COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Tax Laws Amendment (2007 Measures No. 2) Bill 2007

MONDAY, 23 APRIL 2007

MELBOURNE

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SENATE STANDING COMMITTEE ON

ECONOMICS

Monday, 23 April 2007

Members: Senator Ronaldson *(Chair)*, Senator Stephens *(Deputy Chair)*, Senators Bernardi, Chapman, Hurley, Joyce, Murray and Webber

Participating members: Senators Adams, Allison, Barnett, Bartlett, Boswell, Bob Brown, George Campbell, Carr, Conroy, Eggleston, Chris Evans, Faulkner, Ferguson, Fielding, Fifield, Forshaw, Hogg, Kemp, Kirk, Lightfoot, Ludwig, Marshall, Ian Macdonald, McGauran, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

Senators in attendance: Senators Bernardi, Hurley, Ronaldson and Webber

Terms of reference for the inquiry:

Tax Laws Amendment (2007 Measures No. 2) Bill 2007

WITNESSES

Committee met at 10.01 am

CHAIR (Senator Ronaldson)—Good morning. I declare open this meeting of the Senate Standing Committee on Economics. This hearing has been convened to receive evidence in relation to revision of the Tax Laws Amendment (2007 Measures No. 2) Bill 2007. These are public proceedings, although the committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera.

I remind all witnesses that in giving evidence to a committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If the witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the ground on which it is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, also be made at any other time.

We turn now to the Tax Laws Amendment (2007 Measures No. 2) Bill 2007. It is an omnibus bill that will implement changes to Australian taxation in a variety of areas. The committee is due to report to the Senate on this bill by 30 April 2007. The majority of submissions received by the committee confined their comments to schedules 1, 2 and 3 of the bill and it is on these schedules that today's hearing will concentrate. With the committee's concurrence, the format I intend to follow today is as follows: firstly, I invite Treasury officers to give the committee a quick rundown of the schedule we are considering, then we will hear any witnesses on the schedule and we will then return to Treasury who will be invited to answer any questions members may have.

[10.03 am]

FLAVEL, Mr Matthew, Manager, Industry Tax Policy Unit, Treasury

FRANKS, Ms Susan, Specialist Adviser, Industry Tax Policy Unit, Treasury

PORTAS, Mr Anthony, Head, Taxation, Asia Pacific, Minerals Council of Australia

RYNNE, Mr David, Assistant Director, Economics, Minerals Council of Australia

Evidence was taken via teleconference—

CHAIR—The first schedule is schedule 1, which is to amend division 4 of the Income Tax Assessment Act 1997 to align more closely with the decline in the value of deductions for mining rights with other depreciating assets. I invite the Treasury officers to make an opening statement or give us an overview of this schedule.

Mr Flavel—I will give a very brief overview in relation to the effective life of mining rights. I guess this is a reasonably straightforward element of the bill. The schedule to the bill gives effect to changes which were announced in the 2006-07 budget. The Minister for Revenue and Assistant Treasurer put out a press release as part of the budget which noted that a draft taxation ruling had been previously put out by the Australian Taxation Office, which had generated a number of comments from industry and stakeholders about the way in which the law would be applied in relation to the effective life of mining rights.

As a result of taking into account those concerns, the government agreed to make changes to the way that the effective life of mining rights would be treated and announced those changes in the budget. Under the draft ruling which the tax office put out, the holder of a mining right would have had to have written off their right over the whole life of the mine almost irrespective, if you like, of any previous use. They would also have had to have made an annual estimate or re-estimate of the effective life of the mine. The point on both of those things is that they would be inconsistent with the way that other depreciating assets are treated and therefore the changes that the government announced were largely designed to ensure that mining rights would be treated in a similar way to other depreciating assets.

There are a couple of things to note. The estimates of effective life of mining rights were based on industry standards, including professional oversight of those standards to determine the remaining life of the mine. The effective life of a mining right is really the amount of reserves estimated in a particular mine, obviously divided by the extraction rate. There are examples in the explanatory memorandum that give an overview of circumstances and how this would be calculated. Also, the bill makes provision for giving relevant taxpayers a choice for reassessing the life of the mining rights but without actually having to force that to be done on an annual basis.

That is a very brief overview. As I said, I think it is a fairly straightforward provision. You have obviously noted the fact that the Minerals Council has made a submission to the committee. I will leave it to them to make their comments, but we would of course note that we have had very constructive dialogue with the council and stakeholders in relation to this element of the bill. I am not aware of any particular sensitivities or issues that the industry has with these changes.

CHAIR—Thank you. I think we will go straight to the Minerals Council and hear from them, then we will come back to you with any questions. Gentlemen, can I ask you to give a brief overview, if you want to add anything further to your submission.

Mr Rynne—I will briefly give a few introductory remarks and then throw to Anthony. Thank you very much for the opportunity to discuss our position on this very important piece of legislation. We apologise that we could not actually appear in person before the committee today.

CHAIR—With the amount of time it is going to take I suspect that you do not need to apologise to us. We are happy to hear from you via teleconference.

Mr Rynne—Thank you very much. By way of background, the MCA represents Australia's exploration, mining and minerals processing industries nationally and internationally. MCA member companies produce more than 95 per cent of Australia's annual mineral output. When I say 'minerals' I am referring to commodities such as iron ore, coal, base metals and the like. Whilst one or two in our membership produce oil and gas, we do not represent them in those endeavours. This is important for schedule 1 of this legislation because the legislation pertains to mining, quarrying and prospecting rights and how they are depreciated. We only represent mining, so our comments pertain only to the mining rights and our position in relation to that, not quarrying and prospecting rights.

The MCA strongly supports schedule 1 of the legislation and the accompanying text and the explanatory memorandum, as I said, as it pertains to mining rights. My colleague Anthony Portas has been closely involved with the issue as both a mining tax practitioner and a member of the MCA's tax committee responsible for advocating the views of the industry to government. He will talk now to two key dimensions—firstly, the technical and practical dimensions of the schedule and, secondly, the benefits of the proposed legislation to the Australian mining industry.

Mr Portas—I am the head of tax in Asia-Pacific for Anglo American PLC. This issue has a little bit of history. Mining rights prior to 1 July 2001 were not actually depreciable for tax purposes at all. That change was made when division 40 was introduced into the act with the uniform capital allowances provisions. Since 2001, we have actually worked very constructively with the Australian Taxation Office and others to come up with appropriate interpretations of how the relevant provisions in division 40 that deal with mining rights should be interpreted. Some of these issues were exacerbated in 2003 when a number of amendments were made to division 40 which particularly impacted on mining rights. That culminated, as Matthew Flavel has commented before, in 2006 when the ATO released a draft ruling which contained some interpretations that the Minerals Council disagreed with. We wrote to both the ATO and the government expressing our concerns. In particular, we were concerned that they were very inconsistent with government policy as it pertains to the treatment of depreciating assets. Our main concerns were, firstly, that the proposed methodology to determine the life of a mine was inaccurate and inconsistent with industry practice, and, secondly, that there was a suggestion that taxpayers had to reassess the effective life of the mining right each year, which is actually not the case for other depreciating assets.

