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SENATE

RURAL AND REGIONAL AFFAIRS AND TRANSPORT
REFERENCES COMMITTEE

Reference: Plantation forests industry

WEDNESDAY, 5 MARCH 2003

CANBERRA

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SENATE
RURAL AND REGIONAL AFFAIRS AND TRANSPORT REFERENCES COMMITTEE
Wednesday, 5 March 2003

Members: Senator Ridgeway (*Chair*), Senators Buckland, Heffernan, McGauran, O'Brien and Stephens

Participating members: Senators Abetz, Boswell, Brown, Carr, Chapman, Colbeck, Coonan, Crossin, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Harradine, Harris, Hutchins, Knowles, Lees, Lightfoot, Mason, Sandy Macdonald, Murphy, Payne, Santoro, Tchen, Tierney and Watson

Senators in attendance: Senators Colbeck, Heffernan, Murphy, O'Brien, Ridgeway and Stephens

Terms of reference for the inquiry:

To inquire into and report on:

The findings of the Private Forests Consultative Committee's review of the 'Plantations for Australia: The 2020 Vision' which is due to report to the Primary Industries Ministerial Council in November 2002:

- (a) whether there are impediments to the achievement of the aims of 'Plantations for Australia: The 2020 Vision' strategy;
- (b) whether there are elements of the strategy which should be altered in light of any impediments identified;
- (c) whether there are further opportunities to maximise the benefits from plantations in respect of their potential to contribute environmental benefits, including whether there are opportunities to:
 - (i) better integrate plantations into achieving salinity and water quality objectives and targets,
 - (ii) optimise the environmental benefits of plantations in low rainfall areas, and
 - (iii) address the provision of public good services (environmental benefits) at the cost of private plantation growers;
- (d) whether there is the need for government action to encourage longer rotation plantations, particularly in order to supply sawlogs; and
- (e) whether other action is desirable to maintain and expand a viable and sustainable plantation forest sector, including the expansion of processing industries to enhance the contribution to regional economic development.

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Committee met at 6.33 p.m.

CHAIR—I declare open this public hearing of the Senate Rural and Regional Affairs and Transport References Committee to continue its inquiry into the plantation forestry industry and the 2020 vision strategy. Today's hearing is public and open to all. A *Hansard* transcript of the proceedings is being made. The *Hansard* will be available in hard copy from the committee secretariat next week or via the Parliament House Internet home page. It should be noted that the committee has authorised the recording, broadcasting and rebroadcasting of these proceedings in accordance with the rules contained in the order of the Senate of 23 August 1990 concerning the broadcasting of committee proceedings.

Before the committee takes evidence, let me place on the record that all witnesses are protected by parliamentary privilege with respect to submissions made to the committee and any evidence given before it. Any act by any person which may operate to the disadvantage of a witness on account of evidence given by him or her before the Senate or any committee of the Senate is treated as a breach of privilege. While the committee prefers to hear all evidence in public, if requested the committee may agree to take evidence in camera and record that evidence. Should the committee take evidence in this manner, I remind the committee and those present that it is within the power of the committee at a later date to publish or present all or part of that evidence to the Senate. The Senate also has the power to order production and/or publication of such evidence. Any decision regarding publication of in camera evidence or confidential submissions would not be taken by the committee without prior reference to the person whose evidence the committee may consider publishing.

[6.35 p.m.]

BUCKLEY, Mr Michael Thomas, Manager, Resources and Environment Unit, Department of the Treasury

MULLINS, Mr Peter Joseph, General Manager, Business Income Division, Department of the Treasury

CHAIR—I welcome the first witnesses for this evening, the representatives of the Department of the Treasury, Mr Mullins and Mr Buckley. I thank you both for coming along this evening. I should remind you that, following the conclusion of the evidence from the Australian Taxation Office—I understand the committee secretariat has already spoken to you in advance about this—the committee may wish to recall you. I would therefore appreciate your remaining until the adjournment of the hearing. I now invite you to make some opening remarks.

Mr Mullins—In the case of Treasury, we did not put forward a written submission to the committee. I wish to make two comments. Firstly, I would like to make clear that we are from the Revenue Group in Treasury and our understanding is that you would like the focus of the questions to be on taxation issues, which is our area of specialty. Secondly, we have looked at the submissions on the web site. Understanding that you are looking at the impediments to the 2020 vision, from what we can see there do not appear to be any significant tax impediments. That is not to say that there may not be some issues that need to be looked at, but there do not appear to be any significant issues that have been raised in those submissions from our perspective. That is all I would like to say at this point.

Mr Buckley—I will just reiterate Mr Mullins's points in that regard.

CHAIR—The committee has held inquiries in a number of locations across the country and here in Canberra over the past few weeks. One of the things that has become obvious through a number of the submissions is that witnesses have argued that there appear to be a number of taxation disincentives to investment in plantations. I do not know how familiar you are with those views that have been expressed, but we would be interested in any comments you might wish to make on them. You might care to explain to the committee the arrangements that are in place for investments in plantations—I will probably ask the same again of the Taxation Office from their perspective—and comment about primary producers in taxation terms and your role.

Mr Mullins—Regarding disincentives, we are aware of the ones that have been flagged in some of the written submissions. It would be fair to say that we have not had a lot of representations on these issues. That may be because there is this committee. The issues around the rights issues, the profit a prendre, are probably the only ones we have had much feedback on. Even then, there has been very little. I am not sure what you would specifically like to know about the broader tax issues and primary producers. It is a big area.

CHAIR—Does Treasury have any involvement at all? If so, can you explain that in terms of investment in plantation industries, but more particularly from the point of view of the tax

regime's interaction with the tax office for certain types of investment schemes being put in place?

Mr Mullins—We do not have a lot of involvement with the ATO on these issues. Certainly from our group's perspective, if there are issues or concerns raised in the work the ATO does they will be flagged with us. From the revenue group perspective, we do not have an active involvement; our fiscal group may. Mike's unit handles primary producer issues in general and, obviously, there are issues on the public agenda around things such as farm management deposits and so on, but certainly the forestry issues have not been a big issue.

Senator MURPHY—In terms of policy formation with regard to the application of taxation measures, do you give any thought to how taxation measures might be applied to plantation forestry or, indeed, to other agricultural businesses of that nature?

Mr Mullins—It depends on the measure. We have a broad range of tax measures that we consider, and if it appears that the measure does have an impact, for example, on the primary production sector then we will consider those impacts.

