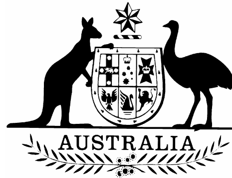

COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Tax Laws Amendment (2008 Measures No. 5) Bill 2008

TUESDAY, 28 OCTOBER 2008

CANBERRA

BY AUTHORITY OF THE SENATE

INTERNET

Hansard transcripts of public hearings are made available on the internet when authorised by the committee.

The internet address is:

http://www.aph.gov.au/hansard

To search the parliamentary database, go to:
http://parlinfoweb.aph.gov.au

SENATE STANDING COMMITTEE ON

ECONOMICS

Tuesday, 28 October 2008

Members: Senator Hurley (*Chair*), Senator Eggleston (*Deputy Chair*), Senators Bushby, Cameron, Furner, Joyce, Pratt and Xenophon

Participating members: Senators Abetz, Adams, Arbib, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Ellison, Farrell, Feeney, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, Marshall, Mason, McEwen, McGauran, McLucas, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Stephens, Sterle, Troeth, Trood, Williams and Wortley

Senators in attendance: Senators Bushby, Cameron, Eggleston, Hurley and Pratt

Terms of reference for the inquiry:

To inquire into and report on: Tax Laws Amendment (2008 Measures No. 5) Bill 2008

WITNESSES

CROOKE, Mr Matthew, Manager, Domestic Demand Unit, Department of the Treasury 16

HAMILTON, Mr Bruce, Spokesman, Indirect Tax, Urban Development Institute of Australia.............. 4

HARMS, Mr Michael, Manager, GST, Property and Government Unit, Department of the Treasury 16

KNIGHT, Mr Stephen William, Chief Executive, New South Wales Treasury Corporation.................. 13

LEGGETT, Mr Christopher Murray, Senior Adviser, Philanthropy and Exemptions Unit, Personal and Retirement Income Division, Department of the Treasury.. 16

LILLEY, Ms Louise, Policy Analyst, Department of the Treasury... 16

LINDSAY, Mr Richard James, Chief Executive Officer, Urban Development Institute of Australia 4

LYNCH, Dr David, Head of Policy and Markets, Australian Financial Markets Association 11

MIHNO, Mr Andrew, National Policy Manager, Property Council of Australia.. 2

POTTS, Mr William, Manager, International Tax Unit, Department of the Treasury 16

Subcommittee met at 6.32 pm

CHAIR (Senator Hurley)—I declare open this public hearing of the inquiry of the Senate Standing Committee on Economics into the Tax Laws Amendment (2008 Measures No. 5) Bill 2008. On 25 September 2008, the Senate referred the inquiry into the Tax Laws Amendment (2008 Measures No. 5) Bill 2008 to the Senate Standing Committee on Economics, and the committee was asked to report to the Senate by 13 October 2008. On 13 October, the Senate granted an extension to the committee, permitting it to report by 10 November 2008. The bill has five schedules. Schedule 1 amends the GST tax base to overcome deficiencies dealing with real property. Schedule 2 modifies the thin capitalisation regime to adjust for certain impacts of the 2005 adoption of Australian equivalents to international financial reporting standards. Schedule 3 extends the eligibility for exemption from interest withholding tax to bonds issued in Australia by state and territory central borrowing authorities. Schedule 4 removes an anomaly in the fringe benefits tax law as it applies to benefits for investment properties held jointly by an employee and their associates. Schedule 5 amends the eligible investment business rules for managed investment trusts.

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 the witnesses that, in giving evidence to the 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 a witness objects to answering a question, that 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 which 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 also be made at any other time.

[6.34 pm]

MIHNO, Mr Andrew, National Policy Manager, Property Council of Australia

CHAIR—I welcome the Property Council of Australia. We can continue the proceedings—I realise that you have a time line—but, contrary to what I just read out, we are not covered by parliamentary privilege if the committee is not quorate, which we are not. If you are prepared to go ahead on that informal basis, we can have the hearing. Be aware of that if, when you give your answers, you wish to be protected by parliamentary privilege. Are you prepared to—

Mr Mihno—That should be fine.

CHAIR—Do you have an opening statement, Mr Mihno.

Mr Mihno—I do indeed.

CHAIR—Please proceed.

Mr Mihno—I want to thank you all for the opportunity to come here and present to the hearing. I am the National Policy Manager for the Property Council of Australia. I want to talk to you today about two of the schedules in the Tax Laws Amendment (2008 Measures No. 5) Bill 2008. They are schedule 1, relating to margin schemes and GST, and schedule 5, relating to managed funds, which I will refer to as containing the interim division 6C amendments. I would like to start with the interim division 6C amendments.

The Property Council welcome the introduction of these interim measures. We congratulate the government for undertaking the reforms, which will help transform Australia into a global funds management hub. Overall the new safe harbour framework will provide clearer boundaries regarding the types of income that a trust can earn. This will provide some certainty to industry going forward. The measures will help modernise Australia's REIT rules. However, there is more work to be done. By far most of the heavy lifting on rent reform will be done under the board of tax managed investment trusts review, and industry is looking to this review to provide the comprehensive reforms needed to drive the property industry forward into the future.

In relation to the GST margin scheme amendments, however, the industry is concerned that the proposed margin scheme amendments will burden the sector with higher costs at a time of economic uncertainty. While the Property Council are very pleased that government has responded to industry, to minimise some of the worst technical impacts of the measures, we have consistently stated that the measures will hurt industry and the economy. We respect government's decision to move forward with these measures. However, currently, given the unexpected severity of the market downturn in recent weeks and government's response regarding housing initiatives, we consider that the commencement of the measures should at least be delayed. The measures introduce more piecemeal legislation, which obviously increases the complexity of the margin scheme. More importantly, this increases flow-on costs from the GST in relation to property right at the time when the market is heading into a further downturn.

The going concern and farmland provisions are available and used for legitimate commercial purposes. The businesses that are developing property will face significant increases in the cost of developing that property. Straight away this increase in the cost of development means that there will be a reduced supply of viable future residential developments. Essentially, what we are saying is it will cost more to develop property, which will mean that fewer houses will be built.

Housing affordability has to be eroded in this circumstance and in the medium term what this really means is that costs will be passed on to the consumer, which will further erode housing affordability. Increased costs for new housing will actually affect the price of all houses in the market. This will work against the government's initiative to boost the first home owners grant. The Treasury estimate at the moment is that it will raise $523 million over the next four years. The measure directly and specifically affects new houses. On Treasury's own 2008 estimates, these measures will impact about $3.7 billion worth of new housing. To put it in other terms, that is 12 per cent of all new houses that were brought to the market in 2008.

This impact, if we look at Treasury's own examples, could be as high as $25,000 in additional GST for a new $500,000 home. This is a significant impact. It will affect the government's first home owner initiatives. What we are basically saying is very simple: the best way to maximise the effectiveness of the first home owners scheme is to delay the measure until the economic climate stabilises. We think that commencement of the measures should be delayed to allow time for the market and industry to recover. This can be simply achieved in one instance by introducing the bill with a commencement date set well into the future.

CHAIR—Thank you, Mr Mihno. You quoted a possible $25,000 increase on a $500,000 house. Taking the nature of the scheme, it clearly depends very much on how long the property has been held and the arrangements under which it is sold and so on. But that seems like a high figure.