As Mr Flavel said, on 9 May 2006, the Treasurer announced some changes to deal with these anomalies. We have worked with Treasury and other stakeholders to come up with the appropriate fix. From our point of view, what the amendments in the bill do is allow mining rights to be treated in the same way as other assets from a division 40 perspective—that is, to be depreciated for tax purposes over the economic life of the asset as determined on the date of its acquisition. It does this by requiring the taxpayer to assess the life of the mine and then attribute that life of the mine to become the life of the permit for tax purposes. If there is more than one mine then the life of the longest mine becomes the life of the permit for tax depreciation purposes. It is important to note that the effective life of mining rights needs to be self-assessed by taxpayers. If I were buying a truck, I could go to the ATO's published ruling and use the safe harbour effective life rate for tax depreciation purposes. No such safe harbour rate exists for mining rights, and thus mining companies need to determine the effective life of their mining rights using the rules set out in the amendments before us.

During the consultation process with Treasury and the ATO, one of our main aims was to be able to determine the effective life of the mining rights using principles and practices already used in the mining industry. In fact, we said consistently that we as tax practitioners wanted nothing to do with the effective life determination, nor did we want some separate process to be undertaken to determine it. Rather, what we wanted was to be able to go to our technical personnel—say, our mining engineers or geologists—and say to them, 'Give us your report on the life of the mine.' They would have that already prepared and use it for a range of other purposes. We then use that life of mine for tax depreciation purposes. In determining the life of the mine, these mining specialists rely on their experience and training, as well as industry standards and practices, such as the JORC code, to determine the matters that are critical in assessing the life of the mine. They are the personnel in our organisations that are best placed to make the life of the mine assessments. These amendments in schedule 1 now ensure that we can use the existing data produced by these specialists to assess the effective life of the mining rights for tax depreciation purposes.

CHAIR—Thank you very much. Are there any questions for Treasury or the Minerals Council?

Senator BERNARDI—My question is to the Minerals Council. Mr Portas, you might be able to answer it. I understand that there was a significant consultation period entered into between you and Treasury. Are your stakeholders unanimous in their support for this legislation? Are there any concerns about it?

Mr Portas—There are no concerns that I am aware of. All members of the Minerals Council tax committee, which is headed up by the heads of tax of most of the main mining companies in the country, have all had some involvement in this. My understanding is that everyone is comfortable with it.

Senator BERNARDI—It is quite common practice for listed mining companies in particular to reassess their mine life and to extend it. What are the implications if a life of mine is established at the purchase of a tenement or a mine and then later on it is extended? Are there any implications or issues that you think we should consider in relation to those circumstances?

Mr Portas—There are none that we are concerned about. These amendments bring mining rights in line with all other depreciating assets. The general rule for all assets is that you can make a choice at any point in time to reassess the effective life if there are changed circumstances. That is a choice; it is not a requirement to be done every year or even periodically. It is a choice that taxpayers can make. We in the mining industry now also have that choice to reassess if there are changed circumstances.

Senator HURLEY—You say it is a choice if there is a reassessment of the life of the mine. Should there perhaps not be a requirement if there is a significant reassessment to report that to the ATO?

Mr Portas—That is going to a question of policy. We as the Minerals Council asked for as much consistency as is practically possible with other depreciating assets. That is the whole aim of the uniform capital allowances provision: to treat different depreciating assets consistently but recognise that some have different qualities. Our point of view was that it was appropriate that our mining rights be treated consistently with other depreciating assets.

Senator WEBBER—You mentioned that the schedule does not apply to oil and gas. Because I am from Western Australia I am particularly interested in oil and gas—

CHAIR—But you were born in Melbourne—

Senator WEBBER—I was born in Melbourne, absolutely. Does that mean that the concerns of the oil and gas industries are addressed in other legislation, or can we anticipate that, once we pass this legislation, they are going to have a requirement for legislation that addresses their sector?

Mr Rynne—To clarify my comment on that, this legislation does encompass prospecting—which includes oil and gas—quarrying and mining rights. The point I was trying to make is that there is sometimes a perception that MCA looks after companies who have interests across all those three areas, and we do not. We specifically just look after the endeavours of those who have the mining rights. APPEA, the Australian Petroleum Production and Exploration Association Ltd, have been involved. They did not put in a submission, and I understand that they are comfortable with the proposed schedule and explanatory memorandum. They have had input into it.

Senator WEBBER—You mentioned in your opening remarks that there was initially a draft ruling from the ATO and you had some concerns about it. Does this legislation pick up all of your concerns?

Mr Rynne—Yes, it does.

CHAIR—Mr Flavel or Ms Franks, would you like to make any comments on the evidence from the Minerals Council?

Mr Flavel—I have one additional point in response to Senator Webber's question. My understanding is that there was also consultation with the quarrying industry—the name of the peak body escapes me—and that they had not raised any objections to, or concerns about, the proposed bill either.

CHAIR—It seems that everyone is in agreement with this. Are there any further questions?

Senator WEBBER—I have one question for Treasury. It has been mentioned that prior to 1 July 2001 there was no depreciation. Did that apply to a specific part of the sector or right across it?

Mr Flavel—The point is that, as a result of the review of business taxation, a new regime was introduced to provide a uniform capital allowance—in other words, a uniform arrangement for depreciating assets. Mining rights previously did not have depreciable treatment but that was altered as a result of those broader business tax reforms that were introduced from 1 July 2001.

CHAIR—Thank you to the Minerals Council and to Mr Flavel and Ms Franks for coming in on the teleconference.

Proceedings suspended from 10.21 am to 10.47 am

FLAVEL, Mr Matthew, Manager, Industry Tax Policy Unit, Treasury

HAWKINS, Mr Adam, Analyst, Industry Tax Policy Unit, Treasury

MASON, Ms Sandra, Partner, PricewaterhouseCoopers

WAUGH, Mr Garry, National Research and Development, Lead Partner, PricewaterhouseCoopers

Evidence from Mr Flavel and Mr Hawkins was taken via teleconference—

CHAIR—Welcome. Mr Flavel, could you give us just a brief overview of schedule 3, which is the expenditure on research and development activities? Then I am going to go to Ms Mason who, I assume, will probably be talking about the retrospective issues involved in this or the request for retrospectivity.

Mr Flavel—Before launching into the detail of the schedule itself, I would just provide some very brief context on the R&D tax concessions more generally. The committee may be aware that since 1985 Australia has had an accelerated or enhanced deduction available for basic R&D expenditure. It was previously 150 per cent but was changed to 125 per cent.

In 2001 two new elements were added to the overall framework. The first was the introduction of what is referred to as a premium concession—which is a concession set at 175 per cent of eligible expenditure where a particular firm has increased its expenditure over a three-year average. There was also the introduction of a tax offset, which is basically designed to ensure that small firms that are in a loss-making situation are able to get the benefits of undertaking R&D expenditure. Because they are in a loss-making situation, a tax deduction quite obviously will not have any immediate benefit for them. So the tax offset provides them with a refund or a rebate which basically gives them an up-front credit for the R&D expenditure which they have undertaken. The technical amendments in schedule 3 are basically aimed at improving the usage of the 175 per cent premium concession and the tax offset. They arose through the normal interchange that we have with our colleagues at the Australian Taxation Office.

