear that they apply from 1 July?

Mr Carmody—Yes, he can.

Senator CONROY—The tax cuts are going to be blocked in terms of the legislative vehicle and will be passed in August, and you are perfectly comfortable to anticipate that?

Mr Carmody—I am.

Senator CONROY—Okay. I defer to Senator Mason.

Senator MASON—Commissioner, you may remember the last time we had an enjoyable chat about charities.

Mr Carmody—I will need to get my expert up.

Senator MASON—Mr Carmody, by way of preliminary: do you have a copy of the answer to the question that was taken on notice, that I received this morning? Do you have that with you?

Mr Konza—I am not sure that I have.

Senator MASON—Can I give you a tiny bit of background before I ask a few questions. This morning at about 8 am—my friend Senator Murray alerted me to this—I received the answer to the question you took on notice I think on 17 February. It related of course to concern that some members of the committee had about the Wilderness Society and their political activities. Was it just a coincidence, by the way, that I received the answer this morning? I nearly missed it. It was only serendipity that allowed me to pick up on it.

Mr Konza—The answers that you receive come from the minister's office, so I am not really in—

Senator MASON—I will follow that up with the minister.

Senator SHERRY—Blame the minister.

Senator MASON—In effect you have given a five-page summary of the law as it relates to charitable institutions, and I thank you for that. I read it. I am not sure that I am enlightened following that.

Senator SHERRY—Blame the Treasurer.

Senator MASON—Let us not talk about the law; let us talk about your administration of it. Let us keep it on that basis. When you are determining the charitable purpose of an entity,

do you look both at the rules and the constituent documents, the constitution and so forth, of an entity as well as the particular activities that an entity undertakes?

Mr Konza—Yes, we do.

Senator MASON—All right. How many times have you investigated over the last 10 years an entity on the grounds that some of its activities are political? How often have you done that?

Mr Konza—I would have to take that on notice, obviously.

Senator MASON—That would be good. Has any entity lost their charitable status on that ground?

Mr Konza—Over a 10-year period?

Senator MASON—Yes.

Mr Konza—I would have to take that on notice.

Senator MASON—That is fine. Finally, as I say, I did read the advice and I thank you for it. You will recall that we were having a bit of a debate about what was incidental to the primary purpose, the charitable purpose. For example, the Wilderness Society has a million dollars and it uses 51 per cent of that for environmental education and gives 49 per cent to the Greens, the political party. Is that 49 per cent merely incidental and therefore it is still appropriate that the Wilderness Society maintain its charitable status? We went backwards and forwards.

Finally, I went right down—it was 51 per cent at first, and then down to 40 per cent, 30 per cent, 20 per cent and 10 per cent. You might recall that. You said that you would not be drawn on that, that you would be speculating, and that you would need to go and find out what the law actually says. You have given me what the law says and I thank you for that, but you did not really answer the question—that is: is it 10 per cent, 20 per cent, 30 per cent, 40 per cent or 49 per cent?

Mr Konza—I gave you the answer as—

Senator MASON—As clearly as you could.

Mr Konza—clearly as I could. In fact, I think the answer may even have said that the law does not permit application of mechanical tests to questions of this sort. But we make it clear that for a charity to be a charity all of its purposes must be charitable.

Senator MASON—But not all of its activities?

Mr Konza—Those activities that are not directly charitable must be either ancillary or incidental to the carrying out of charitable activities. This is not something that our administration has developed and it is not peculiar to this jurisdiction.

Senator MASON—Indeed; I do appreciate that. I recall that we got into a debate that there could be a political party that says it wants to destroy the environment, let us say, and a charity whose principal purpose of course is to protect the environment, and if they were to spend all their money attacking that political party, for example, would that be part of the primary purpose?

Mr Konza—The law—

Senator MASON—We did this last time, and I know it was not fair. But I just raise it because—

Senator SHERRY—It was not fair? Mr Chair, he has just admitted he was unfair.

CHAIR—I am sorry, Senator Mason, but if I allowed the question it would have been fair.

Senator MASON—It was not fair of me because I expected Mr Konza to answer questions that I suspect perhaps no-one could.

Mr Konza—In your question then you said that it spent all its money, and that is a relatively easy question to answer. If it had spent all its money fighting a political rival that would not be charitable.

Senator MASON—But you are not sure if it is 40 per cent, 30 per cent or 20 per cent?

Mr Konza—I am sure that 100 per cent is not, because there have been court cases—

Senator MASON—I understand that. You will take those other questions on notice about political activities?

Mr Konza—Yes.

CHAIR—Who else has some questions for Mr Carmody?

Senator SHERRY—I have hours of questions.

Senator LUNDY—I have about 15 minutes on output 3.1.3 in Treasury.

CHAIR—Senator Sherry, I will give Senator Lundy the call to ask her questions, I will give Senator Murray the call to ask his questions and then you can have the rest of the day. Does that suit you?

Senator SHERRY—Thank you, Chair.

[2.53 pm]

Department of the Treasury

Senator LUNDY—My questions are to the Competition and Consumer Policy Division in Treasury. Firstly, can you outline the key or primary consumer issues your division has been focusing on in the last 12 months or so, perhaps in priority order?

Mr French—We have over the last 12 months been focused on a number of projects. Some of those have been principally driven through the MCCA and SCOCA processes—the Ministerial Council on Consumer Affairs and the Standing Committee of Officials on Consumer Affairs. The first of those projects relates to a review of product safety, and we have issued a discussion paper on that issue. We have also been working in the SCOCA context on a review of the penalty provisions that apply to the consumer protection provisions of the Trade Practices Act. That is a project that has been undertaken in consultation with a SCOCA working party which involves the states and territories as well. The third issue relates to work we have been doing with the ACCC, ASIC and the Attorney-General's Department on the compliance of Australia's consumer policy framework with the OECD guidelines on cross-border fraud. I would say those cover the main projects that we have been involved in.

Senator LUNDY—You provide advice to the Parliamentary Secretary to the Treasurer in his capacity as spokesperson for consumer affairs?

Mr French—That is correct.

Senator LUNDY—Can you describe your relationship with the ACCC and how you work with the ACCC in some of the various projects that you have talked about?

Mr French—We would view the Treasury's role as being policy adviser to government. We work quite closely with the ACCC in developing policy, and that reflects their role as enforcer of the law. So on an ongoing basis we are in consultation with the ACCC about issues that might arise in their enforcement role.

Senator LUNDY—In that communication between the department and the ACCC, does the ACCC take the opportunity to raise with the department various consumer issues that they see as emerging problems and, vice versa, do you take the time to advise the ACCC or direct the ACCC to develop a stronger focus on consumer affairs issues that you see developing as a problem?

Mr French—We are in ongoing contact with the ACCC. If they are raising particular problems, then we will certainly discuss that with them. We do not direct the ACCC to do particular things, because that would be inconsistent with the independence of the commission.

Mr Murphy—There are instances whereby the government seeks the ACCC to act in terms of price monitoring in the insurance area. They have been doing that. Consumer matters cut right across the policy responsibilities of the ACCC and Treasury's Competition and Consumer Policy Division. To some extent, although there are specific projects or actions or programs labelled 'consumer', a lot of what else would be termed competition matters have a consumer focus.

Senator LUNDY—Can I use an example. The ACCC currently monitors petrol pricing in both metropolitan and regional areas and then places upon their web site a limited amount of that information in the interests of transparency and scrutiny. Has this department advised the ACCC to make any changes to the way they allow scrutiny of the data they collect?

Mr French—Not to my knowledge.

Senator LUNDY—Would that be a matter of government policy to give that direction to the ACCC, or is it something that you would expect the ACCC to do of their own volition if they felt it would be of some benefit to consumers and indeed competition?

Mr Murphy—We would expect the latter but at the same time, if the government, through ministers or through the department, got feedback that the work the ACCC was doing was not as effective as it should be, we would not be reluctant to pass that information onto the ACCC and talk to them about it. Ministers are very reluctant to give formal directions to regulatory bodies, but that does not mean there is an exchange of information. If the work they were doing on petrol pricing could be made more effective and we were aware of that, we would just talk to the ACCC about it.

Senator LUNDY—So there would not be a formal exchange between, for example, the minister and the ACCC; it would just be informal advice at a departmental level to the ACCC?

Mr Murphy—That would be the starting point. If we felt strongly about it and the ACCC disagreed, and there were representations coming from the public, the minister may be involved—if it were worthwhile.

Senator LUNDY—Further on consumer affairs, the ACCC have an information centre where they collect and collate a whole raft of complaints and process them in various ways. We heard evidence from the ACCC that those complaints only escalate in their status and are actually entered into the information centre's database if they have a relationship with the ACCC—that is, the complaints are an alleged breach or, in their analysis, require further investigation. What feedback or reports, either qualitative or quantitative, about that information centre data do you receive from the ACCC?

Mr French—It would very much depend on the issues that might be emerging. If the ACCC saw a particular trend in the sorts of complaints that were arising, they would generally approach us. If they saw that they were having difficulties which they could not properly address, that is when they would approach us. We meet with them periodically to discuss these sorts of things. I think that would essentially cover it.

Senator LUNDY—If the ACCC were receiving a lot of complaints about an issue but they had formed the view that it was not important enough to advise your division, how would you find out what was happening on the ground and therefore be able to develop policy or policy advice, or at least make some assessment of those issues?

Mr Murphy—I think all regulatory agencies have got to have certain criteria upon which they are going to act. Usually one of the criteria is the number of complaints. I cannot speak for the ACCC but, if there were a plethora of complaints coming in, one would think they would look into that to see whether they had sufficient power to take action. If they felt that they did not have sufficient power, they would bring us into it and say to us, 'You need to do something about the way the act is structured,' or alternatively, 'We haven't got sufficient power; should we have that power?' If it were a sensitive issue or a hot spot, or if the ACCC did not raise it with us, more likely than not there would be representations being made either through consumer bodies or through the general public to ministers. Again there is a litmus or benchmark test, however you want to describe it: as soon as we started getting a few ministerials on a particular subject matter, in proper response to those ministerials we would be going back to the ACCC and asking, 'What's the story about this?' So it is not just the one stream of information.

Mr French—I might add that, in the context of the SCOCA and MCCA processes, there are regular meetings of officials. Not only is Treasury represented on SCOCA but ASIC and the ACCC are also represented there. Our regulators participate in the working groups of SCOCA as well. One of the working groups is looking in particular at emerging issues. Those issues are drawn to our attention in that fashion as well.

Senator LUNDY—I have a couple of questions to ask about that shortly. We also heard from the ACCC that, with respect to their information centre, they do not process or place on

the database issues that do not relate to the Trade Practices Act. So some 20,000 complaints that they receive do not get processed in any way and therefore have no chance of getting to you. Do you think that is an insight and a resource worth tapping into to inform policy development?

Mr Murphy—It depends on the nature of the complaint. I am surprised. I would have thought there were possibly referrals to other bodies.

Senator LUNDY—I believe there are referrals to other bodies, but I am approaching this on the basis that it is a vast source of publicly funded intelligence about consumer related matters and it does not seem to be used to its full capacity.

Mr Murphy—We could look into that for you, if it is a database of raw material for complaints. My understanding is that, like with other consumer bodies, there is one which refers matters to others. The other thing is that, while the ACCC has a wide jurisdiction because of what it is, often complaints may be inappropriately directed to the ACCC. Oftentimes a quick: ‘No, you should talk to some state government body,’ is actually what people need.

Senator LUNDY—I think this is where it gets confusing. I note that the ACCC can only process issues and communicate with you on issues relating to consumer problems or detriment that falls under the Trade Practices Act. Who provides the minister with advice on consumer issues that are not necessarily a potential breach under the TPA as it currently stands but are potential issues that could in fact point to a need to strengthen or change the Trade Practices Act? I want to raise the issue of unfair contracts as an obvious and topical example of that problem.

Mr Murphy—Treasury has a policy responsibility for competition and consumer policy, and that is not limited to the Trade Practices Act. That is the main vehicle to implement competition and consumer policy, as well as the Corporations Act and the ASIC Act. In terms of policy responsibility, it is up to the Treasury. If it was felt that there was a need for further extension or intervention by Commonwealth legislation or Commonwealth programs, it would be a matter for the Treasury before you would go to unfair trading. A classic example of that is the financial literacy program. That is not an initiative of the ACCC, the state governments or anything; it is an initiative of the Commonwealth. Financial literacy is a consumer oriented policy program, and it is nothing to do with the Trade Practices Act.

Mr French—The parliamentary secretary also has an advisory body called the Commonwealth Consumer Affairs Advisory Council, which has just met in its newly constituted form. That body is chaired by Colin Neave, who is the banking ombudsman, and includes representatives from consumer movements and other groups. For example, Peter Kell, from the Australian Consumers Association, and Fiona Guthrie, from the Consumers Federation of Australia, are members. The parliamentary secretary also takes advice from that group.

Senator LUNDY—You have anticipated my question. If that information flow is not necessarily coming from the ACCC, where does the information that informs the policy decisions of the parliamentary secretary, or indeed the Treasurer, come from? You have mentioned the consumer affairs council, the Ministerial Council on Consumer Affairs,

SCOCA, the ACCC and ASIC. Are there any other agencies, departments or formally constituted bodies that would provide input on policy development or issues?

Mr Murphy—There would be a range. You are also looking at representation from state bodies, industry bodies and other Commonwealth departments. They could all raise issues about consumer matters. That is one of the problems—it is so pervasive.

Senator LUNDY—Is it part of your role to provide advice to ministers and parliamentary secretaries on the demarcation in regulation between federal and state jurisdictions?

Mr Murphy—Yes. That would be fundamental to advice that was given.

Senator LUNDY—Do you provide advice relating to what issues you believe should be regulated federally as opposed to at a state level?

Mr Murphy—Yes, according to criteria, matters of importance and what have traditionally been areas of Commonwealth responsibility and state responsibility.

Senator LUNDY—What is the government's policy, very specifically, on unfair contracts, given that the parliamentary secretary has made what I would interpret as some conflicting, or at least confused, statements in the public domain?

Mr Murphy—I do not know about that.

Senator LUNDY—I said 'in my opinion'.

Senator Kemp—They might have confused you, but everyone else might have understood them.

Senator LUNDY—You said at one stage that the Commonwealth should look at strengthening the law in this area, and later you said that this was not an area that the Commonwealth would be looking at, so you tell me.

Mr Murphy—As a starting point, we would say that the law at the present time, dealing with the general powers of false and misleading statements under the Trade Practices Act—

Senator LUNDY—I think it was the unconscionable conduct laws that they were citing.

Mr Murphy—That, plus the unconscionable conduct laws, would give you ample jurisdiction to deal with matters relating to unfair contracts.

Senator LUNDY—Is that the government's policy?

Mr Murphy—That would be the government's policy position. The rider to that is that it is felt that the introduction of unfair contracts legislation could be detrimental to consumers.

Senator LUNDY—Was the policy of the government driven by the ACCC's assessment of the issues in unfair contracts?

Mr Murphy—The ACCC's view is one factor to take account of. As with all these policy areas, the regulator is a very important source of advice, in light of not only their experience but also the various other factors and inputs that come into designing the policy advice which Treasury would give the minister. It is then for the minister to make a decision as to what they feel is in the best interests of the public. So it is not just the ACCC's advice, but it is of course very important to get advice from someone who is on the ground and working in this area.

Senator LUNDY—I will place further questions on notice.

CHAIR—After the break we will go back to Tax.

Mr Murphy—I will just correct something I said this morning. The end date for public submissions to the report on financial services refinements is tomorrow.

Proceedings suspended from 3.15 pm to 3.33 pm

Australian Taxation Office

ACTING CHAIR (Senator Watson)—Senator Sherry, I understand you have some questions.

Senator SHERRY—I would like to look at the budget allocation for the tax office in totality, Mr Carmody.

Mr Carmody—Sure.

Senator SHERRY—I note in the budget papers that the total revenue from government and other sources goes from \$2,430 million to \$2,487 million. By my calculation that is a slight increase of \$57 million approximately.

Mr Carmody—There is a slight increase I understand, yes.

Senator SHERRY—Looking down at the average staffing levels, I note that there is a slight decline budgeted for staffing levels from 20,800 down to 20,792—is that correct?

Ms Moody—Yes.

Senator SHERRY—Given there is a slight increase in budget allocation, why is there a slight decrease in staff numbers?

Ms Moody—In calculating the staff numbers we take into account expected pay rises, for instance, and other staff related costs. It sometimes, even though the dollars are going up a little bit, means that the average cost of the staff is increasing.

Senator SHERRY—Fifty-seven million as a percentage is a little over 2.2 per cent. I assume you are anticipating the staff salary increases will average slightly above that?

Ms Moody—I think our agency agreement which covers the 2005-06 financial year allows for either a 3½ or a four per cent pay increase.

Senator SHERRY—It would seem to me, looking at the slight increase in budget allocation, that it shows a decline of eight staff in 20,800, which is virtually no change. How are you going to hold the staff level at almost exactly the same level as the 2004-05 year with a 3.5 to 4 per cent wage increase? Are there efficiencies in other areas?

Ms Moody—Yes, certainly. When we do the budget for the tax office, we look at both how we can minimise our supplier costs, for instance, and how we maximise the amount that is available for labour. The staffing numbers, by the way, are average numbers, and certainly during the course of 2004-05 our starting full-time equivalent number was less than that. So, across the year in 2004-05, we have increased our staffing which results in that average whereas going forward we expect for 2005-06 that the staffing number will be much more stable. How the staffing numbers work with the labour dollars can be affected by the average. The other issue that comes into play is that between 300 to 400 full-time equivalent staff from

our IT area are funded from our capital budget rather than our operating budget because they work on internally developed software and we capitalise those labour costs. So there is some extra money that goes to labour that is not reflected there, which I think is about \$40 million for 2005-06.

Senator SHERRY—Given the restrictions that you are working under, Mr Carmody, are you experiencing any difficulties in attracting qualified staff through recruitment when replacement is needed?

Mr Carmody—We have very stable staffing numbers, actually. We do not have large numbers of people leaving the organisation. On average I think it is only around 4½ per cent. Some of our major recruitment is in the graduate area, and we have been reasonably successful. However, it varies in some markets. I think, for example, Sydney is a harder market in which to attract people. That is a function of comparative incomes.

Senator SHERRY—I posed essentially the same questions to the Audit Office and they acknowledged difficulty in retaining qualified staff because of outside demand. There is the issue of account and audit staff, for example, where apparently there is an eight to 10 per cent movement in the market.

Mr Carmody—They are a smaller office with a concentration around a particular skill base. We do not face the same sort of proportions or dimensions of difficulty that they do.

Senator SHERRY—So you are not experiencing any problems with staff retention or recruitment?

Mr Carmody—I am not saying that we do not have issues. There are some issues in some markets but, overall, I am satisfied that we are getting the staff we need to do the job. There are always some specialist skills that you need, and we need to look at particular recruiting techniques to do that. So I am giving an overall answer, acknowledging that there are some pressure points that we need to cover.

Senator SHERRY—Are those pressure points increasing and do you anticipate that they will increase over the next couple of years?

Mr Carmody—At times it is getting harder in some particular specialist areas. I would say, overall, we are doing reasonably well.

Senator SHERRY—I want to turn to total revenue from other sources. Estimated actual in 2004-05 is \$58.3 million and it declines reasonably significantly down to \$43.989 million—let us say \$44 million. What is the reason for that decline in revenue from other sources?

Ms Moody—The revenue from other sources comes from a number of places. Over a number of years we have provided a range of corporate services to the Child Support Agency, which included, in effect, subletting parts of our properties to the Child Support Agency who then paid us rent. Certainly from 2005-06 onwards there are only very limited numbers of properties where the Child Support Agency still exists within tax office premises. In fact, it is probably down to about three across the country. That decline is really in the rent that we would have received previously.

Senator SHERRY—Has that been an ongoing decline? Or has it come about as a result of the reorganisation of child support and other payment agencies within Finance?

Ms Moody—No, it predated that and it has been going on for a little while.

Senator SHERRY—So there is vacant office space in tax office buildings?

Ms Moody—No, we have largely consumed that office space for our own needs.

Senator SHERRY—Even though the staff numbers are not going up?

Mr Carmody—They did go up in the current year.

Senator SHERRY—So the space has been absorbed by existing staff in previous years?

Ms Moody—In 2004-05, the staffing between the current financial year and the end of the last financial year did increase. Some of that increase has been absorbed into the space that we reclaimed from the CSA.

Senator SHERRY—The other area in the overall tax office budget, compliance assurance and support, shows a significant decline in budget estimates for 2005-06. Why is that happening and what are the implications for that?

Ms Moody—What page of the PBS are you referring to?

Senator SHERRY—It is page 226. Departmental appropriations, compliance assurance and support revenue collection—oh, that is revenue collection; I am sorry.

Ms Moody—Yes, there are actually two compliance suboutputs.

Senator SHERRY—Yes. I understand Senator Murray was going to ask some questions. I do not have any more questions on that overall budget allocation.

Senator MURRAY—I have some very brief questions for taxation. My main interest is in Treasury revenue.

ACTING CHAIR—It is your turn.

Senator MURRAY—I have been asking over a series of estimates questions concerning the off market buybacks situation. The answer to my question of 17 February 2005 was taken on notice and is on page E82-83 of *Hansard*. The answer said:

One of the difficulties in providing an estimate is establishing an appropriate benchmark against which the revenue impact of current off market share buybacks can be assessed.

The process of making an estimate against one or more of the benchmarks is resource intensive and will take some time.

... Treasury advise that the treatment of off market share buybacks will be examined in this context.

Reading between the lines, I read that as saying the tax treatment is concessional and will be considered for review in the tax expenditure statement.

Mr Carmody—I will have to defer to my Treasury colleagues on that.

Mr Callaghan—If the thrust of your question is whether it is concessional, that is an issue that needs to be looked at. You could look at the treatment now but it is not concessional in the sense that, depending on where the revenue is sourced, it is being taxed appropriately or in accordance with the law.

Senator MURRAY—I have previously given you figures, and I fall on the side of those who think it is concessional, but the point of my question is that the answer indicated that Treasury were examining the issue. Is that true?

Mr Callaghan—That is true. Yes, we are looking at the issue. The issue has been referred to us by the ATO. We are looking at it in consultation with the ATO.

Senator MURRAY—I do not wish to pre-empt the review but, if the review were to find that it was concessional, would the eventual home of the result of the review be the tax expenditure statement?

Mr Callaghan—That is pre-empting it because, if the issue is whether it gives rise to a tax expenditure, it would depend on whether the current treatment was not receiving the appropriate taxation depending on the type of distribution taking place. As it stands now, and depending on whether it is coming from the dividend component, that is taxed the same way as other dividends. If it is coming by way of capital gain or loss, you can say it is being treated the same way as other capital gains or losses are being treated. I think the issue that you were raising previously covers such aspects as the size of the discount that may be taking place in off-market share buybacks.

Senator MURRAY—Which is an advantage, as you know, to certain classes of taxpayers within the same corporation.

Mr Callaghan—My understanding is that it is offered to all classes—to all taxpayers—and it can depend on whether they accept the offer or not.

Senator MURRAY—But they have a different capacity to get a reward or a return from it.

Mr Callaghan—Depending on what their tax position is—that has been the debate. There are a range of issues there. As I say, it is not clear that it is a concessional tax expenditure. There is a debate—and we are seeing it in the newspapers—with some defenders of the current position saying that they believe there are problems with it. As to where we stand now, if we go back to what the review of business tax said a number of years ago, we see it concluded that the current treatment was appropriate. A number of issues have been raised in terms of the treatment now of off-market share buybacks. These are in the range of issues that we are looking at in the sense of: is there a problem there that needs to be rectified?