Mr Mihno—That is a very high figure, but it comes from the example in Treasury's own documents. A new home owner grant of $21,000 would be completely eroded in the case of a house which is worth $500,000 and has this margin scheme provision applied to it. For a $250,000 house, there is still $12,500 worth of GST—using the same example in Treasury's notes.

CHAIR—The amount that will be raised is said to be $523 million over four years—a little over $100 million a year. How common are these projects that they will have that sort of effect on the price of a house?

Mr Mihno—The reality is that everybody is providing their own back-of-envelope estimates of exactly how many are going to be affected. But, if you take Treasury's figures alone, quite a significant number of housing developments are going to be affected by this.

CHAIR—Do you accept the view that this justifiably closes a loophole in the existing legislation?

Mr Mihno—We have actually worked with government in relation to this. We took the view that if they wanted to provide this particular measure then they had to understand what the impact was going to be. As for it being a loophole, it is actually an interaction of the margin scheme with the provisions of 'going concern' and 'farmland'. It is essentially used for legitimate commercial purposes, so, in that sense, it is not a loophole per se; it is simply the way the world works.

CHAIR—Do you wish to add anything further?

Mr Mihno—I have nothing further to add, but if there is something you want at a later date, please let me know.

CHAIR—Thank you very much for coming in.

[6.42 pm]

HAMILTON, Mr Bruce, Spokesman, Indirect Tax, Urban Development Institute of Australia

LINDSAY, Mr Richard James, Chief Executive Officer, Urban Development Institute of Australia

CHAIR—Welcome. Would you like to make an opening statement?

Mr Lindsay—Yes, we would. I am here with Bruce Hamilton, from Ernst & Young, who is UDIA's spokesman on indirect tax matters. I will be talking to you on the broader policy issues. Mr Hamilton is our GST specialist, so he will be answering those questions for you. UDIA welcomes the opportunity to present evidence to the committee's inquiry. We are the peak body representing the property development industry throughout Australia. Our interest is in schedule 1 of the bill: 'GST and the sale of real property'—the integrity measure. UDIA participated in the consultative process for the drafting of this legislation for this measure, and we are appreciative to Treasury for that opportunity. However, we are concerned that a number of the issues that were raised during that process have not been addressed in this legislation. For reasons we have already outlined in our submission and during the consultation process, UDIA believes that the proposed amendments are neither necessary nor required, That said, we acknowledge that, during the consultation process, Treasury accepted UDIA's recommendation that, if this measure is to be implemented in its current form, it should be prospective from the date of royal assent only.

Further, we wish to make the following points. The development industry does not shirk from meeting its share of GST compliance and, in general, considers that the current process has been working well, apart from some abuses by a limited sector of the industry that have already been dealt with. UDIA is cognisant that the GST act provided for the margin scheme's operation to address the potential, under the normal rules, for taxing value added to real property while held by a person who is neither registered for GST purposes nor required to be so. It is UDIA's view that the introduction of this measure will have undesirable impacts that are likely to exceed the intended purpose.

At a time when the need for additional housing around the country is significant and the part that the housing development industry can play in reducing the impact of the growing global economic crisis on the Australian economy has already been recognised by the government by way of changes to the first home buyer subsidies, the proposed legislative change will have significant impact on the future costs of housing developments. It is, in effect, an increased tax on new housing developments which will be passed on to homebuyers through increased prices—and by this we note that on Treasury's estimates the revenues that will be raised by this measure are more than what the government will be spending on its Housing Affordability Fund.

As the Treasury has no doubt found in its attempts to model the impact of the proposed measures, it is difficult to estimate the percentage of development projects that will be impacted by this change; however, one of our developers has estimated that the cost impact of the measure, where it will apply, will be in the order of an additional $11,000 per lot on a 60-lot infill development and around an additional $4,800 per lot on a 717-lot mixed townhouse and land development. In the event that the parliament decides to implement some form of these measures, UDIA seeks to ensure that the form that they will take is such that they are fair to all parties and will address only the issues that the government perceives to exist, without having unintended consequences.

Mr Hamilton—Moving on to some of the technical issues and also a policy issue, UDIA would also like to note that the increase in the first home buyers subsidy will largely, if not entirely, be offset by the impact that has already been stated with respect to the projected tax increase as a result of these provisions. Specific issues that UDIA has raised in its submission include concern with the anti-avoidance provision amendments that have been suggested. In particular the UDIA is concerned that the changes to the anti-avoidance provisions are intended to have overall application, not merely to the property development industry and not merely to GST and real property. This provision has far-reaching effect. The UDIA is concerned that, by inserting this amendment into the bill, many participants in the economy far outside of the property development industry are at risk of being caught by concerns with this provision without having any real knowledge of it and without having had it pointed out to them that this provision is potentially going into the legislation.

It has been introduced under the GST and real property amendments when in fact it has far-reaching and considerably wider effect. In this respect, what UDIA would like to note as well is that, given the apparent concerns of the Treasury in respect of the perceived loophole—or however one wants to deal with it—in our

view what could have been done with the amendments would have been either to have the provisions that they have introduced for insertion in division 75, or to have the provisions that have been introduced in respect of division 165. There is no need for both of those provisions at all because they are both addressing the same perceived loophole. Certainly, as far as UDIA is concerned, if a concern with this perceived loophole is apparent to Treasury, then an anti-avoidance provision in the nature of what has been introduced as an amendment to division 165 should have been introduced as a specific anti-avoidance provision to division 75, which is a margin scheme division, so that it only had issues with division 75 and does not have the far-reaching effects that are clearly apparent now. Having said that, our concern is always that, as inevitably happens, taxpayers are going to be addressing situations in the tax regime where they are not aware of those provisions.

This idea of creating a 'circumstance or state of affairs' is one which directly attacks the ability of taxpayers to make an election under the GST legislation without fear or concern that what they have done might be perceived to be creating a state of affairs or a circumstance under which the tax office would then be at liberty to attack them for. So that is a real concern from our perspective.

The other main concern that the UDIA has with the draft legislation was, unfortunately, not taken up during the consultation process. The provisions, as they currently stand, do not allow for a situation where property that has been moved into and then subsequently out of the GST regime is subsequently re-introduced to the GST regime. We provided an example of this in our submission and it is one which I have come across on numerous occasions: that people register for GST at the outset under the mistaken—and justifiable—belief that they are required to do so. They subsequently go through the full process of deregistration, which includes making a judgement in respect of any input tax credits that they have claimed. Some years later they are caught by this regime. Effectively, under the draft legislation as it stands now, the developer is required to account for GST based on the 1 July 2000 valuation of that land, not on the time at which the legislation really becomes applicable to that land, because the person has become required to register at that point in time. That effectively means that, as they get further and further away from 1 July 2000, that person is then in a situation where the margin should be from the date where the property goes back into the legislative regime by virtue of the person being required to register. That value will be further and further away from the value of 1 July 2000, and that essentially means that there is going to be an issue of double taxation, which the margin scheme was specifically designed to avoid. It was specifically designed to ensure that there was no taxation on the value in real property that was in place before the property entered the regime by virtue of the person owning it becoming required to register. Under this very unfair circumstance. that value will be taxed again.