Senator MURPHY—For instance, in the case where the government proceeded with the change to the 12-month rule application, what things in plantation forestry did you consider were different from other agribusinesses in the same sort of agronomic area—to use the Taxation Office's words?

Mr Mullins—Whenever there is a policy issue under consideration, as I said before, we consider a range of issues. I am not sure that we can discuss in this committee whatever advice we gave to government, but—

Senator MURPHY—So it was a political decision, was it?

Mr Mullins—I cannot comment on whether it was or was not a political decision.

Senator MURPHY—Your responsibility is revenue, is it not?

Mr Mullins—Our responsibility is revenue, but the government's responsibility is policy issues, and they make the decisions.

Senator MURPHY—From an equitable taxation point of view, if a decision—political or otherwise—is taken at government level to allow for certain deductibility activities to take place in respect of plantation forestry on the basis of seasonal problems, so perceived, what have you done about other seasonal agribusiness activities that, as far as I can see, confront the same seasonal problems? Surely, some assessment ought to have been made about the equitable application of tax law. I am not arguing against what happened in regard to plantations; I am just wondering how we got to a point where it was found that we ought to do it for plantation forestry but not for other agribusiness sectors.

Mr Mullins—As I said, the government have made a decision about that issue. I do not think it is for us to argue whether they should have granted it to plantation forests or granted it to other types of business.

Senator MURPHY—Mr Buckley, what is your role in terms of being the manager of the Resources and Environment Unit? Do you formulate any tax applications that might be put forward to the government to consider in respect of environmental plantings for salinity reasons and the like?

Mr Buckley—I have not had that put forward to me at this time. These decisions were taken in 2001, before I moved into this area, but I have reviewed the files on these matters. We start from a position where we have an income tax base, so we have an understanding of a general definition of income, and we have general rules relating to what are deductions in deciding what can be deducted from assessable income.

Senator MURPHY—Have you give any thought to the future?

Mr Buckley—On occasion, proposals are put forward relating to how assessable income should be characterised in industry or how deductions should be treated in particular industries. That was what happened in the case of the forestry industry. There was the issue of what should be allowed as a deduction and what should be the timing rules relating to that particular industry, taking account of the unique circumstances of that sector. As I said, from a Treasury perspective, we look at what the income tax base is, evaluate proposals against that income tax base and put forward advice to government on proposals for exceptions to the general rules.

Senator MURPHY—So you do not really have a proactive role in looking at discussions that are occurring in a very public way about salinity issues and whether there ought to be a different regime for deductions for plantations or other cropping activities that might assist in reducing the salinity problems?

Mr Buckley—Treasury has an environmental policy unit but it is in a different group; it is in our budget area. This would be looked at on the expenditure side. You can deal with these issues from an expenditure side or from a revenue side. We will look at those proposals if they are put forward to us. We monitor the literature so that we can educate ourselves on what issues are in the public domain. But we evaluate proposals that are put forward, or meet government requests for advice on these matters.

Senator MURPHY—Does your environment unit ever put forward suggestions to you in terms of taxation measures that might be considered?

Mr Buckley—Not in the period that I have been working there. Our priority has been to look at the Farm Management Deposit Scheme, and the other side of my unit has been looking at resource tax issues for minerals and petroleum.

Senator MURPHY—Has Treasury given any consideration that you or Mr Mullins are aware of to the environmental issues that face this country?

Mr Buckley—Research in that area is more the work of the Productivity Commission or ABARE or those organisations that undertake that type of analysis.

Senator MURPHY—There are a number of reports out that make suggestions that we need some form of activity. From a plantation point of view, which is what this committee is dealing with, suggestions have been made to us that taxation treatment ought to be taken into account

when you are considering dealing with environmental problems that may be able to be solved or partly solved from a plantation forestry point of view. Has Treasury given any thought to that?

Mr Buckley—We reviewed the recent Productivity Commission report on the environment and the role of the tax system in it.

Senator MURPHY—Mr Mullins, have you done any close scrutiny of deductibility in terms of the current tax law? There is a paper written by Alan Cummine—I am not sure whether you are aware of it or have read it—that talks about the things that are deductible. At page 4 it sets out a range of plantation establishment costs that are legitimate tax deductible business expenses. A number of those are listed here. Given the circumstances that occurred in the mass-marketed schemes debacle, and given that, as I understand it, capital acquisitions such as land are not deductible items, have you had a look at how the current plantation industry is operating or, at least, how its managers are operating?

Mr Mullins—Generally, we would not look at that. Those issues that are raised in that paper, certainly the deductibility issues, would be monitored more by the ATO, if that is what you are concerned about.

Senator MURPHY—You do not look at those from your point of view, as to whether or not you might need to remove some of those items?

Mr Mullins—From the deductibility?

Senator MURPHY—Yes.

Mr Mullins—I would not have thought that there would be a reason for us to do that, as far as I am aware. Certainly, as I said earlier, if there are concerns around the taxation system and the taxation base, we would rely on the ATO to give us advice if there are concerns in those areas.

CHAIR—As a division has been called in the Senate, I am afraid we will have to suspend the hearing for a few minutes.

Proceedings suspended from 6.50 p.m. to 7.00 p.m.

CHAIR—Can I go back to my earlier question, where I was talking about the role that Treasury might have in relation to tax issues, particularly as they affect plantation forests. I understood—and you can clarify this or correct me—that Treasury's role was to develop tax policy and the tax office's role was to administer that and perhaps give some guidance in terms of rulings. Is that correct or not?

Mr Mullins—Yes, that is right—it is Treasury's role to develop tax policy. I think what we were trying to point out was that, obviously, the area of tax policy is a very broad area. We keep a watching brief and, as Mr Buckley said, we do have involvement at different levels, depending on the issue. I think the point we were making earlier was just that, certainly at this point in time, it has not been a big issue for us in terms of matters under consideration. But partly that is because of the size of the workload and the size of the issues that involve taxation.

CHAIR—Was the Senate Economics Committee inquiry that Senator Murphy raised in relation to the mass-marketed tax-effective schemes one that the Treasury would have looked at or had a watching brief on? If the answer to that is yes, has there been a response to either the committee's recommendations or the issue as it was raised by various investors across the country?

