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Reference: Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009

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**SENATE ECONOMICS
LEGISLATION COMMITTEE**

Monday, 9 November 2009

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

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

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

Terms of reference for the inquiry:

To inquire into and report on:

Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009

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Committee met at 9.10 am

CHAIR (Senator Hurley)—I declare open this hearing of the Senate Economics Legislation Committee into the provisions of the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009, concerning non-commercial losses, more commonly known as the hobby farm measures. On 28 October 2009 the Senate referred the provisions of schedule 2 of this bill to the committee for inquiry. Schedule 2 of the bill is designed to ensure that persons with an income of \$250,000 or more are generally not able to claim excess losses from their non-commercial business activities as deductions. The committee is due to report on 16 November 2009.

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 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, 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 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, of course, also be made at any other time.

I remind members of the committee that the Senate has resolved that departmental officers shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions to superior officers or to a minister. This resolution prohibits only asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

[9.12 am]

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

CHAIR—I welcome Mr Yasser El-Ansary from the Institute of Chartered Accountants. Would you like to make an opening statement?

Mr El-Ansary—I would, thank you. Let me start by apologising for my 10-minute tardiness this morning. I will blame it on Qantas. Now that I am here, let us get underway. Thank you for the opportunity to appear this morning in relation to your inquiry into certain aspects of the Tax Laws Amendment (2009 Budget Measures No. 2) Bill. As the committee will already be aware, the Institute of Chartered Accountants in Australia is the professional body representing over 50,000 chartered accountants right across Australia. The institute's membership comprises chartered accountants who work in diverse roles such as public practice, commerce, academia, government and the non-profit sector. Owing to the diversity of this membership, the institute believes it is well positioned to provide independent and expert comment in respect of almost all aspects of taxation policy in Australia. The institute considers that appearing before this Senate economics committee inquiry this morning is an example of how the institute seeks to promote not only the standing of its members as leading tax advisers to individuals, businesses and other taxpayers but also its vision for a simpler and more equitable taxation system for all Australians.

Turning specifically to schedule 2 of the tax laws amendment bill that is the subject of this inquiry, the institute would like to make the following brief points. Point 1 is that the proposed new tax laws imposing restrictions on a taxpayer's ability to offset losses against other assessable income will, in some cases, impose considerable additional compliance costs on certain taxpayers. The institute does not concur with Treasury's view that these proposed new laws represent integrity measures that are aimed at closing existing shortcomings in the law. Instead the institute is of the view that the proposed law changes represent a change in tax policy settings, and as such these proposed amendments should not be viewed as anti-avoidance measures. Point 3, following on from the previous point, is that the proposed new tax laws will in effect have an adverse retrospective impact on certain taxpayers, which is an outcome that contravenes the principles of good tax policy and lawmaking.

Point 4 is that the proposed new tax laws will require the Commissioner of Taxation to make an objective assessment of whether or not a taxpayer's affairs should be regarded as being of a sufficiently commercial nature or not. It is the institute's view that such an obligation ought not to be placed on the role of the commissioner. This view is based on the premise that it would impose on the statutory office holder an obligation to reach concluded positions on matters on which they are not well positioned to rule without having to rely on considerable third-party expertise and judgment. That is the conclusion of my opening statement. I am happy now to take some questions from the committee.

CHAIR—Thank you. In your submission, which I have just had a quick look through, you say that some of the aspects of your submission on the exposure draft were accepted. Could you just run through those for us?

Mr El-Ansary—There was one particular element of our original submission lodged with the Department of the Treasury on 24 July this year that was of considerable concern to our members. The one specific area that we highlighted—which, I am pleased to say, has been addressed in the new bill—is the area which relates to scenarios where taxpayers, having acquired property or other assets under the government's temporary tax investment allowance regime that was announced late last year and thereby having an entitlement to an increased 50 per cent tax deduction in some cases, could, as a result of these proposed new laws, be in a tax loss position solely by virtue of the fact that they have accessed a government incentive, via the investment allowance, which entitled them to claim a 50 per cent uplift on their tax deductions.

We thought that that outcome, were it not addressed in the final bill that was put to parliament, would be quite an adverse outcome for some taxpayers, particularly having regard to the fact that the investment allowance is there as a component of the government's fiscal stimulus strategy for the economy, which brings with it an expectation that businesses would take up the incentive and go out and buy assets. Ultimately, if they did so, they might well find themselves, or may have found themselves, subject to a punitive outcome by virtue of the quarantining of losses under this proposed change from 1 July 2009. As I say, we highlighted that in our first submission. We are pleased that changes addressing that potential adverse outcome have been addressed in the final bill that has now been presented to parliament.

CHAIR—Going on to the further changes that you are seeking, I am particularly interested in the commissioner’s discretion aspect of it, because other submissions have raised this. You are of the view that, if the taxpayers can demonstrate that the business is conducted on a commercial basis and that any extended yield time is caused by natural conditions, then that should be sufficient. There must surely be some dispute occasionally between what the ATO believes is sufficient and what the taxpayer believes. Are you proposing to leave it entirely to the taxpayer’s discretion?

Mr El-Ansary—This is a point of contention. This goes really to the heart of what I expressed as point 4 in my opening statement. The issue here is really that, in almost every other aspect of the taxation system, the Commissioner of Taxation’s role is to administer the laws as they are found by the commissioner, as they are passed by the parliament, having regard to the intention of the parliament at the time they were passed. It is not commonplace within our tax system for the commissioner to have a role whereby he is a final decision maker and a final arbiter in respect of whether or not a taxpayer’s business affairs should be regarded as being commercial or not. It is an area of the taxation law that is fraught with some risk. It is fraught with complexity and it is fraught with a high degree of uncertainty for taxpayers, who ultimately need to operate with some degree of certainty around their affairs and obligations so as they can make informed decisions about their businesses.

The reason that this a particular concern and we have made the comments we have made with respect to this issue—suggesting that taxpayers can perhaps determine their own position when it comes to commerciality and the extended yield times, in particular—is that in all other aspects of the taxation system it is a self-assessment system. In all other aspects of the law taxpayers are obliged and expected to take positions about their own tax affairs, to determine their eligibility or otherwise to access certain provisions and to determine their liabilities within the tax system. In this area of non-commercial losses, and in particular, in light of the proposed amendments contained in this bill, the role of the commissioner is now expanding. Whilst non-commercial loss provisions have been in place for some years now, the changes proposed in this bill go further towards obliging the commissioner to make decisions and assessments about a taxpayer’s affairs with respect to whether or not they have engaged in a commercial undertaking. I think that is fraught with risk. I think that to extend the requirement on the commissioner to determine commerciality of certain business arrangements and business decision making and whether or not taxpayers have entered into a business arrangement on commercially viable terms or not is a judgment that the commissioner will need to exercise only by having regard to independent third-party expertise, simply because the commissioner is not able in his role to be an expert on every possible industry and sector across this country for which taxpayers may have engaged in a business.

The proposal contained in our submission really highlights the potential risks to taxpayers, as well as the tax office, I might say, in putting them in a position where they need to make such important decisions about commercial viability. Whilst having regard to the policy design objective of the non-commercial loss provisions—which is in effect to limit taxpayers’ entitlement to offset losses against other assessable income in certain circumstances—our proposal looks to find a balance between ensuring there is a sufficient level of integrity and a sufficient level of understanding of how those rules work, balanced up against still providing taxpayers with ample opportunity to engage in self-assessment practices that are consistent with every other aspect of the taxation system.

CHAIR—Practically speaking, if someone enters into an industry—say, alpaca breeding—and decides that their yield time, because they choose to buy a small farm near where their permanent residence is, so it is not a viable area really, do they then decide that nevertheless they are a commercial business? Practically, what happens if the tax commissioner says, ‘No, this really is not a commercial proposition; this is just a weekend retreat?’

Mr El-Ansary—In answer to that, I will just go back one or two steps. There are a couple of important points in the question that you raised that I think are worth considering for a moment. The first one is that we must not forget that taxpayers always are in a position where they make decisions about their affairs based on a variety of factors. With respect to those who conclude that taxpayers only make decisions about their affairs based on the tax outcome, in certain situations that might well be the case.

But I think by and large taxpayers are in a position where they have access to considerable information about alternative investment products and alternative strategies that they could employ in the use of funds. If they so decide to invest in a business opportunity that may have a considerably long lead time before becoming profitable, then I think it is the rightful place of that taxpayer to determine that yes or no decision at

the outset. If they make the decision to invest knowing those outcomes and knowing the lead times that might exist, then I think those taxpayers should be left to make those decisions unfettered by the tax system.

That said, though, I can understand and appreciate that there are some situations—particularly, as the committee will be aware, when the debate moves towards managed investment schemes—where certainly for some taxpayers there is a very high motive centred around the investment decision making that stems from the tax outcome. But my contention is that, even in those scenarios, those taxpayers are not investing for tax reasons, they are still making investments based on an expectation of deriving a return. Anyone who invests money with an expectation to lose it probably should not be investing from the outset, if that is their intention.

CHAIR—But isn't the crucial difference here, and the reason why there might be different circumstances, that many hobby farmers are people who are actually just purchasing a weekend property or somewhere where they can go for holidays and that the tax deductibility or otherwise of that investment means that it is much cheaper for them? Isn't that the crucial difference here that we are looking at? Often, it is not people investing in a small business per se; it is people buying a property for the weekend or for retirement.

Mr El-Ansary—This is where it does come down to an important distinction between the sorts of scenarios that are being considered. If an individual, a taxpayer, is interesting in a business activity, even if that business activity constitutes some sort of farming business that runs alpacas or any other type of product on the land, if it is fundamentally a business activity then there should not be a discrimination as between those business activities and any other business activity that might be more commonplace or regular in the eyes of the law, such as a corner shop or a small professional business. Ultimately, that distinction around whether or not the activity constitutes a business is the key definitional boundary around which our tax system operates. If a business is in place and it does exist, and a business has certain indicia that can be married up against the actual activities that are being carried on, then that business ought to be given access to the exact same tax rules that apply to any other business activity.

CHAIR—Except that, as you say, no-one would invest in a business that they know is going to lose money unless there is something else in it for them.

Mr El-Ansary—Correct. I agree.

CHAIR—Okay.