The final issue that we would like to raise with the committee at this point of time is simply what I would term a 'nice to have'. In a recent tax case, the Brady King decision, uncertainty was created in relation to certain aspects of the legislation. Most of those aspects were subsequently dealt with by the courts under the appeal situation, but one area that has been left slightly hanging out there to dry is the definition of a 'date of acquisition' of real property. The reason I raise this is that, under the normal circumstance where I sell something to you, the definition of a date of acquisition will be the date on which you acquire it. Under a real property scenario I can sign an agreement with you to sell the property, but the date at which you acquire that property can be some significant time later. And when I say significant, it can be years later. When we are dealing with the date of acquisition there is now uncertainty as to whether that is the date on which you sign the contract for the acquisition of the property, or whether it is the date on which you actually take settlement of that property. It would be great if, given the fact that legislation and amendments are being introduced, that was sorted out once and for all. It would be easy enough to do and it would make the position of members of the UDIA a lot easier to handle and it would certainly be a good outcome.

CHAIR—Both of you referred to the quite marked effects of this change—I think you called it a 'far-reaching' effect, Mr Hamilton. But let us just go through this illustration where you have the tax department, and then talk about how often this might occur.

It says a GST-registered entity holds land on 1 July valued at $110,000. That person then sells land under the margin scheme to a GST-registered property developer for $165,000. That developer then goes on to put residential premises on the land and sells to another party as a GST-free going concern for $440,000. Under the measure, it is not a GST-free going concern and the relevant GST under the first scenario is $5,000, collected between holding the land at $110,000 and selling it at $165,000. There is no GST collected between the sale price of $165,000 and the going concern of $440,000. Under the new scenario, that will change and the GST collected will be $30,000. That is land being sold, not houses being sold. You are saying that the cost

of the measure could be $11,000 per lot or $4,800 per lot. From that kind of example, it does not seem to me that that is going to result in that kind of difference being felt for each individual lot on a development.

Mr Hamilton—As far as I am aware, the example that Richard quoted in his opening address was specifically provided to us by a developer who was able to look at a specific project that they had on hand.

CHAIR—Do you have details of that project?

Mr Hamilton—Not with us.

Mr Lindsay—I do not have it with me, but I can talk to your secretariat about providing that information.

CHAIR—That would be very helpful. I appreciate that you said it was very difficult to say what percentage of development would have that kind of GST difference in the margin scheme, but can you give us any indication of how often that kind of margin scheme would be invoked in any development?

Mr Hamilton—From the client base that I have dealt with on a regular basis, it certainly is dealt with reasonably often. You will probably find that it is mainly bigger developers that will do it, but it is certainly not restricted to bigger developers at all. It is mainly bigger developers that will use that facility for the simple reason that they will pick up a farm or a large tract of farmland, but often developers will pick up a tract of farmland, split it up into what they call a super lot or a series of super lots and then pass on some of those super lots to smaller developers. It spreads right through the, as it were, food chain of developers; it is not only the bigger developers that do it.

CHAIR—How many of this kind of scheme would we see each year?

Mr Hamilton—I probably see four or five of them in a year, but then I do not necessarily see every one that a client of mine might deal with. I would only see it if they have other issues that they particularly want to deal with.

CHAIR—Is it only farmland that we would be dealing with? Are they any—

Mr Hamilton—No. As I said, there might also be situations where a developer will pick up what they call a super lot, which is carved out of another development. There they would typically acquire it as a going concern, because the development is in process already. The main developer might be in a situation where they are cash constrained and need cash for something else so, rather than going through the process of developing the whole project on their own, they will sell off a couple of the super lots to other developers and leave them to deal with that.

CHAIR—You wouldn’t see this as a case where someone might artificially create that situation so that they do not have to pay GST?

Mr Hamilton—I have not seen that in latter years. Quite honestly, I think the developers that I deal with had situations back pre 2005 whereby they were sold advice by certain advisers and those were dealt with very adequately by the tax office issuing taxpayer alerts and identifying what they perceived as inequities in the way that tax was being dealt with. Certainly the developers that I deal with took that on board very quickly and got out of anything where they thought there was a risk that they were going to be affected by that and they have made sure that they do not get involved in anything like that. That is why to an extent in my opening address I suggested that I almost felt that the draft legislation in front of us is overkill.

We have got a provision, in the amendments as to division 165, and a provision—in the proposed changes to division 165, which is on antiavoidance provisions—which are both addressing the same thing. They are not addressing anything else. Quite honestly, if one accepted that there was a loophole which needed to be closed, I think that, by taking the proposed amendments as to division 75 and simply including those as an antiavoidance provision in division 75, you would have dealt with everything. You would then not have impacted on anyone else who might quite legitimately be looking to make an election that is allowable under the GST act or making a choice which is completely allowable and acceptable under the GST act. Rather, they are now going to be in a situation where they have serious concerns, they have to seek advice and they incur additional costs through compliance costs in order to make sure that they are not inadvertently going to be caught by someone suggesting to them that they are creating a particular circumstance or a state of affairs. If the concern is as to division 75, then we do not need the amendments that are suggested for division 75; we simply need an antiavoidance provision which is applicable to division 75. I think that would sort out all the problems.

CHAIR—I refer to the example you have given about superlots. Do you have an example where the situation has originated in something else other than farm land? Is it only where farm land is subdivided and you get this margin scheme or is it also for any other kind of large tract of land?

Mr Hamilton—Well, other large tracts of land which might have had zoning changes, where previously they had been regarded as a greenbelt area or something of that nature, and they are now available for use. Looking particularly at where I come from, Brisbane, I note there is a lot of area along the riverfront which has previously been harbour front wharf sites and those sorts of areas which could not be developed for a variety of technical reasons because the land was affected by chemicals. There were all sorts of reasons. That has now been brought within the tax regime.

CHAIR—So why would anyone think that they could sell that land without that GST component in it? Why would they not factor that in in any case under the circumstances?

Mr Hamilton—If it is being sold as GST free, that is simply the same as any other business, as part of business, selling an asset of the business. That is accepted and there are specific provisions in the GST act for that. The only difference that we are dealing with here is this: the business happens to revolve around real property, rather than revolving around a franchise store or something else; there is no other particular difference. That is why it seems unusual to try to close the door on people using the going concern provision. As the gentleman from the Property Council of Australia mentioned, essentially it is not a loophole; it is simply an interaction of different provisions in the legislation. If that is perceived as a loophole, fine; we will accept that for the purposes of the argument. But, as I say, if the issue is really to deal with misuse of the provisions of the act, then the use of an antiavoidance provision would sort that out without something as dramatic in effect as this division 165 proposed amendment, which is going to catch all sorts of people who have no nefarious intentions whatsoever.

Senator CAMERON—The taxation department do not seem to be as sanguine as you are about the tax issue here. They are saying that this is an area that could grow substantially as people identify this as a loophole and then build on it. Is it not proper for the tax department to close that loophole?

Mr Hamilton—If it is a loophole, then use an antiavoidance provision. That would then allow a situation where it is not someone dealing with a loophole—and where it is a legitimate business activity—and that person can continue to conduct a legitimate business activity.

Senator CAMERON—The taxation department also said that these amendments were drafted in consultation with industry to avoid unintended consequences. As I read the legislation, this is an amended situation from the original legislation. So what was the problem with those consultations and why does Treasury think that the consultations have dealt with the issues?