Mr Mullins—Certainly, we did keep a watching brief on that committee. Most of the focus, of course, was around issues relating to the ATO and dealing with those schemes. Certainly, my understanding, and what I picked up from the submissions, is that, since the Managed Investments Act of 1998, a lot of those issues are not related necessarily to the plantations. That is my understanding from the submissions. That might reflect why our division, certainly, has not had a lot of issues raised around the plantations and the mass-marketed schemes.

CHAIR—So would you have only general familiarity with issues that have been raised as part of the plantations inquiry and views that were expressed by people who have invested or is there a greater degree of familiarity that might lead us to open up a little more on some issues?

Mr Mullins—It is very hard to express views on degrees of familiarity. I may be more familiar than you are or I may be less familiar. It is difficult to answer.

CHAIR—Let me ask a question, then, to try and test some of that. One of the criticisms about the way that the plantation forestry industry is treated is that they are taxed more heavily when compared to other primary producers, particularly because of income being in large lump sums rather than generated annually. Do you think that is a valid criticism? Is it fair to compare in that way?

Mr Mullins—My understanding is that the issue they have raised is basically access to the five-year averaging provisions that are available to primary producers. I think that is my understanding of the issue they are raising. My reading of the submissions is that they are saying that, assuming that they are not connected to any other primary production business, the nature of forestry is such that they might get a large amount in one year, when the timber is cut, or whatever the circumstances. The first time I saw that issue raised was in the context of these submissions. I have not seen that issue raised before. Once again, it would not be high on the agenda because, as far as we were aware, the averaging provisions were operating okay for primary producers across the board. Whether they have a valid argument is difficult to answer because, as I said, it would depend on their circumstances.

Senator O'BRIEN—As I understand it, the 12-month prepayment rule for plantation projects was estimated to cost the budget \$25 million in the first year, \$5 million in the second, zero in the third, then returning to \$25 million. What is the actual history experience, or is it too early to know?

Mr Buckley—I think we would have to take that one on notice.

Mr Mullins—Yes. It probably is too early to know. My recollection is that \$25 million came in, I think, in 2001-02. We will take it on notice and get back to you.

Senator O'BRIEN—In terms of that issue of the general farming community's access to tax solutions, am I correct in understanding that farm management deposits are not open for plantation forestry operators?

Mr Mullins—As far as I am aware, they are open—

Mr Buckley—If you meet the definition of a primary producer and you are an individual or the beneficiary of a trust that operates a primary production business, you can make a farm management deposit.

Senator O'BRIEN—But, if you run a managed investment scheme for the purposes of establishing a plantation, you are not eligible?

Mr Buckley—Companies are not able to make them.

Senator O'BRIEN—Has the Treasury done any work to compare taxation treatment under the 12-month rule with, say, an orchardist who established another type of tree operation that had at its end point a timber recovery purpose and had available to it a capital tax incentive deduction over the first 15 years. Has any work been done to compare the two schemes as to how they would fit together, cost to the budget—

Mr Mullins—As far as I am aware, that work has not been undertaken.

Senator O'BRIEN—It has been suggested to us that current tax arrangements do militate against schemes whereby we could encourage the management of plantations for longer rotations and higher value sawlog recovery. I am sure you have seen that in the submissions. What are the tax implications, for example, for a scheme that would allow, instead of harvesting of a plantation at 10 years, the sale of that plantation to another entity that would manage it for a further 10 years? Has any work been done on that?

Mr Mullins—Is this around the secondary market type issue?

Senator O'BRIEN—Yes, perhaps. We have been told that managing, for example, blue gum plantations for higher value products such as sawlog or veneer requires pruning and a longer lifespan, so the person who is investing at first instance may not be prepared to invest over that longer period. It was suggested that, but for the lack of a suitable tax regime, we might be able to recommend encouraging the sale of the asset—that is, the plantation—prior to harvest, to another entity who would keep and manage the plantation for another 10 or 15 years until it reached maturity for harvesting for the higher purpose. Has any consideration been given to varying the current arrangements to encourage the managing of plantations for higher value over a longer period?

Mr Mullins—On that issue specifically, as far as I am aware no work has been done, although a lot of this often involves the sale of rights. You are probably aware that, arising out of the recommendations of the Ralph review around rights and some of those issues, the government has said that this matter is under consideration. I think 1 July 2005 is the date that the government has announced. A whole range of issues are being looked at in the context of the tax value method that the Board of Taxation looked at, which of course came out of the Ralph

review. The government has said that it will look at black-hole expenditures and rights. Often these are rights type issues. They are under consideration.

Senator MURPHY—They do not have to be rights issues.

Mr Mullins—No, they do not have to be rights. There are tradeability issues. Generally, in those cases the ordinary law would apply; I assume it is then a question of whether you give incentives or some kind of taxation concessions to make them more tradeable or more saleable.

Senator MURPHY—You might change the taxation system up-front in terms of its application.

Mr Mullins—To what?

Senator MURPHY—At the moment, if you are an investor in a plantation wood lot, you might be charged, say, up to \$10,000, which is the cost for the establishment and management of that plantation for its life, which might be deemed to be 10 or 11 years. As Senator O'Brien says, what consideration has been given to changing the taxation structure to see whether you can drive higher end value growing of plantation timber to enable people to trade it at a certain point in time? It does not look to me as though you have given that too much consideration.

Senator HEFFERNAN—The creation of a 'bunny' market, in other words.

Senator MURPHY—A what?

Senator O'BRIEN—I would not want to categorise it in any particular way. There are probably a range of options. As I understand it at the moment, if you enter into an investment without the intention of harvesting the plantation, you are not eligible to make your claim under the 12-month rule, or indeed you may be deemed to be ineligible for that tax deduction at some later time if it were determined that you had intended that the plantation would be harvested at the end of the, say, 11-year period. It would obviously require a change if you were to encourage plantations to be managed on a longer rotation and for that to be encouraged by allowing someone to trade the investment rather than hold it until it came to maturity upon harvesting of the whole of the plantation.

Mr Buckley—I will come back to that issue. Our starting point, from policy which came out of the Ralph review, was the desire to lower the general rate of corporate taxation, so you would have a lower rate of taxation, and to remove differences between the taxation of different asset types, so you simplified the tax system by treating investment classes equally. That reduced the complexity in the law and improved certainty for investors. The proposal here is whether or not investors in plantation forests should receive a tax treatment which is different from other long-lived investments. Doing that raises additional complexity for other investors in how to judge between one investment class and another.