Senator MURRAY—I am sure you would concede that the market is much more active in that area than it was at the time of the Ralph review—and for the benefit of the *Hansard* I record the fact that you are nodding. I guess the only place that I can take it now, as the matter is under review, is to ask you when the review is likely to be completed.

Mr Callaghan—I have not got a date. There are a number of difficult issues that we are looking at.

Senator MURRAY—What is in my mind is not an attempt to hold you to a deadline. But, to my mind, if ever it were to be considered tax concessional—and I must admit I do not get any comfort from your remarks so far; but if ever it were—then I would expect the deadline to be set so that it could be included in the next tax expenditure statement when it is printed. That would meet my needs. The second reason I ask the question is that I would assume that, having accomplished the review, you would convey the answer to the committee, either

directly or via Mr Carmody, because the question has come from the committee. So I would like to know when to expect it.

Mr Callaghan—There is not much more that I can say other than that it is an issue we are looking at. I certainly take your point that it depends on whether there is a change in the view as to whether there is a tax expenditure. Our view now is that the various components are taxed appropriately and there are other issues that are the source of the concern that you are raising. But, to the extent that no doubt you will be raising it when the committee meets again, we will certainly endeavour to enlighten you as to what our thinking on this issue is as it develops.

Senator MURRAY—I would be grateful for that because I intend to ask until I have a definitive answer, which I have not had yet.

Mr Callaghan—I understand that.

Senator MURRAY—I appreciate how difficult it is for the tax office and Treasury. I do not make light of the difficulty of it. My other brief set of questions concerns both the tax office and Treasury, and I am not quite sure who to ask. I will ask the questions generally. They relate to the issue that Senator Mason has been on about—that is, the issue of tax concessions to what are broadly called charitable agencies. They have a more specific title. I just want to be assured that the tax office collation of information and its dispatch to the Treasury is as complete as possible to enable the tax expenditure statement to reflect the true nature and depth of tax concessions in this area.

I will indicate some of the background for my question. The tax expenditure for the fringe benefits tax exemption for public benevolent institutions in the tax expenditure statement is just under \$500 million. I want to be assured that that is as complete and as full an estimate as possible. This applies to all the other variants of concessions available to the charitable and not-for-profit sectors as well. It is really a question of data collection and assessment.

Mr Carmody—I cannot do a quality review for you here. I can assure you that we would be providing the best information that is available to us but I do not know that we have here the specifics of how we go about that. Of course, they do not report it if they are exempt.

Senator MURRAY—I am not asking that. But I have noted, as you have, the interest which is being expressed about this issue not only in estimates but through some of the specialist business media. It is really competitive neutrality, transparency and those sorts of issues which are occasioning interest.

Mr Carmody—I understand.

Senator MURRAY—I would like to be sure that we are getting the best statistical feed we can.

Mr Carmody—I am sure we are doing the best we can but I will undertake to you to go back from here and make sure. I will have someone have a look to make sure that we are doing absolutely all that we can in this area.

Senator MURRAY—Thank you; I appreciate that.

Senator SHERRY—Mr Carmody, I suspect that you would be familiar, in general terms, with the agreement with respect to the Hardie's payment for asbestos liabilities?

Mr Carmody—Very broadly.

Senator SHERRY—The agreement provides for the extinguishment of a compensation liability and then ongoing payments to victims over a period of time. Would those payments by Hardie be eligible for tax deduction status?

Mr Carmody—You know that we do not normally talk about affairs of individual taxpayers.

Senator SHERRY—I am just using this as an example.

Mr Carmody—I do not know the specifics but there is probably a question about whether it is a capital expenditure.

Senator SHERRY—In cases where there is an ongoing compensation liability of this type—

Mr Carmody—It depends on what the payment is being made for and whether it goes to the integrity of the business and structure. All I can say, without having the full details, is that there would be a question about whether they are capital rather than revenue.

Senator SHERRY—The answer to that would be dependent on the structures that are established?

Mr Carmody—We would have to look at the whole facts and I do not have those.

Senator SHERRY—So, to date, the ATO has not been approached about a ruling on the issue of compensation liabilities?

Mr Carmody—You are asking me to get into the affairs of an individual taxpayer. I cannot say any more than that it is possible that in those circumstances a ruling would be sought.

Senator SHERRY—Has a request been received from the Treasurer on this issue?

Mr Carmody—You are going into detail that I am not aware of. Again, I am hesitant to talk about the affairs of an individual taxpayer.

Senator SHERRY—Has the ATO followed up general and specific allegations about tax avoidance in the construction industry?

Mr Carmody—The building and construction industry is an area that we obviously pay attention to in respect of cash economy operations and other things. We have made that clear and we have at times reported on our activities in the industry.

Senator SHERRY—Do you have any more detail or is there an officer who can give us some more detail?

Mr Konza—We have teams who work in both the GST section and the income tax section of the tax office concentrating on building industry issues, and we follow up community information regarding tax evasion.

Senator SHERRY—So this team is dedicated to building and construction?

Mr Konza—We have some dedicated teams, yes.

Senator SHERRY—Is there one in this area?

Mr Carmody—In building and construction, yes.

Mr Konza—Yes.

Senator SHERRY—You mentioned that they have been following up complaints and issues referred to it. What is the source of the complaints? Is it individuals, employers, unions or others?

Mr Carmody—We cannot reveal that.

Mr Konza—We get complaints from all sources. We follow up community information that comes through our general community information hotline, which people ring. We get complaints from industry participants as well, including the unions and contractors.

Senator SHERRY—Have you been able to recover any tax in the building and construction industry over the past financial year?

Mr Konza—Yes, we have.

Senator SHERRY—What order of magnitude and type of recovery are you looking at?

Mr Konza—Can I take that on notice? I need to give you accurate figures.

Senator SHERRY—What about the type of recovery and the circumstances? Are we just looking here at GST or income tax or both?

Mr Konza—GST and income tax.

Senator SHERRY—Are you able to identify some of the malpractice?

Mr Konza—It is just the general types of non-compliance such as understatement of income and non-registration. In the area of phoenix operations, as we call them, we have a specialist team operating, because this industry, slightly more than most, has rebirthing of liquidated companies—that is, phoenix operations.

Senator SHERRY—Have meetings been held with Mr Hadgkiss in respect of tax avoidance in the industry?

Mr Konza—Can you assist me with Mr Hadgkiss' position?

Senator SHERRY—He is on the building industry task force.

Mr Konza—We have had meetings with the task force and we receive information from it.

Senator SHERRY—So you have received information from the task force?

Mr Konza—Yes, we have. I do not recall the particulars, but I do know that in the past we have received information from that task force.

Senator SHERRY—In this current financial year?

Mr Konza—I do not know whether we have received information in this current financial year.

Senator SHERRY—I am not sure what date it was set up myself. I assume it would be this financial year.

Mr Konza—It was probably two or three years ago that it was set up.

Senator SHERRY—Are there any issues outstanding that are still being pursued?

Mr Konza—These are issues referred from the task force?

Senator SHERRY—Yes.

Mr Konza—I would have to take that on notice, I am sorry.

Senator SHERRY—On another issue, there was an article in the *Australian Financial Review*, Mr Carmody—I think it might have been carried in other media as well. In the case of the *Financial Review* it was headlined ‘ATO lashed for hoarding GST refunds’. You are laughing, Mr Carmody?

Mr Carmody—It is a very descriptive title.

Senator SHERRY—Well, this is your chance. Do you want me to go into the detail of the article?

Mr Carmody—No, I am aware of the article. It was in response to the inspector-general’s report into our processing of GST refunds. If your invitation is to comment, I would make these comments. This has always been a balancing act. We were made aware when the GST was introduced that the issue of credit fraud—improperly claiming input tax credits and so on—was a genuine compliance issue that we needed to be alert to. We introduced a process of identifying higher risk refunds so that we could verify them before they were paid out. The law actually provides that if refunds are not paid out within a certain period interest applies. You would understand that when we first introduced the GST we did not have a lot of history on which to do our risk profiling. So it is true that during the first period we held up more than we currently do. The inspector-general pointed to the very large dollar values we withhold to review before immediate refund and where ultimately we give the refund.

The issue has always been: how sophisticated can you make your risk profiling so that you do not hold up inappropriately, as far as possible, refunds? As I indicated, we did not have a lot to base our risk profiling on when we first got the GST. As it turns out—I think it was around the middle of 2003 or so—we started to build more sophisticated risk profiling based on our experience to date. So we had in fact acted and were in the process of acting to improve that risk profiling at the time the inspector-general did his review. For example, we estimate that about 8,000 taxpayers who would have previously slipped up on our risk profiling and would have had their refund held up while we reviewed it will now be able to go through because we have improved the sophistication of that. There is always going to be an issue about holding refunds while you review them. The inspector-general pointed to some processes while we go through a review that we need to improve, and we will do that. But the key question has been: how do you identify the risk profile to target the appropriate cases? We have made significant inroads into reducing the number that we hold up.

Senator SHERRY—In the article I am looking at—I do not have the full report here—it says:

According to data supplied by the ATO, between July 1, 2003, and February 29, 2003,—

I suspect that is 2004, so that is an error in the media report—

20,020 taxpayers had an average of four successive activity statements stopped before the funds were released.

Firstly, do you have the correct date? It is not your fault, I know—I am sure it is the reporting.

Mr Mann—My understanding is that the data the inspector-general relied on was for the 2003-04 financial year.

Senator SHERRY—That figure of 20,020 is accurate for that period?

Mr Mann—I would have to check in the report, but it sounds reasonable.

Senator SHERRY—Mr Carmody has referred to a further 8,000 taxpayers. Does that mean that in the following year, 2003-04, it dropped down to 12,000 or is it in the process of dropping down?

Mr Carmody—It is in the process of dropping down. Based on our experience and the improved risk profiling we developed, we started to implement in—

Mr Mann—From July 2004 through to about December 2004 is the period in which we have implemented the revised tests across our large business clientele, our small business clientele and more recently our government and community sector clients.

Senator SHERRY—What was done in the period during 2003-04 before this phase-down started to occur?

Mr Mann—The inspector-general was reporting on a snapshot of our activities during the 2003-04 period. The key point he made was that while we were checking only four per cent of refunds prior to issue, the concern was that that represented about 89 per cent of the total value of the refunds. One point that even in 2003-04 did not make its way into the press reportage is that only two per cent of those refunds were not released within that 14-day period that we commit to turning those refunds around in. In fact, 88 per cent of that total value even in 2003-04 was released within the 14-day service standard. The point really was that we were taking a cautious approach on the high value refunds. Generally speaking, they were all—88 per cent—released within the 14 days. But on reflection we agreed that, with the benefit of our experience over the last three years, as it was at that time, we could refine those rules to allow 8,000 taxpayers' activity statements to be processed with refunds issuing without us needing to undertake a pre-issue verification.

Senator SHERRY—Before the report of the inspector-general is released to the public, does the tax office have an opportunity to respond?

Mr Carmody—The tax office provides a response to the inspector-general with our report. It is actually recorded in the report.

Senator SHERRY—Obviously you did not have historical experience, but do you think in retrospect that this verification process could have been initiated earlier?

Mr Mann—Given that 88 per cent of the value was released within our 14-day service standard I think we tried to strike a reasonable balance. Particularly in the early days of implementation, with accounting systems being bedded down, even innocent errors could have led to large amounts of money being refunded incorrectly. I think it was an appropriate approach in the early days given international experience. After three years of experience it was time to review and reflect on whether we needed to take such a conservative approach. We have certainly fined tuned our approaches and will continue to do so.

Senator SHERRY—Mr Carmody, at the previous estimates we had a discussion and you acknowledged the difficulties concerning the collection of surcharge tax revenue. That then moved into a discussion about a similar problem that impacted on the payment of the superannuation guarantee. We also touched upon co-contributions. Can we have an update? There was some detail given about outstanding assessments. Perhaps we could start with the issue of the surcharge tax.

Mr Jackson—I am pleased to report that our current position is that the surcharge backlog assessments will be finalised by the end of this financial year. There may be a very small number, perhaps a couple of thousand, that might not be done. Not all of those will be issued because the next surcharge run is I think in August. So it will not be until August, at the final run, that managing those exceptions will occur. But the numbers have certainly dwindled enormously since we spoke last time.

Senator SHERRY—On the last occasion we spoke we were looking at approximately 20,000 assessments. I think that was the figure.

Mr Jackson—That were remaining?

Senator SHERRY—Yes.

Mr Jackson—Just off the top of my head, at the beginning of May, about 25,000 assessments were outstanding. They were some of the more difficult ones that required a fairly significant level of human intervention, and they are the ones that we have been working on for that period. I checked this morning, and my information is that they will be completed by the end of this financial year. I hasten to add that the assessments will not actually issue until the next surcharge run occurs, which will be about August.

Senator SHERRY—In the financial year to date, approximately what number of surcharge assessments has been issued?

Mr Jackson—The normal number is about 900,000 to 950,000. I would have to check to confirm the figure for last year.

Senator SHERRY—Of those, how many, if any, are a consequence of people who are issued an assessment failing to provide a tax file number?

Mr Jackson—How many of the 900,000 or so that we have issued this year?

Senator SHERRY—Yes, of the approximately 900,000.

Mr Jackson—There are two categories of exception in the surcharge system that we are dealing with here. The ones that I referred to a moment ago are general processing type exceptions. An indicator on the system is triggered when the system runs that says: 'We'd better have a look at that case; it might need some intervention or treatment.' There were about 800,000 of those last year, and they are the ones that were down to about 25,000 in March.

There is a different body of exceptions, which are really cases where individual reports from funds have not provided a TFN. When we were taking about co-contributions before, I mentioned that we get 16½ million each year and about three million do not provided a TFN. We can match about two million of those using our soft matching techniques. We are left with

this group of about a million where there is no TFN and insufficient data on the member contribution statement to match it to a tax return. We are looking at those and categorising them. One category includes cases where the amount of contribution on the member contribution statement suggests to us a surcharge assessment may arise. In those cases, we are writing to the affected people and saying: 'You haven't quoted your TFN. You've got 60 days to do so. If you don't do so you might get a default assessment.' There were 10.4 million of those.

Our soft matching techniques are better now than when the system was first developed. We were able to match 1.5 million of those directly, using better soft matching. That gave rise to about 8,500 assessments, which in the end were liabilities of about \$3½ million. We got rid of 1½ million there, so we were back to about nine million. Of those nine million, about 8½ million relate to member contribution statements where there are no contributions, so there is nothing to give rise to a surcharge assessment. So, essentially, we have used the computer system to archive those and no further action will be taken with them.

So we are down to a group of about 400,000 to 500,000 where there are no TFNs, we cannot match them and the level of contribution at least says to us that there could be an assessment derived here. In February, we issued 80,000 letters saying, 'Can you advise us of your TFN?' I would have to check the exact date, but I think we either have issued recently or are in the process of issuing about another 120,000 of those letters to the next group of people. We are having another look at the remaining 150,000 or so because they are in the range where the level of contribution suggests that it may not be worthwhile going through the process of raising an assessment. Potentially, it could cost more to do that than what we would collect by way of a liability. So we are looking at that remaining group to make sure that, before we go through what can be quite a significant process, we are pretty sure that the surcharge level warrants it.

Senator SHERRY—Where you are looking at contributions, particularly if it is SG nine per cent—it may not be—it is based on income, which is a different definition—

Mr Jackson—It is based on ordinary time earnings.

Senator SHERRY—Yes, ordinary time earnings excluding overtime, whereas the surcharge tax definitional base would obviously include overtime and also other FBT, for example.

Mr Jackson—Reportable FBT, that is right.

Senator SHERRY—So there is some question mark about accuracy in the approach you are outlining?

Mr Jackson—Absolutely, there is. I would not for a moment suggest that this is a precise science. But, in terms of the operation of our system, there are a whole lot of risks and things that we deal with every day and we have to make some decisions about where to deploy our resources.

Senator SHERRY—I understand the approach. I do not know whether you recall this, but the issue of tax file number provision was something we discussed way back in 1996.

Mr Jackson—It has been drawn to my attention.

Senator SHERRY—I have raised the issue at almost every estimates. Putting that issue aside for the time being, my concern is that there are almost certainly some taxpayers who should have been paying the surcharge tax who you will not catch up with because you do not have a tax file number and you cannot identify those who would be on a surchargeable tax income. There is a group of those who must slip through the system, based on the less than perfect approach you are taking.

Mr Jackson—It would be a pretty small number, though, in the operation of the system. We have obviously done some analysis. We have worked out what level of contribution—when you work that back to the income level—would have an income level that goes over the surcharge threshold. We have done some analysis and we have worked out what that is. Whilst I agree with you that there will be some around the margin that might be up or down, we are pretty right on that. Of those people it then comes back to a question of whether we can find them. So we are writing to them. If you remember the operation of the surcharge, the assessment does not go to the individual.

Senator SHERRY—No. It goes to the fund.

Mr Jackson—It goes to the fund. So if we cannot find them and cannot get the TFN, we raise a default assessment to the fund. Then the person has to come back to us and say, ‘You should not have assessed me, because my income level was so and so.’ That is the process broadly. So there is no reason—unless the fund has left the country, which is highly unlikely—

Senator SHERRY—It could close.

Mr Jackson—It could.

Senator SHERRY—There are a few of them closing at the moment.

Mr Jackson—It is more likely that it would merge—and the contribution assets would be transferred to another fund—than simply close down.

Senator SHERRY—Are you chasing those up? That leads to a whole degree of additional complexity, doesn’t it?

Mr Jackson—I think that might be a question for another agency.

Senator SHERRY—Oh, is it? So you will pass that problem to someone else? We are looking at approximately 900,000 this financial year?

Mr Jackson—I could get the exact number for you, but it is in that order. I hasten to add that that does not mean there are 900,000 individual people impacted, because people have multiple accounts. I think there are about half a million individuals.

Senator SHERRY—We are looking at approximately half a million individuals once you take into account the multiple accounts thing?

Mr Jackson—That is right.

Senator SHERRY—I have seen the figure of one million beneficiaries from the abolition of the tax surcharge, which puzzled me.

Mr Jackson—This is all a matter of definition. Over time there could be many more than one million people who are beneficiaries of the system. The number of people who currently get an assessment each year is around 500,000. There will be some who got assessments in previous years who will not and some people who might have got them in future years who will not. It depends on your parameters.

Senator SHERRY—So, as accurately as you can identify, we are looking at approximately half a million?

Mr Jackson—That is right.

Senator SHERRY—I want it for the record, because I have seen some pretty grand claims of how many people will benefit from its abolition. I notice in the forward estimates that there is still a component of collection beyond the abolition date. Obviously there will be a collection, because there is a time lag in the funds providing the money, but it seems that a reasonably significant figure—a couple of hundred million, if memory serves me correctly—will be collected despite the fact that the abolition will apply from 1 July, if it passes the parliament.

Mr Jackson—There are others who might comment on the numbers but at an operational level the surcharge continues to apply on contributions made up until 30 June 2005. Next year, to all intents and purposes, the system will continue to run. The final receipt of tax returns and, potentially, some member contribution statements can occur quite late in the financial year. So we may get some in April, May and June next year. They will be part of the run that occurs in August 2006. So that goes out to next year. There will be ongoing situations where funds re-report to us—where there are amendments to tax returns and where further information has been provided—which will have a tail that goes out for some time. There may be better people to speak to on how the numbers were derived but, in the operation of the system, those are the reasons why there is a tail.

Senator SHERRY—Perhaps the officer who has come to the table can give some additional information on the tail through the forward estimates.

Mr Lonsdale—Just to add a little to what Mr Jackson said, there are a few things that are mixed in the forward estimates tailing off. One is the compliance activities that Mr Jackson talked about. The other issue relates to the ongoing debt accounts and the interest that would accrue to those. As they accrue, they would be booked as revenue over the forward years.

Senator SHERRY—So the accrued debt obviously continues. From some of the calls I have had, I think some people are under the mistaken belief that the accrued debt will disappear. However, they will continue to get these ongoing accrued debt statements.

Mr Lonsdale—That debt will remain and will accrue interest.

Senator SHERRY—So, despite the fact that the proposal is to abolish the tax from 1 July, those who have received an accrued debt statement will continue to receive that because it will have to show the interest being added.

Mr Lonsdale—I am not sure whether they will receive a statement but certainly interest will accrue on that debt.

Senator SHERRY—Will they receive an ongoing statement once a year that shows the accrued debt? Surely they would have to.

Mr Jackson—At this stage, not from us. I think we are talking about members of defined benefits funds.

Senator SHERRY—There are quite a few of those.

Mr Jackson—There are a few.

Senator SHERRY—We are probably talking about tens of thousands, if not 100,000-plus, in DB funds.

Mr Jackson—There could be a few.

Senator SHERRY—It is a few! As a principle, aren't they entitled to know the accruing debt level?

Mr Jackson—Yes, except that that accruing debt is accruing within their fund. We are not accruing that debt at this point.

Senator SHERRY—And the fund is notifying them?

Mr Jackson—I would expect the fund would notify the members.

Senator SHERRY—Is there a requirement for the fund to notify them on an ongoing basis of the debt level?

Mr Jackson—As far as I know, not from the surcharge legislation perspective. I would expect there would be obligations under other legislation for the trustees of those funds to notify their members of material matters like that.

Senator SHERRY—Could you check the position? You can take it on notice, because I do not think you would know now. It would seem to me, given there is an ongoing debt build-up for many members of defined benefit funds, that they do have a right to know the amount of debt that is building up

Mr Jackson—If you recall, one of the issues we talked about a little last time was a qualification of our financial statements in this area. The law does not require us to keep an account in those circumstances; the account is kept by the fund. These are generally government funds. I am fairly confident, but we will check into that for you.

Senator SHERRY—But it is a government tax that is accrued as a debt, with interest being added despite the fact that the base debt will not grown any larger as no more tax surcharge being added. It would seem to me that there is an obligation for someone to inform the individual of their level of accrued debt. It would seem only fair that that should occur.

Mr Jackson—I would expect that the trustees of the funds would be able to do that.

Senator SHERRY—We know they are able to do it because they are doing it at the moment.

Mr Jackson—You want to know whether they have to do it?

Senator SHERRY—Whether they have to do it once the surcharge tax is abolished.

Mr Jackson—I will find out for you.

Senator SHERRY—Mr Lonsdale, you touched on this. The part of the ongoing revenue—is that the revenue being derived as people retire and are paid the moneys or the fund withholds the moneys from the individual at the point of retirement and then the fund sends the money to the tax office from their accrued debt?

Mr Lonsdale—What we are talking about here is accrued amounts. These are accrued revenue items. So, as debt is booked each year—

Senator SHERRY—It is accrued regardless of whether it is received?

Mr Lonsdale—That is my understanding.

Senator SHERRY—I want to give you a note on the surcharge tax that is payable depending on the level of employer contribution and assuming the top surcharge rate is payable because their income is in excess of the \$121,400 surchargeable tax income. I will pass the note up. I want to verify whether the figures are accurate on surchargeable tax owing. The calculations are based on an assumption that the person is actually paying the top surchargeable tax obligation. Obviously, the surchargeable tax is not just dependent on their surchargeable tax income but also, in this case, the employer contribution I have shown. I have shown an example of a nine per cent contribution, which equates to \$11,250 on an income of \$125,000. Assuming that they are at the top surchargeable tax rate—which is 12.5 per cent and was scheduled to go down to 10 per cent, I think—on a nine per cent contribution, in this case an employer contribution of \$11,250 a year, the surcharge tax payable at 12½ per cent was \$1,406. Would that be right?