As one might expect, with the introduction of those two new elements there are always issues. My understanding is that a number of minor technical issues raised as part of our normal dialogue with the Australian Taxation Office were considered by the government. The government considered those and agreed as part of the 2006-07 budget to implement these technical amendments. An overview of the amendments was provided as part of the 2006-07 budget papers. There are 10 technical amendments in the schedule to the bill and they are all aimed at improving the ability of firms to access these concessions. So they provide additional rights to small firms, for instance, in relation to the tax offset. There are also changes to the way that the premium concession is accessed by firms that qualify for that. There are also a couple fairly minor technical amendments—things like removing an incorrect reference in existing legislation. I am aware that the two submissions received by the committee both raise the same issue of retrospectivity. However, if it pleases the committee, I might wait and make comments on that after.

CHAIR—Have you read those submissions?

Mr Flavel—Yes, I have. I am happy to address that issue perhaps after the relevant witnesses have had the opportunity to talk about the issues in their submission.

CHAIR—I think Ms Mason has also been flying around battling the elements as well. I welcome Ms Mason. Feel free to talk about other matters. It seems to be the retrospectivity that is the issue, but if you could give an overview of PWC's position in relation to the schedule generally, which I gather you support, that would be good.

Ms Mason—I am a partner at PricewaterhouseCoopers. I would like to address the committee today in relation to items 19 and 20 of the Tax Laws Amendment (2007 Measures No. 2) Bill 2007. Essentially, item 19 deals with changing the operation of the 175 per cent concession, which is the premium concession that Mr Flavel just covered in his discussion. If we refer to the EM which accompanies the bill, we see that at paragraph 3.6 it says:

> 3.6 The 10 technical amendments in this Schedule seek to ensure that the R&D tax offset and the premium incremental concession reflect the original policy intent. They clarify the law in situations where the intended outcome did not occur.

So what I am addressing here today is where the intended outcome did not occur. It is our opinion that applying the changes to the 175 per cent legislation to income years after the legislation receives royal assent is unfair and that the changes should operate retrospectively from the time the 175 per cent concession began to operate, which was from income years starting after 30 June 2001.

Just to discuss what the existing legislation does, the premium amount is covered in the 2001 explanatory memorandum to the Taxation Laws Amendment (Research and Development) Act 2001. In general terms, the premium amount is equal to the current year's R&D spend minus the average of the prior three years' R&D spend. Once that was enacted, or shortly after the introduction of the new provisions in 2001, it became apparent that these sections had some serious flaws. The first one was that, in the case of the single company which had increased its R&D spend above its three-year average but not above its Y minus one or year minus one spend, it was not clear whether or not that company would be entitled to a premium deduction, so it was unable to pick that up. The second serious flaw was that, in the case of group companies, there are several adverse effects when the largest company as measured by the R&D spend in a company group had increased its R&D spend above its three-year average but not above its Y minus one or year minus one spend.

What we are discussing here today is that the legislation as worded and introduced was not giving effect to the associated policy intent. The amendments contained in the bill at items 19 and 20 in our view are designed to rectify the problems with the legislation. However, we want to discuss with you today the timing of those proposed changes. At the moment, item 20 only allows claimants to pick up the deduction or apply item 19 for the year of income following the year of income in which this act receives royal assent and later years. We are suggesting that this be given retrospectivity. In our view, companies that in prior years have not been able to claim their calculated 175 per cent entitlement should be allowed to receive these deductions.

However, if the application of the proposed changes to the 175 per cent concession applies retrospectively, group companies would have to reassess their position in relation to the

distribution of any additional deductions under the 175 per cent concession. In almost all circumstances, group R&D claimants that claim the 175 per cent concession would have to recalculate their 175 per cent deductions and amend their tax returns to include these revised allocations with the additional deductions. In most circumstances the total group deductions under the 175 per cent concession will remain the same but will be shared differently between the group members. We do not believe it is the intent of the amended 175 per cent legislation to adjust the allocation method between the group companies.

What we are suggesting—and it is in addition to what we have submitted to the committee—is that the amended legislation only applies retrospectively if requested in writing by the 175 per cent claimants in a particular group detailing the additional tax deductions the group would receive under the new legislation's retrospective action. This would be consistent with the intent of the R&D and the 175 per cent legislation by allowing companies a tax incentive for undertaking increased R&D activities but it would obviate the need for all group 175 per cent claimants to reassess their 175 per cent entitlements and adjust their prior tax deductions due to the change in the legislation.

Our proposed solution to ensure that not every 175 per cent claimant has to review their deduction back until their 2001 year is to apply a possible wording for item 20. The wording is this: the amendment made by item 19 is to apply from assessments following the year of income in which this act receives royal assent and later years unless the company makes an election in the income tax return for the year of income following the year of income in which this act receives royal assent. This election allows companies to claim the 175 per cent concession under the amended legislation from the years of income starting after 30 June 2001. I will just make that clear: that is our suggested wording. It should be noted that this election should be able to be changed through amendment to the income tax return.

CHAIR—Sorry to interrupt. Just so the Treasury officials are clear: I assume you are suggesting this because if it were a wider requirement it might negatively impact on some taxpayers. You are providing an option so that, if it were going to have some negative impact for some organisations, that would not occur. But this would be an opt-in as opposed to a broad brush thing.

Ms Mason—That is right. It would address that issue of people having to reallocate the 175 per cent deduction around members in their group. So it would be taking away that compliance burden when it was not required.

CHAIR—Right.

Ms Mason—There is a precedent for the election of retrospective application of new rules. There is a recent history of changes to the law allowing companies to elect or nominate which device to use in calculating tax deductions, and this was done through changes undertaken in December 2005 to the operation of the continuity of ownership test in divisions 165 and 166 of the Income Tax Assessment Act 1997 per the Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005. So, under these pieces of legislation, companies can elect to have the old provisions apply, which may result in reduced tax liability for the taxpayer. So we are referring to some previous law that has been enacted that allows this selected retrospectivity.

CHAIR—Sure. I assume that, in schedule 3, item 19 is the principle and item 20 is the practice, effectively.

Ms Mason—That is right.

CHAIR—And item 19 you support—

Ms Mason—Yes.

CHAIR—It is item 20 where there is the timing issue. Have you been able to ascertain the likely cost to revenue of this measure, if it is adopted? Can I also get you to comment on another submission, which referred to a date of May 2006, which was actually the date of the announcement of the proposed changes.

Ms Mason—Right. We have not costed it out. We do have some clients that are affected, but we have not costed out what the cost to revenue would be. But we point you to the extracts from the explanatory memorandum where the general outline and financial impact are noted. The financial impact is estimated—by Treasury, I presume—to be 'decreased revenue of $2.5 million per year as a result of the premium incremental concession changes' and amendments. So we presume, not having done our calculations, that the impact would be in line with that.