Senator O'BRIEN—But they do receive different treatment now to some extent through the 12-month rule, don't they?

Mr Buckley—In terms of the changes to the deductibility, the general principle there that deductions should match expenditures, so the deductions should line up with when the

expenditure was incurred. If a deduction occurs, that reduces assessable income, but it is offset against the earning of other assessable income to better align income and deductions. In the case of forestry, there was an impact on the industry at that time and the government reviewed that impact and decided to modify the application of the general rules to that sector. That is the role of government—to monitor and to respond to changes in industries. But we start from a general base, and that is that the objective is to have a low corporate tax rate and a broad tax base. That is achieved by having standardised deductions.

Senator O'BRIEN—So it would not be inconsistent with the government's current approach to further vary the approach to plantation forestry if it was desirable to encourage a longer term investment in that sector?

Mr Buckley—That is a decision for the government. But there are a number of elements in that. There is a more threshold decision, and that is whether or not the tax regime is the best way to achieve that, or there are other more targeted programs which could achieve the same outcome.

Senator O'BRIEN—Given that we are examining this matter at the moment and there are submissions regarding that before us, it is important for us to understand the financial implications.

Mr Buckley—In general, one would think that anything that increases the rate of deductions or the speed at which deductions could be made would cost revenue.

Senator O'BRIEN—Would that necessarily be the case if, on the one hand, you were expecting the investor to have earned income through the harvesting of a plantation for woodchip but, instead of earning income in that way, they earned income by selling the investment to someone who would manage it again? For example, what if, instead of chopping all the trees down and replanting and starting another 11-year scheme, it became an 11-year scheme followed by another 11-year scheme on the same amount of trees, with a return in the middle and at the end and maybe even a third rotation? I am just trying to understand whether we would necessarily be stepping beyond the principle that has already been accepted by the government if we were to seriously examine that. I guess the difficulty we all have is understanding what the financial implications of doing that would be.

Mr Buckley—I think anything which accelerates the rate at which deductions can be made will have a revenue implication, and that is a cost to revenue. What the dynamic effect would be of that in terms of output and income generation I do not know. But you would have to think that, in the case of forestry, the objective of this deduction is that it comes before the income is actually earned. There is a period of time, and we cannot change the environmental conditions, over which trees grow and when you can harvest them. The tax system will not modify that in any way.

Senator O'BRIEN—No, but I guess my question is: if we are of the view that a beneficial tax regime would encourage investment in wealth creation that is not now happening to the extent it possibly should be—that is, growing trees for a higher purpose than pulp—how do we understand the financial implications? You suggest that the question we should ask is: does it accelerate the rate at which deductions can be made? I guess that is almost unknowable at this stage, but we can speculate. If it were the same, if the hypothesis that I put—that is, instead of

cutting the trees down and chipping them and thereby deriving income, income were derived by one investor from selling the plantation, as a plantation, to someone else who would manage the trees for a longer rotation—

Senator MURPHY—Isn't that a capital sale, though?

Senator O'BRIEN—That probably is the case, but I do not think it is a valid operation in terms of whether the original investment was eligible for the deduction under the 12-month rule, because it was not an investment with an intention of harvesting at the end of the cycle, so it would require that variation. But let us say you go through a series of cycles where you are investing in the same trees but, by doing so, having a higher value return at the end and therefore higher income at the end, and income at two stages in the process but at almost the same intervals as if you cut the trees down and replanted them three times. Should we look at it that way and use your test—that is, does it accelerate the rate at which deductions can be made?—to determine whether that is going to be an additional cost to the Commonwealth? It is complex, I know. It is difficult to talk across the table on this.

Mr Buckley—I would like not to do the modelling at this time. They are the issues which would have to be taken into account.

Senator MURPHY—Could you have a look at that?

Mr Buckley—I have not looked at that.

Senator MURPHY—But could you have a look at it from the committee's point of view? If you have a blue gum plantation which has a rotation of, say, 10 or 11 years and the grower—who has claimed the deductions up front and claimed the deductions for the establishment and the management of the plantation for that rotation period—says, 'I would like to sell the plantation at year 5,' you can consider the sorts of things that Senator O'Brien is talking about. You could say, 'You have claimed this amount of deductions and, from the sale proceeds, we must add in these tax factors.' There must be processes that can be considered, and we would like know whether you have given or can give some consideration to that sort of thing.

Mr Buckley—It depends on how you characterise it, but in one way these forestry investments are a means by which people can make an investment, and the expenses incurred in the forestry sector can flow through to those people and they can offset that against other assessable income.

Senator MURPHY—That is right.

Mr Buckley—To the extent that that happens, overall taxable income is less than it otherwise would be. In a different business structure, those deductions would not be able to be used until that business generated income.

Senator MURPHY—I understand that. All I am saying is that, if that were the case, either you could make an adjustment at the beginning as to the allowable deductions—I would think; this is just a discussion point—you could change the allowable deductions, or you could allow the deductions to stand, for instance, and if it were sold at year 5 instead of year 10 or 11 then you would have to make some adjustment in terms of the income derived from the sale against

the deductions claimed. Is it possible for Treasury to give some consideration to those issues and come back to the committee with some suggestions about the questions that have been raised with us?

Mr Buckley—We can look at those. That is what I was talking to before, because, in allowing the deductions to flow through, in a way you do not have a membership interest in that. You are treated as the operator and you do not have that interest to sell. So we are mixing, as it were, our business structures.

Senator O'BRIEN—What I am trying to get at is: if the committee were of the view that it was desirable to encourage these longer rotations and we were also of the view that the current tax structure was an impediment to that, how do we come to understand the cost implications of changing that—examining it and perhaps making recommendations to the parliament which are in proper understanding of those cost implications? Can you look at that and give us some principles that we should apply?

Mr Buckley—We can advise you on the policy that is underpinning our tax law at the moment but I do not think we can offer you alternatives. We are not in a position to provide advice to you on alternative policies.

Senator O'BRIEN—I am not asking for you to advise us. I am asking you if you can tell us what principles we should apply in an attempt to ascertain the cost of those things.

Mr Buckley—We can characterise the nature of the transactions.

Senator O'BRIEN—Has there been any work done on providing taxation deductions for plantation forestry where environmental benefits are the key aim of that plantation?

Mr Buckley—No. There is considerable work being undertaken on environmental programs. The question is whether or not there is a specific tax program. I have not worked on a specific tax program. But I would not want that to be characterised as nobody having looked at the environment in taxation. Clearly, it has been looked at, but we do not look at those microarrangements until we are asked to do so.