Mr Jackson—The mathematics looks right.

Senator SHERRY—If it had been 10 per cent, obviously it is 10 per cent of that figure.

Mr Jackson—Yes.

Senator SHERRY—But the surchargeable tax collected is also a function of employer contribution. There is a higher amount collected if the contribution level is higher—in this case, 15 per cent. There is a higher level of super contribution; therefore, there is a higher level of surcharge tax collected. Is my understanding right?

Mr Jackson—It seems to be right.

Senator SHERRY—I have given the example of a 50 per cent contribution based on a \$125,000 income and the 12.5 per cent tax revenue figure and then the 10 per cent. Of course, that all disappears if we assume the surcharge abolition bill is passed. It is a function of both income level and the percentage of contribution made to superannuation—and I have used employer contribution. That is as it operates, isn't it?

Mr Jackson—Yes.

Senator SHERRY—I want to go back to the uncollected surcharge tax. On the last occasion, you referred to a figure of approximately \$323 million that was uncollected. Do you have an update on the figure at this stage?

Mr Jackson—It is not quite finished, and we are still working on the processing of the cases without TFNs. In total, our current best estimate for the collection is around \$150 million.

Senator SHERRY—Sorry, that is money that has been collected?

Mr Jackson—No, that will be collected.

Senator SHERRY—At the last estimation there was \$323 million uncollected, so does that mean that in the last three or four months you have collected the difference between \$150 million and \$323 million?

Mr Jackson—No. I will go back to the issue that confronted us at the time that this emerged. We made some approaches for funding to deal with this back in 2003, and in the May 2004 budget there was some funding provided, so we started doing some work. As we started to do the work, the number of cases emerged a bit more clearly and the commissioner decided to inject some more resources to process these things more quickly and so forth. One of the issues that confronted us at the time that this was unfolding was this rather large number of what were known as exceptions. There were various categories of cases. The challenge before us was to bring those to account in our financial statements. To do that, we took the information that we had and the analysis that we were able to produce and we extrapolated that out and produced a number for the financial statements. I think that was \$323 million for last year. Because this work has progressed and because we have become a lot more definite about the numbers, I am now able to give a more accurate assessment of the likely overall figure. Some of that \$150 million has been collected and some is yet to be collected, based on the letters we are posting out and the assessment.

Senator SHERRY—So you have narrowed down the figure that you gave back in February of approximately \$323 million. You have narrowed it down to \$150 million.

Mr Jackson—Thereabouts, that is right.

Senator SHERRY—Thereabouts. So you are reasonably confident that that is the final figure, some of which has been collected and some of which remains to be collected?

Mr Jackson—Subject to confirming that. It might be \$140 million or it might be—

Senator SHERRY—I am not going to hold you to an exact figure.

Mr Jackson—It is not \$500 million or something. It is in that territory. Yes, the assessments have been raised and the money has been collected. Some we are in the process of raising and some we are in the process of checking the tax file numbers for through that mail-out process I described. Being so far advanced in the process as we are now, we are able to much more accurately estimate the remaining collections. We can add those to what we have already collected, and it is in that order. The estimate we made to include in our financial statements last year was a little overstated.

ACTING CHAIR—Why do you take so much time trying to chase the individual? Why don't you just trace it back to the fund that gave you the information and debit the account?

Mr Jackson—Because there are certain processes that the law describes that we have to follow. We cannot simply decide to raise an assessment against this because we think it is a quick and expedient way of doing it.

ACTING CHAIR—No, not because it is quicker. But, if the person is not available and not answering correspondence and you are unable to locate him, surely it is automatically a situation where, having established that, you can debit the person's account.

Mr Jackson—There is a legislatively described process that we have to follow. The process broadly means that we need to write to the person and give them 60 days to respond. If they do not respond within 60 days, we have to write again and tell them that if they have not responded in 14 days we may raise a default assessment. That is the process we are following right now.

ACTING CHAIR—So you will still collect your money?

Mr Jackson—That is what I was saying to Senator Sherry before. Yes, ultimately, the assessment will be raised to the fund, not the individual.

Senator SHERRY—Senator Watson may not be aware that we discussed this extensively on a previous occasion. There was a major statement by the Commissioner of Taxation, Mr Carmody, about some internal IT issues of data assessment and collection. I think that was the major hiccup, if I can describe as that, wasn't it?

Mr Jackson—In terms of the audit report?

Senator SHERRY—Yes.

Mr Jackson—No. Someone else may help me with this, but my understanding was the qualifications to the financial statements with regard to both the surcharge and the super guarantee were based on the proposition that the Audit Office were unable to independently verify that the amounts were accurate within a range that they felt was appropriate. Therefore, they qualified the accounts accordingly. The situation now is that not only have we processed most of this work—and we will have collected a good deal of money or we will have a definite assessment raised and a liability in our accounts—but we will be able to quite accurately quantify and identify for our accounts the small number that may be left.

So, yes, there were some systems problems, particularly in the super guarantee area. It is a cause-and-effect kind of thing. They caused us to be unable to estimate the amount accurately, but the actual reason for the qualification was the inability of the Audit Office—and I do not mean that in a derogatory sense—to replicate our estimation of the amount, and they were therefore not able to definitively say that was correct.

Senator SHERRY—I was going back to the reasons that Mr Carmody outlined on the last occasion. I don't want to return to it; I am just interested in identifying some particular issues that were not dealt with over a period of six or seven years.

Mr Jackson—That is correct. Over the last year, we have moved to remedy that. I think it is worth noting that the surcharge revenue has grown a significant amount over that period. As we look back now, whilst it is true that there were a large number of exceptions there, the actual revenue from those, if you distribute it over seven years, is \$20 million a year on average. Compared to our operation, it is a modest amount and we have now moved to remedy that.

Senator SHERRY—Yes, I understood that. Of the approximately \$150 million, you said some has been collected and some remains to be collected.

Mr Jackson—That is right.

Senator SHERRY—What is the approximate figure that has been collected now you have narrowed it down and got a tighter figure?

Mr Jackson—I will see if I can get that for you. I thought I had it with me but I cannot find my note.

Senator SHERRY—While someone is attempting to find the figure, there is another issue that you have already raised. We have dealt with the surcharge tax issue and the co-contribution issue. This is the issue of unpaid superannuation guarantee which, again, was discussed on the previous occasion. On the previous occasion one of the officers stated there was unpaid SG remaining for approximately 12,000 individuals.

Mr Jackson—I think that might have been assessments outstanding for 12,000 employers.

Senator SHERRY—The officer went on to say that it was expected to be cleared within the next six to eight weeks. Obviously, that was back in the third week in February. Where is that at now? Has it been cleared?

Mr Jackson—I checked the other day. We are down to about 2,000 assessments and we expect those to be cleared before the end of the financial year.

Senator SHERRY—So it has taken a little longer than anticipated.

Mr Jackson—It has taken a little longer. I suspect what happened there is a bit like the surcharge—we were down to the more difficult ones to adjust and it took a little longer.

Senator SHERRY—Yes. While I am on the subject of the SG and compliance, there is one question I am sure you can answer and one that might require another officer. I have received a complaint about SG compliance. I will raise the context of it. I do not think the complainant minds me raising their name. I thought it was an interesting issue in the context of enforcement. An employer has written to me. He paid his SG on time to the superannuation fund; however, the superannuation fund recorded the payment as employee contributions, not the employer's superannuation guarantee contribution. This is a small business person who owns a lawn-mowing business. The tax office has assessed \$3,498 in penalties. Even though the employer paid the money on time to the superannuation fund, the error made by the superannuation fund does not record it as the employer contribution. It records it mistakenly as an employee contribution. The operator of the business, and I am happy to provide the name off the record, has been informed that, as the law stands, he is liable for the penalties despite the error made by the superannuation fund. The superannuation fund—it is a major company—refuses to take any responsibility. Even if they did, I am not sure in law whether they could take responsibility. It did surprise me that, given the fund made the error and not the employer, the law provides for the penalty still to apply to the employer.

Mr Jackson—It will be a matter of fact ultimately. On the basis of the information you have provided there it sounds as though the employer has met the super guarantee obligations. However, my experience over a long period of time tells me that people do tend to present their own take on a series of events. I would be happy to have a look at that case if you would like to provide the details to me.

Senator SHERRY—So you cannot tell me specifically whether in fact, if the superannuation fund makes an error in its internal record keeping that shows the employer has not paid their superannuation obligation even when they have, the tax office can still apply the penalty provision to the employer?

Mr Jackson—I would think not. I would think that if the employer has met their obligations by making their payment and the fund has received the payment by the due date then the internal accounting of the fund is a separate issue. I hasten to add that people often do put their own spin on these things and I need to check their facts.

Senator SHERRY—Yes, I understand that and I accept that caveat. I have got some fairly extensive correspondence on the matter. Unfortunately, under the secrecy act I do not think you can respond though—not to me anyway.

Mr Jackson—We will have a talk about it.

Senator SHERRY—You can have a look at it. I will send a note off in the next week or so and outline the circumstances the employer has conveyed to me.

Senator MURRAY—I have a brief question arising from the question and answer that you have just had on the superannuation surcharge. Have there been any beneficial by-products of this activity? Obviously collecting the money is a nice by-product, but there are two others I am thinking of. Firstly, has it helped do a bit of housekeeping with TFNs, which as you know have been an issue over time, and, secondly, does it assist in tying up some loose ends with respect to members' funds which are not traceable, are lost or are in some way not connected back to the person concerned?

Mr Jackson—In answer to your first question, yes, it will have an impact as we write progressively to the 200,000 or more people for whom we do not have a TFN at the moment. We will, I suspect, in due course have TFNs for most of those accounts. We will then be able to use the account number for matching into the future, which is part of the matching process we use now—once we have account numbers we can connect those to TFNs if we have them earlier. So, yes, there will be a help there, notwithstanding the fact that we still get a million each year that we are currently unable to match even with our more sophisticated software matching processes.

Senator MURRAY—When you say a million, do you mean a million TFNs?

Mr Jackson—No, I mean a million reports from super funds. You can have more than one report per person.

Senator SHERRY—So we are talking about people who do not provide TFNs to the funds?

Mr Jackson—Yes, that is right.

Senator SHERRY—But it would be a smaller number of people than that because of the multiple account issue.

Mr Jackson—Yes, that is what I was saying. In answer to your second question, I think we are talking about the lost members register. There has been a much more limited impact on the lost members register. We have a fairly extensive process of reuniting people now on the lost

members register which would overwhelm the results we will get out of this kind of activity. We have two online tools. One is called SuperMatch and one is called SuperSeeker. One is for funds to use and one is for individuals to use. I think between those we reunite something like 600,000 or 700,000 cases a year.

We also take a lot of calls in our call centre from people asking whether or not they might have lost superannuation, and there is some matching done on that. At the moment we are writing to 500,000 people, where we have a sufficiently high level of confidence that we have their correct address, to say, 'We think you may have money on the lost members register and you might want to contact your fund or do something about that.' We will continue that process over the next couple of years as well. So there are some fairly significant processes already occurring there.

Senator MURRAY—Is another consequence of the identification of many of those accounts, if I can call them that, where the people concerned are foreign and have been here on working visas or contracts or whatever, that you will effectively have to write off a substantial number of them?

Mr Jackson—Not to my knowledge at the moment. In the overall scheme of things, the number of people on those visas is not great. There will certainly be some amongst them but I do not have any numbers; I am sorry.

Senator MURRAY—Are there any other by-products from this process?

Mr Jackson—There are a couple of perhaps slightly different by-products, if you want to call them that. One is that there is now a well-developed process for dealing with these exceptions and these things that the system produces when the normal operation does not pick that up. We now have developed processes inside the office to handle those so that the backlogs will not redevelop, and those processes will be helping us as we move forward with the co-contribution system, which is a similar sort of system. They are positive outcomes of the operation of these programs.

Senator MURRAY—With the super surcharge ending from 1 July 2005, has anyone made an estimate as to how long it will take for the backlog of debts and liabilities in that area to work their way out of the system?

Mr Jackson—The unfunded defined benefit type of thing we were just discussing?

Senator MURRAY—Yes.

Mr Jackson—We have not made an estimate of that, but commonsense would suggest that it could go on for some years. There would be people in Commonwealth superannuation funds—for example, the Public Service funds—who would be in their 40s now, younger perhaps, who would have a debt that could go on until they retire.

Senator MURRAY—My instinct was—and I would be grateful if you told me I was wrong—that in some cases it could be 20 or 30 years.

Mr Jackson—In terms of that particular type of case?

Senator MURRAY—Yes.

Mr Jackson—As things stand at the moment, yes, that could well be right, but I do not know—

Mr Lonsdale—I do not think we have a final year for when the debts will be worked out of the system. I concur that it may be quite a while—a long time—but we would expect the revenue flowing from the surcharge to taper down.

Senator MURRAY—Yes. I am not referring to large numbers, but I take the point Mr Jackson made that somebody in their mid-30s who is in a Commonwealth scheme right now might well find they meet their liability only in their early 60s.

Mr Jackson—That is entirely possible.

Senator SHERRY—On the tax file number issue, do you have any idea, based on the experiences you have been through, of the approximate proportion of fund members the fund has a tax file number for?

Mr Jackson—We have not done that sort of analysis, but I guess that, if you look at three million reports to us out of a total of 16 million reports, that is probably some sort of reflection.

Senator SHERRY—I had understood from funds that it was approaching 70 or 80 per cent.

Mr Jackson—That do not have TFNs?

Senator SHERRY—That do have.

Mr Jackson—That would concur. Three million is about 20 per cent.

Senator SHERRY—I thought you might have a more accurate figure. Senator Murray raised the lost members register and I was going to get onto this. You report in the annual report each year on the raw number and the quantum of money. Are you able to give me a current figure?

Mr Jackson—The number of accounts—again, without precision—at the moment is getting close to five million, and the amount of money is getting close to \$8 billion.

Senator SHERRY—I acknowledge your best efforts in terms of identification, repatriation et cetera, but the figure has been growing slowly but steadily year by year, hasn't it?

Mr Jackson—It has been. I look fairly regularly at the number of new accounts coming on compared to the number that we are able to reunite. Whilst we are able to reunite 600,000 or 700,000 cases a year, it is growing faster. That is true. It is part of the nature of the system—the way it operates at the moment. If someone works for a restaurant and their superannuation goes into a certain fund, as the law requires, and then they move to a mining company and the money goes into a different fund, as the law requires, many people find it difficult to go through the process of bringing all those accounts together.

Senator SHERRY—Is that the case even though, legally, once they have left employment they can transfer the money unless there is an exit fee involved—and that is a whole different set of issues?

Mr Jackson—That is right.

Senator MURRAY—There is a problem that I have identified through correspondence people have had with me—that is, they wrap up an account and transfer it, and subsequently the employer discovers that they have underpaid them or have not paid them an amount and the employer deposits that amount, which is left there. The original member is not aware of it because they think that they have cleaned up the two accounts.

Mr Jackson—There was an interesting occasion not long after I was first working in superannuation, when I was in a taxi in Brisbane. The taxi driver quite happily told me he had 20 different accounts. He was quite sanguine about the whole thing. People have different perspectives about these things.

Senator SHERRY—While we are on this issue, I have a question about the operation of the super choice law. I assume you would not have the response to this but there may be someone who can assist me. I just have one issue that has been raised with me. There will be others. Is there someone who can assist?

Mr Carmody—We can try to do that.

Senator SHERRY—The issue relates to the requirement in law for the employer to issue a standard choice-of-fund selection form to a new employee, and whether or not each time a casual employee is re-engaged that constitutes a new employee. I will give you some context. You can have what are called ‘regular casuals’. They are not permanent employees. The legal definition of a casual employee is that each period of employment stands alone. They work at a workplace and legally the period of engagement concludes when they leave the workplace at the end of the work for that day. The issue has been raised about whether, under the choice-of-fund legislation as it is currently written—and it sounds absurd—an employer is required to issue to a casual employee a new choice-of-fund selection form virtually every day they come back to work. Can you throw any light on this matter?

Mr Boneham—Subsection 32N(2) basically says that they must hand the form out to an employee when they first commence employment. So they only have to hand it over once. If they are expecting to employ them again, they would have met their standard choice form obligation by handing it over the first time.

Senator SHERRY—That raises an interesting issue. What if an employee—let us say they are a permanent employee—leaves that employer for a period of time, it might be a year or two, and then comes back? Does that provision in the bill mean that when they come back to their original employer—albeit it might be a year or two before they come back—the employer is not obliged to give them a form?

Mr Boneham—I would imagine that would depend on the circumstances—for example, if the employee left that employment and got paid out unused leave et cetera, and then came back to the employer two years into the future, then the employer would have to hand over another standard choice form because the person had ceased employment with that employer.

Senator SHERRY—That seems to conflict with your earlier view about a casual employee who ceases employment—and legally they cease employment when they leave the workplace at the end of the day because they are not continuously engaged.

Mr Boneham—Take the case of a casual employee where the employer is expecting to again engage that person. An employer would not have to hand over another standard choice form to, for example, a shop assistant who might have regular weekend work. That is a bit different from the situation of a permanent employee who definitely finished their employment with an employer, was paid out according to all their rights, moved on and came back in two years.

Senator SHERRY—What about a seasonal employee, an employee who is employed for a season? Employment in rural industries would be pretty typical and that could even apply to the hospitality industry during peak tourist season. Such an employee might be employed for three or four months. Say they leave for an extended period of time—it could be for half the year—and say they had been engaged for a three- or four-month period either as an ongoing casual or as a permanent employee just for the season. What would be the position if they came back to that employer six months down the track?

Mr Boneham—If there is some sort of arrangement with the employer—for example, if there was an expectation that the employee was going to come back—I would imagine that subsection 32N(2) would still capture that.

Senator SHERRY—But you say ‘imagine’. You do not sound particularly certain on this one.

Mr Boneham—In that situation, if there is some sort of belief or understanding on the part of both the employer and the employee that the employee is going to come back, that would apply. That is obviously the policy intention of that section.

Senator SHERRY—‘Belief’ is a little bit loose. Let us look at a couple of situations. Take the scenario where the seasonal employee says, ‘Look, will you give me employment next season?’ and the employer says, ‘Yes, re-present yourself about this time’ for whatever reason: the crop is due for picking or there is extra work because of the seasonality of the industry. That seems to be pretty clear to me. There is a clear commitment to engage. But if there is no commitment and the employee comes back six months later and asks, ‘Can I have work?’ and there is no previous commitment that was entered into, does that constitute a circumstance where the employer would be required to issue a form?

Mr Boneham—Once again it depends on what the original employment contract was and what the original employment arrangement was. If it were ‘you are on a three-month contract’, for example, in that case there may not have been an expectation that the person would be employed once again. For example, a shearer who may have regular work with a farmer might come in March and do the shearing and might come back in September and do the shearing again. In that case the employer would not have to hand over another standard choice form. Take the situation where a person may go out and do just three months work as a casual employee—they might be a university student—over Christmas and are not expected to be seen again. The employer would not have to hand over the form again. As I say, it would depend on that contract arrangement. It is definitely the case that for casual employment, where you expect the person to come back on a weekend basis, you would not have to hand over a standard choice form every weekend.

Mr Jackson—Senator, you made the observation last time that the implementation of new systems like this will always have some period of transition. One of the things that we will be doing over the next little while as the system starts to operate is clarifying some of these issues with rulings and other advice for the community. This is an interesting one that we will need to have a look at quite urgently. Clearly we do not want employers to be uncertain. There is another side to this, though. Let us go back to the conversation we were having a moment ago about the lost members register. When the temporary employee goes from employer to employer, now they will be able to specify that they want to stay with the superannuation fund that they are in, so there is an advantage in this for them. But I accept that we do need to clarify this. I am sure this will not be the only issue of that nature on which we will need to get some urgent clarification out.

Senator SHERRY—Has this issue been raised by employers since the notification went out to employers?

Mr Jackson—It has not been raised with me, nor with any—

Senator SHERRY—I do not mean you individually.

Mr Jackson—It has not been raised with me individually, nor with any of the officers who are working on this with me. I have not had that particular issue raised.

Senator SHERRY—I am surprised, because it was raised with me by a couple of employers individually, in the rural industry in particular. I had some other issues on the implementation of super choice, but I want to get to that a little later.

I am looking at an answer to a question on notice entitled, ‘Taxation and superannuation compliance challenges—summary’. There are a number of items under ‘Cash collections’ for financial years 2004-05 to 2007-08. ‘Employer obligations’ shows \$85 million for 2004-05, \$100 million for 2005-06 and \$95 million for 2006-07. There is no number to this question, unfortunately. Are you familiar with the answer? It is entitled ‘Taxation and superannuation compliance challenges—summary’. Under ‘Cash collections’ it has the categories of ‘Employer obligations’, ‘Small to medium enterprises’, ‘Individuals market for capital gains tax, rental deductions, high risk refunds and profiling agents’, ‘Superannuation surcharge’, ‘Non tax revenue’ and ‘Superannuation guarantee’.

Mr Jackson—The compliance challenges were a composite of a range of different initiatives. Superannuation is part of those. Could you perhaps give us a bit more information on what it is you are after?

Senator SHERRY—It leads to a series of different questions in different areas. We have dealt with the superannuation surcharge issue.

Mr Konza—Yes. There were two parts to superannuation surcharge and the compliance challenges—the TFN one and the general exception. We have covered both of those here.

Senator SHERRY—The revenue listed year by year comes to about \$140 million, so it is not far from the—

Mr Jackson—Coincidentally, I have the figures here for that. It is actually \$160 million, \$110 million of which we currently either have collected or have assessments out for and \$50 million of which we will be issuing assessments for shortly.

Senator SHERRY—My assumption is that the detail I have here in the answer to the question on notice in respect of the super surcharge is the same issue we were talking about earlier. That is my assumption. If I am wrong, once you have been able to get hold of this, perhaps you could just confirm that?

Mr Jackson—Okay.

Senator SHERRY—Under ‘Non tax revenue’ and ‘Superannuation guarantee’ it has \$15 million for 2004-05, \$35 million for 2005-06, \$30 million for 2006-07 and \$30 million for 2007-08. That is the revenue collected because the employers fail to contribute?

Mr Jackson—That is right, yes.

Senator SHERRY—So it is SG—it is an extra levy collected?

Mr Jackson—Yes, it was for processing extra SG audit cases.

Senator SHERRY—Why does it jump from \$15 million in 2004-05 to \$35 million in 2005-06? It is a pretty big jump.

Mr Jackson—I think the funding was not for a full year in the first year or there was a ramping-up process, whereas in subsequent years it was for a full year of operation.

Senator SHERRY—Okay. It is just headed ‘2004/05’. It does not indicate that it is half a year. That is a logical explanation; it just does not indicate that.

Mr Jackson—It might not but, as I recall, it was in the May 2004 budget announcement. We recognised that you cannot just instantly materialise a field force to do that, so we allowed some time to ramp up that field force. That is why the collection in the first year is lower than the others.

Senator SHERRY—Do some of these moneys flow into the SHAR?

Mr Jackson—Not a lot. A little would flow into the SHAR, I would expect.

Senator SHERRY—That brings me to the status of the SHAR. You would be aware that the SHAR is to be shut down from 1 July 2006—there has been a year’s extension for the SHAR.