Senator EGGLESTON—I was interested in what you just said, Mr El-Ansary. It appears to me that what we are really talking about is different sets of rules for different sets of investments, and that based on subjective assessments to some degree. I would have thought that there should be one set of rules governing the business activities of all taxpayers—a simple set of rules which provides for them to make an investment, to deduct the costs of running that business, and if it makes a profit they pay tax and if it makes a loss they can claim the loss.

Mr El-Ansary—I would agree with that. Every aspect of tax policy design in Australia is typically centred around core principles of attempting to deliver—it is not always the case, unfortunately; but most taxation law that is designed in Australia now attempts to deliver—a level of consistency and simplicity and certainty for taxpayers. In that respect I would fully agreed with those comments, Senator. But in an ideal tax system, tax rules should be designed with a high degree of consistency as between various investment choices. Essentially, delivering that level of consistency ensures that investment decision making is not artificially distorted by the tax rules alone and that, instead, the taxpayer or the individual at large is left to make their own decisions about their own investments having regard to their own expectations about profitability and return on investment in the longer term.

Senator EGGLESTON—Thank you. Most of these businesses we are talking about, whether they be alpaca farms or herds—or whatever you call alpaca farms—vineyards or various other businesses, are legitimate businesses, are they not? They do require an investment to set them up. They do employ people and there is a product that is sold.

Mr El-Ansary—Regardless of the underlying components of the business—in other words, regardless of whether it is an alpaca farm, a deer farm, an ostrich farm, a vineyard or any other type of business—if fundamentally the business activities constitute a business, then, I agree to the extent that, if a business is in existence within the bounds of the taxation law, that business is in existence and that should be the end of the story when it comes to determining whether or not particular tax rules ought to apply in a consistent or an inconsistent fashion. If a business exists it should be able to access the same rules that apply to other businesses.

Senator EGGLESTON—Some of the submissions, and I think the National Farmers Federation submission is one, talk about possible flow-on effects to property investment, which is something a lot of people engage in. They buy a business that happens to be a house, a unit or a block of flats. They derive an income in the form of rent, and if it makes a profit they pay tax and if not, because they have geared it highly, they make a tax loss against the interest on their loan, and this is called negative gearing. Do you see some sort of impact on negative gearing and property investment as a flow on from this legislation if it were passed?

Mr El-Ansary—I will not provide a comment in respect of the potential economic flow-on effects, because I am not, quite frankly, in a position to provide expert comment on that.

Senator EGGLESTON—Just in principle, though.

Mr El-Ansary—Changes to the taxation law at any time, particularly in an area like this which does have a direct link to investments and decision making by individuals and taxpayers, do give rise to uncertainty for taxpayers—as well as for administrators, for that matter. They also have the potential to impact on trends in the marketplace in terms of people's decision making. That is not to say, as I said earlier, that decision making by people centres solely on taxation and tax outcomes, but it is to say that tax is a feature of people's decision making. If the tax laws change in a particular area, as is proposed in this bill, it is understandable to quarantine losses. I would have an expectation that there would be some consequential impact in the marketplace but, as to the precise impact and the precise flow-on effect from these changes, I will leave to others appearing before this committee to provide their expert comment on that.

Senator EGGLESTON—I was particularly interested in negative gearing because, when the Keating government temporarily abolished it, it caused a great slowdown in the building industry and a great loss of jobs. The building industry is a key industry. I used to live in the Pilbara, where people make a lot of money and work very hard, and the most common refrain I heard from people was that the Australian taxation system does not reward effort, unlike in the United States and the United Kingdom. It seems to me that this is another example of the Australian taxation system seeking to ensure that people do not really get to use the financial capacity generated by themselves to its full potential and that this is a disincentive to hard work and reward for effort. Would you agree with that observation in general terms?

Mr El-Ansary—On the matter of the policy decision taken by the government, again I will refrain from providing a comment on the merits of the policy decision itself. Instead, what the institute has been focused on is the consequential impact from an administrative and compliance perspective of the proposed policy decision as contained in the Tax Laws Amendment Bill. So with due respect to the committee, I will refrain from providing a particular comment on the policy design. We are operating on the basis that the government has made a policy decision to limit the entitlement of losses to be offset against assessable income in announcing this measure, and we are working within the bounds of that framework and focusing on the administrative and compliance costs associated with the policy decision.

Senator EGGLESTON—You said the commissioner would have to seek advice on the viability of various kinds of investments. I suppose that, to some degree at least, that makes his potential decisions subjective rather than objective as would be possible with a simple set of rules. Would you agree that there is a possibility of a higher degree of subjectivity in the framework under which this legislation has been constructed?

Mr El-Ansary—Yes. I want to clarify one point first—that is, the obligation to provide the independent expert judgment, if you like, for the most part rests with the taxpayer in putting forward their case for the commissioner to exercise a discretion in their favour in order for them to be able to offset losses against other assessable income. In effect, it would be the taxpayer presenting the third party information. Notwithstanding that, it would still require the commissioner to sit back and take in that expert third party information as well as the information presented by the taxpayer themselves and consider whether the case being made before them is worthy of the commissioner exercising a discretion in the taxpayer's favour or not. Does that bring with it a level of subjectivity? I am not sure that it brings with it a level of subjectivity but I think it certainly does bring with it a level of judgment and decision making that will be very challenging for the commissioner to exercise and engage in, particularly when it is not the normal course of the commissioner's role to exercise decisions in that manner.

Senator EGGLESTON—In general terms, would you agree that if the taxpayer has to make a decision bearing in mind the fact that the commissioner may make a decision against him that this will be a disincentive for taxpayers to invest in as wide a spectrum of businesses as they might otherwise have done and, therefore, that will have an impact on job creation and business creation?

Mr El-Ansary—There is no doubt whatsoever that these proposed changes, if they were to pass into law, would have an impact on taxpayers' decision making and would have an impact on the way in which taxpayers determine whether they will invest in certain types of investment products. As for the precise impact, as I said earlier I am not in an expert position to provide comment on that. But I would certainly agree with the principle that any change to the tax laws, this proposed change included, will have an impact on taxpayers' decision making when it comes to the categories of investment they may well consider to put their money into in the future.

Senator EGGLESTON—Thank you. Would you regard this as an example of the dreaded Australian 'tall poppy syndrome' by which you cut down anybody who is achieving and succeeding and try to bring them back to a median level?

Mr El-Ansary—I think this is a measure by the government that is seeking to deliver certain policy outcomes. There are certain objectives that the government has prescribed around this particular tax law change and what it is seeking to achieve. Whether it goes to the tall poppy syndrome, I will leave that to the Treasury officials to answer this afternoon, if that is okay.

Senator EGGLESTON—I would say that it is certainly consistent with the underlying socialist objectives of the Labor Party.

Senator BUSHBY—You mentioned that these proposed changes further policy outcomes. What is your understanding of the policy outcomes they are trying to achieve?

Mr El-Ansary—My understanding is that the policy design outcome is to further limit, beyond what is already the case, the ability of certain taxpayers with adjusted incomes above \$250,000 per year to be able to offset losses against other assessable income. That is the stated policy objective and that is our reading of it.

Senator BUSHBY—So, in summary, to basically protect the revenue, essentially, to increase the amount of taxes that are received in any one year.

Mr El-Ansary—Rather than express it as protecting the revenue, I would probably flip that around and express it more as boosting revenue by way of limiting the ability of those taxpayers with incomes above \$250,000 to access losses.

Senator BUSHBY—You would acknowledge that there are a number of uses that a government can use taxes for, and one of them is for revenue purposes. But, in terms of the structure of taxes, they can also use that to promote activity within the economy in certain areas and limit it in others.

Mr El-Ansary—I would agree with that.

Senator BUSHBY—But in this particular instance you think that the intention is to boost revenue, effectively. I do not want to paraphrase what you said before. What you said was very eloquent and well said. But, in summary, it boosts revenue rather than delivers other policy outcomes that they may be able to use the tax to deliver.

Mr El-Ansary—If the question is, 'Does it appear that the government is seeking to influence certain types of behaviours in order to achieve another policy objective?' unfortunately, from my position, I cannot see that policy objective coming through the documentation that has been publicly released so far in relation to this change. The public information that has been released has been very clear around its objective of limiting the entitlement to access losses and the consequential boost to revenue that that will have as a result of its introduction.

Senator BUSHBY—Nevertheless—and I have had Treasury confirm that in general every tax distorts the economy in some way—making this change may actually have policy ramifications that extend further than just boosting the revenue.

Mr El-Ansary—As I said earlier to Senator Eggleston, I think without doubt a change such as this proposed in this bill will have a consequential impact on investment decision-making in the community by certain individuals. But I cannot say as to the precise impacts and which sectors may stand to lose and which sectors may stand to benefit, assuming of course that in broad parameters the total investment pool of funds that is available to be diverted into various uses remains constant as a result of this change, so that this change would not take people out of the market altogether but instead may just push them into other investment products, be it negative gearing or other types of investments.

Senator BUSHBY—And there are alternatives. If you are a high-net income individual looking to minimise your tax over the coming years, there are other areas where you could actually look to invest money to do that rather than this if this became less attractive.

Mr El-Ansary—If you are a high-income individual with income above \$250,000 a year and you are looking for a variety of investment products, certainly there is a variety of investment products out there in the marketplace from which you could select.

Senator BUSHBY—And if these proposed changes became law, I think it is fair to say from your earlier comments, this would be less attractive relative to some of those other options than it currently is.

Mr El-Ansary—Yes, I would agree with that. These changes will make investment in certain types of investment products less attractive.

Senator BUSHBY—Do you think there will be a significant shift, from your experience or the experience of your members, or do you think it would be marginal?

Mr El-Ansary—That is really hard to gauge at this point. Without the benefit of some anecdotal evidence starting to flow in after these changes have been in place for some time, it is really hard to tell.

Senator BUSHBY—Could it potentially be significant?

Mr El-Ansary—I think there could be potentially significant impact, yes.

Senator BUSHBY—Treasury estimate an additional revenue of around \$700 million. I am going to ask them some questions about that this afternoon, on the basis of how they have actually arrived at that figure—whether it is just a first-round effect or whether they take into account second- and third-round effects, which presumably would include things such as moving to other forms of investment. If, as I suspect, it is just a pure assessment of the numbers of people currently involved in hobby farming—for want of a better term—and the amounts of money which are involved with them, do you think that it is realistic that \$700 million will actually be raised?