CHAIR—Do you think it might be three-point something million dollars or four-point million dollars or $2.5 million going back to 2001?

Ms Mason—I could not comment because I have not done those calculations.

CHAIR—No; I understand.

Ms Mason—In relation to the alternate submission, our preference would be that it was applied back to 2001, not to 2006. We would like to see it back to its original—

CHAIR—Yes, I understand. Another submission was suggesting a possible compromise, and I presumed by the date that it was the budget announcement.

Ms Mason—The date the announcement of these was made.

CHAIR—Mr Flavel, we will wait until my colleagues have asked some questions and then we will come back to you on those matters. I will now throw to my colleagues. Who wants to start off? Senator Bernardi.

Senator BERNARDI—I do have a couple of questions, Chair. Ms Mason, in your submission you talked about what you have framed as 'serious flaws'.

Ms Mason—Yes.

Senator BERNARDI—And, for a single company which is spending above its three-year average but not above Y minus one, you raised a question about how that should be treated. How has your firm advised its clients to treat those particular circumstances?

Ms Mason—At the moment, they are not able to claim the premium deduction, so they cannot pick it up.

Senator BERNARDI—So from your perspective, it is not ambiguous or anything else?

Ms Mason—No.

Senator BERNARDI—It is pretty clear-cut.

Ms Mason—The law at the moment does not allow you to pick up the deduction.

Senator BERNARDI—Okay. It just was not quite clear from your submission. Similarly, in the case of group companies making the changes and doing a reassessment of their tax returns, are you suggesting that the application stating all of this would be approved immediately by the ATO?

Ms Mason—The general principle is yes. When you undertake and complete an application for the R&D tax concession, you also complete an R&D tax concession schedule which is submitted to the ATO, and on that we would presume you could elect to apply retrospectively in order to pick up deductions from the prior years for which you have not been able to claim—not until items 19 and 20 receive royal assent.

Senator BERNARDI—Which would mean relodging the 2005-06 tax returns?

Ms Mason—Yes, it could do. It would only be, though, if you elected to do so under our revised amendment which we tabled today. So we are removing the compliance burden for those who do not need to elect to do that.

Senator BERNARDI—Okay. It would be then a balance between the costs and benefits for the individual firms concerned?

Ms Mason—That is right, yes. It is about whether they have been in this position where they have not been able to pick up the deductions because they do not have a Y-minus-one average. It is where, for example, the largest company in our group has expanded its R&D spend above its three-year average but not above Y minus one. That is where the challenge comes in.

Senator BERNARDI—We have mentioned the $2.5 million, the figure which has come out of Treasury documents. How many firms in a large group situation do you think would be affected by this? Do you have an opinion on that?

Ms Mason—I do not, to be honest. So, no, I could not comment.

Senator BERNARDI—Thank you.

Senator HURLEY—It may be a misunderstanding on my part, but from my reading of what you were saying it seems to me you expect the group companies to be more affected than single companies—

Ms Mason—Yes.

Senator HURLEY—or is that just a reflection of your client base?

Ms Mason—That is just a reflection of my client base.

Senator HURLEY—Yes. So do you have any feeling for whether single companies would be more or less affected?

Ms Mason—I imagine that they would be affected if they were in the same predicament, yes.

Senator HURLEY—Can you outline for me how many companies, or what percentage of companies, would have that kind of group arrangement and why they would have separate companies doing the R&D?

Ms Mason—I can. It is difficult to outline because each company is structured differently. It becomes apparent, I suppose, from group structures—so, when a company or a group of companies makes some acquisitions or merges with other companies—or if the structure itself is set up so that there are several entities within a group that may well be undertaking R&D. It comes about, generally, in my view, as a result of the corporate structure that is established. I do not think that companies and grouped companies are set up just for the purpose of undertaking the R&D tax concession. It is generally where the R&D is being undertaken and where the projects fall. It sits within those companies and therefore it can be scattered around a group, not held just within one company. It is fairly common that it is across a number of claimants within a group.

Senator HURLEY—If a group is doing significant R&D, I suppose in one sense it makes more sense to have the R&D contained within one company that understands the nature of R&D, rather than—

Ms Mason—It would, but in general circumstances in commercial operations that does not always occur.

Senator HURLEY—Right. Is this premium R&D concession more likely to apply to a group situation than to a single company?

Ms Mason—No. It can be picked up in both scenarios. I have seen it in both.

Senator HURLEY—Okay. Thank you.

Senator WEBBER—I am sure you would have raised these concerns in the consultation process that led to this legislation. Was your organisation the only organisation that raised these concerns with Treasury, and what reason did they give for not adopting the proposal?

Ms Mason—To be honest, I could not comment on who else was involved in the consultation. We utilised contacts that we had within Treasury, ATO, government and opposition. So I cannot comment on what other companies or firms are doing in this circumstance. The program operates as a commercial-in-confidence program. So whilst we do have some consultation with AusIndustry and the ATO, which is very productive, firms do not generally sit together and go together as a joint submission; it is done separately in practice.

Senator WEBBER—Which then makes it hard for us to work out—

Ms Mason—Yes, I understand.

Senator WEBBER—the impact that this will have in terms of numbers.

Ms Mason—That is right.

Senator WEBBER—I take it that Treasury has rejected your proposal.

Ms Mason—No, that is not the case. I am unaware of their position at this point.

Senator WEBBER—Okay. We will ask them.

Ms Mason—Yes. I would be interested to hear what their position is.

CHAIR—Treasury are waiting for us, so we will put that down as a question. When was this issue first raised by PWC or by others?

Ms Mason—I knew of its existence prior to the budget last year, so it was raised prior to that. Once it was announced in the budget, we began talking to our various contacts et cetera.

CHAIR—I ask that only because you said that it was a drafting error—I think you made reference to where the EM was talking about original policy intent—that became evident last year and therefore needed to be addressed.

Ms Mason—It is a small area of the law. In terms of the number of claimants who are picking up the R&D tax concession and the premium amount—remembering that it came in in 2001 and you need a three-year average, so there are probably more claimants coming into the three-year average pool now than there were in 2001—it not a big claimant area. I do not have the numbers in front of me, but Mr Waugh, who has just joined us, may well do.

CHAIR—Welcome, Mr Waugh. Your position is partner, legal and tax services. Is that correct?

Mr Waugh—Yes, I am heading up the R&D tax incentives practice for the whole of PWC in Australia.

CHAIR—I am having some discussions with Ms Mason about when this was brought to the attention of Treasury and if it was an issue following 2001. I am just trying to ascertain why it took until prior to the budget last year for this issue to be raised. Are you able to throw any light on that?

Mr Waugh—I can make a comment that it probably was not recognised in 2001 or 2002 that there was an issue. It did not come about until the amending legislation in 2001-02 that the means by which the 175 per cent premium was brought in for companies created this problem. It took a couple of years for companies to get into the swing of making claims in respect of these new benefits. I am not sure whether Sandy has explained that the companies have 10 months within which to make their claims. Usually you have a year end and you then find that there is almost a 12-month delay before a company makes a claim. In order to get into this premium area, you have to have a three-year registration history. So it is only in your fourth year and subsequent years that this might come to light.