Mr Hamilton—I was involved in the consultations on behalf of the UDIA. To be fair on Treasury, I thought the consultations generally were great. I think we achieved quite a lot in those consultations and got a number of the rough edges off. As a process, it was good. In terms of some of the issues that we have raised today, I am not quite sure why Treasury chose not to make legislative changes. I certainly raised in both of the submissions that I made the concern I have with the movement of property into and out of the GST regime, as it were. I also discussed it in the consultation process. I am not quite sure why that was not taken up. We were certainly not given any reasons for it not being taken up. To my mind that is anything but a loophole scenario. That is a situation where there is a genuine double taxation situation, which I do not believe is the intention of the margin scheme legislation as it stands currently or should be the intention of closing any loophole.

Senator CAMERON—Treasury also raised the option of reduced margins for developers, as distinct from the costs being forwarded on to the consumer. The submissions that both you and the previous submitter have made just say that everything goes on to the consumer. Where is the price elasticity? When can you not put it on so you have to take a cut in your margins?

Mr Hamilton—Let us be quite honest. Most of the bigger developers are companies—some of them are public companies and some of them are not—and they have shareholders. Their responsibility—and certainly their directors' responsibility—is to ensure that the particular company is run profitably. What I think is not necessarily well understood outside of the property industry is that from go to whoa, in terms of obtaining land and then finally selling off the various lots, can take five, six or 10 years or even more.

So there are significant holding costs that will be incurred by any property developer along the way. Furthermore, increasing interest rates—granted they have suddenly come down recently, but for the last three or four years they have certainly been increasing—have been eating away at profit margins anyway. To answer

your question, though, I think what you have is a competitive situation where different developers are acting in competition. They are finding that they are price constrained in terms of their own costs of input; so there is inelasticity in that respect. But generally what will happen is a developer, in looking at a development, will look at it, in the first instance, to see whether it is feasible. If they face a situation where they decide it is not feasible because of an additional burden being thrust upon them, then they will tend to try and market their property differently, or they will not do it at all.

Senator CAMERON—Or they could take a cut in their margin?

Mr Hamilton—They may not have much of a margin. We need to remember, also, that they are taking what might be a five-year risk. As we have all seen, a risk that was acceptable eight or 10 months ago would be entirely unacceptable now.

Senator CAMERON—But five years for some of these big corporations is not an overly long time in which to get profits back to shareholders. The Business Council of Australia has raised the problem of short termism, and if it is all about short termism and short term returns then you may be right. But if these companies have to have a longer horizon for their profitability then that is a culture that could start coming into the industry.

Mr Hamilton—Fair enough. The question is: what is an acceptable profit margin there?

Senator CAMERON—That is right.

Mr Hamilton—I cannot give you an answer on that. It is something well beyond my scope.

Senator CAMERON—I am just saying that Treasury have indicated they think there is room for the margins to come down. I have not heard of any property developers who have been crying poor for the last few years, so there must be some margin there. There must be some capability for them to adopt some of these costs of fair treatment on tax.

Mr Hamilton—With all due respect, I beg to differ with you there. I think we can point to a number of specific entities and a variety of other property developers who, if they are not already going to the wall, are not far off it. That is because they have no profit in what they have been doing because of the changes in circumstances over the last 10 months, or slightly longer. So they are very aware of it. They are dealing with risks which they cannot predict five years out. So they have to preserve a relatively conservative view on what profit margin is the minimum required to make a project feasible.

Mr Lindsay—If I could just jump in there, I think it is worth pointing out that the Commonwealth Treasury is not the only Treasury around Australia which thinks that additional taxation on the industry will be something that can simply be soaked up by the developers' margins. If you look at what has happened in the various states in terms of the levies and property taxes which have been gradually increasing over the last 15 to 20 years, in the same way that is something which the industry has been expected to take up and soak into its margins.

Senator BUSHBY—This has been a very interesting conversation. I am interested in exploring this aspect a little bit further. You have referred to the impact of this change on house prices, in particular, of new developments. What is the potential impact, do you think? Obviously you are saying that it will be an upward pressure?

Mr Hamilton—Yes, absolutely.

Senator BUSHBY—We have just had a discussion about margins and that in every property developer's back pocket there is not a sufficiently fat margin to be able to absorb these costs and continue. We are in a climate, as you noted, of uncertainty in the financial area. What impact do you think that is going to have on the demand for new housing?

Mr Hamilton—I think—and Mr Lindsay would probably have a comment here as well—we have already seen a significant downturn, and I think that the government is to be congratulated for having made changes to the new homebuyers scheme. That has the potential to assist a lot of property developers who have product which they can bring to the market. I am assuming, although I have no actual justification for this, that the new homebuyers scheme in its current form will quite possibly extend beyond June next year, depending on how the economy is moving at that time. It would be a terrible waste if whatever benefit is given to the industry by the changes to the new homebuyers scheme did not flow into the economy the way the government is intending it should but were to simply flow back to the government by way of a change in the taxation.

Senator BUSHBY—Is it your understanding that part of the rationale for the government in introducing these increased measures for first home owners is to counter the effects of the international financial crisis?

Mr Hamilton—Given that it was part of the Prime Minister's address dealing with the measures that the government was taking to address the economic circumstances pertaining around the world, and likely to impact on us, I would have thought so, yes.

Senator BUSHBY—So, presumably, you could read into that that the government is expecting there to be an impact on demand, given what is going on internationally, in the absence of such measures?

Mr Hamilton—Absolutely, yes, and I think we can already see the start of that.

Senator BUSHBY—And, as you say, you have seen that personally. In the normal course of events, what effect would such a fall in demand have on property developers' decisions as to whether to proceed on new projects?

Mr Hamilton—My understanding from discussions I have had with clients in the industry is that they are not, with very few exceptions, buying properties at the moment. They are not, therefore, setting in train a scenario where they are going to be able to develop new estates in the years to come. They are sitting on the sidelines at the moment because they are concerned on a variety of levels. Another impact is that where they have got property, they will slow down development because they do not perceive there being the ability for them to produce property at affordable prices for individuals. What also might well happen is that to an extent they will refocus where they are providing properties. They may perceive that providing properties to the higher end of the market—rather than affordable housing, which is where there is a serious shortage—will allow them to maintain margins and will allow them to have a readier market which can access finance to purchase properties. That is likely to be where they will focus, rather than on affordable housing where there is a great need.

Senator BUSHBY—It is interesting that you say there is a shortage of housing stock in the more affordable end of the market. In the normal course of events, as we have seen in the last few years, that would lead to quite a high level of demand. How is it that that level of demand is dropping off at the moment? We just discussed the financial crisis. Is that the main reason why people might not go looking for houses even though there is a shortage of housing stock? I am just trying to work out in my mind how this will actually play out?

Mr Hamilton—From my own personal circumstance, I am finding that children are staying at home a lot longer, really because they cannot afford rental properties and they cannot afford to purchase housing. I think at the moment investors are right out of the market because they have taken a hit—

Senator BUSHBY—Which has an impact on rental markets.

Mr Hamilton—Absolutely. They are not buying cheap houses to rent out. At the moment they are not buying any houses to rent out, from what I can see. There is a double impact on the economy. If no-one is in the market to buy houses, whether they are investors or first time home buyers, the developers either are going to go to the wall or are going to slow down what they are producing in order to meet what the market level requirement is rather than what the real need is.