Senator O'BRIEN—Presumably a primary producer who plants an area to treat environmental concerns on a property is able to make deductions for that expenditure against income. Would they be able to do it under the current 12-month rule?

Mr Buckley—That is a question better put to the tax office, because it will depend on the facts.

CHAIR—I have a final question that follows on from most of the discussion. Are you able to tell us what the Department of the Treasury's position might be on profit a prendre?

Mr Mullins—The answer is no. As I said earlier, that issue is linked to the rights issue because it is a form of right. The government has made it clear that it is under consideration as part of the broader rights regime. I do not think it is appropriate for us to provide a Treasury view of what that might be. As I said, the matter is under consideration and we are considering it in the context of the Ralph report and some of the recommendations it made and we are just

looking at the issue generally. I think the government's intention is to have something done by 1 July 2005.

CHAIR—As there are no other questions, thank you, Mr Mullins and Mr Buckley, for the time being. We may need to speak again later this evening.

[7.30 p.m.]

FIELD, Ms Cheryl-Lea, Assistant Commissioner, Small Business, Australian Taxation Office

HAMMERSLEY, Mr Gary, National Business Manager, Product Rulings, Australian Taxation Office

OLIVER, Mr Nick, Assistant Commissioner of Taxation, Office of the Chief Counsel, Australian Taxation Office

CHAIR—Welcome.

Senator HEFFERNAN—Mr Hammersley, did they name the Hammersley Range after you?

Mr Hammersley—An ancestor.

CHAIR—Would you like to make some opening remarks, particularly in response to your submission?

Ms Field—In the Taxation Office's written submission we have provided details particularly around our two major initiatives in this area. The first is taxation ruling 2000/8, which commenced its consultative process back in 1997 with the original issuing of taxation draft ruling 97/D17. We have provided copies of those to the committee. The second is the introduction of the product ruling regime that was announced by the commissioner in 1998, which provides some certainty of the taxation aspects for specific projects, covering a range of agricultural and other industries. Part of that is the forestation industry, and we have provided statistical information specifically around the forestation industry for the committee.

Senator MURPHY—On the first page of your submission you say:

The second category is comprised of managed plantation industry.

In this sector, a management company with forestry expertise contracts with a number of smaller entities, often individuals, to establish a plantation, to maintain the plantation during a defined growing period and, at the end of that period, harvest and sell the trees or wood produce on behalf of those participants.

Going back to the question we asked Treasury with regard to the application of tax laws and the way the deductions are claimed by the participant, is it possible in your view to have a tax regime that would allow the sale of a plantation to another purchaser at a time earlier than the declared rotation period and then for it to be sold a third time if it was deemed that the plantation was of sufficient quality to be grown on for a higher value end-use purpose? I ask you that question in light of the statement contained in the submission.

Mr Oliver—I can make an opening attempt at answering your question but it will appear to be longwinded, I am sure. The simple answer is yes, because you can envisage a specific situation of a particular individual, for example, who is classified as carrying on a business of trading in interests of that sort. The very fact that they do carry on business in that way means

that those interests in their hands will be trading stock and the trading stock rules in tax law will operate. Effectively, the cost of their acquisition of their stock will be on revenue account. That is rare—and it is not my experience that we have actually seen anyone individually carrying on a business of that sort—but it is certainly conceivable within the existing provisions.

The submission has a number of attachments to it. As I am sure you are aware, one of the largest items is the tax office public ruling on investment schemes, TR 2000/8. For my sins I was involved in the production of that. The analysis in that ruling covers, predominantly, two main areas of tax law: general deductibility and the operation of the antiavoidance provisions. In terms of general deductibility, the analysis is a fairly standard one of looking at the deductibility of the fees from the perspective of someone who is carrying on a business—in this case a business of afforestation. So, when you see a variation from that perspective, such as someone who is not carrying on a business with the view to going all the way through to derive income from the sale of timber but is more concerned with making a profit from dealing with their interest, a wholly different analysis comes into play. In particular, it raises the spectre of whether that interest in their hands is a capital asset and, more particularly, whether the amounts that have been said to have been for things like lease and management fees are really not in truth and substance the cost of that particular asset. So the cost is on capital account, and it is not to say that it is not deductible at all, because you are really talking about, it seems to me, the form in which you might get that cost as a deduction of some sort and at what time.

Senator MURPHY—I think the courts have made that fairly clear to some degree.

Mr Oliver—I think that is right, yes. So, if the asset is sold at a profit and that is part of a profit-making scheme that gives rise to that profit being ordinary income, our understanding is that you would net off the cost of the asset in calculating that profit but you would do that not at the time of incurring that cost—at the time of entering and acquiring the interest—but at the time of its disposal.

Senator MURPHY—So you are saying that, under the existing tax laws, you could allow for the sale of a plantation prior to its otherwise deemed term of rotation?

Mr Oliver—It is conceivable—that is correct—with that sort of tax outcome that I have just described.

Senator MURPHY—I have another question about the issue of deductibility. In another committee, the economics committee, we dealt with this to some degree, but it has always been a worry for me in terms of the issue of management fees and what form excessive fees. Your TR 2000/8 goes to that issue of grossly excessive and inflated fees. Given that we know that a lot of the second category plantation sector managers have used fees derived from investors to purchase land to grow the investors' trees on, I still pose the question: does the Taxation Office think that is a fair and equitable process?

Mr Oliver—I would prefer not to answer the question in those terms, because my experience has been on the basis of what the law as actually applied gives as a result. So 2000/8 says in basic terms, particularly in terms of those paragraphs that deal with whether a management fee can be dissected and whether it should be apportioned in some way, that the starting point is the management agreement itself. That is in line with a number of court decisions that we have referred to previously in relation to the committee that you have mentioned—decisions like

Lau's case of the full Federal Court and a single Federal Court decision in the case of a Mr Merchant, which involved an afforestation scheme. In the latter case, the proposition quite strongly in terms of a particular application of the general deduction provisions was that there were no legal principles to allow you to go behind the management agreement. We do not agree with that, because we think there is other case law which says that that is not universal rule to follow and there are exceptions to it. But, by and large, we say, as we do in TR 2000/8, that that is the vital starting point for considering the initial deductibility of a particular fee, such as a management fee.