Mr El-Ansary—I must confess that I found the number of \$700 million to be a significantly high number, in my estimation.

Senator BUSHBY—If there are behavioural changes that result, with people choosing alternative forms of investment to set up their affairs, then that will have an impact on that \$700 million presumably.

Mr El-Ansary—Undoubtedly.

Senator BUSHBY—You also mentioned that it would be within the realms of the taxpayer to actually find the independent evidence that they would need to back their case. That is your clear understanding of how it will go, so what is to stop taxpayers shopping around to find the independent expert that is going to say what they want to say?

Mr El-Ansary—I do not think in the proposed legislation there is anything that would prohibit that, but ultimately, if a taxpayer does shop around, as you put it, and finds an independent expert who will agree with some position that the taxpayer wants to take, it will still rest on the shoulders of the commissioner to make a determination as to whether or not he believes, in his assessment, the information that is laid before him justifies the exercising of his discretion to allow the use of the losses or not.

Senator BUSHBY—I agree with that. Ultimately, it will. But, if taxpayers on the whole start shopping around and start presenting cases to the commissioner which vary within industries because they have gone and got independent expert advice which backs their particular case, and you get a whole range of people making exemptions, the commissioner will have to end up looking at the independent advice that is coming in and give less weight to that when exercising his discretion, which will eventually undermine the whole process, won't it?

Mr El-Ansary—That goes to the issue I mentioned earlier, which is that imposing an obligation on the commissioner to make determinations and decisions in this type of situation—objective decision making based on third-party information which will vary greatly between different sectors, and between different communities within Australia, for that matter, depending on climate et cetera—is fraught with danger. Really that is further manifestation of the point I raised earlier, which is that, even though the commissioner has some responsibilities and some powers in this area of the tax law as it stands at the moment, expanding those responsibilities and requiring the commissioner to do even more decision making and rely on even more

information to reach those decisions brings with it additional compliance cost, uncertainty and risk for all stakeholders.

Senator BUSHBY—I do not disagree with anything you have said, but I am really trying to explore how it might work in practice as we are looking down the track. The commissioner in this particular circumstance will be asked to rely on the independent advice to inform him when he makes his decision. It is human nature for people to try and find independent advice that backs their position; if the independent advice, over a period of time, is consistently seen to be as such, then ultimately the commissioner must start to exercise his judgment to a far greater degree without relying to any great extent on the independent advice that is received. The fact that people will be shopping around and getting the best advice they can that suits the case that they are trying to make will mean that ultimately the independence of that advice will have to be questioned by the commissioner in his mind when he makes his decisions.

Mr El-Ansary—Certainly I think that is a possibility.

Senator BUSHBY—Which then places the onus back on the commissioner, as you say, to be making decisions which are questionable decisions given his role.

Mr El-Ansary—I would agree. I think over time it certainly would potentially be the case that the commissioner will be in that position, where the value, if you like, of the independent expert reports or analysis diminishes. At the same time other possible outcomes from that scenario could be that investors themselves, the taxpayers, stop investing in particular types of products altogether because there are no experts who are able to offer opinions that are worth the paper they are printed on. It may also result in situations where taxpayers engage in disputes with the ATO over positions that they think are appropriate and businesses which they think are commercial and viable with which the commissioner may disagree.

Senator BUSHBY—On that question, are you aware whether there is any right of appeal from a decision made by the commissioner in these circumstances?

Mr El-Ansary—I will have to review the legislation. It does not immediately come to mind. I will do that and come back to you.

Senator BUSHBY—I am going to ask Treasury this afternoon but I was interested in your view, since you raised that. You also raised the issue of compliance costs. How will those costs actually arise for taxpayers?

Mr El-Ansary—On the issue of compliance costs, there are really a couple of points in here, if I may briefly touch on those. One is the element of retrospectivity, which is also relevant to this discussion. The point here is that introducing these proposed new laws from 1 July 2009 for the 2009-10 income year will mean that certain taxpayers who have taken positions based on the law as it stood prior to the budget announcement this year may potentially be disadvantaged in an adverse way by virtue of the fact that they are claiming what are referred to as division 40 and 43 capital allowance deductions on an ongoing basis because they are depreciation non-cash items that are deducted on a cyclical program over the effective life of an asset. The taxpayers who are claiming division 40 and 43 capital allowance deductions will find themselves, in much the same way as I identified earlier in response to Senator Hurley's question about the changes the government made as a result of our submission on the investment allowance deductions, in much the same way as that outcome could have arisen there will still be scenarios where taxpayers who claim depreciation deductions may find themselves in a position where they are generating tax losses and therefore are not able to satisfy the non-commercial loss rural tests and therefore be denied access to their losses simply by virtue of them claiming depreciation deductions. I think that is a significant issue which should not be dismissed or underestimated.

Senator BUSHBY—That would also cross over into your comment that it is not just an integrity measure but also changing tax policy settings.

Mr El-Ansary—Absolutely. I would agree with that. The other point, on a related issue to that, is that for those taxpayers who have generated losses before the commencement of the 1 July 2009 changes and who will now potentially be subject to the changed taxation laws that apply in this area, they may be disadvantaged in adverse way as well by virtue of in effect the goalposts having been shifted on them from 1 July 2009. I think it would be appropriate for those taxpayers in those situations who have generated losses before the commencement of this current income year to be also given some transitional relief as part of the introduction of the new regime to ensure that their decision-making based on the tax law as it stood at the time that they engaged in certain decisions has not shifted unduly in a prejudicial way which has an adverse impact on their affairs.

The third point goes to the compliance cost. That really is all about the issues which we have been discussing just now, that taxpayers will be required to go out and seek this independent expert advice and present it to the commissioner.

Senator BUSHBY—Presumably there will be a whole new industry providing that sort of independent advice, and those who actually provide the particular advice you are after might even charge more.

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

Senator BUSHBY—Do you know whether those compliance costs would be tax deductible if they were unsuccessful in getting the exemption?

Mr El-Ansary—I would have to defer and check on that as well. I am not sure if they would be immediately deductible or—

Senator BUSHBY—You would hope that they would at least be deductible.

Mr El-Ansary—Perhaps they might well form the cost base of the investment. I am not sure.

CHAIR—Thank you, Mr El-Ansary, for coming in this morning.

Mr El-Ansary—Pleasure. Thank you.

[9.56 am]

MURRAY, Mr Peter, National Councillor, Taxation Institute of Australia

ROBERTS, Ms Joan, President, Taxation Institute of Australia

CHAIR—Welcome. Do you have an opening statement you would like to make?

Ms Roberts—First of all, thank you for the opportunity to appear before the committee. I am the current President of the Taxation Institute of Australia. With me is Peter Murray. Peter is one of our national councillors and he is very involved in our technical work. Peter is a partner at KPMG in Melbourne.

We have not put in a written submission prior to attending here today. We did make a witness submission earlier on the exposure draft. Obviously if there are any points that you would like us to follow up on after today's proceedings, we would be happy to put in a written submission at that stage. First of all, I would like to say a few words by way of introduction about the Taxation Institute of Australia. We are a professional body of over 15,000 members, counting our student members. The Taxation Institute was established in 1943 for the purpose of providing tax education and information to tax professionals—bureaucrats, politicians and the community at large. We have more members who are in public tax practice than any of the other professional bodies. This plus the diversity of our members—we have accountants, lawyers, judges and bureaucrats—makes us very well placed as an independent commentator on tax issues and with respect to tax policy and its administration. We have certainly worked very closely with the government and the bureaucracy over a very long period, including ongoing consultation with the ATO and Treasury. We are committed to making a real contribution to developing better tax laws for Australia and improving their administration.

The Taxation Institute accept that the non-commercial loss provisions in the Tax Laws Amendment (2009 Budget Measures No. 2) Bill have been introduced as an integrity measure and are to complete an announcement in the May budget.

In our July submission on the exposure draft, the main point that we made was around the need for greater guidance on the exercise of the commissioner's discretion. That certainly remains one of our prime areas of concern. We would make an alternative suggestion, because there are a lot of problems with the discretion. I will briefly outline our reasons why more guidance is needed and note two other points we wish to raise. The first of these is the \$250,000 income requirement and the final point I will look at is to raise some social considerations, and that would include some of the issues that have been raised, including investment decisions. Also there are wider issues to do with productivity.

First, it is appropriate to give you a feel for where we come from. The Taxation Institute has long and consistently advocated reduction in complexity in our tax laws and administration. Tax can be complex and it might not be achievable to have very simple tax laws. Business affairs are complex and obviously if you are dealing with some of the more complex areas in business, you are going to have complex law. But by and large we think that, where possible, we should always be aiming for greater simplicity in our tax laws. We test all proposals and new legislation from this point of view and from the point of view of having a tax system that is efficient and fair, so it is our opening point that in achieving such a tax system we will have more simplicity and greater transparency and we would aim to avoid uncertainty arising from tax laws. We are concerned that the current non-commercial loss provisions that we are discussing today fail on a number of these accounts.

Passing to the three areas of focus that we would like to raise, first of all there is the \$250,000 income requirement. We acknowledge that that is set at a level so that it probably only affects a small percentage of taxpayers. However, it does seem to be an arbitrary number and we would like perhaps a better understanding of why that figure has been chosen. Also, there could be issues where a taxpayer moves in and out or under and over this requirement and whether it might be appropriate to make some provision for taxpayers in those circumstances.

On the commissioner's discretion, I guess we would say that further guidance is required. But I think that, perhaps as a starting point, we would question the merits of having discretion in this area. It seems these days that the commissioner is not terribly fond of having to exercise discretion, and I think with good reason—it does not promote certainty in the tax law. However, with this new bill, we now have a situation where the only way someone on an income over \$250,000 can deduct losses against other income is by having favourable exercise of the commissioner's discretion. So, if that is the case, then we would certainly say that greater guidance is required.