Senator BUSHBY—So what you are saying is the scenario that we are facing is that, despite what is in fact a shortage of housing for what a notional demand would be, people who might be buying houses are looking at other arrangements, like staying at home with their parents, in the short term while they are working out where things go with the international financial crisis, which means that demand has dropped off, despite the fact that there is a shortage of housing stock. As I understand it, your submission says that this legislation is imposing an additional cost on some developers who have bought in a way that is affected and that this will actually lead to a lower incentive for them to do further developments.

Mr Hamilton—Correct.

Senator BUSHBY—But you said earlier that that may be different depending on who they are targeting and on their financial resources.

Mr Hamilton—What I was saying is that, if they have an additional tax imposed upon them, they may alter their way as to where they are focusing their attention, rather than going for affordable housing. To use an example that the gentleman from the PCA gave, an extra $25,000 on a $500,000 house is a significant amount. If you double that on a million dollar house or even if you halve that, developers will try to alter where they focus in order to get the best effect from the situation.

Senator BUSHBY—That is understandable.

Senator CAMERON—Treasury say that this is about creating a level playing field in the industry, as some developers are already paying the GST on land, and that significant tax minimisation will be created if the loophole is not closed. Can you comment on the level playing field and on the minimisation?

Mr Hamilton—I am not quite sure how that conclusion is arrived at. No-one can lock up land permanently. If it becomes available for sale, then whoever is interested in purchasing that land can offer the best price. So there is no one developer benefiting to the exclusion of any other developer. They both have the same opportunity to purchase that land.

Senator CAMERON—That is an opportunity to purchase land at a reduced cost because the GST is not there.

Mr Hamilton—But if that land is put to the market, it is not put to the market in one way for one developer and in a different way for another developer. They are both going to be—

Senator CAMERON—No, but the land should be put to market on a level playing field basis in respect of anyone else who is selling land. That is the argument, isn't it?

Mr Hamilton—I understand what you are getting at. Land will always have different reasons why it goes at different prices. I suppose the reason why I do not see it as a loophole is that it is a buy-and-sell situation and anyone is in the same position to buy that land in the same way, or they can choose to buy other land.

Senator CAMERON—I understand your argument. I do not accept that argument for one minute. I do not think that is a legitimate argument in relation to this. However, Treasury also say that this will only affect a small proportion of the industry. How come they have got it so wrong?

Mr Hamilton—With all due respect, if they say it is only affecting a small proportion of the industry, why is it such a problem?

Senator CAMERON—In the context of what the industry is worth, that is not a lot of money.

CHAIR—Our time has concluded, so I think we can argue this out among ourselves. Thank you for attending this evening, Gentlemen.

[7.25 pm]

LYNCH, Dr David, Head of Policy and Markets, Australian Financial Markets Association

CHAIR—Welcome. Would you like to make an opening statement?

Dr Lynch—Yes.

CHAIR—Please proceed.

Dr Lynch—Firstly, I want to thank you for the opportunity to appear before the committee and to provide some brief opening comments as well. I am Head of Policy and Markets with the Australian Financial Markets Association, AFMA. AFMA represents the interests of participants in the wholesale banking and financial markets. Our members welcome the government's decision to eliminate interest withholding tax on non-resident investors in state government bonds issued in Australia, as is proposed in schedule 3 of the bill under consideration. They believe this will promote the further development of our domestic bond market. Non-resident interest withholding tax is levied on state government bonds issued in Australia but an exemption is available for similar issues that take place in offshore markets. The effect of this is to fragment the market into domestic and offshore segments.

By way of background, while there has been a steady increase in government bond issuance in recent years, the majority of the issuance has taken place in the offshore segment rather than in the domestic segment, not to lose sight of the fact that there has been growth in both. The measures in schedule 3 of the bill will enable unification of the domestic and offshore segments into a single market. This will happen over time. It will add liquidity and depth to the domestic market. The associated benefits include a larger and more diverse market for investors, greater product innovation and a more effective state government bond yield curve. In essence, it will also strengthen Australia's presence in the global bond market indices and enhance our standing as an international financial centre. Apart from all this, state governments will have significant infrastructure investment programs, which will enhance the productive capacity of the states' and national economies. It is important, from the broader community perspective, that these programs be financed as to the most efficient and least costly options available. We think schedule 3 will assist in this regard.

In summary, we believe the reform is well timed to improve the efficiency of the fundraising process for the states and to also assist state market development and facilitate innovation in the offerings that are available to investors.

CHAIR—Dr Lynch, I think that the financial markets probably need all the help they can get. So you see this as a way of extending the range of investments that can be made?

Dr Lynch—Yes. In essence, at the moment the market, as I have mentioned, is fragmented into two segments. If you can bring the two together and unify them, that will actually bring liquidity benefits, which will lower the cost of borrowing in the market.

CHAIR—Why liquidity benefits?

Dr Lynch—If, for example, I am an investor and I hold a position which I wish to trade, the cost impact of my trading in a thin market, where it is more difficult to find a counterparty who wishes to trade with me, will be higher.

CHAIR—I see.

Dr Lynch—Over recent times the differential between state government bond debt and Commonwealth government bond debt has increased, so state bond debt has become relatively more costly to issue. One of the reasons why people suggest this has happened is that liquidity in the Commonwealth government bond market is greater. If you can help develop liquidity in the domestic state government bond market, I think you will see benefits flow through from that. As I see it, that will benefit the state. But from our perspective more generally in the context of financial markets developing, that will actually enable the states to begin to innovate and to develop new bond products. For example, index linked bonds will become more prominent as a feature if the states have the ability to finance infrastructure investment through the issuance of bonds that have that mechanism attached to them. So I think the potential is not limited to the issue of liquidity and the benefits that flow from that. There is also the range of instruments that might be developed and offered over time.

CHAIR—In the light of the fact that both state and federal governments have talked about improving infrastructure development around the country, do you see other ways, generally speaking, of making different kinds of instruments that might benefit from this?

Dr Lynch—I think the question of infrastructure finance is an aspect of what we have explored here. From our perspective we have primarily looked at the financial market benefits; in other words, the relative efficiency of the system which delivers benefits in terms of borrowing costs and so on. In more generally looking at infrastructure investments there are a range of options that can be explored. The potential for a wider range of debt instruments will perhaps enable the states—for example, in dealing with local authorities—to offer then a better range of instruments which more closely match their particular needs in terms of developments they might have in place.

CHAIR—Thank you, Dr Lynch.

[7.25 pm]

KNIGHT, Mr Stephen William, Chief Executive, New South Wales Treasury Corporation

CHAIR—Welcome. Do you wish to make an opening statement?

Mr Knight—Yes, thank you. I am the Chief Executive of the New South Wales Treasury Corporation. We are the central financing authority that issues the state government bonds on behalf of New South Wales. I will keep my opening comments very brief because, in essence, our submission is really very much in sync with the previous submission you heard. In fact, we worked very closely with AFMA in terms of much of the initial background work so, in submitting this paper, we are really just providing some more of the detail behind some of the information in the arguments.

The only other point I would make is that some of the background and information in our paper feels somewhat dated now, given that financial markets are moving forward at an amazing rate of knots. We put this information together about a year ago, but the key arguments still remain very relevant. In a sense, given the challenges of the current global financial crisis, I think it makes this initiative even more important in terms of its improvement of market efficiency and improved liquidity of markets at a time when markets are challenged.