Mr Jackson—There is an extension, that is right.

Senator SHERRY—What will happen to the moneys currently held in the SHAR, assuming there would be some by the shutdown date?

Mr Jackson—I expect there would. I do not think the final details of that policy change have been announced yet.

Mr Lonsdale—The government announced in the budget, as you know, that the SHAR will be closed for contributions from 1 July 2006, but there is a one-year period where the SHAR will be an eligible choice fund. That will be for that period.

Senator SHERRY—Yes, but that does not answer my question about what happens to the moneys that are sitting in the account at the time of the shutdown that are not transferred out. Where will they go?

Mr Lonsdale—My understanding is that they will remain in that account.

Senator SHERRY—Okay. So there will be an ongoing account which will, over time, decline?

Mr Lonsdale—With no new contributions going in.

Senator SHERRY—With no new contributions flowing in.

Mr Lonsdale—That is correct.

Senator SHERRY—What is the fee charged on SHAR at the moment—if there is one?

Mr Jackson—There is no fee on SHAR per se. As I understand the operation of the law, it requires the costs of operation of the system to be recovered before there is any crediting to the account. At this stage the cost of operation exceeds the earning rate that would be applicable. Whilst there is no charge, there is no credit—no interest being accrued— into the account.

Senator SHERRY—No interest at all is credited to those accounts?

Mr Jackson—No.

Senator SHERRY—The closing of SHAR is predicated on no moneys being received. What do you do if the employer does not have a superannuation fund—has not nominated one? If SHAR closes it does not receive any more moneys. I assume this is a vain attempt to force all employers to make a payment into a superannuation account. Where does it go to if the employer has not done that?

Mr Jackson—There are numerous options. SHAR has been around for a while and, as I understand it, the original policy was to provide a place for low account balances to be deposited so employers were able to deal with that. Now there are other options like retirement savings accounts. Employers are much more familiar with the superannuation guarantee system.

Senator SHERRY—I accept that but there is still money flowing into SHAR because employers do not nominate a fund. You mentioned RSAs; I will not get sidetracked into what a dud account that is. The fact is that there is still money flowing in despite these other options that you have referred to. What happens to the money where there is no other option nominated by the employer? It is all very well to say that the employer shall pay it, but where does it flow to if they do not do that? What happens to it?

Mr Jackson—It is not clear to me that there would be such a situation. Employers would be able to find an account, either a retirement savings account—

Senator SHERRY—They can do that at the moment and some are not doing it.

Mr Jackson—They can, but over a period of time there has been a behaviour established to use SHAR. Some employers have got used to using SHAR and do use it. Once that is no longer an option for them they will revert to other activities and other approaches.

Senator SHERRY—You are confident that all the employers—what is the approximate number at the moment?

Mr Jackson—Off the top of my head, I do not know the number of employers but there are about 150,000 active accounts in SHAR.

Senator Kemp—On a housekeeping matter, we have a large number of people here in areas other than superannuation. Can Senator Sherry indicate whether it is possible to let some of these officers depart for their offices or families, depending on which they wish to do?

CHAIR—Perhaps Senator Sherry could indicate whether they could go completely or at least until after the break.

Senator SHERRY—I cannot at the moment. We are concentrating on superannuation at the moment but I have a significant number of other tax and revenue matters to raise.

CHAIR—Senator Sherry, are there any topics you are sure you will not reach before dinner, which we will take as 6.30 pm?

Senator SHERRY—I might move on to employee tax benefit arrangements. I certainly will not need the Inspector-General of Taxation before dinner.

CHAIR—Whoever is here from the Inspector-General of Taxation need not come back before 8 pm. Can anyone else be released until after dinner?

Senator SHERRY—Unfortunately I cannot indicate that at the moment.

CHAIR—Then I think we should press on, Senator Kemp.

Senator SHERRY—The issue with SHAR shutting: you do not have an idea of the approximate number of employers?

Mr Jackson—No, I do not.

Senator SHERRY—You might take it on notice and have a look at this issue. SHAR shuts on 1 July 2006. It seems to me likely that there are at least a few employers that will not have a nominated superannuation fund, despite best efforts. Where does the money go? It cannot just go into the ether. It has to go to a fund, so it has to go somewhere.

Mr Jackson—Okay.

Senator SHERRY—I will now move to the issue of the implementation of superannuation choice. We will deal first with the advertising campaign. What are we looking at in terms of the budget allocations for the information campaign?

Mr Jackson—Broadly speaking, for 2004-05 I think it is \$17.2 million, of which about \$11 million is for direct advertising: television advertisements, press advertisements, placements, bus shelters, bus stops and things.

Senator SHERRY—And people travelling on buses, talking on buses and getting on and off buses.

Mr Jackson—Getting on and off buses.

Senator SHERRY—The buses seem to be very prominent in this campaign.

Mr Jackson—We are very conscious and environmentally concerned. Next year the campaign is about \$5 million, of which about \$3 million relates to direct advertising costs.

Senator SHERRY—When we are talking about the advertising, this is targeted at employees, not employers—or are they included in this \$17.2 million for this year?

Mr Jackson—Whilst it has a strong employee flavour, the television campaign is also a general awareness campaign. But there are more particular advertisements in the press, focused on employers and reminding employers that they need to get ready. We are currently one running one that says: ‘You’ve got this long to go,’ and then, ‘That long to go.’ This year we also have a mail-out. We are spending about \$3.7 million on a couple of mail-outs to all employers.

Senator SHERRY—Just to clarify: is this in the \$17.2 million?

Mr Jackson—Yes, that is in the \$17.2 million.

Senator SHERRY—When you say ‘mail-out’, does that include the tax office mail-out—the kit that has already gone to employers?

Mr Jackson—That is the first one, yes, and there will be another one that is imminent.

Senator SHERRY—This is a reminder, is it?

Mr Jackson—It is a reminder. The first was, broadly, a letter from the commissioner explaining to people that they have an obligation under choice—

Senator SHERRY—Yes.

Mr Jackson—and providing them with a copy of the simple employer guide and copies of the standard choice form.

Senator SHERRY—Yes, I am aware of that.

Mr Jackson—The second—

Senator SHERRY—Did that go out in the name of the commissioner?

Mr Jackson—Yes.

Senator SHERRY—I am sorry for you, Mr Carmody, because some of the comments I had back about it—

Mr Jackson—We had very positive comments about it.

Senator SHERRY—Did you?

Mr Jackson—They are the ones I conveyed to the commissioner.

Senator SHERRY—Well you would, wouldn’t you. I will not convey some of the comments I got about it. I thought was a bit rough. I did try and square off for you, Mr Carmody.

Mr Carmody—Thank you, Senator.

Senator SHERRY—I said, ‘Look, Mr Carmody’s not a bad bloke. It’s not his fault. He’s just doing what the law requires. Don’t blame him.’

Mr Carmody—Thank you.

Senator SHERRY—So there is another mail-out going out. When is that going out?

Mr Jackson—Pretty soon. It is in the next week or so. It will be a reminder letter from the commissioner—we’re thinking of a photo—

Senator SHERRY—I don’t think you need to go that far.

Mr Jackson—along with a list of relevant fact sheets that are available on our web site or by phoning 132864. In all likelihood, it will include the super choices booklet—the small booklet with the coloured bubbles. I think I have a copy here I can show you.

Senator SHERRY—I have seen it.

Mr Jackson—It will include some more copies of the standard choice form. One of the issues for us about the standard choice form is that we did not want to overwhelm people with vast amounts of information.

Senator SHERRY—Yes, I know that. You did not print enough.

Mr Jackson—No—

Senator SHERRY—Not yet, anyway.

Mr Jackson—We had a look at the numbers we used for our group certificate employee statement mail-outs. We have provided enough copies of the standard choice form to meet the requirements of 95 per cent of employers. Those who are outside that 95 per cent are the bigger employers. They can get copies of the standard choice form by either logging on to our internet site, where they can download it in multiple formats, or they can ring the contact centre and we will post them out copies. Or they can photocopy copies of the version they have got. We are conscious of not overwhelming people with material. That is the second mail-out, which is happening very soon.

Senator SHERRY—That will obviously occur before July 1.

Mr Jackson—Yes.

Senator SHERRY—Are there any other mail-outs to employers planned at this stage?

Mr Jackson—No, not at this stage. We are monitoring how the campaign is working. We will look to adjust our strategy into the new financial year, first of all to focus perhaps a little more—

Senator SHERRY—Before we go on to that, I want to clarify the issues with the mail-out to the employer. That is to all employers?

Mr Jackson—That is to all employers, yes.

Senator SHERRY—And that includes those under state awards? We did discuss this matter last time.

Mr Jackson—Yes, we did. It is difficult: if you are based in Albury, what award your employer is under and so forth.

Senator SHERRY—Yes, I understand the difficulty, but I want to confirm: all employers last time, so it is all employers this time.

Mr Jackson—Yes, it is all employers again.

Senator SHERRY—There is a significant number of employers who are not required under law to go through this process, at least from 1 July this year, and perhaps 1 July next year—and in all likelihood I suspect that is the case. Have there been queries from employers that are not required to comply this year? Have they been inquiring about whether or not they are legally obliged to conform this year or next year?

Mr Jackson—No, we have not had a large number of inquiries about that.

Senator SHERRY—How many calls from employers have you had to the hotline so far?

Mr Jackson—Can I take that on notice? As at the end of May, we had 20-something thousand calls in total.

Senator SHERRY—Approximately.

Mr Jackson—I would have to get the split between what are employers and what are others, but many of those are from employers.

Senator SHERRY—Yes, I would certainly anticipate that.

Mr Jackson—But I hasten to add that we have had 400,000 or so hits on the web site, so there has been a large number of hits on the web site.

Senator SHERRY—Do you keep a log of probably not all of the hits or the phone calls but of the range of issues being raised and the number?

Mr Jackson—I do, yes.

Senator SHERRY—Do you have information there on that?

Mr Jackson—I will have to check on that. I will get someone to have a look but yes, we do. Obviously, one of the reasons we do that is to try and respond with the information we are putting out to deal with those issues which are raised the most.

Senator SHERRY—The issue of employee communication is obviously the advertising campaign and its various formats. Is there anything to be sent directly to Australian employees?

Mr Jackson—No, there is not.

Senator SHERRY—Once we move into the post 1 July phase—we did talk about this in some detail on the last occasion—you mentioned that there was to be an increase in the number of inspectors employed that you have visiting workplaces on compliance issues.

Mr Jackson—Yes, that is right.

Senator SHERRY—You also said their inspectorate role was not just the superannuation choice compliance; it was also mainly SG compliance?

Mr Jackson—Can I clarify? When I said there are more inspectors to be employed, it may be that, in the light of our overall funding arrangements, there is a transfer of people from one job to another within the office and not new employees coming in. But there will be an injection into our general field force of a number of staff. Those staff will not go out and do choice of fund audits, but they will increase the overall pool of auditors that we have. Those auditors will then, as part of their visits to employers, ask about choice.

Senator SHERRY—So it will not be about just the choice of fund and the issue of forms. I think they have to keep a record for five years—is that right?

Mr Jackson—That is correct.

Senator SHERRY—It will be SG compliance and other issues as well?

Mr Jackson—We are still working on that. It will be on choice of fund. Choice of fund obviously has an immediate link to super guarantee, so we will be looking to have referrals back from the field staff to the superannuation specialist auditors to deal with those issues as they arise.

Senator SHERRY—So primarily—or, from what you say, exclusively—the role of the field officers will be the choice of fund legislation?

Mr Jackson—I think they will be looking at income tax, GST and other things while they are there.

Senator SHERRY—They will have other things to look at as well?

Mr Jackson—That is right. But, as part of being there, if it is an employer, they will ask questions about choice of fund.

Senator SHERRY—Amongst the things they check, will they be checking to ensure that the forms were handed out in the first place?

Mr Jackson—They will be.

Senator SHERRY—How will they check that?

Mr Jackson—There are various mechanisms. They can ask the employer. Are there copies of forms where employees have made a choice which are being held by the employer? What is the mechanism the employer used to provide the choice of fund form to people? We can ask staff whether they have received the choice of fund form. There are a whole range of mechanisms we can employ to look at whether those forms have been offered.

Senator SHERRY—I suppose the ultimate check is to talk to the employees to see whether they have received the forms in the first place.

Mr Jackson—I have said that we talk to the employees to see if they have received them.

Senator SHERRY—It sounds like a fairly substantial workload to check this out—talking to the employees.

Mr Jackson—The only answer I can give you is that it depends. If it is a very small employer with one employee it is probably quite easy to check. If it is a larger employer it may be a little more difficult, although larger employers often have more defined and easily traced systems than smaller employers. So it depends a bit on the employer.

Senator SHERRY—When the field force go to a workplace, will they know whether they are under a state or a federal award?

Mr Jackson—They will be able to determine that quite easily.

Senator SHERRY—How will they do that?

Mr Jackson—They will be looking at the employment arrangements the employer has and making that assessment.

Senator SHERRY—They will ask for the information?

Mr Jackson—Yes. They will ask whether you are covered under a Commonwealth award—and then you are eligible for choice of fund—or whether you have workplace

agreements or certified agreements and whether they offer superannuation choice. It is quite a straightforward process.

Senator SHERRY—What is the extra number of staff that are going to be employed?

Mr Jackson—There are about 90 extra compliance staff for choice, of which about 50 will be injected into the overall growth of our general field force and 40 will be retained to do the more specialist follow-up.

Senator SHERRY—So the 50 that are added to the field force are added not just for super choice compliance but for more general compliance?

Mr Jackson—Yes, for more general compliance. But then the total field force will do, as part of its process, a check.

Senator SHERRY—What is the total field force—approximately?

Mr Jackson—It is 3,500 or thereabouts.

Senator SHERRY—So the total field force of approximately 3,500 will have a new addition of approximately 50 individuals but they will be doing compliance across the board?

Mr Jackson—That is right. I want to clarify that not all of those field staff are dealing with employers as they go around and do their work, so there are ratios and things.

Senator SHERRY—I did not include the question on advertising. You gave the figures for 2004-05 and 2005-06. Is there anything for 2006-07?

Mr Jackson—No.

Senator SHERRY—The answer to a question on notice I asked in February was that the advertising research company had not be retained then. But they have been now?

Mr Jackson—This is for co-contributions?

Senator SHERRY—No, this is for choice.

Mr Jackson—Yes, they have.

Senator SHERRY—Who was that?

Mr Jackson—The companies involved are Campaign Palace for the actual advertising and creatives, Universal McCann for the media buy and DBM Consultants for the market research and testing.

Senator SHERRY—What sums of money have been paid to each of those?

Mr Jackson—Campaign Palace, \$1.8 million; Universal McCann, the media buyers, the \$11 million that I mentioned earlier; and market testing is about \$650,000.

Senator SHERRY—Is that included in that \$17.2 million figure that we talked about earlier?

Mr Jackson—I have just checked and it is \$17.9, but, yes, it is included.

Senator SHERRY—You mentioned market research by DBM. Has the tax office or Treasury received any copies of any market research carried out?

Mr Jackson—We have seen copies of the research that has been done.

Senator SHERRY—Are you able to make available copies of those research documents that Treasury and/or the tax office have?

Mr Jackson—Normally that research is not provided. It is part of the campaign process and policy advice to government.

Senator SHERRY—Can you provide me with the file name of the research?

Mr Jackson—I do not have it here but I will see if I can find it.

Senator SHERRY—I would like the name of the files. Will the checking for compliance with respect to choice of superannuation fund commence as of 1 July, which is the operative date of the system? Will that also be the time at which the field force will commence checking on compliance?

Mr Jackson—Subject to some finalisation of training and support material, our compliance activities will start thereabouts. I would hasten to add that, in the first instance, our focus will be very much on support, education and helping people to fix things up. If we find somebody who is doing something wrong, our focus will be on getting them to correct that. Obviously, if we find people who are deliberately not offering choice or who we have warned before and who have not taken any action, we will move forward with more robust compliance and enforcement action. We accept that there will be a period of transition where employers will be coming to grips with this new system and getting used to doing it. Through that time, we will be more focused on support than enforcement.

Senator SHERRY—You mentioned the approximately 3½ thousand field force. What is the average visitation level? Do they get to every employer once a year or every two years or five years?

Mr Jackson—No. I cannot tell you. I do not know if there is someone else here who can help me.

Senator SHERRY—Can you tell me effectively what the field force inspection rate is?

Mr Jackson—It would be between eight to 10 per cent of coverage of all business—not just employers, but probably a proportionate ratio across employers.

Senator SHERRY—That is eight to 10 per cent per annum?

Mr Jackson—That is right.

Senator SHERRY—There are obviously a number of issues relating to the giving of advice that have been discussed, in ASIC in particular. If a field force officer is able to ascertain prima facie that an employer has in fact given advice—

Mr Jackson—Financial advice?

Senator SHERRY—Yes, prima facie. I would not reasonably expect a field force officer to get involved in the detail of that. Would they pass that on to ASIC for follow up?

Mr Jackson—We are in the process of developing with ASIC some protocols around that. We have not quite finalised that yet, but I would say there is some likelihood that that would be the case.

Senator SHERRY—So where a field officer discovers prima facie information that is not within their direct responsibility it would be passed on?

Mr Jackson—Certainly, inside the tax office that would be the case. To the extent that it is something like an employer providing financial advice, we are still working that through, but I would expect that there would be some link. We have been working quite closely with ASIC on the implementation of choice.

Senator SHERRY—What about other issues, for example so-called third-line forcing, which is prohibited under the act?

Mr Jackson—Employer inducements?

Senator SHERRY—Yes.

Mr Jackson—It would be the same.

Senator SHERRY—As we have gone into the area of advertising, are any other advertising campaigns planned by the tax office?

Mr Jackson—This year?

Senator SHERRY—Yes.

Mr Jackson—The co-contributions campaign is continuing this year.

Senator SHERRY—What are the budget arrangements for that? What amount of money has been spent so far this financial year, approximately?

Mr Jackson—The budget I have here for marketing education for co-contributions for 2004-05 is \$8.1 million. I cannot tell you off the top of my head how much of that \$8.1 million has been spent so far, but it would be almost all of it.

Senator SHERRY—And 2005-06?

Mr Jackson—I do not have the 2005-06 figures, but certainly the co-contributions advertising is phasing right down. Off the top of my head, I do not think any campaign for co-contributions is scheduled for 2005-06.

Senator SHERRY—Was any market research involved in the \$8.1 million campaign?

Mr Jackson—There would have been. I think the market research there was done by Worthington Di Marzio.

Senator SHERRY—Do you have a figure for that?

Mr Jackson—I do not have a split on that; I am sorry.

Senator SHERRY—Were copies made available of their market research reports to Treasury and/or the tax office?

Mr Jackson—I am not sure if they would have been made available to Treasury in that case.

Senator SHERRY—But they would have been made available to the tax office?

Mr Jackson—Yes.

Senator SHERRY—I will not ask, because I know what the answer will be, but can you take it on notice to give me the titles of the reports that were provided.

Mr Jackson—Okay.

Senator SHERRY—We have dealt with the choice and co-contribution campaigns. Are there any other campaigns by the tax office on other matters?

Mr Jackson—There are no more within superannuation. I do not know about other parts of the office.

Senator SHERRY—Mr Carmody?

Mr Carmody—We are continually putting out information on a range of things. If you are talking about the sorts of campaigns that go through the government processes, I am not aware of any others. We are doing something, for example, to promote our electronic facilities, but that is part of our ongoing operations.

Senator SHERRY—Are those campaigns detailed in your annual report—the breakdown, the costs and whoever they are contracted to?

Mr Carmody—I am not sure what we provide by way of marketing. I will get someone to check. Some of those develop through the year—

Senator SHERRY—That is fine.

Mr Carmody—as we see things that need to be done. For example, the electronic facilities program is one that we are developing at the moment.

Senator SHERRY—I understand that, but could you take it on notice to provide a list of the campaigns and their costs through this financial year, and whether any private sector consultants or marketing people have been involved.

Mr Carmody—We will take that on notice and provide it to you.

Senator SHERRY—I have some issues relating to the mature age tax break. I notice Mr Gallagher answered—

CHAIR—Can the superannuation people go now?

Senator SHERRY—No, not quite yet. There is an issue at the back of my mind that I have to ask about, but I cannot recall it. Hopefully, it will come to me by the time I have concluded the mature age tax break questions. Now I have remembered the superannuation issue, and it might involve Mr Gallagher anyway. We had a discussion earlier about lost unclaimed superannuation. You may recall that there was a measure to allow temporary residents—I think ‘entrants’ is the correct terminology—to claim their superannuation on departing Australia. Do you recall that measure?

Mr Jackson—Yes.

Senator SHERRY—And then the tax office collected some revenue from the moneys claimed.

Mr Jackson—That is correct, yes.

Senator SHERRY—Can you give me an update on the number of departed temporary entrants or residents who have claimed moneys?

Mr Jackson—I will just see if I have that number to hand.

Senator Kemp—This is a pretty good policy.

Senator SHERRY—I would turn it into a ripper, but I freely acknowledge where the idea came from.

Senator Kemp—That is right, but not freely—it was wrung out of you.

Senator SHERRY—I acknowledge the source of the inspiration for Labor policy in this area.

Mr Carmody—While Mr Jackson is looking that up, I will answer an earlier question that you asked about the annual report for 2003-04, which I assume will be replicated under this process for the coming annual report. At appendix 5 we provide details of advertising, direct mail, market research and media placement, so we will provide the same in the coming annual report.

Senator SHERRY—That is fine. When is that to be issued, Mr Carmody? Do you have any idea of the approximate time?

Mr Carmody—Last year I signed it off on 25 October.

Mr Jackson—As I was looking for that update, I found the numbers for the lost members register. The value of accounts at April 2005 is \$8.1 million and there are 5.4 million accounts—slightly more than I mentioned a moment ago.

Senator SHERRY—And that will be updated for the annual report, presumably?

Mr Jackson—It will be.

Senator SHERRY—That was as of when?

Mr Jackson—That was as of April. I do not have the number of claims made. I can talk to you about—I hesitate to mention this—web site hits and departure card notifications.

Senator SHERRY—We have been through that before, and web site hits are not revenue or numbers.

Mr Jackson—No, but overall those things are progressively growing as the scheme becomes embedded. But I do not have the number of claims made. The claims are made directly—

Senator SHERRY—To the fund.

Mr Jackson—to the fund, and the fund remits that back as part of their withholdings for the year. We do not have that separately.

Senator SHERRY—Yes, but there was a revenue item that was identified separately. How is the revenue going? What does your analysis show of the revenue collected?

Mr Jackson—That is really a question for the Treasury. Mr Gallagher might answer that.

Senator SHERRY—Mr Gallagher, how is the revenue collection going in this area?

Mr Gallagher—We last revised the estimates of revenue in the 2004-05 budget. I think the revenue fits the pattern of that revision. We have not revised subsequently. The numbers are unpublished. I will need to take questions about the detailed numbers on notice.

Senator SHERRY—I thought I might get away with it this estimates.

Senator Kemp—That is hard to experience for you.

Senator SHERRY—I will put this to Mr Carmody. Do you think it is desirable, Mr Carmody, where there is a policy for a new revenue collection, that we do not receive an update on the revenue that is actually collected? Do you think that is a desirable principle?

Mr Carmody—I think the representative of the Treasury has explained the approach. It is not for me to comment on the desirability or otherwise.

Senator SHERRY—While we are on this, Mr Gallagher, did you do any research on the Labor Party's policy on lost superannuation moneys that was announced during the election campaign?