Senator MURPHY—I cannot recall—I would have to go back and check this—whether it was the Lau or the Merchant case that actually did allow for apportionment.

Mr Oliver—That is not my understanding of the decision.

Senator MURPHY—I just want to go back and check that—that is going back to my memory of the last hearings—but I understood that that could be the case. The reason I ask the question is that, if you are looking at a future taxation law application—and going to the first question I asked you, which was whether or not you could allow for somebody to sell a plantation at an earlier stage than would otherwise be the case—excessive management fees are an important aspect of that from a revenue point of view, I would think.

Ms Field—I suppose those matters were covered in substantial detail in submissions to the previous Senate inquiry.

Senator MURPHY—Yes—I have all of the material, but I cannot not recall and I did not have time to go back and check. But I will.

Ms Field—I suppose the essential issue here under our current product ruling regime is that, if a person has a purpose of carrying on the business of afforestation, they will get that up-front deduction.

Senator MURPHY—I am not disputing that.

Ms Field—But, if they do not have that intention to continue carrying on that business and they wish to dispose of it at an earlier stage, it will then change the nature.

Senator MURPHY—Yes, I understood that from Mr Oliver. I have no question about that. What I am really asking about—and this is a question which is of concern to me and has been for some time—is excessive fees. When I asked the Taxation Office before about what they considered a reasonable fee for the establishment of a hectare of Blue Gum plantation, I think—again, I would say this is from memory—they said something in the order of \$20,000. They had bandwidth of, say, between \$10,000 and \$20,000.

Ms Field—We would need to refer you to our previous submission.

Senator MURPHY—From my point view that is extremely excessive. I am concerned that you would make a judgment like that and I was concerned at the time. Given that you have a product ruling in there which outlines costs of around \$4,000 to \$4,500 per hectare, the issue I want to get to is how you view excessive fees and how you look at the future of plantation

establishment and the sale of those plantations to encourage the plantations to be grown for longer periods of time.

Mr Oliver—I would put it this way: in my experience, the very fact that a particular scheme might be judged to have an excessive fee is not in itself something that we have relied on to say that general deductibility of that fee is hampered in some way.

Senator MURPHY—Can I ask you about a couple of other things in your submission. I am concerned about the third paragraph under the subheading ‘Product rulings’. In the first paragraph, you say:

The ATO’s second initiative was the introduction of Product Rulings which were announced by the Commissioner in a major speech in June 1998.

In the third paragraph, you say:

It should be noted that the Commissioner’s actions in this regard have recently been confirmed by the courts in relation to several mass marketed arrangements, including a forestry industry case, *Puzey v FCT [2002] FCA 1171*.

That is not quite accurate, is it, really? I have to say that it concerns me that you would put in there that the commissioner won this matter hands down as a factual statement for the members of this committee. You have not made any mention of this being subject to appeal and, in fact, the commissioner did not win all of the points in this case, did he?

Mr Oliver—That is certainly correct.

Senator MURPHY—It was a split case, wasn’t it?

Mr Oliver—The major finding of practical significance was that the general antiavoidance provisions in part IVA applied to—

Senator MURPHY—only one thing—the seedlings—but not to the other parts.

Mr Oliver—The seedlings were the excessive component. They were the particular component in relation to the analysis in taxation ruling 2000/8 that had the financing mischief underpinning them. The management fees and the lease fees were considered to be neither uncommercial or excessive in any way nor backed by any financing that triggered the sorts of analysis in TR 2000/8.

Senator MURPHY—Nor were they subject to the antiavoidance provisions.

Mr Oliver—That is correct. The commissioner’s determination was confined solely to the excessive seedling purchase fee component. I apologise if that is considered to have misled the committee in any particular way; it was not our intention to do that.

Senator MURPHY—I just raise it as a concern because any of us who were not aware of some of these cases would think from this that the commissioner had won this matter, and that does not quite reflect the facts.

Mr Oliver—Duly noted, Senator.

Senator MURPHY—Further down that page, you say:

Product rulings are a form of public ruling (as distinct from a private ruling) that allow the ATO to provide a clearly defined ‘class of persons’ with certainty by ruling publicly on the taxation aspects of specific projects.

With regard to a product ruling that goes to the antiavoidance provisions, you do not really provide certainty with respect to antiavoidance provisions, do you, except to say that you cannot conclude at the point of time of issuing the product ruling?

Mr Oliver—You are correct in the sense that there is the possibility that the arrangement actually carried out may materially differ from that ruled on and described in the notice that is the product ruling. But that is inherent in all the tax laws that are ruled on; it cannot be confined to part IVA. There may be issues in relation to a material change in the arrangement that go to whether the fees are deductible as general deductions.

Senator MURPHY—So it is not certainty on all aspects of taxation—

Ms Field—It is certainty in that if the—

Senator MURPHY—in what is deductible.

Ms Field—If what is outlined in the product ruling is carried out as has been disclosed to us, we can provide that certainty. We make due inquiries to sufficiently satisfy ourselves in that regard.

Mr Oliver—That proviso, in my experience, is well understood by the promoters of these arrangements. The disclosure statements to investors make it clear that the product ruling has got that proviso, that it is going to be binding on the commissioner providing the arrangement is carried out as described in the product ruling.

Ms Field—Senator, these issues were also covered in detail in our submissions and our appearances at the previous Senate committee that you were a member of.

Senator MURPHY—In product ruling 2002/56, at section 55, you say:

Generally, a Grower will be carrying on a business of afforestation, and hence primary production, if:

the Grower has an identifiable interest (by lease) in the land on which the Grower’s trees are established.

As I said at the outset, I am worried about this approach being taken by some plantation companies whereby, as they did identify to the Senate economics committee, a large portion of the management fee, so-called, is used to purchase land. I still cannot understand why that should be an allowable deduction.

Mr Oliver—I am acutely aware of your discomfort with that outcome. It seems to me that it gets down to a comparison between, for example, the tax outcomes and the differences that you get depending on whether, for example, you go out to buy a motor vehicle or you lease a motor

vehicle, only in this case we have the interposition of a particular entity promoting certain tax benefits. My experience has been that they are never going to frame a management agreement with an investor where that management agreement says, 'And we are going to sell you land.' The access to the land will usually be by way of a lease agreement and, as was said in TR 2000/8, the starting point for characterising that management fee is the management agreement itself.