CHAIR—I take it that other states would agree with New South Wales?

Mr Knight—Yes, the central borrowing authorities of each state worked cooperatively on this project. We collaborated and combined information and worked in conjunction with AFMA as well. So I do not think I would be misrepresenting any of them by saying that these views, and the initiative, are backed by all of the issuers.

CHAIR—Just getting back to the point I made earlier with AFMA, as we have heard in both submissions, the semigovernment bond market has been growing. Would you expect that to continue and to involve infrastructure provision?

Mr Knight—Certainly, based on the policies of the various state governments in terms of looking to increase their expenditure on infrastructure, essentially the role that we, the central borrowing authorities, do is very much one of responding to those needs. So it seems to be a fairly common theme around the states. They are looking at their infrastructure needs. They are then setting policies that have a portion of that infrastructure investment funded by increased debt. And that is where we come in. It is our job then to implement that increased debt requirement and to fund it in the most efficient way, and we interface with the financial markets to do so.

CHAIR—I suppose it is a bit early to say, but given the current crisis in financial markets you would think that semigovernment bonds would be fairly attractive. Would you see continued growth in that area, particularly with the assistance of this measure?

Mr Knight—We are hopeful of it. It is clear that Commonwealth bonds, and also semigovernment bonds given that all the states are very well rated, have traditionally been seen as good flight-to-quality investments. The waters are a little bit murky at the moment because the investors globally are trying to interpret what the bank guarantee initiatives of the various governments around the world will look like. That is adding a layer of complexity to the markets at the moment. In speaking with the investors—people such as the offshore superannuation funds; central banks; and other large, traditional investors in semigovernment paper—it is clear that they are very keen to see this initiative passed. There has been quite a degree of interest in this particular initiative because they see it as very favourable for the development of the marketplace.

CHAIR—In general terms for the information of the committee, are you looking at any other areas to assist in the type of instruments that state governments are developing or looking at?

Mr Knight—I think the major source of financing for the state governments will continue to be what are called the benchmark bond lines, and that seems to be what the marketplace wants. That is very consistent with the federal government's strategy of maintaining its core benchmark lines and it is a strategy that is embedded right around the world, whether it is US Treasuries or UK gilts or other core markets. But what we have also been looking at—and we made reference to it in our submission—is expanding into, for example, index-linked, CPI-based issuance. That has been a very recent development and, again, that is a market where we have had some interest from amongst domestic investors but we have also had strong interest from offshore investors who are currently not investing because of the withholding tax imposition. Just as you

talked about level playing fields in other areas, this is an area where the existence of this tax seems to be a bit of an anomaly when you look at how it is applied elsewhere.

CHAIR—So, generally speaking, if this measure goes through you are happy with the tax treatment of state government bonds?

Mr Knight—Yes. The critical point is—and we are working with the Commonwealth on this—the fact that it can be clearly demonstrated that there is no real loss of revenue for the Commonwealth.

Senator CAMERON—Mr Knight, in your submission you talk about implications for public-private partnerships. Could you expand on that for me?

Mr Knight—Yes, the main point there was really just to identify the level playing field argument. It was not meant to be a commentary on whether governments should be raising money through on-balance sheet or PPP type arrangements. That example was simply used to identify that, with deals that could be done as public-private partnerships, the bonds that were created off those deals—and we used one example—can then be sold to investors free of withholding tax. On the alternative basis, if a deal were to be funded using that particular state's Treasury corporation to issue, then it would be at a margin disadvantaged. There are other factors that determine the relativity of interest rates of those two bonds that are created out of those alternative financing arrangements, but the point was really one about a levelling of the playing field in terms of the investor base.

Senator CAMERON—You also talk about 'coupon washing'. Can you explain that to me?

Mr Knight—That is a practice which has developed in the markets over the years as a way of getting around the inefficiencies of the markets relating to withholding tax. As a coupon is coming up, investors might sell the investment in a particular security if it is going to be subject to certain taxation treatment. They will then buy that security back in two or three weeks time. But it creates needless transactions and is a very inefficient way of operating.

Senator CAMERON—Is that tax minimisation?

Mr Knight—Yes, in the hands of the offshore investors; that is right.

Senator CAMERON—Minimisation or avoidance?

Mr Knight—It is not really for us to comment. We do not get involved in the practice, but obviously it is something we observe offshore investors engaging in from time to time.

Senator BUSHBY—I note that in your submission you say:

- Australia would benefit materially,—

from this change—

because it would lower the cost of financing the infrastructure projects that are being planned.

How substantial is the lowering of that cost? Are we talking about something at the margin or something that would be quite worthwhile?

Mr Knight—It is part art and part science, I would have to say. In terms of the cost or the benefit to the semigovernments from being able to consolidate their programs and benefiting from that global liquidity, it could be around 10 to 15 basis points. There are so many other things going on in the marketplace at the moment that it is very difficult to be too precise.

Senator BUSHBY—If that were to materialise, that would be quite worth having.

Mr Knight—Very much so. I think that, as David Lynch mentioned in the previous presentation, there are various factors that drive the margin that state governments issue over the Commonwealth and relative to other markets. As to the best we could gauge, when the announcement was made back in May, when the government announced this initiative, there was a noticeable contraction in semigovernment spreads. The market immediately reacted and said this was a good thing for liquidity. We were able to observe a good 10-basis-point contraction on that.

Senator BUSHBY—You also say:

Removing IWT from semigovernment bonds has the potential to lower borrowing costs for all bond issuers, including the Commonwealth.

Mr Knight—It is more of a judgement call rather than any scientific thing. Remember that this paper was produced back before the Commonwealth announced the initiative of increasing its issuance by $5 billion a

year. There were very strong concerns in the marketplace at the time that unless Commonwealth bond issuance grew then that market might well become dysfunctional and therefore you would end up with a higher structural cost of finance. I think one of the conclusions that the review of the Commonwealth government securities market came to back in 2002-2003 was the need to maintain liquidity and the need to maintain outstandings as a way of providing the best cost of financing possible. Based on feedback we had from the marketplace, investors saw that the more that this initiative worked the more that would then help the liquidity of the semigovernment market, which would increase the attractiveness of Australia—of both the Commonwealth and the semigovernment markets—for offshore issuers. So it is about being more on their radar screen. We saw that that could then attract investment across all sectors, not just the semigovernment sector.

Senator BUSHBY—Thank you.

CHAIR—Thank you, Mr Knight, for coming in to us this evening.

[7.48 pm]

CROOKE, Mr Matthew, Manager, Domestic Demand Unit, Department of the Treasury

HARMS, Mr Michael, Manager, GST, Property and Government Unit, Department of the Treasury

LEGGETT, Mr Christopher Murray, Senior Adviser, Philanthropy and Exemptions Unit, Personal and Retirement Income Division, Department of the Treasury

LILLEY, Ms Louise, Policy Analyst, Department of the Treasury

POTTS, Mr William, Manager, International Tax Unit, Department of the Treasury

CHAIR—Welcome. Would you like to make an opening statement?

Mr Harms—No. Could I just say that Ms Lilley and I are here to answer any questions on measure No. 1 and my colleague Mr Crooke is also here to assist on that.

Mr Potts—If the committee has any questions on the withholding tax issue I will be happy to answer them.