Mr Gallagher—We did, but in the end we did not get a costing request.

Senator SHERRY—So you have not published anything. Do you have some figures there?

Senator Kemp—It is your policy. We should be asking you questions about it!

Senator SHERRY—It is, and it was well costed.

Senator Kemp—I do not think you should be asking us questions about it.

Senator SHERRY—It was well costed, but I am interested to know—

Senator Kemp—If you want any answers about your policy, I suggest you ask yourself.

ACTING CHAIR (Senator Watson)—You might embarrass him.

Senator SHERRY—If he wants to embarrass me, he can go ahead and attempt to. But it was costed, and legally had to be costed under the charter of budget honesty.

Mr Gallagher—We costed it on the basis that we thought you might ask, so we had better do a costing. In the end you did not request a costing formally. I think the best thing for me to do is to take the question on notice—

Senator SHERRY—Again, Mr Gallagher?

Mr Gallagher—I can provide you with a costing of the policy, as specified in the—

ACTING CHAIR—Were there any surprises that you came across?

Senator SHERRY—Mr Gallagher, just be aware that, if you get into the detail, we should get all the detail—no partial detail, once you have crossed the bridge.

Senator Kemp—In that case, I don't think we will get into any of the detail.

Mr Gallagher—I would prefer to take the question on notice.

Senator SHERRY—I thought that might happen. Bad luck, Senator Watson.

Senator Kemp—Senator Sherry, you should be delighted that someone has actually read your policy.

Senator SHERRY—As I said, it was a great revenue raiser. I was truly inspired.

Senator Kemp—After your triumph with the parliamentary super.

Senator SHERRY—I have acknowledged the source of the idea. I have done that.

Senator Kemp—Thank you. I will take credit for that.

Senator SHERRY—We discussed the mature age tax break costings on the last occasion. Has there been any revision of the costings of that initiative?

Mr Gallagher—No. The costings have not been revised since MYEFO. The thing that has happened since we last discussed this is that a budget measure has been published in relation to it.

Senator SHERRY—Yes. I saw that.

Senator Kemp—Is that the end of super? I think so. Don't you?

Senator SHERRY—You hope so.

Senator Kemp—I think we have to get some movement here.

Senator SHERRY—Yes, I think so.

Senator Kemp—Okay, super can go.

Senator SHERRY—Except as it applies to issues relating to the future fund.

ACTING CHAIR—That would be a Treasury matter rather than a tax matter. So all the superannuation surcharge and superannuation guarantee people can leave.

Senator SHERRY—I did not see a great flood!

ACTING CHAIR—Thank you very much for your appearance.

Senator SHERRY—Mr Gallagher, we were into the update as notified in the budget. What does that bring the totals to?

Mr Gallagher—The totals are still the totals published in MYEFO, which are essentially \$1.4 billion over the forward estimates period. All that costing does is give you effectively the split between the parameter revision that I advised you about previously and the amount that came from the definition of earned income.

Senator SHERRY—Have you re-examined the costings in light of the Welfare to Work measures?

Mr Gallagher—Not as yet. The details of the Welfare to Work measures were being worked on intensively during the budget period. Now that there are costing details around, we may well have a look to think about the implications in terms of the age distribution. We do not expect many from sole parents, but it might be the case that some people who otherwise would have been on disability support will be of the correct age.

Senator SHERRY—Therefore it would have a costing impact.

Mr Gallagher—It may have. We need to look at the numbers. As you know, I have already made a substantial revision to allow for the number of people who are over the age of 55 and working.

Senator SHERRY—Yes, I am aware of that. But that was before the announcement of the Welfare to Work measures.

Mr Gallagher—That is true. It just might be that the additional effect is small.

Senator SHERRY—I know you are involved with and familiar with the intergenerational modelling, Mr Gallagher. Can you just refresh my memory? Are organisations outside government allowed to access that modelling and request work to be done?

Mr Gallagher—If you mean the detailed modelling for the *Intergenerational report*, the report has been published—

Senator SHERRY—I understand that the report is published.

Mr Gallagher—and, since we have published that, the Productivity Commission has published its own report on the same issues, which extended their report to the state. In terms of what is available, the Productivity Commission has put its more up-to-date information out on its web site. I do not think I have had a request to actually do the analysis.

Senator SHERRY—I just want to clarify this: for the PC report, where did they draw their modelling from? You said it is updated. Where did they get their research from?

Mr Gallagher—They have taken their demographic work from the ABS and, to some extent, from the ANU school of demography. Their labour force projections are their own. They have taken a cohort approach to their labour force projections. Their health modelling, which they have done on the basis of Australian Institute of Health and Welfare data and Health Insurance Commission data, is their own. The social security modelling was based on the information that they had received from Family and Community Services. So they have gone to a range of sources. They discussed our modelling with us in the preparation of their own. We have discussed where their modelling varies. The thing that they took from us in particular was the modelling of age pension in relation to superannuation, because they did not have the resources to construct anything like the RIM group.

Senator SHERRY—So they partly used your data, but they did not use your model?

Mr Gallagher—It is not one model; it is a multiplicity of models. But, no, they have not used it per se.

Senator SHERRY—So, per se, they did their own modelling, if you like, but they crosschecked on a range of areas with you?

Mr Gallagher—We discussed approaches—in particular, in relation to issues such as disability support pension and the Pharmaceutical Benefits Scheme. We discussed approaches.

Senator SHERRY—But—just coming back to my earlier question—does Treasury receive any requests to have modelling done using RIM?

Mr Gallagher—We do occasionally receive requests in relation to superannuation modelling from people such as the Committee for Economic Development of Australia or the Institute of Actuaries.

Senator SHERRY—Are you able to meet those requests?

Mr Gallagher—Generally, no. The reason is that obviously, as a Treasury unit, we work for the Treasurer and for the Assistant Treasurer. It is an issue of what their priorities are.

Senator SHERRY—Have any requests been agreed to in the past?

Mr Gallagher—I cannot think of any.

Senator SHERRY—Perhaps you could take it on notice.

Mr Gallagher—I will take it on notice and see if there are any requests. A lot of our material is in the public domain. Our web site still contains the material from our conference papers, and it contains things like submissions to the Senate select committee inquiry into retirement income adequacy. That is all on the web site.

Senator SHERRY—When is the next *Intergenerational report* due for publication?

Mr Gallagher—The *Intergenerational report* is required by the Charter of Budget Honesty to be done at least every five years, so the latest that the next one can be done is May 2007. But the option is open to do it before then.

Senator SHERRY—Of course. Will that include an update of the intergenerational impact of policies implemented since the last report?

Mr Gallagher—It will take into account our current policies. The pillars of the *Intergenerational report* are current policies and current trends. Current policies will be reflected in the *Intergenerational report*.

Senator SHERRY—For example, it would include the Welfare to Work package as part of the components of that model?

Mr Gallagher—Yes, to the extent that we can know about it and have numbers in relation to its effects at that point in time. It will depend on what information is available that will allow us to detect the changes.

Senator SHERRY—I think we discussed this on the last occasion. When policies are announced they are not individually run through the RIM at the moment, are they?

Mr Gallagher—No, not as a matter of course.

Senator SHERRY—I have some issues relating to the future fund.

Mr Callaghan—The future fund is not the revenue group's responsibility.

Senator SHERRY—Where does that fall?

Mr Callaghan—With the fiscal group.

Senator SHERRY—Okay, we will leave that then.

Senator Kemp—Senator Sherry, is there a group you could finish with before dinner so they do not have to come back?

Senator SHERRY—I am trying to do that. The trouble is that I have questions on the same area in different parts of the brief.

Mr Carmody—Are there any questions on our IT systems, for example?

Senator SHERRY—Other than the issues we have touched on, no.

Mr Carmody—Are there any questions on debt? I am just trying to give people a chance to go.

Senator SHERRY—On debt issues, yes.

Mr Carmody—Have you finished with our financial accounts?

Senator SHERRY—Yes. I want to turn to the issue of identity fraud. There was a recent article in the *Courier-Mail*—it may have appeared elsewhere—that concerned the issue of massive identity fraud—this is the media’s terminology—after the discovery of some 3,500 taxpayers and tax claimants who were not who they said they were. It said that the Australian tax office was investigating this. Mr Monaghan was quoted as saying that the identities were being stolen rather than created—names, tax file numbers and personal details were pilfered from bank accounts, mobile phones and post offices. That is not a direct quote, Mr Monaghan. I am always a bit careful about the media when it comes to comments. Could you give us an outline of the extent of the problem, the investigation and the source of the identities being stolen?

Mr Monaghan—Identity fraud—identity crime, more correctly—is an issue for us. I have no idea where they got 3,500 from. I did give a speech, which is available on our web site, outlining the areas of concern. We are certainly finding that identity crime as a vehicle to commit fraud is growing and that takeover is a more common form of identity crime than identity fraud as in made-up identities. The numbers, relatively speaking, are quite small, but it is undoubtedly a growing concern for us.

Senator SHERRY—You say it is growing. What are the numbers?

Mr Monaghan—It is quite difficult to give you precise numbers, because frauds are not clean, crisp matters—there is often a lot of different aspects involved and interconnections between different taxpayers. But we believe that, as a vehicle to commit revenue fraud, identity is now a feature of certainly over one-third of matters that we encounter. The figure I used there was extracted from a manual check of all our cases—we came up with about 30 per cent. We think it is continuing to slowly grow as an element of revenue fraud.

Senator SHERRY—How many cases are there at the present time?

Mr Monaghan—Of identity fraud?

Senator SHERRY—Investigations as to fraud.

Mr Monaghan—We have about 500 investigations on the books at any point in time. Again, giving a precise number of matters is problematic because of the nature of those, but it is in that order. It comes and goes, of course, over time, but it is more or less around that number over a period.

Senator SHERRY—What are the features of identity fraud? How are they obtaining false identities?

Mr Monaghan—It can happen in the sorts of ways you mentioned earlier on.

Senator SHERRY—How do they get tax file numbers, for example?

Mr Monaghan—With a fraudulent identity, there is often a mixture of fraudulent and real parts of that identity. Tax file numbers can be obtained from people you have a relationship

with sometimes, be it a client or somebody in your business. There are other matters we have come across—and we have done some communication work on these—such as people advertising things on the net. They may say they are an employment broker, for example, and they may suggest that you send all your details so that when they get you a job you can start really quickly.

Senator SHERRY—Including a tax file number?

Mr Monaghan—Yes. Unfortunately, people do that. As I said, we did some work earlier this year, which got a lot of coverage, to try to remind people that they should not do that. People do literally find documents in letterboxes, garbage bins and dumpsters. They piece together different bits of information.

Senator SHERRY—What sorts of documents are you referring to?

Mr Monaghan—It may be bank accounts, bank statements, electricity bills, rates notices or tax assessments. Whatever it is, they piece together those details into something that looks credible.

Senator SHERRY—What about births, deaths and marriages registries—that is, state based identities?

Mr Monaghan—Do you mean is that where people get information?

Senator SHERRY—Yes—can there be possible identity fraud if someone dies, for example? It is a state based register, isn't it?

Mr Monaghan—Yes.

Senator SHERRY—There is no national data?

Mr Monaghan—No.

Senator SHERRY—So presumably, in the case of someone who has died, someone could try and reconstruct an identity around that person in another state?

Mr Monaghan—Yes. I am not aware of specific instances emanating from the registers themselves, but certainly people do create identities from a huge range of sources, including cemeteries and the like. People do research around an identity that might be a good one to take over for a particular type of fraud. The only limits are the bounds of the imagination.

Senator SHERRY—You mentioned that you believe it is growing. Why is it growing?

Mr Monaghan—In relation to tax matters I guess we are seeing it growing because of the ability to use modern technology to create a document which appears to be genuine and which is compiled from a range of other sources. It is much easier than it was. I think that would probably be one of the major elements.

Senator SHERRY—How are tax file numbers removed once a person dies? Are they removed from the records or recovered, in a sense?

Mr Monaghan—We have processes to deactivate a tax file number where someone has died or left the country.

Senator SHERRY—Let us take the case of someone who has died. How do you gain notification that someone has died if it is a state based register?

Mr Monaghan—We actually do runs, as I understand it. I think we do get notified by some states where it is an electronic register, and in other cases we do runs. It is not my area, but I understand that we do runs to check the records.

Senator SHERRY—But it is only some states. That does not sound to me like it is—

Mr Monaghan—I think we do runs in all states. It is just that in some states it is electronic and in others it is not.

Senator SHERRY—What about people who leave the country? Are you notified, presumably by Customs or the airlines, and do you cross data match the names of those people with their TFN?

Mr Monaghan—Again, it is not directly my area, but I understand that we have processes in place with the department of immigration to conduct those sorts of matches.

Mr Carmody—I think the Australian National Audit Office's *Numbers on the run* report might have been tabled today. I think you will find in that report a full exposition of all that we do.

Senator SHERRY—I was not aware of that. What was tabled today?

Mr Carmody—I think it was going to be tabled today. It is called *Numbers on the run*. You might remember a little while ago that large numbers of tax file numbers were quoted. Since then we have done a lot of work through some of the processes that Mr Monaghan has been talking about. I think you will see in that report, which I understand was due to be tabled today—and, if not, then very shortly—that there is quite an exposition of all that we do now.

Senator SHERRY—That is in respect of tax file numbers and presumably other numbers as well?

Mr Carmody—It was on tax file numbers.

Senator SHERRY—I notice that the article refers to fraudsters using professional advisers like accountants and financial planners for credibility. Why are they using professional advisers for credibility?

Mr Monaghan—These are small in number but there are cases of people becoming somewhat more sophisticated in their methodologies, and they actually use quite innocent professional advisers to send through their false documentation. So they give it a guise of credibility by using—and treating well in fact—professional advisers. The other side of that is that there are still cases—and these are in very small numbers—of tax practitioners essentially stealing the identities of their clients and using those to defraud both the clients and us. There have been a number of cases in the courts of late and quite severe penalties have been handed down.

Senator SHERRY—I am not sure whether or not this was sourced from your speech but the ATO is apparently building a new fraud unit. What is this new fraud unit?

Mr Monaghan—That was the bringing together in July 2003, under me, of the functions in the organisation that deal with serious noncompliance, which is the worst of the noncompliance behaviour. That is what that would refer to. Not all the quotes were perfect.

Senator SHERRY—Pardon?

Mr Monaghan—Not all the quotes in the articles were exactly right.

Senator SHERRY—I would not suggest that. That is why I am always cautious when referring to articles. This one was on 30 May and the implication is that the unit has just been set up but, as you say, it was set up some time ago. Has that unit had anything added to it, other than some new emphasis perhaps, such as new staffing levels or new techniques?

Mr Monaghan—Yes, we did increase resourcing in that field of work slightly. The focus, rather than on numbers of people, has been on different approaches, in particular working more closely and more strategically with our partner agencies—the law enforcement agencies, for example—so we do work much more purposefully with those other agencies. We also have a very strong program of developing the capability of our people and of people in other agencies, so we actually do a lot of training. We provide that and we invite other agencies to attend. We have just launched a program of trainees—30 mid-level public servants. We are putting them through quite a strong program of investigation and financial forensic accounting skills, setting up the next wave to come into this area in the future. Those are the sorts of things that we are doing to build that capability. We are also looking at our intelligence—and my intelligence does need looking at!—

Senator SHERRY—Intelligence gathering?

Mr Monaghan—Yes. We are building a stronger strategic capability in intelligence in the national office and putting tactical and operational intelligence out into the field. In doing that, we are working very closely on good approaches, rather than on the content of intelligence, with our partner agencies. So it is a very cooperative effort.

Senator SHERRY—Does this extend to international work? Presumably some of the fraud that takes place—at least some of the identity fraud as well—would be across our boundaries.

Mr Monaghan—Some of the work does involve international issues.

Senator SHERRY—Such as?

Mr Monaghan—With the electronic capability we have examples of attempts from offshore to create false transactions or false identities in our systems, for example.

Senator SHERRY—Does your activity include issues relating to GST evasion?

Mr Monaghan—Yes, my area looks at the worst cases of evasion.

Senator SHERRY—When you say ‘the worst cases’, you mean worst in the sense of—

Mr Monaghan—The most fraudulent.

Senator SHERRY—So it is the size of the fraud?

Mr Monaghan—Where the behaviour is bordering on criminal—that is the area I particularly focus on.

Senator SHERRY—Do we have any indication of the risk to revenue in this area?

Mr Monaghan—No. I am looking at examples that we have identified of attempted fraud, particularly on GST refunds. No, I do not have that.

Senator SHERRY—Can you give me some examples of the size of moneys we are dealing with here per case? Obviously they vary, but is it \$100,000 plus or \$1 million plus?

Mr Monaghan—They do vary incredibly. In the overall scheme of things they are quite small. If you were to look at some of the court decisions in the last year you would see that they vary from a couple of million dollars down to \$10,000.

Senator SHERRY—While we are on the issue of GST fraud, did you see the article in the *Sun Herald* on Sunday 29 May involving GST fraud and brothels?

Mr Monaghan—No, I did not.

Senator SHERRY—I am a little sceptical of the report, but it was by a Mr Eamonn Duff in the *Sun Herald*. It says:

THE Tax Office is set to clamp down on taxi drivers who hide extra income paid by brothels in return for finding new clients.

Mr Carmody—It is good to see we are on to it.

Senator SHERRY—It does not give any more detail of tax office activity, but I thought it was little odd that there is a report that the tax office was specifically targeting this area. It does not give any detail about any specific activity in this one particular area, beyond that the tax office is doing it.

Mr Carmody—I am not particularly aware of it.

Senator SHERRY—Can you throw any light on this report? It quotes a tax office spokeswoman, not man, who said:

“Evasion includes omitting income from tax returns, whether it be in cash or another form.”

Mr Carmody—We have got the answer here.

Mr Mann—As part of our cash economy compliance program, we have a project looking at compliance with tax obligations in what we call the adult industry. As part of that project, we have been working closely with players in the industry. We do not have a specific focus on the particular practice that you have just identified in that report—that is, the payments being made to taxi drivers—but we certainly have got a focus on a range of issues on declaration of income and tax withheld from employees in that industry. No doubt, with reports like that, we will also be looking at payments of that kind.

Senator SHERRY—This refers to finder’s fees for clients.

Mr Carmody—I am told it may be a reference to an inquiry into the taxi industry done by the state government. That might be the source of those points.

Senator SHERRY—It says:

The ATO focus on cabbies coincides with a Crime and Misconduct Commission inquiry, Regulating Prostitution, which follows reports that cabbies are extorting money ... by threatening to deliver clients to rival businesses.

But there is an ATO spokeswoman quoted. I suspect it might be a quote taken way out of context. It is probably a quote in respect of a general crackdown rather than the specific crackdown referred to in the article.

Mr Konza—I cannot give you a definitive answer, but when I followed up that report I was informed that there was a Queensland state government inquiry into the taxi industry.

What you see there are allegations that came out of that inquiry, which may have been put to tax officers in Queensland and who naturally responded that they would follow up information of that sort. I do not think it is much more than that.

Senator SHERRY—So you have no knowledge of the ATO spokeswoman who is quoted in relation to this article?

Mr Konza—No, I do not.

Senator SHERRY—Mr Mann, what issues do you focus on in respect of tax minimisation in the adult industry?

Mr Mann—A range of issues: whether activities are registered with the tax system, whether income is being declared and whether amounts are being properly withheld from employees who operate within the industry. Those would be the key issues.

Senator SHERRY—Can you enforce the law where such activities are illegal?

Mr Carmody—The legality of the activities does not impact on whether they are earning income for tax purposes.

Senator SHERRY—What about GST compliance?

Mr Mann—That covers GST compliance, income tax and withholding compliance.

Senator SHERRY—You say you have a special unit dealing with the industry?

Mr Mann—Yes.

Senator SHERRY—Have you any idea of the sort of revenue at risk or recovered?

Mr Mann—I do not have those details with me.

Senator SHERRY—You say there is a special unit dealing with this industry. Presumably, because you have a special unit, it must be worthwhile in terms of revenue recovered.

Mr Mann—Yes, but I do not have those figures with me. We have been working with various parts of the industry. As Mr Konza indicated, there has been a special focus on Queensland but we are also working in Victoria and other states. For example, we have been working in Queensland with adult entertainment venues in relation to how they are treating their contract workers. We have been working with Centrelink, the police and the immigration department. As a result of that, for example, something like 1,100 contract dancers have been registered and several hundred have been removed from Centrelink benefits. So it is quite a significant project in that respect.

Senator SHERRY—Eleven hundred in one state!

Mr Mann—Yes.

Senator SHERRY—Dancers.

Mr Mann—Yes. We are now working across other states.

Senator SHERRY—Why the focus on Queensland?

Mr Mann—I think there was an initiative within that state which we formed a part of. The project started off in that area, and we are now progressing across the other states to see if their situation might be the same.

Senator SHERRY—If there are 1,100 dancers in Queensland there must be a hell of a lot elsewhere in the country.

Mr Mann—Yes. At the moment, we are planning to write to around 500 licensed brothels and adult entertainment venues in Victoria. So it is a fairly large-scale project.

Senator SHERRY—Is there a register in that state?

Mr Mann—In some states they are licensed and legal.

Senator SHERRY—Clearly, where there is a register and it is legal, it is easier to access the data that you need to carry out the enforcement activities.

Mr Mann—Yes.

Senator SHERRY—So it is not just recovery of GST and income tax; it is also information that can be passed on to social security for reduction or adjustment in benefit payments.

Mr Mann—Correct. And we are working, as I said, with law enforcement and the immigration department, if there are overstayers on visas et cetera.

Senator SHERRY—So there may be visa overstayers. There was some publicity recently given to, effectively, slave workers in the industry. Has it been of assistance in that regard?

Mr Mann—I am not sure that our activities have been involved in those operations.

Senator SHERRY—Going back to the 11,000 dancers in Queensland—

Mr Mann—Eleven hundred.

Senator SHERRY—I was going to say, ‘What is going on in Queensland?’ Eleven hundred is a more likely figure. In terms of social security payments, do you know what the adjustment was as a result of that activity?

Mr Mann—No, I do not have those figures with me.

Senator SHERRY—Could you take on notice the moneys recovered as either tax revenue or social security adjustments as a result of the unit’s activity?

Mr Mann—I will undertake to provide what information I have on that matter.

Senator SHERRY—Thank you for that. Part of this *Courier-Mail* article, Mr Carmody, reported that the Treasurer had announced moves to close a legal loophole that allowed a convicted drug dealer, a Mr Francesco Dominico La Rosa, who had told the tax office that some \$224,793 was stolen from him during a botched drug deal, to successfully claim it as a tax deduction. Is that correct?

Mr Carmody—Yes. That went through the courts and that was the finding.

Senator SHERRY—I have not seen legislation yet. Is it pending?

Mr Carmody—I think it has been announced, but I am not aware that it has been prepared yet. Treasury would know.

Mr Callaghan—Yes, I know that it was announced. The Treasurer put out a press release. The legislation has not gone forward yet.

Senator SHERRY—Presumably that will be retrospective legislation?

Mr Callaghan—I am not sure of the start date of that. I would have to check on that.

Senator SHERRY—If it is not retrospective then presumably you cannot prevent the—

Mr Callaghan—You are right; I assume it is retrospective.

Senator SHERRY—Sorry?

Mr Callaghan—For that very reason, yes.