CHAIR—Was expenditure prior to 2001 able to be included in a 2002 or 2003 claim?

Mr Waugh—Yes, it was.

CHAIR—I am just trying to work out why this did not become an issue until last year when clearly, if those claims were made for pre-2002 expenditure, people had been alerted to the situation.

Mr Waugh—It is a fair question. I think that a number of major groups have got into a situation where, in the first couple of years, they found it very difficult to work their way through the complex provisions. I am not sure if there has been some mention of that. I am aware of some major groups within the country that do not access the 175 per cent premium claims because the provisions are too complex. That is an issue in itself. We are not here to talk about that today, but I make that comment. Some of these things have taken some time to come to light.

CHAIR—I can understand for the 2003-04 year and perhaps the 2004-05 year, but it just seems to be very late in 2005-06 that this has actually come to people's attention. Given that, on the evidence given by Ms Mason and on your submission, it is addressing an acknowledged technical drafting error, I cannot quite understand why it took four years for this acknowledged technical drafting error to come to everyone's attention.

Ms Mason—I think, to reiterate what Mr Waugh said, that it is essentially because of the complex nature of the rules that cover the 175 per cent legislation that these errors did not become apparent until that time.

CHAIR—With the greatest respect, your organisation is internationally acknowledged. I am sure you will say that the other submitter is not quite as internationally acknowledged as yours, but again is another large organisation. Perhaps Treasury officials might have some comment on this. I will just ask you another question. Apart from the EM, where is the evidence that it is an acknowledged technical drafting error? Was that somewhere else that I did not see?

Ms Mason—No.

CHAIR—That is commentary.

Ms Mason—That is what we have based that comment on.

CHAIR—Have you got any evidence for that comment other than the EM?

Ms Mason—No.

Mr Waugh—I think there is an additional thing that we could add to that.

CHAIR—It is not a reflection. I am just asking whether there is anything else there.

Mr Waugh—No. I think there is something else that does have some bearing in the context of suggesting that it has been recognised elsewhere. That is that the error exists for both single companies and for groups of companies. I am not sure of the exact timing of this, but the Australian Taxation Office made an administrative decision a couple of years ago—I would not like to be held to the precise timing—when this first came to light. The Australian Taxation Office made an administrative decision to not apply the law as written to single entities or single companies. I guess that is an additional source that the law was not working in the manner that it was intended to work for single companies as opposed to groups of companies.

CHAIR—If there are no other questions for these witnesses, perhaps we can throw back to Treasury. There have been a number of matters raised, Mr Flavel—the retrospective nature and when this was first brought to your attention. Could you comment on that? Senator Webber also had a matter she wanted clarified as well.

Mr Flavel—Thank you. I will just run through a few comments based on that evidence. The first is to note, as has been discussed, the way that the law has operated in relation to this particular issue has been clear. I think Senator Bernardi asked that particular question. The response was that it has been clear. Based on our understanding and reading of the original explanatory memorandum back in 2001, we would say that that was the case. There was a comment made that this was a technical drafting error. I think that you had sought to ascertain

whether in fact that was the case or on the record. We are not aware of that being on the record. I draw the committee's attention to the budget papers last year. Budget paper No. 2, which is the measures document that describes all the government decisions, noted that, in relation to this broader issue of amendments, of which there were 10, this one was categorised as an improvement to the 175 per cent premium R&D deduction. It was not ever categorised as being an oversight or an error but rather an improvement to the way the law operates. On the issue of when we were made aware, my understanding is that—

CHAIR—Sorry to interrupt; how do you explain the wording in the EM which says:

... ensure that the law reflects the original policy intent in relation to the R&D tax offset and the premium incremental concession—

in light of your comments before?

Mr Flavel—I think that is a generic reference to the entire 10 amendments that are contained within the bill rather than each technical amendment being categorised according to whether it was an oversight, an error or an improvement to the law.

CHAIR—It does specifically refer, though, to the premium incremental concession.

Mr Flavel—There are other changes to the premium incremental concession as well.

CHAIR—Okay, fair enough.

Mr Flavel—The other comment I want to make is about when we were made aware. We were advised, I understand, by the tax office of a number of technical issues in the way that the law operated. It goes without saying that that is pretty normal between Treasury and the ATO, not just in relation to this issue but the entire tax law. I am not aware that any stakeholders had raised this issue either directly with us or with the government, but I would obviously need to take that on notice. Perhaps the relevant witnesses might wish to comment as to whether they made any submissions in writing on this issue or as part of pre-budget submissions to the relevant ministers. We are not aware of them having been made directly with Treasury.

CHAIR—The only evidence we have at the moment is that it was prior to the budget last year.

Mr Flavel—As far as I am aware, none of those submissions or representations were made directly to us or to the minister. It is a point we would like to clarify.

CHAIR—I think the evidence was that nothing was done about this until last year prior to the budget, hence my questions about the four-year drag in relation to it. Presumably, someone made some submissions last year which led to these changes, or has this just been done?

Mr Flavel—That is the point I am seeking to clarify. As far as I am aware, these were issues raised directly by the ATO with Treasury as opposed to with individual stakeholders or representative groups.

CHAIR—That is even more interesting. Ms Mason, have you got some comment on that?

Ms Mason—I think clarification on that is needed. I raised earlier in my evidence that there is a consultative committee where this was raised. I cannot recall the exact dates, but

this certainly was raised where the ATO and AusIndustry were present. That was the forum that I was referring to where it has been raised. That is a general forum which we utilise as practitioners in this field to raise issues around the operation of the concession. That is our general practice. I could not tell you the exact date of when that was raised, but it was certainly discussed at the forum.

CHAIR—Mr Flavel, your information is via the ATO I take it?

Mr Flavel—That is right, yes. There are a couple of other minor points before I get onto the substantive issue. There was mention of the costing and the fact that the explanatory memorandum mentions the cost of $2.5 million. That is the forgone revenue going forward from the change in the way the law operates. We have not costed what the impact on revenue would be from allowing a retrospective application of those changes.

CHAIR—I am not too sure how you could do that, given the evidence we have had today.

Mr Flavel—It would be difficult and off the top of my head I am not aware of what sort of population we are talking about.

CHAIR—Mr Waugh, you are nodding your head; do you think it would be difficult to ascertain that?

Mr Waugh—I do think so, yes. If it is going to be useful I can provide some information about the increase in uptake of the 175 per cent premium in recent years. The assumption could be that the cost to the revenue in respect of earlier years is likely to be less than the current year because of the four-year history requirement that I mentioned before, plus the lower uptake in those earlier years.

CHAIR—Sorry, Mr Flavel, continue.