CHAIR—I would like to start with the GST. In passing, again, we heard mention—and I could be misrepresenting these people—that it would add $25,000 to the cost of a $500,000 house. My understanding of the illustration of the change in the scheme is that it refers to that kind of money, the $25,000 difference, being on the cost of the whole development, not on each individual lot within that development. Can you go over that example.

Mr Harms—I guess the first thing is to say that it is just an example. It is simply meant to illustrate what can happen. What we are talking about here is a typical high-rise or flat land development that converts one sale of a going concern or farmland into multiple sales of properties at the other end. So in reality those costs would, in fact, be apportioned against the individual residential property sales at the end of the day. Whilst our example does show that there would be $25,000, it is just for illustration purposes. It is not in any way trying to infer what the original property costs were and what the proportion of the property costs would be in the final transaction. It is just for illustration purposes.

Senator BUSHBY—Is that $25,000 for the project or per unit, in that example?

Mr Harms—In this example it would mean that the value of the land attributable to the particular residential house started off being $110,000. That might be $110,000 out of the $20 million sale of flat land, for the purposes of our example. On the figures here that we have here, yes, it would be $25,000 per house. This can be compared to the evidence in the UDIA where they claim that in one development it would be $10,000 and in another development it would be $4½ thousand or thereabouts

CHAIR—It is pretty hard to get a handle on it, then. I think it was the Property Council who said that if it is $25,000 then that wipes out the new first home owners' grant. It more than wipes it out. What kind of figure would you be looking at? I know it depends very much on the development, but that is a scary kind of figure.

Mr Harms—It all depends on how much of the value-add that has been in that development has escaped the tax net through the use of the going concern provision. If I could put this in context, the way in which the GST system works is that it is a multistage tax. In every transaction, one-eleventh of the price is remitted in GST. So if a business is buying something and they have incurred tax on their purchase, they are entitled to claim an input tax credit. It is this tax and credit system that ends up producing a result where each business is effectively taxed on the value-add that they add to that transaction.

What we have in the case of the property transactions that we are looking to address is a mechanism that allows properties to be sold either as a going concern or as farmland without that value-add being taxed. The reason that we have that is primarily to assist farmers in being able to sell properties without having to raise the GST-inclusive cost of the property in order to buy it, only at a later stage to claim an input tax credit for the tax that had to be remitted on the sale of that property. It is the same thing with going concerns, so that when you buy a business you do not have to pay the tax and claim a credit later. In effect, it recognises that what is going on is a tax and credit situation that is going to even out with no effect to the tax system—so there are these GST-free going concern provisions.

However, when you apply that to the sale of property where the last sale in a chain is a taxable supply to a consumer, if each stage in the distribution cycle has not been properly taxed, it means that the final transaction does not bear the tax that is intended to be borne. So the $25,000 you mention in our example is the value-add

that has been applied to that transaction and that has escaped the net because of the interaction between the two sets of provisions.

This was never intended to happen. What is intended under the GST system is that the value added to property from 1 July 2000 be taxed, so there is a provision. That is why the margin scheme is there. It allows people two methods of calculating the taxable margin for GST. One method is to just pay tax on the difference between their acquisition costs and their sale price, so they are being taxed on only that margin. That is the consideration method. The other method involves them taking a valuation of the property at 1 July 2000 and only paying GST on the difference between the value as of 1 July 2000 and the sale price. The problem is when you put the going concern provisions into that mix. There is a whole of value add that is taken out of the tax equation altogether—which is unintended.

CHAIR—Given the estimate of $523 million over four years at the current level of development, it still seems to me that you are not estimating that there is going to be a huge increase as to each individual lot sold.

Mr Harms—I could not begin to tell you what the increase per lot would be. Our estimate is based on assuming that the value of property that is in scope here is in the region of $3.7 billion and that, of that total value, something of the order of about $150 billion is escaping the GST net when it should not be. So that is how we have arrived at our estimate of how much is involved and how much value is not being taxed properly. We certainly have not tried to determine how many individual home buyer lots that might involve. But I would say that it is only a small proportion of the new home market that currently uses this and an even smaller proportion of the overall housing market.

CHAIR—But you could not even give a guess as to what proportion that is?

Mr Harms—No.

CHAIR—Okay. I understand what you are saying about going concerns and so on. I think it was the UDIA who asked why this land should be treated any differently from any other business asset or any other going concern. Could you respond to that?

Mr Harms—Yes. I do not know what they were getting at. The provision as to where farmland is GST free is where it is sold with the intention of carrying out a farming business. He seemed to be describing a situation where somebody sold farmland GST free to a developer who broke it up into superlots and then sold each of those superlots as a going concern. That seemed to be the scenario. On the first sale you would say that it did not seem, on the facts that were presented, to meet the test of being GST free because it did not seem to have the intent of being sold for purposes of carrying out a farming business. As for the second example, the sale of the superlot seems to be based on somehow a superlot of property being a going concern. That could conceivably be the case if someone had got all the development approvals and taken it down a path where it was a viable business and so on. The UDIA witness said the value of either of those transactions should not be taxed. I am not sure why he was saying that was a right and proper outcome when the policy outcome is in fact to tax the value add of all property from 1 July 2000.

Senator BUSHBY—I would like to come back to the going concern idea. I have been trying to thrash out something that I thought of while you were speaking. You were saying the idea of this is to catch that proportion of the margin that had not been subject to GST through the chain, to ensure that all the price increase from 1 January 2000 was actually taxed appropriately. Are there situations where land or even a business, one that is not a going concern, might be bought by a business which then pays GST on it but claims all of that back as an input credit?

Mr Harms—That is the alternative choice for people. During the consultation the stakeholders were certainly saying that increasingly that is what is happening: people are simply transacting property on a taxable basis. So if the property—the farmland or the superlot—were sold as a taxable supply, the person purchasing it would be able to claim an input tax credit and when they subsequently sold it, they would by definition only being paying GST on the value add that they had made to that property.

Senator BUSHBY—So wouldn't they be much better off than a person in a similar situation who paid the same price in a GST-free situation and would then be subject to this amended tax?

Mr Harms—Sorry, Senator—

Senator BUSHBY—I am not sure that I am right here. I am just trying to work it out. Say somebody bought it as a taxable supply, paid tax, GST, on it and then claimed that back as a business input, so effectively the revenue has not been added to as a result, and then onsold that, having developed it. You said that they

would only pay GST on what they have added. So ultimately you would only receive the benefit of the GST on what they have added. You would not receive the bit in between, because that has been paid and claimed?

Mr Harms—In the normal situation what happens is that the GST is collected incrementally so that each supplier in a distribution chain pays part of the GST that is ultimately collected on the consumption. But if you interpose a GST-free sale, then there is no value add. In the situation that you are talking about, if somebody buys a taxable supply and claims an input tax credit and then makes a taxable supply, sure, they incur GST on their value add. What we are trying to do with this measure is prevent somebody buying a going concern that has not had the GST paid on it.

Senator BUSHBY—I understand that.

Mr Harms—So the option would be to simply prevent that happening, but there may be legitimate reasons why people want to transact property as a going concern. Obviously, what we want to do is get the amount of tax out of that.