The explanatory memorandum to the bill requires that taxpayers independently demonstrate that their business is genuinely commercial. There are two steps involved, and I guess the first is to determine that there is a business threshold point. Tax professionals are reasonably comfortable with that. There are rulings on what is a 'business'. But then we get down to the objective expectation that the business is commercially viable. We would certainly look for more guidance on that. The guidance that appears in the EM is hardly sufficient, and there are aspects of that guidance that we would question. Perhaps we can discuss some of the examples in detail in questions. There are areas about funding costs and, of course, there are a lot of agricultural operations that will be affected.

The explanatory memorandum refers to 'exceptional circumstances'. More guidance is required on that. The only thing that seems to be referred to in the legislation at the moment is weather conditions. We think that is an area that requires greater consideration so that taxpayers can have more certainty about their positioning. We would certainly be happy to discuss the implications of this being an area where it is proposed to give greater discretion to the commissioner. But an alternative approach we would like to float is that the four objective tests that are currently in the legislation and will continue to apply to taxpayers on incomes under the \$250,000 level might also be used for taxpayers who are above whatever the requirement is but perhaps with higher thresholds. So rather than the income having to be \$20,000 a year, maybe it should be \$50,000—and likewise the value of the property in the business. That is a suggestion we would like to put forward for consideration.

The third area of focus is on the social considerations of this legislation. I guess what the Taxation Institute would do here is make sure that there is a question on the table as to whether all of the social implications of the proposed changes have been considered. Research needs to be done on the effect on land values—and that has already been mentioned earlier today. There may be effects in local communities when you take money out of local communities that would otherwise be there to build up the wealth of the community. Investment decisions might be affected and that has flow-on social implications. Also, there are productivity issues. Sometimes when people are comfortable enough to be in a situation where they follow their passion—whether it is some sort of farming venture, or art—the community ultimately benefits. Some of the examples given in the guidelines show how the current vision of how this might work can really narrow that scope for advances in productivity and invention. I would just refer you to example 2.7 in the explanatory memorandum.

CHAIR—Ms Roberts, we do have a limited time for the opening statement. Perhaps you could just run through it more quickly and then we can ask questions.

Ms Roberts—I am just winding up now. The point there was just that it takes away the idea that necessity is the mother of invention and perhaps we are going to miss out on that. Thank you for your attention and your invitation. If you have questions, Peter Murray or I are happy to answer them.

CHAIR—Thank you for that. I am still not quite sure what you are proposing instead of the commissioner's discretion. You said you had another proposal, rather than giving the commissioner discretion.

Ms Roberts—Yes, that the four objective tests that are in the legislation at present also apply where you have people on incomes over \$250,000, but the numbers in those four objective tests might be lifted.

Mr Murray—That is actually referred to in the submission that was made in July in a broad sense, but you have got to look at indexing those amounts. Those numbers were set several years ago now and it could be appropriate to index those.

Senator BUSHBY—For example, with the property value, people of high value may well often have the ability to get around that one whereas if you lifted that you might make it harder to do so.

Ms Roberts—That is right. One of the criticisms of the existing rules was that it was too easy for high-income earners to satisfy those tests.

Senator BUSHBY—In the interests of full disclosure I should probably mention that Ms Roberts is a past employer of mine, in a law firm in Hobart. I just put that on the record. You talked about the social considerations, which I found interesting. The previous witness was not really the right person to ask about that and we have some other witnesses coming later in the day who can talk about the impact on their industry and in their community. I think it is important to put that on the record, and given that you have raised social considerations I will ask you some questions about it. The reality is that the state of affairs that has developed in all sorts of areas prior to these laws being enacted, particularly some high-profile areas that this would impact on like thoroughbred horse breeding and the like, has allowed products and services to be delivered that benefit the community and support local businesses. By definition these taxpayers are spending money,

because they cannot be making a loss unless they are spending money in the first place, and they are spending money usually in local communities which supports jobs and the development of the communities themselves. Would you care to expand on your comments on that? Is there anything you would like to add?

Ms Roberts—I will make a brief comment and Peter might have more to say about it. Certainly we think it is important that those considerations be on the table and perhaps there does need to be more research done in that area.

Mr Murray—From my point of view, I have a property in a rural area. A lot of my comments have come from observations on things I have noticed and comments from people within the community as to what has been happening over the last few years. As you said, to make a loss there has to be expenditure, and it has been capital expenditure as well as revenue type expenditure. That has boosted the community.

We are in a position where—again, this is what I have been told, so it is observation; I do not have evidence to support this—what we are finding is that a lot of the older farmers are moving out of their properties. The sons do not want to continue with the properties. So there are two aspects here. There is the land itself—looking to sell. This group has allowed the farmers exiting the industry to be able to sell their properties at good prices, which sets their future up for their retirement. Secondly, with a lot of these properties the capital investment has not been there. There are not a lot of rich full-time farmers. There are some—not a lot—who are.

Senator BUSHBY—There have been a lot of hard years as well.

Mr Murray—Correct—over the last 13 years et cetera. So a lot of farms are run down. What that means is that they have got a reasonable return for the land, and the people who have come in new to the industry—they are more part time than full time—have spent the dollars, improved the quality of the land, spent money on fencing et cetera.

Senator BUSHBY—In a lot of ways, the losses of the new people who have come in are actually from repaying the living off the capital that the previous owner has done to actually make a living.

Mr Murray—I think that is a good summary.

Senator BUSHBY—Also, while we are on that area, other submissions have raised the fact that there is a need for a lot of farmers to have off-farm income to help keep their farms viable these days. When the kids no longer want to run the farm full time but do not want to sell the farm, some of them might go off to uni and get good jobs where they might earn more than \$250,000; they might employ a manager on the family property but do not want to lose it. The family property is still a dairy farm that is providing milk that people need or meat, wool or whatever it might be. But, because they are earning over \$250,000, if that farm is making a loss because it has a manager and there are all sorts of things that it cannot necessarily cover, they would no longer qualify under these provisions, so the family farm would be lost. Who knows? The next generation may want to take it on.

Mr Murray—Absolutely. A lot of rural properties, in my view, are marginal businesses, but they also provide, as you said, the milk, wool, beef or whatever. So, yes, it is really that other income source. You may see it in a professional sense. I have also noticed that a lot of those who do have farms do contracting work or some other work on other properties just to find that balance of income. It may not be \$250,000, but I think that is a common feature.

Senator BUSHBY—Yes, on the whole most off-farm income is significantly less, but the National Farmers Federation have submitted that there are instances where there are people earning off-farm income who would be caught by this legislation.

Mr Murray—Absolutely.

Senator BUSHBY—It would not necessarily be in circumstances that are evil from the perspective of the taxpayer. Coming back to your point about discretion, I was asking some questions of the previous witness. His opinion, and the opinion of the chartered accountants, is obviously that it is not an appropriate discretion to place upon the commissioner in the overall scheme of things. Would you agree with that?

Mr Murray—I would.

Ms Roberts—Yes.

Senator BUSHBY—I asked a series of questions—I know Ms Roberts was in the back of the room when I was asking them—about the evidence that taxpayers would have to gather to submit for the discretion to be

exercised. The obligation is clearly on the taxpayers to get that and it is not coming from some set direction where you know you are going to get a consistent answer every time. For instance, with migration, if you are looking to be a skilled immigrant then they tell you where you have to go to get yourself assessed. In this case you can shop around and go and find an independent expert who will give you whatever you think is the best evidence to back your case. Over time, in my view—and I would be interested in your thoughts—that fact must lead to the commissioner attaching less and less weight to the independent evidence that is submitted. Would you agree that there is potential for that?

Ms Roberts—Not entirely, because I think that the people who are providing the evidence are going to be experts. They will be professionals. They have codes of conduct that they need to comply with. So I think that there will be integrity in the information that is provided. What I see as the downside is that it is putting taxpayers to extra expense in having to get the information. Also, until the information is assessed by the commissioner, they are in a state of uncertainty.

Mr Murray—The other point I would add, and I know this has been said before, is the lack of guidance as to what you actually have to do. Where you do have situations, probably like migration, where you are going to have a set of criteria that you can tick off, here it is really the unknown. When you have a position where the commissioner is put in the position of exercising discretion with minimal skills themselves in the particular industries and no guidance as to how they are assessing these businesses, you are going to get to situations where more likely than not that discretion will not be exercised. It will be exercised, but in a negative sense.

Senator BUSHBY—Exactly, except in very rare, clear, specific examples.

Mr Murray—Where it is so obvious, yes.

Senator BUSHBY—Ms Roberts, does the legislation indicate or put any boundaries around who you can seek the independent advice from? My comments were not intended to denigrate proper professional bodies that would provide outstanding evidence of the kind that you referred to. I suspect though that you might find a number of experts popping up as the demand arises and claiming to have expertise in the area with a view to delivering reports that some people might not be able to achieve through the more professional organisations that are out there. Some may well be able to do that with some claim of authority to do so, even though they are not subject to the same rules of conduct and ethics that the more professional organisations are. That is a concern. I am quite sure that if you are a taxpayer and you are seeking one of these exemptions and you sat down with somebody who was a member of the Tax Institute of Australia and they said, ‘Look, we don’t like your chances for these reasons; it’s probably not worth making the application,’ then you will go off to someone else and get an alternative view. I think there will be an incentive for taxpayers to try to do that.

Ms Roberts—Yes, but I think that the new tax agents services regime might control that to some extent.

Mr Murray—If what you are suggesting does happen, then potentially it devalues those other opinions where—

Senator BUSHBY—That is my concern. I would prefer to see a little bit more direction as to the standard of independent advice or what independent advice might be to ensure that there was a bit of consistency and value in the advice to make sure that discretion is exercised in a proper way, taking fully into account the advice that is received by the taxpayer.

Mr Murray—Yes.

Senator BUSHBY—Do you also accept the evidence of the previous witness that the changes proposed in this legislation extend further than just integrity measures, that they actually do represent a change in tax policy settings?

Mr Murray—In my view it does, yes. We had a position where there was a set of criteria that would assess commerciality or otherwise of a business activity, and now, by using income thresholds, there is an overlay that one might have where last year what seemed to be a commercial enterprise now is not. There is a different focus, and it is using income or other assessable income as a basis to make that distinction.

Senator BUSHBY—Presumably many of your members are involved in the provision of taxation advice. Do you think that, if enacted, this would result in a substantial or significant move away from future investment in the areas that we are talking about into other alternative investments?