Mr Flavel—I think the submission from KPMG put forward the idea that as a middle ground, for lack of a better term, if an amendment were to be made to the bill that the date of retrospectivity could be 9 May 2006. We are strongly opposed to that particular suggestion. In our view, if there were any change, it would need to go back to the date of implementation of this law. Choosing a date like the date of the budget provides a number of issues, including the fact that it is part way through an income year. It is also something that has only really been used when there has been a decision which the government has wanted to apply specifically from that date so that there is no adverse behaviour. Going back through time and then picking that as a date would not necessarily appear to be that sensible from our perspective.

CHAIR—I think Ms Mason would agree with you on that.

Mr Flavel—We come back to the general issue here about whether we should apply the law retrospectively, and I note the earlier comment that I made that it has not been categorised as a technical error and there appears to be agreement that the law operated as it said it would, albeit with an adverse consequence for some particular types of companies. Generally, we would try and avoid retrospectivity. We have a particular concern about the idea of allowing an opting in or elective basis to apply retrospectively. If it were to be applied retrospectively, we could not see why it would not apply to all circumstances rather than just simply allowing an election when it may be beneficial to particular taxpayers.

I also note that this provision or this area of the law only applies to those companies which are grouped under the grouping rules. Under those rules, a retrospective application would mean that some firms which have benefited from the premium concession previously would have that reallocated to other firms within the group. Of course, being grouped, there is a degree of common ownership. However, there would be circumstances in which firms within a group would have different shareholders, and therefore the retrospective application would mean that there would be some firms which would potentially have a reallocation to another firm within the group. That could obviously impact on shareholders or owners of those particular firms.

CHAIR—Is that the end of that, Mr Flavel?

Mr Flavel—Yes, I am happy to take any questions.

Senator WEBBER—My initial question is somewhat redundant now but it leads to another one. I wanted to know the reasons why you rejected the approach but you say that you did not know about it. That raises another question: we have witnesses here today who have told us that there is a consultative committee and that they have raised these concerns with ATO and AusIndustry. You say that you are unaware of them. How confident can I be that this legislation reflects the needs of industry and that there has been adequate consultation?

Mr Flavel—We were made aware through those various consultation committees of issues that have been raised by particular stakeholders. Not all of those issues will necessarily be referred to Treasury because a lot of them are simply administrative in nature rather than policy. In this case it has led—through whatever mechanism—to ATO advice to the Treasury about the possibility of putting in place some technical amendments, and those were made. That differs from the approach that we perhaps saw on the previous schedule, in which there was an ATO ruling and quite direct comments were made to both the ATO and the government about potential flaws or deficiencies with that aspect of the law.

Senator WEBBER—That does not really answer my question. We have witnesses here who have said that they have specifically raised these concerns about the consultation, and you are saying that they were not passed on—that you did not know about it.

Mr Flavel—In particular, I am not aware of the date of application having been raised.

Senator WEBBER—How can I be confident that all the other concerns that have gone through this consultation process have been raised? These are informed witnesses that managed to discover that the Senate Economics Committee is inquiring into the bill, so they are obviously significant players in the field.

CHAIR—Senator Webber, the fact that we are discussing these changes, which are supported by both witnesses, and they are the only witnesses to this, would indicate that clearly it is welcomed. It is an issue of when—

Mr Flavel—The application date.

CHAIR—Yes.

Mr Flavel—Again, you may want to check with the witnesses present, but I am not aware of anybody having said that they do not support the amendments which are being made.

Senator WEBBER—They want further amendments.

CHAIR—No.

Senator WEBBER—It is a technical—

CHAIR—I suppose in item 20 they do want some changes.

Ms Mason—That is correct.

Senator BERNARDI—It has operated in the last five years reasonably effectively, even though some people may have been disadvantaged. The proposed amendments will not apply over those five years. Is that a fair comment?

Mr Waugh—Perhaps I could make a comment. I think that when we are dealing with these sorts of issues we sometimes have a wish list compared to what might be realistic. One of the things that comes from listening to some of the comments being made is that in the end the government could see fit to make some changes and to bring the current law up to the level that it was intended in the first instance—and I understand the comments on improvement and drafting error; I understand the points being made. The way it has occurred now is that we have actually finished with a non-level playing field between taxpayers. I am not sure that point has been made this morning. The tax office has recognised that by allowing this administrative practice for single entities, as has been pointed out by Treasury quite correctly, it only applies to groups of companies. If a group had consolidated for tax purposes, then there would not be an issue for companies in those groups. Companies in groups that are not consolidated are then disadvantaged by this particular change. There are some circumstances where it is not simply a reallocation of the premium between parties within a group. There are real dollars being left on the table because of the operation of the provisions in the sense that you could create an example or two that show that the total amount of the premium is not being allocated to all the members of the group. So there is some disadvantage for some companies and I am sure that was not the intention.

Senator BERNARDI—Just one question with regard to what you just said about companies that choose to consolidate as single entities for tax purposes. For people to choose to consolidate or remain as group entities, there must be pros and cons attached to the tax treatment depending on which choice they make. Am I right?

Mr Waugh—Yes, that is correct.

Senator BERNARDI—That being the case, it is reasonable to assume that people would choose that which is most advantageous to them on a holistic basis.

Mr Waugh—Yes.

Senator BERNARDI—So you can say there is an unfair treatment of entities which is not then consistent with what has been happening over the last five years.

Mr Waugh—That is correct and I think that is a very good point. There are some situations though where groups of companies are not allowed to consolidate because they fail being 100 per cent owned. You could have entities where they are required to group for R&D purposes but are not allowed to consolidate. There is a mixed bag here in relation to this and I think that one of the points Ms Mason and I would like to make in relation to this is that we would

always try—and I am sure that the tax office always tries—to have a level playing field in relation to the application of tax levels and, accepting the pros and cons of choosing to do different things, I think that there is an estoppel here in respect of some entities being able to get the benefits of what was intended at the beginning.

Senator WEBBER—Mr Flavel, I have got just one last question for you. Whom did Treasury consult with in drawing up this legislation? Did you just take the advice from Tax—

Mr Flavel—Yes.

Senator WEBBER—So this is purely an ATO view of the way the world should be?

Mr Flavel—I do not know that I would categorise it as an ATO view but they were technical amendments and categorised at such. They were not things on which we then initiated a new consultation process with industry. Also bear in mind that we were aware that given they were all improvements it was going to be highly unlikely that these were going to be contentious, other than the issue that we are now discussing about the date. The thrust of these, as far as I know, is warmly welcomed by the industry.

Senator WEBBER—Did the draft legislation go out for comment?

Mr Flavel—No, that is the point I am making.

Senator WEBBER—I want to make sure that we have that loud and clear.

CHAIR—Is there anything else that you want to raise?

Mr Flavel—I have just one minor point for the committee's benefit. A bit has been made of the difference between a single entity and a grouped entity. Under the way the law operates there are of course benefits under the grouping provisions. In some circumstances where, for instance, there was a large company and a small company grouped together, while the small company may benefit from the R&D undertaken by the large firm, if they were separate firms they may not always be able to be eligible for the 175 per cent concession.

CHAIR—Mr Waugh, just to finish off, when you talked about disadvantage before, I take it that you are talking about disadvantage that might flow from not been able to access this from 2001 if your retrospectivity argument is accepted as opposed to any other disadvantage. I just want to clarify that.