Senator MURPHY—I understand that. But if I wanted to plant a forestry plantation of my own and I went and bought the land to put it on, I would not be able to claim the land as a deductible item. The cost of the land is a capital purchase.

Mr Oliver—That is correct.

Senator MURPHY—And not deductible. What I am saying to you is that if I were to instead give \$10,000 to a plantation company who then took \$5,000 or \$3,500—which seemed to be about the norm they were paying for land in certain areas within Australia—and they bought themselves a hectare of land for \$3,500 and then used the remainder of the \$10,000 to establish the plantation and manage it, isn't that a bit of a backdoor of the tax system?

Mr Oliver—I can understand the sentiment. I feel slightly uncomfortable, given your previous comments, to refer back to the Puzey case, but you have an understanding of that case. You may well recall that one of the arguments the commissioner ran in that case was that the outgoings in question were in substance the cost of acquiring the interest in the scheme. Basically, when the trustee and trust structure was imposed as it was some time after the commencement of the scheme, one of the commissioner's arguments in response was that the outgoings in question were the cost of acquiring that interest in the trust. The judge rejected that argument outright. So I am not saying that we do not have some sympathy with the argument, because it is quite clearly one that we have contemplated running ourselves, but we have recognised—as we have in TR 2000/8—that courts typically have been against us on that sort of argument.

Senator HEFFERNAN—I am not up to speed on this, and you are, obviously. You say there is \$10,000 up front for some person to invest in the plantation and the vehicle uses part of that \$10,000 to buy the land. Wouldn't they pay tax on the \$10,000 because it is income?

Senator MURPHY—You might like to ask the tax office.

Mr Oliver—Certainly if the \$10,000 is paid to the manager it is taxable income.

Senator HEFFERNAN—Then if you buy the land out of the residue of that, well, you have paid your tax, and so what?

Mr Oliver—That is the argument as to why you do not trace through to identify the deduction; that is correct.

Senator MURPHY—I did ask the Taxation Office once if they could indicate to me the amount of taxation that has been paid by the various forest plantation companies that are in existence at this point in time, particularly those that come into the second category, as you put

it. I am still waiting for a response. I was not asking for individual company information, just what may have been paid in a gross sense by all of them. I suspect it is not very much at all.

Mr Oliver—It is certainly something on which I am not prepared—in terms of having done the work—to give you an answer here tonight. If it is the committee’s wish that we attempt to do some analysis of that sort and not breach any of the secrecy provisions—

Senator HEFFERNAN—Are you saying, Senator Murphy, that you can get a tax deduction against a capital acquisition?

Senator MURPHY—What I am saying is that you can set up a company structure that would have you being able to not have to pay tax in the plantation industry. You can purchase land out of the money that you derive from income—

Senator HEFFERNAN—From the savings of tax.

Senator MURPHY—and still not pay any tax because you will have a number of other structures in place that will ensure that you do not.

Senator HEFFERNAN—You must give me the details of that later!

Senator MURPHY—I provided the tax office with one in respect of one company that had about \$24 million worth that they paid no tax on.

Ms Field—I am not aware of that one individually.

Senator MURPHY—No, you are not, because you were not present at the meeting.

Senator O’BRIEN—I am trying to understand Tax Ruling 95/6 and Tax Ruling 2000/8, which are not necessarily dealing with the same subject, in the context of the question I was asking earlier. As I understand it, an investment in a plantation at the moment, where the 12-month rule can be used and the deduction is claimed up front, is predicated on it being an investment which is intended to run until the plantation is harvested. If someone had such an investment, under what circumstances could they sell prior to the harvesting of the plantation, and what effect would that have on tax deductions they have previously made?

Mr Oliver—This goes back to the question Senator Murphy asked me. Essentially, the same analysis would apply to the extent that there was evidence that the investor intention was not really to carry on business but to acquire the interest and sell that at a profit after they have got the up-front tax deductions. We would say that the standard analysis in ruling TR 2000/8 is not readily applicable to your situation, because you are raising questions about whether or not you are carrying on business and whether what you are doing is more correctly characterised for tax purposes as a profit-making undertaking or scheme, the profit or loss for which should be calculated at the time of disposal of the interest. I hesitate again to refer to the Puzey case, but we advanced an argument along those lines in that case and, as I am sure Senator Murphy recalls, we lost on that point as well. In that case, there was a specific finding that the investor was carrying on a business and there was no evidence that they intended to bail out of the scheme before taking income in the form of their share of the sale of the timber.

Senator O'BRIEN—Management of plantations for a longer rotation involves more investment than merely establishing the plantation. There is management, pruning, reduction of hazards, weed control and the like.

Senator MURPHY—Vermin control—1080 poison.

Senator O'BRIEN—I am not sure that vermin control is one of the issues that I was talking about; that would be an establishment cost, I would have thought. Are those the sorts of activities that would assist in determining whether the entity was engaged in the business of growing the plantation—and obviously adding value by doing that—rather than leaving the trees to grow and putting in the investment in the first year?

Mr Oliver—I think it goes into the mix, but I would hesitate to say, in terms of what we have said by way of public rulings on the topic, including product rulings, that we would ever classify it as determinative or conclusive of the matter. In my experience, the more important factor is whether you intend to carry on the business, including deriving the business income and specifically the business income in the form of, in this particular context, the sale of timber.

Senator O'BRIEN—I am looking at it in the context of management of the plantation being, over time, what adds value to the plantation. Looking at blue gum, for example, if you do not manage it for sawlogs, you get material that is unlikely to be valuable for that purpose and likely to be used only for pulpwood. I am trying to understand if an entity that managed a plantation and perhaps recovered some income from thinnings during a particular cycle would be likely to satisfy that test, even though at the end of that they might have one-third of the plantation standing and for sale.

Mr Oliver—I am not sure that I can answer this in a convincing fashion. I am going to go off on a tangent and draw an analogy with the cases that have been litigated in the past that deal with something like whether a particular asset has been acquired for a profit making purpose or not. There is quite a large body of law on that, but essentially it gets down to taking evidence on what was the particular intention of a particular person at a particular time. If you do an analysis of those cases and say, 'Was the commissioner ahead?' in terms of the cases that he took on, you would probably come to the conclusion that he was not, that more often than not—but not by a huge margin—he got done. That was because the courts, the board of review or the Administrative Appeals Tribunal said: 'On the facts, the profit making intention was not there. It was a long-term investment intention.' All of that is really just to say, 'Can you categorically predict that, in such a situation, such and such would always be the result?' I am saying you cannot because it is very much dependent on the facts of the particular case.