Mr Murray—I cannot judge the word ‘significant’, but it is clearly going to be another consideration.

Senator BUSHBY—It will have an impact?

Mr Murray—It is going to have an impact. The word ‘significant’—

Senator BUSHBY—You can choose the word that you would like—

Mr Murray—It will have an impact, yes.

Senator BUSHBY—Some people will sit down, they will get their advice, regardless of their lifestyle preferences, and they will look at their options and they will choose other forms of investment rather than this when they might otherwise have chosen investments of this type.

Mr Murray—I think that is likely.

Senator EGGLESTON—I am quite interested in this change in the structure and rules governing taxation. As you say, it possibly involves a change in the approach to commerciality. Why shouldn't we just have a simple system of rules governing investment in businesses that applies across the board? People set up a business, deduct the costs, make a profit and pay tax or make a loss and declare a tax loss. Do you think it is reasonable that we should be setting up subjective judgments of whether or not any business enterprise is set up purely as a business enterprise or for other motivations? Shouldn't we just make a simple objective judgment based on the financial returns?

Ms Roberts—There have to be business losses—there must be a business.

Senator EGGLESTON—Yes, of course: there must be a business and the business makes a profit or loss. Surely that should be the beginning and end of it.

Mr Murray—As a fundamental principle, I think that is right, but there were certain activities where decisions were made and these non-commercial loss rules and thresholds were introduced. That was an overlay and I can accept that. If your point is to now go to the next level and ask if it is appropriate or necessary—that was considered commercial last year and now we have another set of rules—I sympathise with your view.

Senator EGGLESTON—Thank you very much. You talked about the social implications of the changes in terms of job losses or jobs that would not be created, business development, land values, taking money out of local communities and productivity. Of course, these businesses are businesses: they do employ people and they do involve investment. I would just make the observation that the Margaret River wine industry, which is now a very important industry in Western Australia and for the whole of Australia, began in the 1970s when some doctors in Busselton decided they would follow the advice of a man named John Gladstone, an agricultural scientist who thought it just might be possible to grow wine in the Margaret River district. In the 1970s they invested in what would have been regarded as hobby farm investments with perhaps little chance of commercial success. From that has grown the great Margaret River wine industry. That, I think, emphasises the fact that it is very hard to make objective judgments about the long-term economic impact and prospects of what might be described as hobby farms or tax loss investments. I think that brings us to 10.30, Chair.

CHAIR—I do not know if you want to respond to that in any way.

Senator EGGLESTON—No, I said it was an observation, but I think it makes a very strong point.

CHAIR—I thank the witnesses very much for appearing this morning.

Mr Murray—Thank you.

Ms Roberts—Thank you.

Proceedings suspended from 10.28 am to 10.48 am

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

CHAIR—Welcome. Do you have an opening statement you would like to make?

Mr McElhone—Thank you. The National Farmers Federation is a membership organisation for Australia's major agricultural commodities. We represent it under a federal structure. Individual farmers join their respective state and commodity organisations and these organisations collectively form the NFF, representing farmers on national and international issues.

Regarding this particular issue on the hobby farm tax adjustment or proposal, the NFF is concerned that ill-thought-through policies aimed at closing a perceived loophole surrounding hobby farm investors could inadvertently encapsulate and disadvantage genuine farming operations and regional communities in which they operate. The NFF believes that the proposed changes could lead to significant unintended consequences in key areas, including firstly the impact on regional communities. In many cases we must remember that the losses being incurred by high-income earners are providing a vital injection of funds to rural and regional communities through things such as the wages being paid to farm managers, to contract suppliers and other equipment purchased from local rural trading shops. The NFF believes the proposal to impose an income threshold to the non-commercial loss rules will act to reduce expenditure by these high-income individuals in regional Australia, and we are concerned about that potential.

Secondly, on the impact on environmental outcomes, the NFF is concerned that the first expenses that may be sacrificed as a result of the proposed legislation may be those investments and activities that lead to positive environmental outcomes, including spraying of weeds, pest control measures, planting vegetation that will enhance on-farm biodiversity and so forth. We believe that many of the farms being targeted by the proposed changes to the non-commercial loss rules have a solid track record in environmental management and sustainability, and therefore we do not want to jeopardise those outcomes.

Thirdly, we are concerned about the potential to provide a disincentive to maximise off-farm income by Australian farmers. Clearly, off-farm income has become a very important risk management tool for the Australian farm sector. We believe that we must ensure that imposing a \$250,000 threshold will avoid any impact on genuine farming operations. We are aware of a number of instances where this will in fact be the case. The NFF therefore questions why these farmers who have been more successful than most in generating off-farm income, even for a temporary period, should be penalised under the new proposed laws.

Fourthly, on the impact on start-up ventures, we are concerned about the potential for changes to stifle investment in agricultural ventures where the investor may need to maintain off-farm work as a transitional means to support the early years of the venture. We have a number of examples, and some examples were mentioned in the previous session, about where that has been the case. And there is the impact on existing loans and farm values, which has also been mentioned.

In addition, we suggest that the proposed savings under the budget measure are overestimates. NFF is of the view that the changes are likely to induce high-income individuals to merely shift their investments to alternative tax-effective mechanisms, most likely negative gearing of residential property, usually in metropolitan areas. We are very concerned about that fact. We believe that running a small farm is not vastly different to owning an investment property within a metropolitan area to rent to a tenant. Both are small businesses. Both require regular maintenance. Both have the potential to make losses. On this basis, the NFF cannot see any justification in creating a distinction between the treatment of an investor in a small farm and the treatment of an investor in metropolitan housing, who can access taxation benefits through negative gearing. As a result, we are concerned that this measure will see a redistribution of investor income away from regional areas and towards the metropolitan housing market.

We would also say that we question why further measures are necessary, bearing in mind that existing thresholds are already in place to ensure that hobby farms cannot be entered into purely as a loss-making entity to offset gains from other businesses. That is through the existing non-commercial loss provisions that are measured by the ATO.

Finally, we have a concern that is an ongoing issue that the National Farmers Federation has had with taxation related thresholds: the fact that there is no discussion either way of having any kind of indexation around that threshold. Sure, \$250,000 may seem like a high income now, but will it be in 10 years time? Do we have to go through another legislative process to ensure that it meets an intended level for all time into the future? They are my initial comments. I am happy to answer any questions.

CHAIR—Thank you. In terms of the number of possible problems that you have pointed out with start-up ventures and impact on existing loans, there has been criticism of the level of discretion given to the commissioner, but this is an instance where in fact the commissioner's discretion may be useful. Is that not the case?

Mr McElhone—Absolutely, and we have actually asked for clarification as to where the commissioner's discretion may be able to kick in. Where is the recognition about a horticultural project, for instance, where it could be three to six years before it is actually generating an income? There needs to be some clarity in providing that commissioner's discretion on elements such as those to make sure that that is avoided.

CHAIR—We will have the opportunity to ask Treasury about that later. Secondly, disincentive to maximise off-farm income: you are aware of a number of instances where farmers might exceed the \$250,000 threshold. Is this where they have been farming for some time and, because of conditions on their land, they seek greater off-farm income?

Mr McElhone—Off-farm income is an important part of Australian farmers' operations, as I mentioned, as a risk management tool.

CHAIR—Absolutely.

Mr McElhone—We promote and encourage farmers to broaden their income prospects through off-farm income. Indeed, some of the ABARE figures show that off-farm income on average, throughout the last few years of drought, has averaged about half of farmers' incomes. Clearly some farmers have been more successful than others at generating that income. The question remains: do you provide a disincentive to be more successful than others at generating off-farm income? We are saying that off-farm income should be encouraged.

CHAIR—If it is due to drought, then—

Mr McElhone—It will be a higher portion.

CHAIR—a tax commissioner can take into account the fact that there are drought circumstances on the farm and therefore exempt particular farmers—if the circumstances are due to environmental conditions. Is that not the case?

Mr McElhone—I am uncertain about the commissioner's discretion. That is a big element which keeps on coming out of this—that there will be commissioner's discretion, but there is no clarity about how that will operate. Indeed, if you are making investment decisions with that level of uncertainty or even ongoing decisions about your future income streams, we would question whether that is the best—

CHAIR—It seems to me that, if someone is off earning more than \$250,000 a year, unless they are in a very lucrative business, surely they are not spending much time on their farm business.

Mr McElhone—Sure.

CHAIR—Surely that has to be a consideration.

Mr McElhone—Absolutely. We agree with that and we agree that with the \$250,000 threshold we need to ask, 'Is this the genuine farming business and is this somewhere where we want to maintain the non-commercial loss thresholds in the longer term?' We are saying that you cannot just make a decision like this and not expect there to be broader consequences on regional communities, on environmental outcomes and on the whole system of land use and land use management, and indeed how the farming enterprise is managed into the future. Is this something we want to discourage? In terms of high-income earners, there are divergent views about hobby farmers within the farming community—what kind of contribution they make to rural Australia. I think it is fair to say that high-income earners who do not skimp away from their weed management controls and responsibilities, through their environmental management contributions by joining the Landcare branches in the hobby farming community, are making, in the most part, a pretty positive contribution.

CHAIR—On the other hand I am sure there is the argument that people are occupying land for nonviable businesses, land which could well be used for profitable farming businesses, for real farming, and using tax deductibility to make it possible.

Mr McElhone—Absolutely there are those views as well and that is why we would say that we do have some measures in place, that there are already non-commercial loss provisions in place. We are very

supportive of having those. We just have to make sure we get those right rather than draw an arbitrary line in the sand and say, 'If you are above that limit, you should not be able to get access to these provisions.'

Senator EGGLESTON—I was very interested in your comment in your submission that the estimate of an additional \$700 million revenue was high. Can you expand on that for the purposes of the committee?

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

Senator EGGLESTON—That leads to a couple of other questions, one of which relates to questions the chair has just asked you about non-productive hobby farms. Many hobby farms in my view or experience are actually productive farms. Whether they are growing a crop, like avocado pears, or farming deer or alpacas, they are still actually farms; they are still employing people and they are still producing a product. What percentage would fall into the category of being non-productive? I would be very interested to hear your view on that.