Senator SHERRY—Yes, I would have thought there would be a legitimate argument in this sort of case. Have you had any other cases like that, Mr Carmody? I do not want to know the names. I suppose we have to respect—

Mr Carmody—I am not necessarily aware of any recent cases. That would seem to be a flagship one. We have not had a similar instance, as far as we are aware.

Senator SHERRY—So, as you understand it, the legislation will prevent individuals who are engaged in illegal activities from being able to successfully claim tax deductions?

Mr Carmody—I do not know whether it is all tax deductions.

Mr Callaghan—Not all tax deductions; it is those that are related to where they are convicted of an indictable offence. But, if the business has been conducting a legitimate business, the tax deductions that have been associated with the business are not caught. It is only those associated with the individual who is convicted of an indictable offence.

Senator SHERRY—So it is dependent on conviction?

Mr Callaghan—Yes.

Senator SHERRY—And then identifying what is legitimate business versus illegitimate business that they may be carrying out?

Mr Callaghan—Illegal business. If a company is undertaking legal business activities and an employee there has been associated with an offence, the range of deductions for the business conducting its legal activities is not caught.

Senator SHERRY—So, for example, if it is a hotel or something and there is a legitimate trade in food and alcohol, and it is a front for drug running, distribution et cetera and the owner is arrested and convicted, there are legitimate deductions on the food and alcohol side but not on the drug side. Is that the sort of distinction you mean?

Mr Callaghan—That is right. Budget Paper No. 2 says:

Deductions will be denied for losses and outgoings to the extent they are incurred in the furtherance of, or directly in relation to, activities in respect of which the taxpayer has been convicted of an indictable offence.

Senator SHERRY—Did you appeal to the High Court in that case?

Mr Carmody—I think it went to the High Court. Yes, we did.

Senator SHERRY—And that was rejected?

Mr Carmody—We were unsuccessful.

Senator SHERRY—The next issue I want to turn to is the matter of sportspeople, which again has had a very significant amount of media coverage, and the tax treatment of the income of sportspeople. I understand that the tax office was successful, despite a case that was funded by one of the sporting organisations, I think.

Mr Carmody—I think we funded it under our test case program.

Senator SHERRY—Can you just outline briefly what you believe the outcome of the case is and the implications for sporting people?

Mr Konza—The outline of the case is that the athlete in question had been fairly successful at their sport and had successfully won grants to support them in their sport. They had won prize money in events and had obtained sponsorship from various organisations. The athlete in question was also a part-time employee of the police force, I think. A question was whether the athlete was merely a successful person pursuing an obsession—that might even have been described in the court case—or whether they were conducting a business. The court held that the taxpayer had deliberately turned their talent to account for money in the way they undertook their sport and particularly in obtaining sponsorships, for example, from commercial organisations. The earnings of the athlete in question was therefore taxable. We are examining the ruling that we have. We have a fairly comprehensive ruling on sportspeople and we are examining that. We do not think that the decision significantly upsets that ruling, although we are open to submissions on that. The Australian Sports Commission is chairing a task force, I think with a number of sporting organisations and representatives, to examine the implications of the Stone decision for athletes.

Senator SHERRY—Why would the Australian Sports Commission be examining it? Is it the grants system that they oversee?

Mr Konza—Yes, in particular. We have undertaken to cooperate with that task force in giving feedback on any issues that they might identify.

Senator SHERRY—Does the ruling mean that a grant from, say, the Sports Commission, is taxable or is to be included in taxable income?

Mr Konza—Our taxation ruling, which sets out our position, has maintained that grants that are of a recurrent nature are what is known in tax law as ‘ordinary income’ and they are taxed. That goes back for a long line of tax law. There are other types of grants that you can get which will, say, help you get to the worlds in July. They will cover your airfare or something like that. They are quite different.

Senator SHERRY—Why are they different?

Mr Konza—Because they are one-off; they are not ordinary income. In the case where someone is undertaking a business, that grant income would be income; but, for someone who is undertaking a hobby, a one-off grant that helps them get to the worlds is not taxable.

Senator SHERRY—So if an airline donated a ticket for an amateur to go to the world championships of something, that probably would not be taxable?

Mr Konza—Probably not. Particularly if no services were performed by that athlete, that would not amount to sponsorship. Ordinarily, what we see is that various state sports commissions will help athletes go. Those are some of the implications.

Senator SHERRY—Do you accept that there is a hazy area, if you like, for some sportspeople about what constitutes earning an income?

Mr Carmody—Carrying on a business.

Mr Konza—Carrying on a business is one of the endemic hazy areas of the taxation system. It applies to sportspeople as much as it does to any other person.

Senator SHERRY—Yes, true, but some sportspeople literally may not work at all or work very little because of their dedication to their sport.

Mr Konza—Sure.

Senator SHERRY—It gets a bit difficult, I would have thought, to determine whether or not, at least in some instances, they are actually carrying on a business.

Mr Konza—In our ruling we do try to give people guidance on that question. I cannot repeat that guidance for you off the top of my head, but in the High Court case the concept of turning your talent to account was probably the one that stuck in my memory. As you said, there might be someone who lives on almost nothing pursuing their sport, but if they then are successful, gain some sponsorship, represent people and use their reputation and profile then that starts to indicate that they have crossed the line.

Proceedings suspended from 6.35 pm to 8.05 pm

Inspector-General of Taxation

ACTING CHAIR (Senator Chapman)—I welcome the Inspector-General.

Senator SHERRY—Firstly, I want to deal with the issue of reports and the way they are released. The process, as I understand it, Mr Vos, is that you pass the copies of the reports to Mr Brough?

Mr Vos—The legislation requires me to present the report to the minister, and the minister is either the Assistant Treasurer or the Treasurer. The way the structure is at the moment I report directly to the Minister for Revenue and Assistant Treasurer.

Senator SHERRY—I understand that hard copies of your reports are not made available.

Mr Vos—That is correct.

Senator SHERRY—Why is that the case?

Mr Vos—I think you would have to ask the government that. The legislation requires the government to release the report either by tabling in both houses of parliament or otherwise making it public. The routine that has been followed has been to cite them on our web site and make them available through that so that those who want a copy of it can print them themselves or view them on their computer. The bottom line is that that is an issue for government. It is not an issue for us.

Senator SHERRY—As you say, you publish them online.

Mr Vos—I do not publish them online. I host the published version on our web site. But it is the fact of the government actually making it public.

Senator SHERRY—That is making it public. But what is to stop you or your office printing hard copies of the reports once the government has released them?

Mr Vos—A simple funding exercise, I guess.

Senator SHERRY—You are the only organisation I know of that is not providing hard copies available for public distribution. Regardless of the process, I cannot think of another organisation that comes before us where we do not receive hard copies of the reports.

Senator Kemp—I think that is really not a matter for the Inspector-General. The Inspector-General has made it clear it is a matter for government. What I will do is assume you are asking a question on notice about why these are not provided in hard copy. I will make sure that is referred to the Assistant Treasurer.

Senator SHERRY—You have been through the process. You have outlined the process, Mr Vos. Thanks for that. But I still have not had explained to me why there is a legal impediment on you actually printing the report. You mentioned a possible cost exercise.

Mr Vos—We have in a few isolated cases provided photocopied copies that have been bound and/or in some cases just bulldog-clipped together. But a lot of the people that have asked for them have been either university people who were looking for some material for an assignment that they might be working on or something of this ilk. None of the stakeholders that I am aware of that we have been involved with have raised this with our office. This is the first time I am aware that there has been any concern over the availability of hard copies.

Senator Kemp—I think the truth is that most people now, even people like me, who are able to access things on the computer do so regularly each day. We can access those reports. If people could not access them, I am sure there would be complaints. This is not my area, but the Inspector-General has indicated it is a matter for the government. Therefore, I think it is a matter for the government to deal with, if that is the case.

Senator SHERRY—I do not agree with you, Senator Kemp.

Senator Kemp—I do not care whether you agree with me or not. They are the facts of the matter.

Senator SHERRY—I do not care for your intervention. I am entitled to ask questions and you can answer them in a reasonable way.

Senator Kemp—You are entitled to ask questions. But they are questions on government policy and they have been answered by the Inspector-General. The Inspector-General made a very valid point that no-one has complained to him that they cannot get copies except you.

Senator SHERRY—I am raising the issue.

Senator Kemp—You have raised the issue and the Inspector-General has said it is a matter for the government to deal with. I said I will take it on notice and get you an answer.

Senator SHERRY—Okay. I still have some further questions.

Senator Kemp—Fire away. I am happy with that.

Senator SHERRY—Mr Vos, you have raised the issue of the cost of printing. Did you seek additional funds in your request for allocations through the budget process to cover the cost of printing?

Mr Chapman—No. The office has not sought additional funding through any of the appropriation processes. This issue has not been raised with us, as Mr Vos has indicated. Those people interested in obtaining a copy seemed happy to access it through the web site.

Senator SHERRY—So then you would subscribe to the principle that all reports from all organisations should only be available through the web site?

Senator Kemp—No. I think that is an unfair question.

Senator SHERRY—Senator Kemp, really it is not an unfair question.

Senator Kemp—He is not subscribing to any general principle.

Senator SHERRY—Why is Senator Kemp intervening in this way?

Senator Kemp—What I am speaking to, Senator Sherry—and I would ask you to keep quiet—

ACTING CHAIR—Senator Sherry, Senator Kemp, the minister, is at liberty to intervene at any stage.

Senator Kemp—In all fairness, I do not think it is a fair question. It is not that the officer at the table is subscribing to any general principle. The officer at the table has indicated what the facts of the case are. If there is an issue that the government has to deal with, we will look at it. I have to say, frankly, there are a lot of areas now where hard copies are not available. You will find that your office is not getting hard copies of *Hansard* because the truth is that the parliament says that *Hansard* is available online.

Senator SHERRY—Do you know of any government authority, department or committee that issues reports where we do not receive a hard copy? Can you name me one, Senator Kemp?

Senator Kemp—We used to get bound copies of *Hansard*, if you remember. Senator Chapman may correct me if I am wrong. We in our own offices used to receive bound copies of *Hansard*. I know we get the *Proof Hansard*. The formal copies of *Hansard* we no longer get, as I understand it, because people now say that they are online. I am sure there are other examples. But I would not expect the officers at the table to know that—it is not their area—and neither should they have that knowledge. If they do, they can share it with us.

Senator SHERRY—For the record, I think the intervention of the minister is unreasonable, Senator Chapman.

ACTING CHAIR—Estimates questions are in fact directed to the minister, who then relates them to the officers. That is the proper procedure. The minister is at liberty to intervene at any time.

Senator SHERRY—Are you chairing these proceedings tomorrow morning, Senator Chapman, or are we going to return to Senator Brandis and have him chair tomorrow morning?

ACTING CHAIR—Those arrangements will be made, I suppose, before tomorrow morning. I am not aware of any standing order that precludes the minister from intervening.

Senator SHERRY—I find the intervention of the minister unreasonable. It is going to unnecessarily prolong proceedings if we are going to have the minister intervene in this way.

Senator Kemp—Don't be infantile, Senator Sherry.

Senator SHERRY—I am quite amazed, Acting Chair, that you are tolerating this sort of intervention.

ACTING CHAIR—It is standard procedure that estimates questions are in fact directed at the minister, who then refers them to the appropriate officer. It is only through practice that questions generally go direct to officers. But as I understand the strict interpretation of the standing orders—I might stand to be corrected—questions are asked of the minister, who refers the appropriate officer to answer them.

Senator SHERRY—If that is the way it is going to be, that is the way it is going to be. Mr Chapman, I notice in the budget papers the average staff level is some six full-time equivalents?

Mr Chapman—That is correct.

Senator SHERRY—Is that anticipated to be the total average for full-time equivalent staff for this coming financial year?

Mr Chapman—That is our expectation.

Senator SHERRY—Have you experienced any difficulties in finding or holding suitably qualified staff?

Mr Chapman—Since we started operations in late 2003, we have been fortunate to have a very stable arrangement. We have had the loss of one staff member in that period of time. But, other than that, we feel that we have some very well qualified and very competent staff.

Senator SHERRY—Mr Vos, could you outline briefly the projects you are working on at the present time?

Mr Vos—There are only two projects that we have on the go at the moment. One is dealing with the time to complete audits and other related activities. That project is to a point now where we had our exit interview with the Taxation Office yesterday. We will be in the course of writing up the final report for that report over the coming weeks.

Senator SHERRY—Before we go on, what issues is the time to complete audits project looking at with the Taxation Office?

Mr Vos—The audits that would seem to be taking longer than they ought to in terms of running the normal course of events with tax office intervention with taxpayers.

Senator SHERRY—Obviously this was referred to by the Treasurer or the Assistant Treasurer.

Mr Vos—No. It was at my own initiative. Almost all of the work program within my office is initiated under my own initiative. I can be directed by the government to do something, but I can choose when to do that. I can be requested by either or both houses of parliament or a

committee of either or both houses of parliament or the Commissioner of Taxation. When so requested, I can choose to ignore that request if I wish. In essence, I have almost exclusive control on setting my work program. Having said that, I go to the private sector stakeholders and the public sector stakeholders—ANAO and the Commonwealth Ombudsman—to consult with those groups of people to identify where our work program is going forward. Each six months we publish the list of those reviews that we are likely to be undertaking over the next six to 12 months.

To complete your question, the other review we have going is in respect of the tax office's litigation program dealing with disputes with taxpayers who are seeking to appeal a decision of the tax office in disallowing an objection. So these are court cases brought on by taxpayers where the tax office is involved. That review is well underway. They are the only two reviews that we have on the go as we speak.

Senator SHERRY—Coming back to the first review, the time to complete audits, what organisations and individuals, if you are able to name them—you may not be able to—did you conduct prior to initiating this inquiry?

Mr Vos—The groups of organisations that we have met with ever since I have had this role have been the accounting, tax, legal and business key stakeholders—the accounting bodies, the small business associations, the Chamber of Commerce and Industry and some of the state chambers of commerce. We have sought to get as widespread an input of views as possible on where there are potential systemic problems in the tax system or in the operation of tax administration by the tax office. We published at the end of 2003 some 90 potential systemic issues that had been raised by those groups of people that I mentioned and the ANAO and the Commonwealth Ombudsman. We regularly meet with both those two organisations, particularly to ensure that there is no duplication of reviews and that we are not targeting the same sort of area in the same agency either at the same time or even in contiguous operation. So we are trying to identify, using some criteria that we set out in the issues papers at the end of 2003, the types of matters that are competing for my priority to look at with some urgency.

Senator SHERRY—Once you have in this case determined an issue, such as time to complete audits, do you then go back to stakeholders? What about individual taxpayers that may be concerned about the issue?

Mr Vos—The normal routine is that we do substantial scoping of the issue with the tax office prior to setting terms of reference. We then set the terms of reference and publish those terms of reference and then go to the public seeking submissions. Over the next 40 to 60 days we get submissions. We then approach—this has been pretty much the standard approach in almost all of our reviews—who we think is going to be the most focused to give us the best input on the issues involved. We then take those issues to the tax office and look at their records, books and systems and discuss it with their people and seek to synthesize an outcome that looks to be working with the tax office to find an improved way or a necessary way to better make the tax administration work.

Senator SHERRY—Of the submissions you seek, do you seek verbal presentations as well in some cases?

Mr Vos—Absolutely. There are a number of people who have not got the time, so they say, to commit something to writing. We will have meetings around the country. We do a lot of travelling and we do a lot of consultation with a lot of people. We listen. We have to have the so-called wisdom of Solomon to work out what they are saying and what they are really meaning and what the issue is that they are dealing with. In many cases, it is just the angst of dealing with the tax office because they do not like paying tax. It might be that there is an issue and we need to address that and go and seek to find whether it is a process issue, a management issue or a training issue that is causing this problem in a systemic way.

Senator SHERRY—Let us use as an example the time to complete audits. What number of people and number of submissions would you receive?

Mr Vos—In the case of the litigation review that we are doing at the present time, almost every state's, or certainly the major states', bar councils, the Law Council, many of the states' law societies and law institutes, the accounting bodies, the tax institute—

Senator SHERRY—Do you have an approximate raw number?

Mr Vos—No, I do not. There may be 30 or 50. There may be less. But it is in that sort of a ballpark.

Senator SHERRY—When you meet presumably face to face and take a verbal submission, is that in private or can it be in public?

Mr Vos—We can do them in public, but so far the way we have worked is to deal with it confidentially because we cannot disclose confidential taxpayer information. There is a provision in our law where you can give evidence to us confidentially so we cannot disclose either the person that has given the information or, in some cases, what they have told us. I suppose it is a similar sort of thing to a whistleblower type principle. But the information is supplied in a quite significant fashion. In some cases, individual taxpayers send their whole file in and we get a whole pile of material that is either emailed to us, faxed to us or posted to us.

Senator SHERRY—So you do not only receive submissions by email?

Mr Vos—No.

Senator SHERRY—You will take hard copy?

Mr Vos—Yes. We will take it any way someone is prepared to send it to us.

Senator SHERRY—Good. What about legal representation or specialist accounting and audit representation—is that permitted?

Mr Vos—Yes. I can draw on support where I need it from skills that we have not got in the office. So far, that has not been an issue. We have both accountants and lawyers in the office. Everyone in the office, bar our executive assistant of course, is well-versed in the tax laws.

Senator SHERRY—So the specialist staff in the agency, I assume, may go through the presentation of material and provide a synopsis or overview if that is what you require?

Mr Vos—Correct, yes. The staff do a lot of the hard yards of going through this material and synthesizing down the messages to feed to me in a summary version. In many cases, I go

through the process of the meetings and the reading of the submissions and what not in detail. I am pretty much a hands-on leader.

Senator SHERRY—The time to complete audits has now concluded, has it?

Mr Vos—The fieldwork has concluded. We are now in the course of writing it up.

Senator SHERRY—When do you anticipate a copy of that will be provided to the minister? I am not looking for exact dates in the circumstances, but is it a number of months away?

Mr Vos—These things could move, but we are trying to have it ready to hand to the tax office by about the end of June. They have a 28-day right of reply to any criticism, express or implied, within the report. We would clean it up, incorporate the tax office comments, fix any factual errors if there are any that have been identified by the tax office, and hopefully lodge that with the minister maybe some time into August.

Senator SHERRY—And the tax office litigation?

Mr Vos—That is another two or three months away from being anywhere near to a point where I could say we are now getting to a tail that I can define.

Senator SHERRY—Have you been able to identify work beyond the two reports you are currently involved with?

Mr Vos—Yes. I am in the course at the moment of just starting to get ready to go to the private sector stakeholders and the public sector stakeholders in July, maybe August, to look at the next half a dozen-odd short-list reviews over the next six months.

Senator SHERRY—So you are satisfied, are you, that there will be sufficient work to keep you and your agency occupied in the next full financial year?

Mr Vos—Since I have had this role I have had every expectation that there will never be any shortage of work. It is a process improvement role in part, so there will always be opportunity for process improvement.

Senator SHERRY—The report on the review of the remission of general interest charge for groups of taxpayers was August last year, wasn't it?

Mr Vos—The report to the minister was on 5 August 2004.

Senator SHERRY—Yes, that is the report.

Mr Vos—Yes.

Senator SHERRY—I think you have included in it a letter from the minister, in which you state:

Contrary to my findings, the Commissioner has maintained his previous stance in respect of situations involving his exercise of judgement relating to remission of General Interest Charge for specific groups of taxpayers, the subject of this review, although the Commissioner has foreshadowed a one-off remission ...

Can you explain the detail of the commissioner's previous stance that you believe was contrary to your findings?

Mr Vos—The commissioner had determined, as I saw it, an outcome on a group basis and probably had not looked at individual cases on their own merits as effectively as could have been done. That was the thrust of the difference that was cited in that letter to the minister. That was the very first report that I had lodged of a technical nature. The one before that was the scoping study of all of the issues encountered. What I did not do, which I should have done, was to sit down with the commissioner and establish a common ground that we were both comfortable with.

Senator SHERRY—Is that required, that you need to establish a common ground? You may disagree fundamentally with the commissioner in certain cases or on certain issues.

Mr Vos—I think we have to understand where each other is coming from. That is what I guess I am trying to say.

Senator SHERRY—Just so I am clear in understanding this: you had given him a copy of the report, he had responded, then you had attached a letter to the document in which you made that observation that you believed he had maintained his previous stance and had not changed it as a result of your work. Is that correct?

Mr Vos—That is correct.

Senator SHERRY—So when that process finished, effectively what could you do about it? You seem to have accepted the reality whilst not agreeing with the commissioner's view in this area.

Mr Vos—The best I could put to you is that there had not been a meeting of the minds, in the sense that he was looking at it as: 'I have given a concession across the board,' and I was saying: 'No. You've got to look at each individual case.' So we met subsequent to the lodging of the report. He said: 'I see where you're coming from. I will look at each individual case. I'll give that undertaking.' I also think—you would have to speak to him about this—there was a perception that I was going to be comfortable with the tax office just applying a unilateral 'one cap fits all' solution to all taxpayers in that group. He then came back to me with a proposition that he would look at giving those who had fit certain criteria a reduction of interest to 4.72 per cent for both pre- and post-assessment interest. He was putting them into subgroups of categories of taxpayers to deal with the difference of their nature, which was to the heart of our recommendation in my report.

Senator SHERRY—So you had a meeting or meetings with the tax commissioner, and presumably you had meetings with other ATO personnel as well?

Mr Vos—Correct.

Senator SHERRY—You believe that you were successful in negotiating the terms for groups of individuals within the EBA participants?

Mr Vos—No, I am not going to agree with those words. What I did was put to him a proposition by my recommendation that he ought to have looked at each individual case on its merits.

Senator SHERRY—But he did not do that. My understanding is that he looked at groups of individuals.

Mr Vos—He subsequently decided to look at each individual case and put them into one of three or four categories based on their individual situation.

Senator SHERRY—I am struggling to understand. How many individuals are we dealing with approximately in this examination?

Mr Chapman—It is a little while since that report was lodged. I recall it was around 6,500 cases.

Senator SHERRY—I thought it was a considerable number. So what happened then, Mr Vos, is that approximately 3,500 or 3,600 were put into, what, categories of penalty that was assessed or categories of case type? How was the categorisation done?

Mr Vos—Categories of relative interest to be imposed.

Senator SHERRY—Relative interest.

Mr Vos—Depending on their different character—whether, for instance, they had been the subject of aggressive mass marketing or whether the promoter or adviser that they had acted on had been aware of or was in possession of a tax office advice in respect of employee benefit arrangements. So there were different outcomes for different categories of taxpayers. Then there was another category to deal with those who had no capacity to pay the tax. There was provision for the remission of the interest. I cannot remember now whether it was even remission of the tax, but in some cases it was full remission of the penalties and interest if there was no capacity.

Senator SHERRY—Is the summary of the outcomes you have run through contained in the report given to the minister?

Mr Vos—No. It was subsequently released by the commissioner towards the end of August.

Senator SHERRY—Just so I have the time frame right, the discussions you had with the tax commissioner—

Mr Vos—It was November that the commissioner released his guidelines.

Senator SHERRY—Just so I am clear on the time frame here, you prepared your report and it went to the tax commissioner. Was it then you had the meetings about your recommendations before you sent the report to the minister's office?

Mr Vos—No. The meeting with the commissioner was after the report had gone to the minister.

Senator SHERRY—I understood from the process you outlined earlier that there is a meeting—not necessarily a meeting, I am sorry.

Mr Vos—I did have meetings both with a number of people in the tax office and with the commissioner. But the meeting that I had with the commissioner prior to lodging the report with the minister was also prior to receiving his letter.