Senator BUSHBY—I understand all of that. Would the revenue received by the government, if all the sale prices were equivalent at the end, be the same under this proposal as the revenue that would be received under equivalent sale prices where there are not any GST-free interposed sales? It is given that that is an incremental addition. Say the value of the property were $100,000 when it started and the end value were a million dollars, so there is a $900,000 margin overall, and on one scenario you had a GST-free sale imposed and on the other one you did not. Ultimately, having implemented this proposal, would you end up with the same amount of GST?

Ms Lilley—I am just wondering if the missing point is this. One of your examples was where you have a taxable supply and then you claim an input tax credit, so there is no net GST. If that actually occurs then the next sale—

Senator BUSHBY—picks up the rest.

Ms Lilley—cannot be under the margin scheme, so then it has to be under the basic rules so it is where that sale is made to a consumer.

Senator BUSHBY—As I said, I was not sure if I was right when I was asking that. You made me think of that one as I was asking about this before.

Mr Harms— One of the reasons people do not use the normal rules—that is, to have tax on each sale—and instead use the margin scheme is so that if each supply remitted one-eleventh of the value then the value that existed prior to 1 July 2000 would be taxed. The margin scheme is intended to allow the value prior to that to be excluded.

Senator BUSHBY—I understand that the margin scheme would not apply in that circumstance. That is where the difference is. I think the Urban Development Institute of Australia suggested that this issue could have been dealt with by proven anti-avoidance provisions under division 75. What are your comments on that?

Mr Harms—We do not believe that is the case because, whether or not the sale of a going concern of a property is to somebody who is going to make subsequent supplies of residential premises, we want to capture that value whether or not that is a contrived situation. We are not restricting ourselves to schemes that have been entered into for the sole and principal purpose of avoiding tax. They do not have to be contrived.

Senator BUSHBY—It is more of a general capture of the market?

Mr Harms—Whether we call this a loophole or whatever, the fact of the matter is that legitimate arrangements can be structured to avoid tax. We are trying to prevent that. The reason why we are strengthening the anti-avoidance provisions is that our measure looks back at only one transaction. What happens is that, in some extreme cases, there will be a string of sales of going concerns and by the time the final sale is made to an end consumer more and more of the value has avoided the tax net.

On the one hand we are left with that dilemma while, on the other hand, we do not want to put in place onerous compliance costs on businesses. Our measure only looks back at one sale. We have strengthened the anti-avoidance provisions so that where there are contrived arrangements that have been entered into to avoid tax the anti-avoidance provisions can deal with those. In fact they can act as a deterrent to those happening at all, because the commission would have the power to make a declaration.

Senator BUSHBY—How long has the department been working on the measures in TLAB 5?

Mr Harms—I can answer for my measure.

Senator BUSHBY—Yes.

Mr Harms—This measure was originally part of a package of anti-avoidance measures introduced in 2005. It was deferred at that point. It was originally in the 2005 budget. We would have been working on it prior to that, because it was originally introduced as a package of integrity measures. There are two aspects; that is one aspect of it. All the discussion has been around the going concerns. There is another aspect that deals with associates. That is something that we have been working on for about two years.

Senator BUSHBY—That is probably all I need to know on the timing. Regarding schedule 1, how has the measure changed since you first started working on it? Which key aspects are different now from what you originally looked at?

Mr Harms—The original measure that was introduced in 2005 stated that if you sell under the margin scheme following the sale of a going concern the taxable value is the difference between the sale price and the value at 1 July 2000, so it actually taxed all that value irrespective of what the circumstances might have been in between. Our measure is more pragmatic. We recognise that maybe there were some legitimate reasons for arrangements to be structured, so we just look at the previous sale and if that has been a sale of a going concern then we include that value from the previous sale in the taxable value.

Senator BUSHBY—Senator Cameron said earlier that Treasury has indicated that there is room for profit margins to come down. Is this something that you guys have said or was it said by some other part of Treasury? I am not sure where Senator Cameron got that from.

Mr Harms—I am not sure that we said that.

Mr Crooke—I will address that as best I can. I think that probably relates to something in our submission to the committee that suggests that the impact of this, as it flows through the market, would be on both the demand side and the supply side. We are suggesting that in the ordinary course of market operations you would expect that the burden would be shared. It is, I guess, a fairly neutral point aimed at the fact that the burden is shared, rather than falling on one party or the other.

Senator BUSHBY—Different property developers have different capacities to deal with different sized margins. What if there are particular property developers who are subject to this but who do not have the room in their margins to share it? What are the consequences then?

Mr Crooke—The analysis that we conducted was really based on the fact that we are talking about a very small segment of the market. If you look at the overall market you would not expect the impact to be significant.

Senator BUSHBY—So it is more of a general collective rather than a consideration of how it may impact on individual property developers?

Mr Crooke—That is right. We have not gone to the same level of detail in our estimates of the impact on the cost base for certain developers. I guess the point that I am making, which has been reflected here, is that that is one way of looking at the issue. As it flows through the system I think that you would expect to see a more dispersed impact on property prices.

Senator BUSHBY—So there is no detailed modelling done on the impact on housing prices?

Mr Crooke—No.

Mr Harms—If I could just add to that answer, you asked before how this was different from the original measure. One key aspect is that this measure is completely prospective so that no developments that are currently entered into, or even developments that are up to the stage where people have entered into rights or options, will be affected by this measure as long as they occur before royal assent. It only applies to arrangements after royal assent.

Senator CAMERON—A variation of what we are looking at now was developed and pursued by Treasurer Costello and the Howard government in 2005—is that correct?

Mr Harms—A variation of this measure was in the 2005 budget. In this budget that measure was cancelled out and replaced by this revised integrity measure.

Senator CAMERON—Following consultation with the industry?

Mr Harms—That is correct. That consultation occurred in 2005.

Senator CAMERON—Regarding the figure of $523 million over four years—and you may have to take this on notice—how much of that figure is representative of the total GST take in the industry?

Mr Harms—I would have to take that on notice.

Senator CAMERON—I am just trying to get an idea of how much it is in the context of those that are paying, because there are developers who are paying the GST now on land. I want to get an idea of what this represents.

Mr Harms—Yes, and there are also householders who are paying GST on improvements to their property, so when you say the 'whole industry' do you mean the building industry or do you mean the new residential premises market?

Senator CAMERON—In your submission you indicate that this is to create a level playing field. I am looking to find out how much those other developers are paying who represent the level playing field that we are trying to reach. Is that clear?

Mr Harms—Yes. In our submission we have said that the value of that market is around $30 billion, but as to the total GST payable on that, I will need to take that on notice and get back to you.

Senator CAMERON—Yes, but that is a one-year figure.

Mr Harms—I beg your pardon?

Senator CAMERON—You say it is $30 billion in 2008-09. So you would assume that it could be about $120 billion, and this could be $523 million as compared to $120 billion.

Mr Harms—Yes, that is right, and that is only one side of it. The other side of it is that if this measure does not go ahead then we would expect the amount of GST that is lost to increase, because this method of structuring arrangements would become the norm. So there is an increasing threat to the revenue if the measure does not proceed.

Senator CAMERON—When you say $523 million over four years it sounds like a really big amount of money as an impost on the industry. But when you look at the size of the industry, it is not a huge impost.

Mr Harms—Yes, it is quite insignificant in terms of the overall industry and in terms of the taxable part of that industry.

Senator CAMERON—Yes. Thank you.

CHAIR—Thank you very much to Mr Harms and the Treasury.

Committee adjourned at 8.16 pm