Mr McElhone—We have tried to get more data about hobby farmers and what kind of contribution they make. There is a lack of data in this regard. I think it is fair to say that, with the importance of off-farm income being so critical to the farming community, it has been very difficult to identify who is and who is not a hobby farmer. As you say, what may appear to be a hobby farmer can often be a very genuine farming operation which is making a very valuable contribution to regional economies and the Australian economy, and indeed they are good farmers.

Senator EGGLESTON—One of our colleagues in the federal parliament, who is one of the West Australian lower house members, was a medical practitioner in the northern suburbs of Perth and bought a block of land and grew avocado pears on it. It was probably a hobby farm in the beginning but now he has this huge avocado pear plantation. He lives on it and it is a legitimate farming business which employs people and supplies the West Australian and eastern Australian market. So in fact it is a very useful business. I really question how many of these so-called hobby farms are nongenuine, if you like. They are often employing people and producing an outcome.

The other thing I was interested in from both your submission and your remarks is the flow-on to negative gearing and property. Essentially, there is no special law that talks about negative gearing. But buying an apartment, a house or a block of flats is a business that generates an income and has costs, which either produces a profit or a loss when it is all worked out. When Keating was Treasurer and sought to abolish negative gearing it had a huge impact on the building industry and on our general economy. I am very concerned about the possibility that the principle of this legislation might be extended to cover negative gearing of property. What is your view about that?

Mr McElhone—I think there are concerns that you are right to bring up and it is more about looking at what the broader consequences of making a change like this are. I note the Governor of the Reserve Bank of Australia, Glenn Stevens, talked last week about concern over house prices. If those high-income earners turn away from regional Australia and put their focus on the limited supplies of housing in metropolitan Australia and create an extra level of demand on that housing market, what will the impacts be for the affordability of metropolitan housing? What are the kinds of impacts that we should be thinking about when we are looking at making decisions such as this? That is why we are really encouraging some real further analysis, looking carefully to make sure that we do not get perverse outcomes from taking a decision like this.

Senator EGGLESTON—If it did flow on to negative gearing there would be a significant decrease in property investment and new house start-ups and so on, I would have thought.

Mr McElhone—It is all uncertainty, but I do not think we have gone through the process of looking carefully at that analysis at this point.

Senator EGGLESTON—I was quite interested in your comment that \$250,000 might seem a high income now but in 10 years it might not be. It might be the average annual earnings if the resources boom turns out to be as favourable as some people think it might be. Is it good policy to put in place a threshold like this, or should we simply have a general tax law that applies to business investment, where people make an

investment, there are costs, they may a profit or loss and are taxed accordingly? Why have these sorts of measures at all?

Mr McElhone—There is always concern when you implement an arbitrary threshold. All we are saying is that, if you are going to implement an arbitrary threshold—it might be minimum earnings for compulsory superannuation contributions, which have stayed at the same level for about 10 years—you get into a situation where the threshold do not change and what might initially have been deemed to be an appropriate level becomes obsolete very quickly. All we are saying is that there are concerns about taking a threshold approach at any time. You have to think about that carefully to make sure you get those settings right. But, even if you do go down that path, you have to make sure they are relevant over time and that you do not have to go through a legislative process again to change them to make them more relevant.

Senator BUSHBY—Thank you, Mr McElhone, for coming along and assisting us again today. You mentioned in response to a question by Senator Hurley that you are happy that the commissioner's discretion exists. I take it you are happy that it is there but not so much about the way it actually works.

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

Senator BUSHBY—Exactly. At least there is a door that can be opened, but how you open it is another matter.

Mr McElhone—Exactly.

Senator BUSHBY—I think you have touched on this. The suggestion was made this morning and also in some of the submissions that an alternative and preferable approach, if the government is generally concerned about high net income individuals using these types of operations just to minimise tax, would be to fiddle with the numbers in the four rules that already exists rather than imposing an arbitrary \$250,000 income limit. Would you care to expand on that. How would that work?

Mr McElhone—I cannot comment at this point. We will look at the proposals when they come to the table. Obviously this came about in the budget. We have not had a really good chance to look at whether it is a problem, how much of a problem it is and how we resolve the issues through the existing laws. We would have to do some more analysis into what kinds of changes, if any, need to be made to the existing provisions.

Senator BUSHBY—Senator Eggleston touched on this. Even if there are a significant number of high net income individuals who are investing in these operations with the main motivation being to minimise the tax that they have to pay, are there still positive outcomes for the community overall from their doing that?

Mr McElhone—That is exactly what we are saying. The losses they might be making are the incomes of farm managers, shearers et cetera and machinery and equipment suppliers in regional Australia. They are making a contribution—even though it might be a—

Senator BUSHBY—By definition, if they are making a loss they are spending money. You have quite eloquently described a number of the benefits that might come out of it. But in a greater sense—and I imagine this would be interesting to the NFF—it shifts money out of the cities and into the rural and regional areas.

Mr McElhone—That is exactly right.

Senator BUSHBY—In the overall make-up of the Australian economy that has got to be a good thing because the incomes of people outside the big cities are generally lower than the incomes of people in the big cities. Shifting money from one to the other would have to be a good thing in terms of socially equalling incomes.

Mr McElhone—Yes. On the flip side, if you take that away and shift it back to metropolitan Australia, what are going to be the broader impacts? We have concerns about that.

Senator BUSHBY—We have discussed the indexation of the thresholds. We have also dealt with off-farm income to a significant extent. If the support for hobby farmers continuing to do what they currently do is reduced, what impact would that actually have on operations? We have talked about how it would impact on contractors, local rural service outlets and the communities. But the land will still be there and somebody will still do something on that land. How will this play out? Earlier we had some evidence suggesting that over the last 10 or 15 years there has been underinvestment on many farms and essentially the people who have been working on those farms have been living off the capital—by running the farms down—rather than income.

One of the reasons why these hobby farmers make losses is that they are reinvesting in the land itself, which I would have thought is a good thing. But if the hobby farmers withdraw to some extent, what would happen to the land? What would be the ongoing consequences?

Mr McElhone—This is the big question, the big uncertainty. All we can say is that hobby farmers in that category in particular are not shying away from investments in a whole range of different areas, including the environmental wellbeing of the land. We are not saying that the alternative will stop that investment, but have we really done the analysis to make sure that is going to be the case?

Senator BUSHBY—Are there sufficient individuals, companies or business interests out there that would replace the hobby farmers with sufficient capital to continue proper investment in these farms?

Mr McElhone—There will always be a market for agricultural land. We believe the prospects for agriculture moving forward are extremely strong. There will always be a market. There may be opportunities for some people if this is removed. We are just saying that this is a very uncertain element, and I am not sure whether it has all been taken into account within the projected \$700 million in savings as a result of this move.

Senator BUSHBY—We had evidence earlier from the chartered accountants and the Tax Institute. They were not willing to venture the degree to which this will happen, but they suggested that there would be a move away from high net income individuals investing in farm operations to investing in other forms of investment that would present relatively better in terms of tax minimisation. Quite clearly, their view is that this will be less attractive and investment would fall to some extent.

Mr McElhone—Clearly, yes.

Senator EGGLESTON—Can you give us examples of hobby farm type investments which have grown into significant farming enterprises that make a significant contribution to the Australian rural sector?

Mr McElhone—I do not have any examples with me right now, but I am happy to take that question on notice and come back with specific examples if people are comfortable about divulging that information.

Senator EGGLESTON—I suppose the most obvious must be the wine sector.

Mr McElhone—Sure, if you want to talk generally?

Senator EGGLESTON—Yes, just general comments for the record.

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

Senator EGGLESTON—It would be very useful if you did. I suppose there must be examples of large enterprises, if you like, which go into agriculture and create businesses in different fields and which, if an individual were doing it, might come under this legislation.

Mr McElhone—One of the difficulties is finding the data. Not many people involved in farming, regardless of whether they have other, off-farm income, identify themselves as hobby farmers. It is very difficult to decipher—‘You’re a hobby farmer and you’re not because you meet a certain threshold.’ Coming back to specific examples, sometimes it can be difficult because something has emerged out of initial investment which at that time generated some ability to tap into the non-commercial loss provisions but has developed over time into a very successful business if not industry. As I said, defining who is a hobby farmer and who is not can be difficult at times.

Senator EGGLESTON—I would have thought it not only can be difficult but is very difficult and is a central issue in this legislation.

Mr McElhone—Sure.

Senator EGGLESTON—How do you classify a farming venture as a hobby farm when it could be looked upon as a legitimate business enterprise which may make a loss?

Mr McElhone—We also have to remember that in many regional areas the mining industry has grown and in many areas provides a valuable source of off-farm income—in some cases some quite lucrative off-farm income for some farm businesses working in a partnership style arrangement. Is that something we should be providing a disincentive for?

Senator EGGLESTON—That is something I had not thought of. Would you give us some examples of what you have in mind.

Mr McElhone—The National Farmers Federation has a memorandum of understanding with the Minerals Council of Australia where we are looking at ensuring that we optimise for all sectors the limited supply of labour capacity that exists in regional Australia. We are looking at partnership arrangements whereby farmers can work in the mines and, during harvest time or busy times, go back to their properties. Making a double contribution of an interrelated nature between the two sectors is vitally important. We see a lot of that happening now, particularly in areas like the Hunter and in WA. We believe that there can be mutual benefits for both sectors, which collectively comprise the vast majority of Australia's merchandise exports.

Senator EGGLESTON—Yes, indeed. I suppose the iron ore mines of the Pilbara are actually on someone's station, but you are probably not thinking of investment of that scale! Often you do get groups of, say, professionals in capital cities who buy a wheat farm or a cattle station. I suppose that is another dimension to this. What if it is not an individual but a group of individuals who have clubbed together to make an investment? Where would an arrangement like that stand in terms of this legislation?

Mr McElhone—I am not really sure. I am not sure where that stands with regard to the eligibility under the non-commercial loss provisions—whether this is just tied to an individual. I would have to take that on notice and come back to you.

CHAIR—That is something I intended to ask Treasury, as well.

Senator EGGLESTON—It might come down to the individual's tax return, I suppose. But then you might find that if you had, say, five lawyers who bought a wheat farm, some of them they may fall within this legislation and some may not. So what happens then? You get this variation in the tax circumstances of each individual in the group that buys this farm.

Mr McElhone—That would be of interest to us as well.