Mr Waugh—That is correct, yes.

CHAIR—It was put in a wider context and I am just wanting to clarify that point. Thank you very much, Ms Mason and Mr Waugh. I cannot apologise for the weather obviously but I do thank you most sincerely for taking time to come to this hearing.

Proceedings suspended from 11.39 am to 11.51 am

JACKSON, Mr Craig, Partner, Ernst & Young

MILLER, Mr Nicholas, Policy Adviser, Treasury

PINDER, Mr Gregory, Senior Adviser, Treasury

Evidence was taken via teleconference—

CHAIR—Welcome. Mr Jackson, have you previously given evidence to a committee hearing?

Mr Jackson—No, I have not.

CHAIR—I better just briefly go through some matters. These are public proceedings. The committee may agree to a request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses in giving evidence to the committee that they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If you object to answering a question you should state the ground upon which your objection is taken and the committee will determine whether it insists on an answer having regard to the ground which is claimed. If we do insist on an answer, you may request the answer be given in camera. Such request may be made at any other stage. Could you give us an overview of your client's concerns in relation to schedule 2, which is the taxation of boating activities. In particular, you have requested that there be some retrospectivity to this. Could you advise the committee of Ernst & Young's views on this?

Mr Jackson—We have had an involvement, through both Mr Glenn Williams and I, for a little while, talking with various industry bodies and individuals in relation to the Arthur Bowden matter and the tax office's approach to it. We have had involvement with industry for—

CHAIR—Mr Jackson, if you have people with you, with whom you can seek clarification, feel free to refer any questions to them as well, to come back through you. We do not want to make it difficult if there are others in the office who are also giving you some advice. Feel free to refer back to others who are in the room with you, if you feel you need to.

Mr Jackson—Thank you. As I was explaining, we have had involvement with the industry for a little while. The submission was not made in respect of any particular client but as a result of activity we are seeing from the tax office across a range of clients and as a result of that history we have had with the industry. We have two general comments in relation to it. First, we feel that schedule 2 is heading in the right direction in that it is recognising there should be some equity between assessibility and deductibility in relation to boating activities where people have boats which are used to derive income. The second element of the submission is that we believe that equity should be applied not only prospectively but also retrospectively. The origin of the legislation goes back to sections in the 1936 act and, unfortunately, I cannot recall those directly, but they were rewritten to form the 26-50 provisions in the 1997 act. For many years it is our understanding that the original legislation was primarily focused on a type of FBT concern before FBT existed. Then in the early part of

this decade, the tax office came back with respect to a number of people who had been operating in the industry on an understanding that what they were doing was carrying on a business and were entitled to a deduction. The charter managers had been operating on that basis as well and had effectively been providing fleets by organising individuals to own boats and run businesses or operations which were then managed through the charter managers, who collected a series of these boats which they would make available to the ultimate end users.

The tax office took offence to some of these activities and issued a draft ruling in 2002 which was then reflected in a ruling which came out in 2003, which was TR 2003/4. That ruling effectively imposed a number of standards on the industry, from a tax office administrative point of view, which required people who owned the boats to establish that they were carrying on a business. It was a fairly arduous standard that the tax office were seeking for small business operators. They required them to show business plans, marketing strategies and documentation of arrangements with managers and those sorts of things. People at the time made a choice to either leave the industry or to modify their operations to fall within those guidelines, which the vast majority of people did. What then followed was that the tax office commenced audit activities some time later. In a lot of those audit activities, while people may have formed a view that their operations constituted a business and they had put together what they believed was a business plan or operation, the tax office would then come in and review those and say, 'We disagree with your commercial assumptions. We don't accept these as valid assumptions and therefore we are recasting your model.' Often they will recast the model in a way which substantially reduces the expected profit from the business or which puts the business into a loss on the tax office model. Then the tax office forms the view that, because you are now no longer expecting, on their recast numbers, to have a profit, you cannot be carrying on a business.

That may be in some instances because people have had unduly optimistic views of the success of their business, but that is not in any way restricted to charter boat operations. In some instances people have in fact not performed according to their business model, but there were various commercial reasons why that may have occurred. A lot of people suffered with the airline collapses in the early part of the decade and when the tax office looked back, it saw that through 2001-02 they perhaps were not meeting their budgeted target and things like that. The end result of all of this is that we had seen a range of circumstances where, while people thought they were carrying on a business, the tax office was forming a view that they were not. You can run through an objection process to dispute that with the tax office, but, if that is unsuccessful, the costs to then take the matter to court are often uneconomic for somebody running a business such as this because the profit level is in a single boat and not particularly large.

There has been one matter, which was taken to court and came through last year, which we referred to in our submission. That was the VCK decision. One of the comments in that case, as we highlighted in the submission, was that the court found it odd that we had this anomaly where if you are found not to be carrying on a business, you have a situation where you are still held assessable on all the amounts you received but all of the deductions associated with that operation or that derivation of income are denied to you. So you can have a situation

where you might have derived $50,000 or $100,000 worth of charter fees, and you may have had, say, $50,000, $100,000 or $150,000 in deductions. You may have broken even, made a slight profit or a slight loss, but suddenly, if you are denied all of those deductions, you are left with the situation where you face a tax bill on say $50,000 or $100,000 in addition to the fact that in that particular year you may have made a small loss or you may have been marginal in your level of profit.

The amendments proposed to the legislation appear designed to take away that inequity in that, as currently drafted on a go forward basis, they will allow you a deduction up to the amount of income you derive if you are not carrying on a business. If in fact you are still carrying on a business, you continue to be able to claim a deduction for all of your expenses, but if factually it is found that you are not carrying on a business, you will be allowed a deduction up to the level of expenditure. Beyond that, any expenses will then be carried forward and enabled to be offset in future years if you have additional income in those latter years. For that, we commend the legislation.

We feel however that there are a group of taxpayers who fall into the category of people who believe they were carrying on a business but the tax office has taken an alternative view. It would be appropriate to allow them the same concession—that is, being allowed on a go forward basis, if they choose not to fight the question of whether they are carrying on a business and allowing them at least a deduction up to the amount of income that is derived in those years. That is a little bit of history and a summary of our submission.

CHAIR—Thank you, I appreciate that detailed response. Basically, those who are not operating on a commercial basis according to the ATO, can now offset any income or claim losses up to the level of their income and their income will not be assessed as was previously happening; is that right?

Mr Jackson—The deductions will offset the income. So, while they will be assessable, they will get the deduction and the net effect on their tax return would be a nil or neutral result.

CHAIR—Exactly, whereas before the income was fully assessable without any offset.

Mr Jackson—Yes.