Senator SHERRY—But you believed you had an understanding as to the approach of the tax commissioner by the time the final report went to the minister. The tax commissioner then

subsequently released some information on the EBA participants later in the year. I think you mentioned November.

Mr Vos—Correct.

Senator SHERRY—Prior to the time when you sent your report to the minister, did you ever receive a communication from the minister or the Treasurer's office requesting you or instructing you to resolve your differences with the commissioner over the remission of employee benefit arrangements?

Senator Kemp—This is clearly a matter for the Inspector-General—it is not a matter for me—but let me give an observation. It is fairly unusual in these estimates that advice given to ministers and advice given by ministers is a matter for debate in these estimates. I do not want to interfere in any way or inhibit any response, but I just make that observation.

Senator SHERRY—Do you wish to respond, Mr Vos?

Mr Vos—I received a phone call that suggested that Michael Carmody was wanting to meet with me. He came to my office. We discussed where we were at. From that meeting, the decision was made by him to revise the arrangements that were available for the taxpayers in the groups that I am suggesting he has set. That was not my proposition to him. Never have I put to him what I wanted. You have to understand in this situation that one of my greatest difficulties here is that I cannot stand in the shoes of the commissioner. There is a sort of Mexican stand-off. I can only recommend that what he is doing is not what it should be, but leave it to him to make the decision. That is exactly how that was done.

Senator SHERRY—You mentioned you received a phone call. Was that phone call from the commissioner's office or from the Treasurer's office?

Senator Kemp—Mr Vos is perfectly entitled to answer this how he would like. I just indicate that questions of this nature are not usually canvassed at Senate estimates.

Senator SHERRY—The issue of the phone call, was that from the commissioner's office, Mr Carmody's office?

Mr Vos—I do not think it is relevant to determine. To be blunt, I cannot remember precisely which office it did come from now.

Senator SHERRY—So it could have been one or the other?

Mr Vos—It could have been.

Senator SHERRY—Wouldn't it be a bit odd to get a phone call other than from the commissioner's office?

Mr Vos—No. Many meetings that I have with other government agency heads come from all over the place. Often they are arranged through parts of my office, either through Steve Chapman here or through my executive assistant.

Senator SHERRY—I understand that. Obviously, you would not necessarily take a phone call directly. But if the commissioner wants to meet with you, surely it would be his office or he personally who would call you or your staff. Why would it be organised through the Treasurer's office?

Senator Kemp—You are making assumptions there, Senator.

Senator SHERRY—No. I have asked a question and I have not got an answer.

Senator Kemp—As I said, there are certain issues which are not really matters for discussion at estimates.

Senator SHERRY—Your interventions, Minister, are really making this unnecessarily difficult and lengthy. That is what happens when you keep diving in.

Senator Kemp—I am not. I am just trying to clarify and assist people, Senator. You can interpret it how you like.

Senator SHERRY—I do not think it is providing any assistance whatsoever.

Senator Kemp—It is. Witnesses are perfectly entitled to state what they want. I never restrict witnesses. On the other hand, there are certain guidelines which govern the performance of estimates committees. Sometimes it is worthwhile drawing that to their attention so people do not feel unduly pressured. That is the only point I am making.

Senator SHERRY—Unduly pressured—since when has that been a criterion before estimates for a minister to determine?

Senator Kemp—There are certain questions which are clearly not appropriate to be discussed at Senate estimates. You are aware of that. You have been on that side of the table and I have been on this side of the table for a hell of a long time. You and I are perfectly aware of the way Senate estimates are conducted.

Senator SHERRY—Again, I ask for your guidance, Acting Chair. I do not think I have been unreasonably pressing in my questions, my tone or my approach.

ACTING CHAIR—No. It is also appropriate for the officers to answer the question the way they choose. You are quite at liberty to ask further questions. But if it is clear that the officers believe they have answered it as they regard appropriate, that is the end of that line of questioning. That would be my judgment.

Senator SHERRY—There are a lot more questions, in part because we are not getting a response in some areas. But if that is the way these proceedings are headed, it is going to be longer than I would have hoped. But I will continue. Coming back, Mr Vos, to your meeting or meetings with the tax commissioner when the issues were under discussion, do you regard them as a form of negotiation? You are obviously in a position where you are attempting to press for the outcome that you have recommended, surely.

Mr Vos—'Negotiation' is not the word that I would prefer to use because negotiation implies that you have your mind set on an outcome or a group of outcomes that are on another side of the table to where the person or persons are on the other side. In this particular case, what my role is, as I understand it, and certainly the way I have applied myself to it, is to go into the tax office. That in itself will be a confrontational position. I have been introduced as being a tax investigator, but I do not investigate the affairs of taxpayers; I investigate the tax office. If you take it in that light, I go in and I am seeking to identify issues that are not working as well as they should be or are needing fixing. Having got to that point, it is

important that we identify what our concern is or what we believe the shortcoming is. We then have to stop at saying how to fix it or what to do to fix it, to put it another way.

All we do is highlight that there is an issue. It will take a while to get the relevant people within the tax office to step over that line and say, 'Yes. We agree that that should be done better or done more deliberately or more effectively.' We will often work with them, though, to try to identify where the cause is and whether it is, as I said earlier, in training, skilling or enabling. But once we have got to that point of accepting that there is an issue and it needs fixing, we are then, I believe, because of the independent status of the tax commissioner and my role as an independent statutory officeholder, required to stop there and merely recommend to the government the fix. Having got past that first report, from then on we have established a protocol which operates in a similar way to the tax office operating with the Australian National Audit Office. We now workshop up to a point where there is commonality of understanding. Again, I do not want to call that negotiating.

Senator SHERRY—If we do not use the term 'negotiation', we can use 'commonality of understanding'. What if you do not get that?

Mr Vos—We do not stop until we do. Either we are convinced by Tax that we are on a fool's errand or Tax accept.

Senator SHERRY—But what if they do not accept? What legal redress do you have? You are not able to direct the commissioner, are you?

Mr Vos—It requires some skill and some perseverance.

Senator SHERRY—So when you have reached a conclusion based on the material that you have examined, you obviously give that report initially to the tax commissioner and then it goes on to the government. In this case, in your letter, as part of the report or with the report, you stated that, contrary to your findings, the commissioner had maintained his previous stance. This seems to me to clearly indicate there was a difference on this report and the outcomes from the commissioner.

Mr Vos—When I got his letter back, I read it and took it to mean that he had not taken on board what we had put in the thrust of our report. I have to admit there is an issue that needs to be raised and that is that we wrote a very long report. It was something we learnt from the hard way. It was 250 or something pages. Our reports now are 20, 60 or 80 pages. We now focus our message far more clearly. I will take a lot of the blame for the breakdown in communications. Although we thought we understood where each other was coming from, when we finally got to that letter from the commissioner, it was evident to me that somehow or another I had failed in communicating with him personally and with his senior officers. Maybe they had failed in communicating with us in where they were coming from and what they wanted to do.

Senator SHERRY—This was the first report, wasn't it?

Mr Vos—It was the first report, yes.

Senator SHERRY—Have there been any others completed since then?

Mr Vos—Yes.

Senator SHERRY—There have been others completed since then?

Mr Vos—Yes. There were two released in the last week or two. One dealt with GST refunds from business activity statements—

Senator SHERRY—I am aware of that one.

Mr Vos—and the other dealt with the small business debt collection program. So both those turned out to be lessons learnt from EBAs.

Senator SHERRY—I will come back to that first report. So having been through this process with the commissioner, as he finally communicated in that November letter later, after the report was released, are you satisfied that the commissioner did observe the understanding of the agreement he had with you?

Mr Vos—I am very satisfied.

Senator SHERRY—In terms of that November statement from the commissioner, is there any follow-through from your office—not just you individually—about the outcomes as they are implemented?

Mr Vos—We are keeping tab with the progress by getting periodical updates from the tax office. We meet with the area of the tax office dealing with this settlement program and canvass with them where they are heading. I have to say it is quite early days still and the number of participants who have presented to settle are not as many as I assumed there would be by now. But it is a couple of months since I have had the latest update. I am not really sure where it is at in the last month or two.

Senator SHERRY—So this first report was obviously dealing with a very important issue, whether one accepts the views or not, that has caused a significant degree of worry and concern for 3,600 taxpayers. After the report was released by the minister, was the commissioner's letter detailing what he was doing made public? I assume it was.

Mr Vos—Yes. It was made public on 18 November 2004.

Senator SHERRY—As part of the ongoing monitoring in this exercise, and following the commissioner's letter, which hopefully gave a clear indication of what he intended to do, do you get further feedback from the individuals—not by name necessarily but in terms of the report; I do not know whether you refer to individuals in that report by name or not—afterwards so you can attempt to determine whether the commissioner is in fact following through in the way he has announced?

Mr Vos—Of course. There are a number of people who have written to me. In many cases, we get several hundred letters, all individually sent to me but identical in content. So there is a significant amount of 'lobbying' to our office to indicate views about the tax office's offer.

Senator SHERRY—Since that communication from the commissioner, have you received many representations back from the original complainants about their position—either complaining that they do not believe that the case was dealt with satisfactorily or they are happy about the outcome and they now believe it has been resolved? Has there been further flow?

Mr Vos—I just mentioned that there have been several hundred.

Senator SHERRY—Several hundred.

Mr Vos—But the several hundred in one case was the same letter written 200 times from 200 different taxpayers.

Senator SHERRY—So it was a form letter?

Mr Vos—It has been a roneoed letter that has been sent by a couple of hundred people.

Mr Chapman—In that order.

Mr Vos—We receive on a daily basis a significant amount of correspondence by either email or direct copy on material that has been sent either to the government, to the opposition or to the tax office. We seem to be a repository for a great deal of correspondence from a number of disgruntled taxpayers.

Senator SHERRY—Do you believe that if the position you had stated to the commissioner in your findings had been followed through by the commissioner, the problems would have been largely or totally solved? This is in terms of the resolution being sought by the individuals who had complained.

Mr Vos—Can you clarify what you mean there because we never put a position in our report. We suggested—

Senator SHERRY—Findings.

Mr Vos—But in the findings we did not put a position that we said ought to be what the tax office needed to do. That would have made me look like I am standing in the shoes of the commissioner and making a decision that can only be made by the commissioner.

Senator SHERRY—I am not suggesting that you were standing in the shoes of the commissioner. You made some findings.

Mr Vos—Yes.

Senator SHERRY—Then in your letter on this report you said:

Contrary to my findings, the Commissioner has maintained his previous stance in respect of situations involving his exercise of judgment relating to remission ...

Do you believe if the commissioner had followed your findings the concerns of the complainants would have been resolved?

Mr Vos—No.

Senator SHERRY—Why not?

Mr Vos—The so-called mass marketed tax effective investments that preceded the employee benefit arrangements and that were subject to a Senate inquiry got an offer of zero penalty, zero interest and two years to pay. I have said in this gathering on a previous occasion that I found it was a very generous offer. Having said that, some nearly 10 per cent of taxpayers have never taken up that offer. They do not think that it is good enough. The point to make here is that nothing will ever be good enough as an offer for a number of the taxpayers involved in this matter. No matter what I say and no matter what the tax office says, there will always be an attempt to drag this issue on so that the best deal can be achieved by these participants.

Senator SHERRY—Just going back to your reference earlier. It was zero interest?

Mr Vos—Zero penalty.

Senator SHERRY—Zero penalty.

Mr Vos—We have to be careful here. There were three categories of taxpayers subsequent to the Senate inquiry that the tax office put taxpayers in. There were those who were mum and dad investors who were not tax agents, who were not accountants or lawyers, who were not related to or part of the promoters of these arrangements. They got the zero.

Senator SHERRY—Zero penalty?

Mr Vos—Zero penalty and zero interest. There was then another deal given to tax agents or partners of tax agents. Then there was another deal, which was basically the full penalty and interest, to promoters and certain employees of promoters. So those arrangements were offered, as I suggest, to all of those. There were 42,000 taxpayers in that group. Still, nearly 10 per cent have not yet, to this day, settled.

Senator SHERRY—That is the 42,000 in the zero penalty and zero interest category?

Mr Vos—No, 42,000 is not in the zero interest and zero penalty category. I do not know what the proportion is. But it is nearly the majority. There was only some smaller proportion that was in the tax agents, lawyers or accountants category.

Senator SHERRY—It would be a safe assumption that it would be a smaller group.

Mr Vos—In the case of the EBAs—the employee benefit arrangements—there are 6½ thousand that Steve Chapman mentioned earlier. There was some proportion of that, in the order of 2,000 or 3,000, that already had an offer on foot from the tax office of 4.72 per cent interest pre- and post-assessment. Controlling interests schemes—is that correct?

Mr Chapman—That is the category.

Mr Vos—They already had a deal because there was a court case that had been to some extent taken into account by the tax office. So the remaining 3½ thousand that you referred to before is roughly the number that seems to be in the pool of taxpayers at the moment. My report was saying the tax office had to look at each of those 3½ thousand and deal with them in the same way as he did—

Senator SHERRY—And allocate them to one case—A, B or C?

Mr Vos—Treat them all the same if it was favourable. That was the point we raised. If you were going to treat them all the same, you had to err towards being favourable rather than unfavourable. Otherwise you had to look at them on their merits and attach a degree of culpability to their actions and conduct.

Senator SHERRY—Presumably the different level of penalty for those three categories reflects the degree of, I suppose, culpability and involvement of people. Presumably tax agents and partners of tax agents should have known better or would have had a much higher knowledge than, say, your mum and dad investor?

Mr Vos—I think that was the logic that the tax office used, but you would have to ask them.

Senator SHERRY—I can recall this issue at times being raised in the Senate chamber, both in question time and in debate. I certainly recall receiving correspondence from some of these people in the past. This was an issue that you believed needed resolving if it could be resolved. But from what you say, it appears unlikely that that was ever going to happen.

Mr Vos—It was never going to happen if you pooled them all and treated them harshly. The point that we were trying to make through the interest report was that you could not look at the whole body of taxpayers in this group and treat them as having the same category of understanding and ability to know what they were getting involved in. I think that is the crux of the issue. Everything flows from that. Once you start to look at each individual case, you need to then realise either they had access to a tax office advice or were pressured into this exercise and did not know what they were getting themselves into. Yet others knew full well what they were doing and they were egregious taxpayers or they were involved with an adviser who was an egregious adviser that was pushing them into tax avoidance.

Senator SHERRY—I think you have mentioned this. There was a report released concerning the administration of GST refunds arising from the lodgment of business activity statements.

Mr Vos—That is correct.

Senator SHERRY—I did put some questions about this to Mr Carmody earlier. But dealing with it from the perspective of your office, which wrote the report—this is five years after the GST was introduced—were there compliance issues of concern to the businesses that were identified as being adversely affected by the report?

Mr Vos—Do you mean were people having trouble completing BASs and lodging them?

Senator SHERRY—Was that part of the issue for the complainants?

Mr Vos—No. The context of the report is that there were 1.8 million business activity statements lodged in one year with credit claims on them. So put that into context. There were 1.8 million BASs lodged that were in credit. We were dealing with those that were for one reason or another taking longer than 14 days to issue. The 1.8 million business activity statements are not 1.8 million taxpayers.

Senator SHERRY—I understand that.

Mr Vos—In some cases, there could have been 12 returns lodged by many of these taxpayers in one financial year. There were a number of taxpayers, both large and small, who were consistently complaining about delays and frustration in getting their money back from the tax office because the tax office was for one reason or another reviewing and verifying the rights to that refund. It is crucial to put it into a context, though, because the tax office has to be satisfied that there is no fraud. Fraud is rife in this area. The tax office is regularly prosecuting and getting convictions for fraud. Almost not a week goes by without a press release from the tax office on that point.

Senator SHERRY—I did question—I forget the officer's name—

Mr Vos—Mr Mann.

Senator SHERRY—We did have a discussion about fraud earlier. Mr Monaghan?

Mr Vos—Mr Mann. Neil Mann.

Senator SHERRY—I did have a fairly detailed conversation with Mr Monaghan. What do you mean by fraud being rife in this area?

Mr Vos—An individual will set up an operation, a business, that does not exist. They will get an Australian business number, register and then lodge a business activity statement indicating that they have got a credit of \$50,000 or \$20,000. It is a bogus claim. They do not have a business. If they do have a business, they have not purchased what they have said they have purchased that is in that business activity statement.

Senator SHERRY—So how did you come to the conclusion that it is rife in this area? Is there an indication of numbers or proportion?

Mr Vos—‘Rife’ is probably an exaggeration. There is the propensity for it to occur and it is occurring as a question of fact. It is the tax office—

Senator SHERRY—I am sure it is occurring as a matter of fact. Why exaggerate, Mr Vos?

Mr Vos—The propensity for fraud is rife. I do not know whether as a question of fact fraud is rife.

Senator SHERRY—That is what I am seeking to establish because—

Mr Vos—I have not looked at that and got—

Senator SHERRY—you made the earlier statement. I was just seeking an indication of your observation of evidence on this matter. What will the ATO need to undertake to improve its systems to better match the risk issues associated with paying the GST?

Mr Vos—It has to the most extent done it now by observing that just because a refund is large does not of itself identify that it has risk attached. There will always be risk for large amounts. But one has to look at the character or nature of the organisation making the claim. In many cases, they were government agencies. In many cases, they were very large public companies who were mainly exporting goods or services. The isolation and pulling aside of those refund applications to be intercepted, manually approved or verified was delaying the movement of that money out to taxpayers. That has now been recognised within the tax office. They have changed their processes.

Senator SHERRY—Mr Carmody spoke prior to the break. Did you hear his evidence?

Mr Vos—Yes, I did.

Senator SHERRY—He gave me the impression that was already happening—that you picked a year, 2003-04, and there was to be a reduction because of a changed approach in the following year. That is in fact what has happened.

Mr Vos—It was happening is what I think he said. They are in the course of improving their—

Senator SHERRY—So really your report was not relevant to the actions the tax office was taking?

Mr Vos—Success has a thousand fathers, as the saying goes. Almost always now when we set terms of reference to undertake a review within the tax office, it is evident when we get there that most of the issues are in the course of being, or have been, resolved.

Senator SHERRY—By identifying an area to investigate, you believe that the tax office are on their toes and seeking to remedy it before you get your teeth into the issue?

Mr Vos—I could say that but I cannot prove that.

Senator SHERRY—That is what you are implying.

Mr Vos—It is always funny that every time we go in there now it is always in the course of being fixed.

Senator SHERRY—Mr Carmody did look a little touchy when I read the headline ‘ATO lashed for hoarding GST refunds’. That is a reference to not you individually but to the report. Do you believe that you have lashed the tax office? It seemed to me to be a pretty harsh assessment of your report.

Mr Vos—I did not write that headline. Did I lash? No, of course not. I identified an opportunity that needed fixing. In working with the tax office, we fixed it.

Senator SHERRY—So you believe this issue is now settled or on the way to being settled?

Mr Vos—I believe it is on the way to being settled. It will be a continual process of improvement from the tax office’s side. Obviously it leaves my office with the opportunity to monitor the progress going forward.

Senator SHERRY—How would you monitor the progress? Will you go back in and do another report? Is Mr Carmody intending to introduce some sort of time track mechanism that you can check?

Mr Vos—I am just approaching in August my second anniversary in this role. I am keen to pull myself back and look at the previous two years and just see where I go forward. One of the things that I think is crucial to do is to periodically reassess the workings of the things that we looked at in the past. But whether I am going to do that is something I am yet to decide. But that is the sort of thing that is not unreasonable to contemplate that we might do going forward.

Senator SHERRY—In going forward, it has been reported that additional information that was sought by the ATO for the purposes of verification was requested in an irregular fashion. Do you see the need for a standardised procedure for seeking any additional information that the ATO does not currently hold on taxpayers?

Mr Vos—It is very difficult for me to suggest what is a perfect process that the tax office adopts for working towards being satisfied that the voluntary compliance of taxpayers is working and that self-assessment is leading to behavioural patterns where taxpayers voluntarily comply with tax.

Senator SHERRY—I notice there was a description given that in a number of cases the refunds that were owed to taxpayers were literally shunted around. I am wondering what that

means. Was that officers literally passing the file from one desk to another and just failing to focus?

Mr Vos—No. For instance, in the small business area, if it was a financial institution—a credit union or something like that—it might have been referred to the financial services specialist area to look at. It may have been that, having been through a desk review, someone thought it was better to refer it to a field audit. It would be then scoped by the field audit teams as to whether it should be subjected to a field audit or not. So that is the sort of shunting I mean. It is from one specialist area within Tax to another specialist area.

Senator SHERRY—The word ‘shunting’ certainly seems to me to indicate unnecessary referrals from one section or office to another. How do you identify whether in fact it is necessary or unnecessary?

Mr Vos—On the cases we looked at, there was probably some unnecessary ‘shunting’, if you want to use that word. To the best of my recollection, Tax have taken on board that they are going to better monitor, on a whole-of-office basis, the process that is involved here.

Senator SHERRY—Does that involve a time track management information system?

Mr Vos—What the commissioner has now gone public on is that if you lodge electronically and you are not stopped, you will have your money in your bank account within eight working days.

Senator SHERRY—Is that 100 per cent guaranteed for all taxpayers or is that the best effort?

Mr Vos—No. That is his goal. But he is still presumably going to seek to intervene where he has concern about the risk. That is the management exercise that I will from time to time seek to monitor if I believe, or it is put to me, that this type of issue is recurring or is a problem in the future.

Senator SHERRY—So if it is electronic, what is the commitment on time in the case of an electronic lodgment? Is there a time guarantee that it will be dealt with?

Mr Vos—The commissioner said—I think it was in April 2004—that the process time within Tax was something like three or four working days. The money has to go into a bank account, so it then has to go through the banking system, and that is another two or three days. So the eight days accounts for public holidays and that sort of thing.

Senator SHERRY—I do not know how much more, but more than 94 per cent of GST refunds were processed within 14 days. So that is in and out to the bank account?

Mr Vos—And I heard this afternoon mention of the percentage that we identified—the 4.4 per cent that were held up. But some 88 per cent were processed and in the bank account within 14 days. The only point I wish to make here is that any interception and interference with a process that has not got an end in itself is something that ought to be avoided. I think that is the point that is—

Senator SHERRY—So there is an automatic process. It is electronic, and it will happen within 14 days in the overall majority of cases. If an officer plucks a case out, it should not be

sat on and moved to other offices or departments; there should be some sort of proactive follow-up and monitoring of it.

Mr Vos—The commissioner has undertaken that. In his letter back to me, he has indicated that he is going to put more resources into the small business area to validate the entitlement to these claims in a quicker time.

Senator SHERRY—You said more resources. I gained the impression from talking to the tax office earlier that they are going to have fewer resources. Has he outlined what additional resources will be made available?

Mr Vos—Deploy resources from another area, I guess. It is not more people.

Senator SHERRY—What additional resources would there be then? Electronic equipment?

Mr Vos—No. I think he is just talking about staff.

Senator SHERRY—So there would be extra staff in this area?

Mr Vos—I think that is a matter you should take up with him rather than me.

Senator SHERRY—But you mentioned that he—

Mr Vos—I just mentioned that he has mentioned to me that he will be deploying additional staff to improve the throughput of these refunds.

Senator SHERRY—I can take that issue up with him. It may well be of course that there are staff brought from other areas, given there is a slight decline in total staff numbers. We had a discussion about that with Mr Carmody earlier. Of the cases that are taken out of the system, should there be direct time management and accountability for those cases?