Senator EGGLESTON—That is a question we will put to Treasury.

CHAIR—Before I go over to Senator Bushby there is one point that I would like to make. You are talking about people doing start-up enterprises and then becoming profitable. Under this legislation you would be able to quarantine those losses and take them forward to the period when the farm becomes profitable. Isn't that so?

Mr McElhone—I am not exactly certain.

Senator BUSHBY—Senator Eggleston has raised, I think, the very good example of Margaret River. That would be repeated all across the country in all sorts of industries. It highlights to me how a tax treatment that currently exists can actually be used to foster investment in an industry that in itself is not profitable at the moment but which once established—and that might require branding and all sorts of things to be developed over time—will present as a profitable industry, particularly regional areas like Margaret River or other parts of Australia where you might need to establish that brand for a while. The wine industry might be profitable in South Australia, where it has been for many years, but to establish the Margaret River brand it may take some time for your specific farm investments but also to get that whole area up to a point where you can charge sufficiently for a bottle of wine to make the overall investment for each individual profitable. So there is a big difference in being able to look at the start-up in terms of one person or one operation which is not yet profitable but might be in a few years time, compared to a number of people taking a risk and investing money and losing money knowing that they will for some time and in the hope that the industry in the particular area they are in will actually become profitable down the track. I do not see that there is any scope in the commissioner's discretion to actually look at that. Do you see that as a problem?

Mr McElhone—Potentially. Again, there is a lot of uncertainty on this. I have not seen anything with regard to the commissioner's discretion, to be honest—any kinds of parameters.

Senator BUSHBY—There are some examples in the explanatory memorandum, and they are quite specific. Some of the examples that show where the commissioner would not be entitled to exercise his discretion favourably would cut off an awful lot of circumstances—I think you would be surprised to read it—where it might take a couple of years, because of the fertility of the land, longer than the industry norm. Therefore you would not get it; you would not be considered commercial. It seems to me that this is likely to cut off or even just reduce investment in areas that might deliver great opportunity. I would have thought that the Margaret River branding and the industry that has built up around that is actually a good thing for the overall Australian economy. There are lots of examples like that where investment by people who had the

resources or the additional disposable income to put into these things and were encouraged to do so by the taxation system have actually developed a product or a service that delivers benefits, in the overall scheme of things, to the Australian community.

If that investment in such things is reduced or even eliminated by changes to the taxation system, who will take that risk? Who is going to have that income and who will bear the cost of investing in such speculative—not highly, but basically speculative—developments of new products and services that are going to add to the overall economy if it is not these people who have a little bit of spare income and the ability to do it on a tax effective basis?

Sure, it is something that should definitely be taken into account: the time lags of the initial investment to the time of actual profitability. Absolutely, we want to make sure that these things are taken into account in tampering at all with the non-commercial loss provisions.

Senator BUSHBY—Obviously the commissioner will apply his discretion in the way that he thinks is appropriate given the legislation and that the explanatory memorandum will not be strictly binding on him, but it will give him a guide. Nonetheless, the explanatory memorandum basically says that if independent advice comes in saying that in your particular industry it would take five years to become profitable, and your assessment of your particular operation says that it is going to take six or seven years, then you are not going to get the exemption. That is according to the explanatory memorandum. So the discretion does not appear to have the ability to take into account new industries or development of things like the Margaret River when it did not exist in the first place, because it would be very hard to get independent evidence to say how long it will take to become profitable in the Margaret River given that there was no wine industry before you started.

Mr McElhone—If anyone is relying on the commissioner's discretion in making the initial investment—

Senator BUSHBY—You will not do it.

Mr McElhone—It is not going to be a strong encouragement because there is always going to be that uncertainty there.

Senator BUSHBY—Exactly. And why would you invest in trying to develop a new industry if you are basically just going to wear the full costs of it ad infinitum until it becomes profitable? There must be other ways. Even if your lifestyle choice leads you to want to do that, you are going to have to think long and hard before you do and there may well be other places you can invest your money and get better returns.

Mr McElhone—I agree.

CHAIR—Thank you for your evidence.

[11.28 am]

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

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

Capt. Dwyer—I apologise for the brevity of this. We only became aware of it on Friday afternoon. We have since had a board meeting and a council meeting.

The Australian Alpaca Association—if I could just refer to it as the AAA—was founded in 1990 to represent the interests of alpaca owners in Australia. The first alpacas of the modern era were imported from the Americas in 1988, which was over a century since Charles Ledger had his foray into them in the 1850s. After 1988 alpacas were imported in numbers from Chile until the mid-1990s, when the Peruvian alpacas were found to have greater fleece density and weight and they became more popular.

With the advantage of the Australian woolgrowers experience in genetic development, the alpaca industry has seen rapid advances in fleece weight and fineness, a trend which has been noticed in the original host countries, and not necessarily with much glee. In 2007 the association became a company limited by guarantee with a board of nine, of which I am a member, and I am also immediate past president. I am appearing on behalf of the current president and chairman of the board, Dr Ian Davison. There are 2,425 voting members representing 1,876 breeding or owning studs, which form the modern basis of the industry, with some 106,000 registered animals as at 30 September 2009. There is quite a number of other animals that are not registered, for a variety of reasons. The extended drought in recent years has had an impact on birthing rates in some areas, which has had an impact on the expected reproduction.

Members belong to 14 regions across Australia, each with their own local committees which support and advise members on issues associated with the development and promotion of our industry and in turn represent their regions to the council, the policy body, which consists of the regional presidents together with the board members. The demographic represented by the Australian Alpaca Association is uniquely that of middle-aged people who have been successful in metropolitan based businesses and have retired with their savings and superannuation as ‘tree changers’ seeking lifestyle changes and new commercial challenges. They have invested heavily in the industry in terms of land, infrastructure and livestock and represent a significant and much needed transfer of urban wealth from savings, real estate and super into the struggling rural economies, thereby reinvigorate in those economies. The average holding of 30 alpacas, if averaged to \$3,000 per breeding female, represents a capital investment of between \$50,000 and \$90,000 in today’s terms—most people paid much higher rates for their animals when they came into the industry—so we are talking about approximately \$100,000 in livestock alone. Nowadays, most of them would invest a further \$1 million in land acquisition and infrastructure—without considering their recurrent annual expenditure, which sustains the local community. At a time when much agribusiness is contracting and rural land is being abandoned by its traditional users, the hobby farmer and tree-change investor may be all that stand between rural productivity on the one hand and the only viable alternative of urban sprawl on the other.

The AAA is grateful for the opportunity to assist the Senate’s inquiry into the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009. We apologise for not presenting a formal submission for your consideration. We are concerned to make known our views on proposed changes to the budget to tighten the non-commercial loss rules for individuals with an adjusted taxable income in excess of \$250,000. We are concerned that already strong tax disincentives to investment in our industry will be escalated by the imposition of the new measures proposed, which will disadvantage genuine farming operations.

We support the National Farmers Federation’s submission—in particular, the features illustrating the already tight arrangements in respect of so-called non-commercial losses. There is discriminatory treatment of agricultural investment in comparison to the negative gearing of city property. We particularly agree with the NFF exposition on potential negative impacts such as the disincentive to maximise off-farm incomes; the impact on the environment—alpacas are very soft on the land, and alpaca owners are genuinely concerned for the environment; the impact on regional communities, which I have already heard spelt out quite clearly to you; the impact on start-up ventures; the impact on existing loans, which is a concern; and the impact on farm values. We would also prefer to see the regulatory income threshold indexed. Thank you.

CHAIR—Thank you. I understand that the number of people in Australia earning more than \$250,000 a year is quite small. Your demographic is mostly retired or semi-retired people. Surely those earning more than \$250,000 a year in your industry would be a small number of people.

Capt. Dwyer—My difficulty is that I do not really know. I can think of about 200 or 300 of our membership who certainly have off-farm income and other professional relationships. Without being personal, I note that my own president is a very successful orthopaedic surgeon who employs a farm manager. I have been in the business a little shorter than him. I have been in it for 15 years. He has been much more successful with his genetic improvement. He has introduced a new system for benchmarking the genetic improvement. He has made a very positive contribution to the industry.

I can think of a number of people who started off on five acres—and a lot of them do, just to see if they like the idea of being further removed from suburbia—and then they buy into bigger properties. If I could be excused for saying it, I think there is a stereotypical view of what a hobby farmer is, and I think it is a very difficult thing to define. No doubt there are people who are trying to take advantage of tax loopholes. But the people that I am aware of who have built these businesses up have put a lot back into the industry in the way of their support for things like showing. Showing sounds a bit peripheral, but that is where the industry measures its advancement—and the advancement in genetics in the last 15 years has just been phenomenal, as the host countries have found out. So it is very difficult to generalise about what people do or the way they make their investments and the value of those investments.

CHAIR—]But if you want to assist a fledgling industry to advance, are there not better ways to do it than to give tax incentives to people who are already earning a fair income?

Capt. Dwyer—Can I use my own example to try to deal with that?

CHAIR—Sure.

Capt. Dwyer—In 2002 when the last taxation impost came on our industry, we were invited to have an independent assessment of our industry to try to convince the department of taxation that we might have some reasonable case to put forward. We employed ACIL, at what was a phenomenal cost to a little industry, to produce a report. Their report said that, given normal operating conditions—that is, non-drought—you could expect an alpaca farm to come near to profitability in seven years. The taxation department ignored it. So a lot of people then had to make different arrangements. I did. I attached my farm to my maritime consulting business, and that goes up and down like a yoyo. In the last quarter, for instance, I spent time on a very large commercial case, and if that were extrapolated over a full year I would be in danger of falling into this trap. That is unusual. My normal thing is much lower than that. But I am just saying that it is not so far-fetched. The other people that I think of are not necessarily full-time city type professionals; they are people who travel from regions to do their other work and gain their off-farm income and, in the meantime, are employing people—if it is not their family—to look after their stock. Of course there are the ingoing things, like investment in fencing.

CHAIR—Do you know what percentage of the alpaca farms are profitable?