Senator HURLEY—I understand your point, and the legislation fixes up the problem, but people who have not been able to claim the deduction for their expenses where they feel they have been carrying on a business, do you think large numbers of those people would take advantage of it if it were changed? The retrospective nature of the—

Mr Jackson—I think those that have been adversely affected would. I do not think there are large numbers. My understanding—I am not quite sure where I have got this number from but it is one that runs around in my head—is that there are about 300 taxpayers in this industry. Certainly many of those would believe that they are carrying on a business, but our experience is that we have seen probably half-a-dozen clients in the last 12 months that have had disputes with the tax office and those discussions are in various different stages with the tax office at the moment. They would generally be ones where we felt that, from a commercial perspective, the individual thought they were carrying on a business. Albeit, as I said, in some instances they may have been more optimistic with their expectations of what

they would get out of the business than have proved with hindsight to be the case, but certainly I believe from what was said to me that they intended to run the operation as a business. Of those, we had one where we were, on behalf of the taxpayer, successful in persuading the tax office to change their view. There is another one where the matter is continuing with dispute beyond the objection stage and there are a series of ones where effectively I think the tax office is sitting on their hands a little bit waiting to work out what they are going to do in relation to the VCK case and also where this legislation goes. In answer to your question, I would not think in terms of the retrospectivity that there would be thousands but, depending on how many other taxpayers have had a dispute with the tax office, there may be 50 or 100 would be a guess, but purely a guess.

Senator HURLEY—In those cases where the ATO has not recognised it as a business, presumably it is quite a small business though if the ATO has rejected it and we are not talking about large sums of money.

Mr Jackson—The sort of numbers we see coming through are normally $50,000 to $100,000 a year in rental income or in hiring fees. It is not a very small business, but to a small person tax on that sort of number is $25,000 or $50,000 effectively which can be significant amounts of money. We have had one client where they have effectively been, I think, almost compelled to sell the boat in order to pay the tax involved.

Senator HURLEY—Thank you. That is all from me.

Senator BERNARDI—I just have one question and it is a question of opinion. Why should the people who invest in a boat and derive some income from it, albeit the ATO determines it not to be a business, be treated any differently from someone who decides to invest in a house, derive some income from it even though it does not cover their costs, and they get to offset that completely against their other income? Do you have an opinion on that?

Mr Jackson—I would support a position which allowed a deduction for the whole amount. However, that was not where the legislation was going. The position is that the tax office and Treasury historically had concerns, I suspect—and this may be something better for Treasury to talk to—that people were seeking to argue they were carrying on a business in order to finance a personal craft. Often these types of arrangements will allow the owner a limited use of the boat. Generally when it is not actually out on hire or use by paying customers, and I think Treasury therefore had concerns that if they opened it up to allow a full deduction in all the circumstances, that they may see people seeking to argue that their personal craft were in some way entitled to a tax deduction for the running costs. These provisions still require you to evidence that you are carrying on a business to get the same results. So if you can show that you are carrying on a business, you get the same result as negative gearing on a rental property or share portfolio. If there is a dispute as to whether what you are doing is carrying on a business, and you have to recognise that a landlord with a negatively geared property would also not satisfy the requirements generally to be carrying on a business so that the standard is still being set at a higher level, these rules are—I have lost my train of thought.

Senator BERNARDI—It may be a question for Treasury. It is not directly related to this. I understand the reasoning here, but there are circumstances where you could say, 'Shouldn't this type of approach to non-business enterprises—the tax deductibility—be limited to their

own income and losses carried forward for subsequent years to offset against that income as opposed to being able to deduct it against other sources of income as well? It is a broader question for Treasury and I think maybe Treasury might like to take it on notice or give us a comment on it.

Mr Jackson—Certainly, historically that approach was taken for a short time in the late 80s in relation to rental properties. At that time it caused all sorts of disruptions to both the supply of rental accommodation and then the real estate markets and values more generally. There was a significant drop in the value of properties when those rules were introduced. When they were withdrawn, because the government at the time I think saw problems with the vanishing rental market supply, there was then a spike as people sought to move back into the industry.

Senator BERNARDI—I will stand corrected but I was not sure whether the situation you were referring to was actually the abolition entirely of negative gearing versus this slight nuance in the treatment. Anyway, it is a matter for another time. Thank you very much.

Senator WEBBER—I note that you are largely supportive of the legislation but that you want some changes about retrospectivity. I take it you have put them to Treasury and they have said no.

Mr Jackson—We have not. I have to admit the bill passed through during a period when we were focused on other client matters and it was only when I became aware of the Senate hearings into it that we sought to make representation. I am not sure what Treasury's view is in relation to this.

Senator WEBBER—We look forward to hearing it. Thank you.

CHAIR—Thank you very much, Mr Jackson. Sorry about the difficulties getting in and we thank you and your company for taking the time to speak to us.

Mr Jackson—That is all right. Thank you very much.

CHAIR—Who have we got?

Mr Pinder—Greg Pinder and Nick Miller.

CHAIR—I am sorry, Greg. These have not been satisfactory arrangements and I apologise for that. Mr Pinder, we have basically heard from Ernst & Young. I speak on behalf of my colleagues, who will clarify this if it is wrong: given that Ernst & Young support schedule 2, the retrospective question is the only thing outstanding. What is Treasury's view on the retrospective request raised in the Ernst & Young submission?

Mr Pinder—I would say it is a matter for government. When you want the measure to start is really a policy decision. There are some issues that you would want to take into account. Essentially, this existing law has applied for over 30 years—from 1974—so there would be a question of how far back you want to go. You want to take into account the administration costs and compliance costs involved in amending assessments back that far. Some people may have entered into settlements with the tax office and there would be a question about whether you would want to undo settlements that have been entered into.

CHAIR—I understand.

Mr Pinder—Obviously there would also be a revenue cost. We have not quantified that, but I would expect it would probably be in the order of $4 million to $5 million a year for each year that you went back.

CHAIR—Have you had any submissions in relation to this retrospective matter?

Mr Pinder—No, none of the submissions we got when we consulted made any suggestion about retrospectivity and the only suggestion I have seen was the one in the Ernst & Young submission made to the committee.

CHAIR—How widely did you consult in relation to this?

Mr Pinder—The draft legislation was made available for public consultation. We provided specific copies to a number of more interested parties—several charter boat operators and association representing boat owners—but I think in the end we only had about three submissions; we had one from the tax institute, one from one of the charter boat operators and I think we had another one from KPMG.

CHAIR—When was that?

Mr Miller—It was end of January.

Mr Pinder—The end of January into February this year.

CHAIR—The only retrospectivity that you have seen is from Ernst & Young. Have they spoken to you or is this just what you have read from their submission to the inquiry?

Mr Pinder—This is what we have read from the submission to the Senate committee.

CHAIR—So there has been no direct discussion with yourself?

Mr Pinder—No.

CHAIR—I do not think Senator Bernardi has any questions. Senator Hurley?

Senator HURLEY—No.

CHAIR—Senator Webber?

Senator WEBBER—No.

CHAIR—Thank you, Mr Pinder. Again, I apologise for taking up your valuable time. I thank you and Mr Miller as well. Are Mr Bode and others in the general vicinity or are they elsewhere?

Mr Pinder—I think they are elsewhere.

CHAIR—Thank you very much. We can now leave you.

Committee adjourned at 12.25 pm