Mr Vos—There needs to be whole-of-office management of all refunds that for one reason or another are being delayed.

Senator SHERRY—Of those cases that are diverted, if you like, where there is a question mark or risk level, is there currently a process where, say, 150 files pulled out in a week can be electronically tracked at the end of the month? Is there a process for that at the moment?

Mr Vos—At the moment I do not know. At the time I looked at the issue, there was monitoring in each business line and each area of each business line, but I am not sure there was a whole-of-office approach. They have set up a steering committee to deal with this. I believe that probably by now, if you asked them—

Senator SHERRY—The old steering committee reference. You will be going back to make sure the steering committee reference is followed through?

Mr Vos—I have not done that at this stage because we have put our report to the government. The tax office has modified—

Senator SHERRY—That was a favourite term in *Yes Minister*: ‘a steering committee’.

Mr Vos—Okay.

Senator SHERRY—It always worries me when I hear a steering committee has been established.

Mr Chapman—I think it is a working party.

Senator SHERRY—‘Working party’—that term is familiar as well. So you will be checking this, will you, Mr Vos?

Mr Vos—If I need to.

Mr Chapman—I will add to that. As you mentioned earlier, we receive regular feedback from people that have raised issues with us. So I think we will get a fair indication as to whether those that raised concerns earlier think the system has improved.

Senator SHERRY—In the same way with the mass marketing, presumably you have received complaints from individual businesses and heard concerns about the time it was taking. Have any of those respondents commented since the report was released?

Mr Vos—I am sorry, but I missed the category of taxpayer you are talking about.

Senator SHERRY—In this case we were looking at GST refunds—although I suppose the report was only recently released, so you are unlikely to have had any response so far.

Mr Vos—No.

Senator SHERRY—I want to make a point on this. Do you provide feedback to complainants? Obviously in the case of the GST refunds it is 24 March and it is probably a bit early. Do you actually go back to individuals who complained and say, ‘Look, this is what’s occurred’? Do you do a bit of a follow-up?

Mr Vos—Where we get individual correspondence coming into the office, not a direct input to a review—and I cannot think of a case where we do not, other than maybe where we have chronic complainants that seem to come to a number of government agencies and just continually, on a daily basis, feed information into us—in almost all cases we do a reply. In the case of those who give input to our submissions, in hindsight I do not think we have handled going back to these people and dealing with them at all, because we have relied on our report being our final say on these things. What I do not want is to land into an ongoing continual debate about the degree of nonacceptance of 100 per cent of what they have said. In some cases, we are going to agree to disagree.

Senator SHERRY—Let us take mass marketing. Virtually once the report is issued, you say: ‘That is the final position. We are doing ongoing monitoring to make sure the tax commissioner follows through.’ But you do not want to be in an ongoing correspondence exchange with someone who is not happy. You have dealt with the issue to the best of your ability and that is the end of the matter for your office.

Mr Vos—Of the individuals you asked about before from the employee benefit arrangements who have lodged complaints with my office since the report, very few if any have asked me to do anything. They have just lodged it as a complaint. They have vented their spleen, so to speak, but they have not formally asked me to do anything. We have had some oral approaches but we have not been asked to do anything. Obviously they would love to see the waving of a magic wand and no tax, no penalty, no interest, no anything and to just walk away from the problem.

Senator SHERRY—But in those cases you have already indicated you cannot satisfy everyone. You do not want to be in an ongoing correspondence about it. You believe the matter has been finalised to the best of your office's ability.

Mr Vos—We have to provide a sympathetic ear to a lot of people.

Senator SHERRY—But at some point in time you have to say to people who are not satisfied, 'Look, the matter has been dealt with.'

Mr Vos—Absolutely.

Senator SHERRY—I want to conclude now. On the issue of mass marketing, you mentioned you obviously had meetings with Mr Carmody. Were there other officers of the tax office you had meetings with? Can you recall who they were?

Mr Vos—In the tax office?

Senator SHERRY—Yes. In respect of the mass marketing issue.

Mr Vos—I could nearly say dozens. All up in my office there could have been 30 or 40 people within the tax office that we dealt with—maybe more—in a number of different states. It was a lot of people.

Senator SHERRY—I think that is about it. Thanks, Mr Vos. It went a little longer than I anticipated, but that was partly due to the minister's unhelpful interventions. Hopefully we can avoid that on the next occasion.

ACTING CHAIR—There are no more questions. Thank you, Mr Vos and Mr Chapman.

Proceedings suspended from 9.37 pm to 9.40 pm

Australian Taxation Office

ACTING CHAIR—Welcome. Senator Sherry, you had some questions.

Senator SHERRY—I had a discussion with one or two of your officers after the dinner break. I am not going on with the Coleambally irrigation questions. I want to go to the issue we were just discussing with Mr Vos, which is that first report that involved the employee mass marketing EBA arrangements. In relation to these EBA arrangements, I must say I thought there was finality on these issues at the last estimates, but they seem to keep coming back. How many settlements are outstanding as of now?

Ms Martin—As at February this year, we had settled 958 cases involving EBA arrangements. That is not including the controlling interest superannuation arrangements. They are cases settled in the full context. You are also talking about the commissioner's announcement post the Inspector-General's report on GIC—that is, the remission of the GIC issue. Can I clarify exactly what you mean by 'settlements'?

Senator SHERRY—I mean as of today.

Mr Carmody—I think Stephanie has indicated the number of full settlements. But then there is the question of how many remissions of interest have been granted.

Ms Martin—Because they can occur outside of a settlement context. That was my understanding of what you were talking about before. As at within the last week, we had 926 applications for remission. We have completed 261 of them. Of that 261, 110 were ones

completed where the information provided was insufficient and they have not come back to us; there were 125 where we have granted remission of interest and/or penalty; and there were 26 where there has been no remission.

Senator SHERRY—When you say ‘grant remission’, what does that mean in a practical sense for them?

Ms Martin—In the guidelines issued with the announcement on 18 November 2004, the full guidelines for remission of interest and penalties, there are some criteria and, if they are satisfied, remissions are granted. So 125 of them have been given remission in accordance with those criteria.

Senator SHERRY—Were they the criteria that Mr Vos outlined—in those A, B and C levels?

Mr Carmody—Yes.

Ms Martin—Yes, that is right.

Senator SHERRY—You say there have been 926 applications and 261 have been dealt with. There is obviously a remaining number of some 600-odd.

Ms Martin—That is right.

Senator SHERRY—Is this a resourcing issue, having to look at each of them?

Ms Martin—No. We do look at each one. They were fairly slow coming in. It took people a while to think about exactly what it was and to think about their applications. In addition, we process them according to similar characteristics. So if people have the same characteristics and same circumstances, we will put them through together. We are expecting to finalise pretty well all of them within the next month or so.

Senator SHERRY—One way or the other?

Ms Martin—That is right.

Senator SHERRY—Do you think that will be the end of the matter then, Mr Carmody?

Mr Carmody—That is the remission of interest. There is still the question of whether they pay their tax debt. I think, as Mr Vos indicated, some people are not necessarily going to be satisfied.

Senator SHERRY—So when we are talking about the remission of interest, does that include the penalty?

Ms Martin—It can be ‘and/or penalty’. There are grounds in the guidelines for both remission of interest and/or penalty. It depends on the circumstances they put forward.

Senator SHERRY—Do you have any idea of the approximate number where there has been remission of interest and penalty?

Ms Martin—I do not have that break-up at the moment. My understanding is that probably more of them are around the remission of interest. But I do not have the break-up.

Senator SHERRY—But there were certainly some where both have occurred?

Ms Martin—That is what I have here, yes.

Senator SHERRY—You might just take that on notice for me, if you could. What are the circumstances warranting full remission of the interest and the penalty? What were the general circumstances?

Ms Martin—The guidelines do not outline a circumstance where there is full remission of penalty and interest. The guidelines outline where it would be appropriate to remit interest to the base rate of 4.72 per cent for the pre-amendment period, which is known as the shortfall period. There is also another circumstance where, because of an ATO delay, the interest for that period of time of the ATO delay may be a nil interest period. Then there is another circumstance where we would consider remitting to base rate for the interest both pre-amendment and post-amendment. As I said, that is another range of circumstances. Again, for the penalties, there are issues around voluntary disclosure. That is usually a reduction of 50 per cent of the penalties that would otherwise apply. There is remission where they may have relied on advice from the tax office. Having said that, there are obviously the normal issues around penalties, such as a reasonably arguable position, in which case there is a nil penalty, say, for the controlling interest superannuation funds excess. So they already get that.

Senator SHERRY—Mr Carmody, in many cases there seems to have been a movement from your original position. I can recall where the ATO was imposing penalties of 50 per cent. Has there been a movement between then and now?

Mr Carmody—Certainly in the case of controlling interest arrangements, because I think following a court decision there was a question of what is reasonably arguable and other issues that arose in that. So we moved in that area. In relation to the general interest charge, because of the guidelines there has been a movement, yes.

Senator SHERRY—Do you think there has been movement as a result of the Inspector-General's report?

Mr Carmody—There is no doubt that when we sat down and talked about it and I got a better understanding of his position, I took the decision that it would be appropriate to take the sort of circumstances that are outlined in the guidelines on an individual case-by-case basis to allow for remission. That is the consequence you have seen there.

Senator SHERRY—He seems to be taking the position that just announcing an inquiry into a particular area is seeing a dramatic or significant response from the—

Mr Carmody—We are a very responsive organisation to feedback from parliamentary committees and the Inspector-General and others. I did hear him say that whenever he comes in we seem to be on the improvement. But that is in more areas than where he looks.

Senator SHERRY—Everywhere.

Mr Carmody—We are on the improvement everywhere.

Senator SHERRY—Everywhere.

Mr Carmody—Everywhere.

Senator SHERRY—I am just wondering why I need to bother to inquire at all. Of the taxpayers that have had a dispute in the last year, their issues were examined by the Inspector-General. Obviously there have been a range of new arrangements entered into for a number of

people. Do you believe that, if you had offered terms, this matter could have been settled several years ago?

Mr Carmody—I do not know that we are in a position where they are all going to be settled. They are not all settled now, even with these terms.

Senator SHERRY—No. Some have been settled with these terms.

Mr Carmody—But I am prepared to say that, if I had looked more closely in the way that I did in developing those guidelines, it would have been better for that to have been done earlier.

Senator SHERRY—If a reduced penalty and interest rate is now considered appropriate in some cases, what is the additional GIC cost that has been incurred by these taxpayers? That is for those taxpayers that have recently settled because there has been a reduced penalty and/or interest applying.

Mr Carmody—It has been brought down generally to around 4.72 per cent either before or after or in some cases for the full period.

Ms Martin—The guidelines for the remission apply whether the case had been settled or not. They could still apply for further remission.

Senator SHERRY—You have the authority or the power to be able to make those decisions, Mr Carmody?

Mr Carmody—There is authority under the law to make the remission of GIC. We do it not only in these cases but in a lot of cases.

Senator SHERRY—I just thought of a superannuation issue.

Mr Carmody—I am sorry, but he is not here.

Senator SHERRY—I am not going to go back. I just thought of an issue that I did not raise earlier.

Mr Carmody—I am sure you will put it on notice.

Senator SHERRY—I might just leave it for the next estimates. It will keep. Can you confirm the following example. For a taxpayer which had a disallowed deduction of \$200,000 and the tax rate is 30 per cent, would the primary tax payable be \$60,000, approximately?

Mr Carmody—A taxable income of \$200,000, did you say?

Senator SHERRY—A disallowed deduction of \$200,000.

Mr Carmody—And the marginal rate for that is \$200,000. Often if you have a \$200,000 deduction, it will take you between marginal rates. Actually, it could not be 30 per cent on \$200,000—unless it was a company.

Senator SHERRY—Yes.

Mr Carmody—Sorry. It is 30 per cent of the \$200,000, assuming there are no rebates and other things.

Senator SHERRY—If the penalty was reduced to nil, wouldn't the amount remain the same?

Mr Carmody—The primary tax does not alter if the penalty is reduced to nil. The primary tax does not alter if the GIC is reduced.

Senator SHERRY—What is the full GIC rate?

Mr Carmody—It is 12-point-something per cent.

Senator SHERRY—Just so I understand, are you able to reduce that full GIC rate? Have you made decisions to do that?

Mr Carmody—The full GIC rate is 12-point-something per cent. Where people meet the circumstances in the guidelines, they can have for a period, depending on their circumstances, the GIC reduced from 12.6 per cent, or whatever it is, to 4.72 per cent.

Senator SHERRY—Mr Vos outlined, to some extent at least, his meetings, activities and discussions with you through this period. During this period, were there any representations from the Treasurer's office or any of the Treasurer's staff on cases?

Mr Carmody—On individual cases?

Senator SHERRY—Yes.

Mr Carmody—I am not aware of any, although many members of parliament receive representations from constituents and pass them on. It may well be that there was a constituent of a minister, but I do not know that I know the answer to that. As I say, many members of parliament receive representations on behalf of their constituents.

Senator SHERRY—Of the cases you dealt with, did you actually deal with each one of them individually? Did they all come across your desk, or were there other officers—

Mr Carmody—Which cases?

Senator SHERRY—The employee benefit arrangements.

Mr Carmody—I do not deal with individual cases.

Senator SHERRY—I am interested to know what level you got involved in.

Mr Carmody—I got involved in, for example, the settlement of the guidelines.

Senator SHERRY—The parameters?

Mr Carmody—Yes.

Senator SHERRY—So how many officers would have dealt with these cases in bringing them to finality?

Ms Martin—We have an area in our Moonee Ponds office in Victoria. I cannot recall exactly the number of people involved, but there are a few teams whose work is to specialise in it. The whole area works on employee benefit arrangements. There are a couple of teams within that that specialise on these remissions and where there is a settlement in the process as well. We have an assistant commissioner in that area and a number of senior officers and then more general staff. It would be well over 20.

Senator SHERRY—And it can be determined at that level? It did not have to go higher up?

Ms Martin—No. Sometimes I see some cases. I do not make decisions on individual cases as such. One of the things the commissioner also announced after the Inspector-General's review was a widely based settlement panel to ensure that our settlements have a level of oversight and consistency when they are the same and there is appropriation differentiation. So some things, for example, that I would see help us form the views about appropriate consistency and appropriate differentiation. So we see some. They all get referred to our area in Moonee Ponds, where they actually undertake the work of implementation. In most cases, that is where the negotiation occurs. That is where the work is done.

Mr Carmody—I should correct my answer. There is one case I was aware of where the minister introduced the taxpayer to us. That taxpayer went away and dealt with our officers.

Senator SHERRY—What would those circumstances be? Just coincidental or in parliament?

Mr Carmody—No. The constituent or the person made representations to the minister. The minister facilitated a meeting with me. They were referred to the officers.

Senator SHERRY—In the finalisation of these arrangements, there is an oversight mechanism?

Ms Martin—Yes. We have a widely based settlements panel. I chair that panel. It has a range of tax officers on it that have experience with settlements. Our role is to make sure that there is consistency and transparency about what we are doing. We are in the process of consulting on guidelines for that process, as that undertaking was given before. That is starting now. When we say widely based, 20 or more participants might be involved in similar arrangements. Having said that, we also have a code of settlement practice that we obviously have had for some time. When individual and unique circumstances arise, where there is something that is different that is individual, that comes within our individual code of settlement practice as well. The sort of things that get taken into account at that point are things like litigation risk, the evidence and whether the facts have been properly established.

Senator SHERRY—Mr Carmody, it seems to me that this issue has taken up a very significant amount of time and resources over a number of years.

Mr Carmody—It has.

Senator SHERRY—Do you think the matter is now largely laid to rest?

Mr Carmody—No. I think there are some people who continue to re-raise the matter with different members of parliament and in different forums and who persist in the view that they will get a better deal for people.

Senator SHERRY—I take it from that that you have drawn a line in the sand now? There is a firm declaration?

Mr Carmody—There is.

Senator SHERRY—Can you outline the position of the ATO on service trusts?

Mr Carmody—The position on service trusts is that many years ago, as a result of the decision in what is called the Phillips case, it was accepted, and we accepted in a ruling we put out at that time, that where they are established for commercial reasons to provide

commercially based services and there are reasonable commercially based charges covered, we accept those arrangements. The position has been that we started in the late 1990s a review of legal and accounting firms. As part of that, we felt that in some cases the fees had become excessive. At least in some cases we questioned whether the services provided were actually provided by the service entity or whether they were just book entries.

Senator SHERRY—What is the advantage?

Mr Carmody—If you take a typical professional firm, they might set up a service arrangement whereby an entity is set up. That entity provides to them secretarial and administrative staff. It might provide building support and things like that. So some of what would be normally the gross proceeds of the professional firm are paid to this. Typically, the beneficiaries of that service entity might be family members.

Senator SHERRY—Or relations.

Mr Carmody—Yes. So as a result of our work in legal and professional—

Senator SHERRY—The gain to the primary service—

Mr Carmody—The professional person has some of the income eventually—

Senator SHERRY—A reduction in income and a reduction in tax?

Mr Carmody—Yes.

Senator SHERRY—It sounds like a form of income splitting to me, if it is a partner.

Mr Carmody—Yes. But it was accepted by the court that the service trust in that case provided services that were commercially realistic and were at commercially realistic prices. The court said, ‘Well, what’s wrong with that?’ In the late 1990s, we started a review on the tax affairs generally of legal and accounting profession. In the course of it, we came across arrangements which we believed went past what was originally established. In my 2001 annual report, I noted that fact. In speeches in 2002 and 2003, I also said that we believe there were arrangements that were going beyond what was acceptable.

Senator SHERRY—Can you give me some specific examples of what you believe went beyond what was acceptable.

Mr Carmody—There were questions at some levels about the level of the service fees that were said to be charged and their correlation to the actual services. For example, we were finding cases where 50 per cent or more of the gross income of the professional firm was actually being paid in service fees to the service entity. If you thought of the professional firm, 50 per cent of what would have previously been their gross fees are paid to the service entity or more.

Senator SHERRY—That might be taking a very egalitarian view about wage payments and salaries to the services.

Mr Carmody—They could, but it was at least cause for us to want to examine them. There were some other cases where it seemed to us that the service entity was not actually providing the services. They were in effect book entries rather than an entity providing it. They were the sorts of concerns we were expressing.

Senator SHERRY—I can understand your concerns. Is there some latitude for lean times where the income of the professional service, for quite legitimate reasons, may decline significantly but they still have the fixed cost of the service?

Mr Carmody—All I am saying is that when you see figures like that, you would expect us to have a look at it. I put it no higher than that. It is fair to say that as we have talked to a number in the profession there has been comment that some of them believe that, yes, they have pushed the boundaries a bit too far. As I said, we put it in our annual report. I have made a few speeches about it. As part of dealing with the issue, we released an expanded draft ruling in which we tried to give examples. The next step in that process is that we actually have out for some preliminary consultation what will be a booklet in which we will give, we hope, practical advice as to where people can pitch certain fees and feel comfortable that we are unlikely to question them.

With our compliance approach, I have seen some stories that we are going to go back and audit to 1973 or something. As you know, that is just not possible under the law. I have also heard stories that we are going to audit every small business over their service arrangements. We realise that it is not a precise figure in exactly what you can do.

Senator SHERRY—It cannot be.

Mr Carmody—What we intend to do is, as I say, publish a practical booklet. People do not like me using this term, but we will give them a ‘safe harbour’ rate for legitimate fees where we would say, ‘Well, if you are charging them, we are unlikely to question it. You can charge more, but you’ll have to justify it because we’ll question it.’ My objective really over the next 12 months is to allow people to have that advice and have a look at their arrangements. If they feel it appropriate, they can review them. In 12 months time, we will have another look. If people are within reasonable benchmarks, that is okay.

Senator SHERRY—But there is not going to be a draft ruling, as such?

Mr Carmody—A booklet. Now at the same time there will be some that we will audit. I would say they are really the highest risk cases.

Senator SHERRY—How do you identify them?

Mr Carmody—It is the sorts of factors I talked about. First of all, we would look to make it material to go back, because remember that our general strategy is to provide guidance to allow people to move within it over the next 12 months. We would probably pitch a double-stage test. One would be where the service fees are over \$1 million, for example, first of all. If in addition to that, as I gave in the example before, we are seeing 50 per cent or more of the gross income of the firm being directed into service fees, they are probably the ones we would want to have a look at now.

Senator SHERRY—That \$1 million figure you mentioned, that would have to be a fairly large firm.

Mr Carmody—Yes. Given the history of this, we are really only looking at the big material where we think there is at least on the face of it evidence that they have just pushed and pushed it. We will look at those. There might be, as you said, circumstances that justify it. So for those limited number, we will look at them currently. But our general strategy will be

to provide clear advice, semi-safe harbour rates and allow people 12 months to look at their arrangements.

Senator SHERRY—You mentioned, though, this \$1 million figure. That is a fair sized arrangement. It is reasonably significant in its size. Once you get to that size, are we looking at relatives and spouses employed in those sorts of entities?

Mr Carmody—Not necessarily employed, but the beneficiaries of the income arrangements.

Senator SHERRY—The beneficiaries. Once you get to that size, presumably we are talking here about pretty large medical and accounting type firms to have \$1 million of services.

Mr Carmody—As I said, this is what we are thinking of at the moment. We will be finalising this shortly with the release of the booklet. But given all the circumstances, our general approach will be to give the people guidance over the next 12 months to have a look at the arrangements and, if necessary, bring them into line. But we do believe that we should go out and review the bigger excessive ones now.

Senator SHERRY—So there have actually been cases where have you examined it and you have come to the conclusion that it is wrong, it is outside any reasonable boundaries and you have wanted rectification, presumably?

Mr Carmody—There have been a couple of cases where we have done that.

Senator SHERRY—And you will focus on the larger cases?

Mr Carmody—Yes.

Senator SHERRY—You are not going to go through the entire professional industry top to bottom?

Mr Carmody—No. To deal with this sort of issue, we figure the best way to do it is give them now that practical safe harbour type advice, give them 12 months to look at the arrangements and choose to fit within that or not and then have a look at them.

Senator SHERRY—So you would not accept the criticism that has come from a number of quarters that this is retrospectively trying to change these arrangements and penalise firms?

Mr Carmody—No.

Senator SHERRY—Have there been any agreements or rulings in respect of this issue with taxpayers?

Mr Carmody—I do not know if there have been any formal rulings. But if we go back into the early 1990s or whatever, there are a couple of advices that went out.

Senator SHERRY—Are you able to produce them for the committee?

Mr Carmody—I do not have them on me but we can have a look.

Senator SHERRY—You believe you will be able to provide those for us?

Mr Carmody—I should be able to.

Senator SHERRY—Thank you. Do you have a time frame on the release of these sorts of guidelines, Mr Carmody?

Mr Carmody—I would hope to get them out next week, all being well. So it is imminent.

Senator SHERRY—So it is soon?

Mr Carmody—Yes. My colleague has corrected me. There might be a ruling or two. But we will look at what is available.

Senator SHERRY—If there are rulings and/or agreements.

Mr Carmody—I will see what we can make available.

Senator SHERRY—I do not want individual taxpayers identified; I understand the normal parameters in that regard.

Mr Carmody—Yes. Have you finished with service trusts? I can let my colleague go?

Senator SHERRY—Yes. I have finished with service trusts. That is it, thank you Mr Carmody.

CHAIR—Thank you, Senator Sherry. Thank you, Mr Carmody and the officers. These hearings of the Senate Economics Legislation Committee are adjourned.

Committee adjourned at 10.15 pm