Senator O'BRIEN—Suppose this committee were to look at this issue and say it believed it was in the public interest to encourage the management of plantations in the way that I have described, for a longer-term rotation. If it also said that the tax laws as they are operating are an impediment to that, the committee would have to recommend changes to those laws to make certain that the treatment would be other than the way you suggested it might be. Therefore, for certainty purposes, the law would need to be changed.

Mr Oliver—I believe that to be the case, yes.

Senator MURPHY—I have a question about the issue of single issue product rulings. You say in your submission:

... participants in existing managed plantation projects are also within the scope of the new legislation.

Can you explain to me a little more fully how the commissioner's issuing of product rulings of this type is going to work? It is under the subheading 'Single issue product rulings' and it starts:

As a result of tax law amendments under the government's program of Business Tax Reform, a new category of Product Ruling was introduced from 1 July 2001.

Ms Field—Since 1 July 2001, the issues associated with the non-commercial losses legislation have been covered within a product ruling. There may be existing managed investment arrangements, and they could come to us and apply for a single issue product ruling purely on the application of the non-commercial losses legislation for their specific project.

Senator MURPHY—You then give a list of product rulings, I think it is 57 in total, versus product rulings that had been issued as at October 2002. You say that as at 2 October 2002, the commissioner had issued 57 single issue product rulings. What differentiated them from the other 100?

Ms Field—For example, we wrote to all existing product ruling holders. We said that there had been a change in the law and that, to ensure that individuals could continue to claim any deductions associated with those product rulings, they needed to have a discretion exercised by the commissioner. The letter said that they could apply for a single issue product ruling application and that we would consider their application and then appropriately exercise the commissioner's discretion.

Senator MURPHY—I want to understand why you have issued only 57 against 159 product rulings. Is it that the others have not applied?

Ms Field—From 1 July 2001 we incorporated that commissioner's discretion in the product ruling itself.

Mr Oliver—These were typically schemes that had commenced before that time, but which had losses for the investors occurring after that time to which the non-commercial loss provisions potentially would apply to defer that loss. But they were also candidates for the second arm of the commissioner's discretion, so those product rulings, as distinct from the ordinary product rulings, were issued on a retrospective basis. They applied to people who had gone into the arrangements before the time of the issue of the single issue product ruling.

Senator MURPHY—Prior to 1 July 2001?

Ms Field—That is correct.

Senator MURPHY—What are the dates under the single issue product ruling statistics that go to 2002 and 2003?

Mr Oliver—I think they are more the year of issue rather than being the income years ruled on.

Mr Hammersley—That is correct. That is just the applications that were processed during those years.

Mr Oliver—And they would be financial years.

Senator MURPHY—So there were 57 that fell prior to 1 July, 2001. I should have worked it out myself but I could not quite follow it. You say on the last page of your submission:

In October 2001 the government responded by introducing a new 12 month rule for prepaid expenditure in the managed plantation forestry sector where that expenditure was for 'seasonally dependent agronomic activities'.

How are forestry seasonally dependent agronomic activities different from other seasonally dependent agronomic activities?

Mr Oliver—I do not think I can answer that because, whilst I am involved—

Senator MURPHY—I mean other activities such as the cultivation of, for instance, tea-tree, almonds or olives.

Mr Oliver—To the extent that there is a dependency on a particular time of planting—

Senator MURPHY—You put it in your submission, not me.

Mr Oliver—It is a concept that says where there is certain expenditure dependent on certain things happening—that is, planting—then you would expect that that would translate to other agronomic agricultural activities.

Senator MURPHY—It is your justification, not mine.

Mr Oliver—It is a factual statement in terms of the actual statutory language used in that provision.

Senator MURPHY—Can you tell me, then, how it differs?

Mr Oliver—If there were a provision that said, 'For industries besides the forestry industry that have seasonally dependent agronomic activity expenditure,' then that provision would apply to those other industries. The actual restriction—

Senator MURPHY—I am asking the question from an equitable taxation application point of view. All taxpayers are supposed to be treated equally on this farm.

Ms Field—That is a matter of policy consideration.

Senator MURPHY—Of course! Suppose that a plantation company has planted investors' trees and those trees fail to grow. They replant them, and then maybe replant them again—it has been the case in some instances. Is that company allowed to claim those failures as a deduction?

Mr Oliver—Its own expenditures in doing that planting would typically be on revenue account and deductible for that entity. If there was a failure and they had to do it again, that would give rise to a further amount of deductible expenditure.

Senator MURPHY—Suppose they ploughed the ground one year and put no trees in, and then had to plough the ground again because of weed overgrowth, and then planted trees. Would both those ploughing activities be a deductible claim?

Mr Oliver—I believe so. There is a basic proposition underpinning this, that tax law does not penalise bad business people as such. If those conditions for general deductibility exist—that it is incurred in gaining or producing assessable income or necessarily incurred in carrying on business and it is not of a capital nature—you would have an entitlement to a general deduction.

Senator MURPHY—I would like to make sure that the tax office is going to deal with the question of deductibility claims in terms of rotational periods if you have somebody who has lodged a claim for an investment deduction—for 10 years of managing a plantation, for instance—but decides to sell at five years. The person who buys at five years might sell at 10 years or might decide, ‘Look, I was going to keep it till 20 years but I am going to sell it at 15.’ How could that be dealt with under the existing tax law?

Ms Field—Under the existing tax law there are obviously issues of revenue and capital, but any change to that would require specific policy considerations.

Senator MURPHY—I understand that. I understood Mr Oliver said it could be dealt with under the existing tax law. I would like to know how it could be dealt with, and you may indicate the revenue implications of that.

Ms Field—We can look at that matter, but if there are issues with regard to the policy we would have to defer to our Treasury colleagues on that matter.

Senator MURPHY—I am sure that they are listening and will take that on board.

CHAIR—I will finish the hearing by thanking the witnesses. Thank you, Ms Field, Mr Oliver and Mr Hammersley, for providing assistance to the committee. The secretariat will be in touch with the tax office and the Treasury to follow up requests that have been made this evening. A copy of the *Hansard* of your evidence will be made available shortly. Having conferred with my colleagues, I can say that there is no need to recall you, but we will take the opportunity to write to you if there is anything to be clarified.

Committee adjourned at 8.12 p.m.