Capt. Dwyer—It is quite small. Since the ACIL report, I think we have come to the position that you probably need about 200 alpacas, and what distorts this a bit is that, in the last 15 years the price per breeding female has gone from, say, \$24,000 down to \$3,000 and a lot less. Actually, they have to be quite a good standard animal to bring in \$3,000. Good standard animals can bring a lot more, of course. We just had our national show and sale. The average price paid per lot—there were only 13 or 14 lots—was about \$27,000, and it ranged from \$12,000 to \$78,000 for a stud male that had just won the ‘supreme alpaca’ of the national show.

Again, we do not know everybody’s personal business and they do not rush out to tell us about it, but I would think that the numbers are still low, and that has probably been exacerbated by the drought. In our own case, we stopped mating our animals for over five years. Others did not do that, but we did not believe supplementary feeding would be sufficient for the full development of the crias, as we call the babies.

CHAIR—You are saying that about 200 alpacas are needed to produce a viable farm, and the average among your members is about 30.

Capt. Dwyer—Yes, that would be right.

CHAIR—Are they seriously running a business, then, if they only have 30 alpacas, or is it a hobby?

Capt. Dwyer—The constraint on rapidly increasing your numbers is the sheer price of buying in, so people tend to do as we did. We started with 3½, three and a baby at foot. When we could afford it, we bought services, which at that time were very expensive, in the order of \$2,000 to \$3,000 per service, and gradually started to build up our herd. When we could, we bought half-a-dozen animals in an import from Peru. Despite

the fact that we did not do any breeding for five years, we now have about 75 animals. We have not achieved anywhere near our breeding targets because of the interruption and the fact that we could not afford more money for the better sires, because in this time the level of value of the animals and their genetic improvement has been such that, of course, the best animals are attracting the highest service prices, which is another impasse. It is a very difficult thing. As to whether it can be said to be viable, I think we are probably still in very much a start-up phase, even though we have been going for 20 years.

CHAIR—How long do the taxpayers support that—indefinitely?

Capt. Dwyer—That is a good question. In the time that we have been out here, we have tried a cooperative for fleece processing et cetera. Cooperatives have to raise money from their own members, and that is very difficult, so it was never properly capitalised. When I was president of the association we had to see the demise of the co-op. We started a new enterprise in 2004 called Australian Alpaca Fleece Ltd, a company limited by guarantee. It managed to attract sufficient capital to get it rolling. I think that company is about to declare that it has at least broken even this year and has increased its turnover enormously, so we are very pleased about that. But on the way it has disaffected a lot of members because it did not give them the price per kilo they thought was necessary; it was only paying the world price, so there are lots of little wrinkles in that area about how long it will take to really become viable. But it is progressing. There is a lot more Australian fibre now available in garments et cetera for purchase through the major department stores and some specialty stores, such as my own, which we created as another means of trying to advance ourselves with our industry. Does that answer the question?

CHAIR—Yes, I think it does—sort of.

Senator EGGLESTON—Thank you very much, Captain Dwyer, for coming along today. Alpacas come from South America, as you mentioned. Which countries in particular are most alpaca herds in?

Capt. Dwyer—The two largest herds are in Chile and Peru. There are alpacas in Argentina and certainly some in Bolivia, but in Peru—and this figure has been used and bandied around for years—they say they have more than three million alpacas. I do not know if that is correct.

Senator EGGLESTON—In Peru?

Capt. Dwyer—Yes.

Senator EGGLESTON—That is very significant. And Chile?

Capt. Dwyer—I believe that there are only 300,000 to 500,000, and it was a much greater source of food in Chile.

Senator EGGLESTON—What products are alpacas used for in Peru and Chile?

Capt. Dwyer—Fleece. The alpaca is one of four camelid species, of which the largest in size is the llama, followed by the alpaca, the guanaco, and the vicuna. The guanaco is a wild animal, undomesticated, because there was no attraction from its fleece. The vicuna, of course, is a severely threatened animal and is now found mostly in national parks guarded by people with big guns. It is the alpacas that are most suitable for fleece, and that is why they were developed.

Senator EGGLESTON—So is it the long-term objective of your group to establish alpacas as a source of alpaca wool for garments?

Capt. Dwyer—Yes.

Senator EGGLESTON—At present, of course, in Australia we rely largely on sheep. What is the advantage of alpaca wool?

Capt. Dwyer—Alpaca wool is warmer for equivalent weight—not that it does not blend very well with sheep wool. We have gained a lot from the wool industry. When a person who is familiar with handling sheep wool handles alpaca wool, they will usually say or suggest that it is about five microns finer than it actually is. That is because of its particular handle. It is very low in lanolin, so it does not have the same kind of stickiness. I should say that our goal is to get broadacre farmers with alpaca, but we cannot sell them 100 wethers at \$100 apiece and have an identical micron count through that range. That has been our challenge—to get our genetic development to that stage—but we are getting closer.

Senator EGGLESTON—That is where I was going to go. Your long-term objective is to have broadacre farming with alpacas, but you mentioned that there is a cultural factor because we are very much wedded to sheep wool. You have also mentioned another important factor, which is that you have to improve the genetics.

Of course, the genetics of sheep have been improved over the 100 and more years that we have been growing merino wool in Australia. In other words, you have a long-term objective of broadacre farming, and the time frame for development of alpaca farming to be competitive with sheep is a very long one. Therefore one might say that it is not surprising that, to this point in time—which is only a very short time for the alpaca industry—you are not achieving great profits and you are certainly a long way from achieving your objective of broadacre farming. Would you agree with that?

Capt. Dwyer—Yes.

Senator EGGLESTON—Therefore I do not think it is unreasonable if we take the previous example we have mentioned today, the Margaret River wine industry, where in the 1970s a few doctors around Busselton and Bunbury decided to have a go at growing grapes around Margaret River because somebody thought it might work, and now 30 years later you have this enormous multimillion-dollar industry in Margaret River with the wine industry and associated restaurants and hospitality. The short period of time that the alpaca industry has been developing is not very great given that you need to modify the genetics and overcome the cultural predisposition of Australians towards merino or other sheep's wool, is it?

Capt. Dwyer—That is true.

Senator EGGLESTON—So the criticism that this is just a tax-saving measure for some people who happen to have a high disposable income is probably not very fair if you are thinking of your long-term objective of establishing a broadacre farming industry based on alpacas.

Capt. Dwyer—We do not think it is fair, but we appreciate that there is a level of unintended ignorance in that area. I come from Braidwood, which has always been a fairly heavy sheep area—not so much recently. They are suspicious of alpaca because they fear contamination et cetera, and alpaca is referred to as the 'exotic' animal. Let us face it: they are all exotic animals, and none of them were here originally. I think that, if Charles Ledger had been more successful in the 1850s, people might well have gone for development of the alpaca instead of the sheep.

Senator EGGLESTON—That is a very good point. Where I am really going is that if you are going to diversify the Australian economy and introduce and establish new industries then you have to be prepared to let people experiment. I would say that the Margaret River wine industry was set up on tax-losing investments in so-called hobby farms by a group of people in the south-west. In the same way, you have a group of people here who are setting up an alternative to the sheep industry with a different kind of wool. I think one of the dangers in this kind of legislation is that it confines us to what we know and leaves no space for the development of new technologies and industries in various kinds of agriculture. Would you like to comment on that proposition—to make it a question?

Capt. Dwyer—I wonder what I would have done other than going into alpaca. I was attracted to alpaca—and please steer me back if you think I am getting off the track—because I did not think I would be able to afford a large enough start-up property to handle cattle, for instance, and I thought they would tread on my feet and I would not like that either! I went for something smaller that had a good and worthwhile product. When I started I was still an employee of the Queensland government, so there were tax benefits in doing it. But I do not think I could have done it without them, not for the amount of money I had to keep ploughing back in.

Senator EGGLESTON—What I am trying to suggest is really that this kind of measure limits enterprise, imagination and diversity. If people want to risk their money in going down some new and previously-unthought-of pathway, like growing alpaca wool in Australia or growing wine in the south-west of Western Australia or avocado pears or some other exotic fruit, it would not happen in many cases unless there was an ability to write off a loss in the early years and the development years against taxation.

Capt. Dwyer—I agree with that.

Senator EGGLESTON—So this kind of legislation is counterproductive and, may I say, the outcome of very grey and boring people with little imagination. But that is just my personal view. There have been comments made about the commissioner's discretion. Do you have any views about that?

Capt. Dwyer—Only from our experience with the situation when the five rules were introduced about the \$20,000 profit, which I think was in either 2001 or 2002. Our small industry spent a lot of money—I think it was more than \$20,000—to get a report from an independent body to make the case, and it was not accepted. You could say that we wasted our money, although it did help us to be able to identify those areas where we could put further effort into our industry. Certainly that was a disincentive to quite a number of people at that time.

Senator EGGLESTON—Do you see flow-on effects from this legislation? Might it apply, for example, to areas like property development and so on? If you accept the principle of this, might it not flow on to negative gearing of property?

Capt. Dwyer—It is difficult to quantify but it seems to us that there is quite a possibility. We think it is a little unfair that the whole process of negative gearing is so slanted towards residential. We understand the reason; it is just that we do not agree with it. Certainly out our way, where the big debate locally in the council has been about the size of subdivisions et cetera, people have come down to our area looking at 100-acre blocks, which is the minimum size at this time, and some of those are just a little beyond them. Where I paid \$1,000 per acre in 1995, people are asking for \$5,000 per acre now. It just gets to be very difficult to get a start-up property.

Senator EGGLESTON—My basic point really is that there is no separate legislation for negative gearing. It is just a business investment in which somebody invests in a business that happens to be a property. There are costs that they deduct and there is an income which the deductions are set off against, and it either produces a profit or a loss. What is your view about special case legislation such as this? Should we not simply have legislation for business investments, without trying to involve people like the Commissioner of Taxation in subjective judgments about whether it is right and proper for certain people to make investments in somewhat different kinds of business investments because they might be interpreted as offsetting tax, whereas in fact they are just a business that will make a profit or a loss and be taxed accordingly?

Capt. Dwyer—I would very much like to be part of the development of that kind of idea, not because I have any particular doubts about the ability of the Australian Taxation Office to make a judgment. I tend to agree with your proposition that it is probably not the area that should be having the consideration, that it should be a broader discussion in the community about whether it is worth while supporting this kind of industry.

Senator EGGLESTON—Thank you, Mr Dwyer.

Senator BUSHBY—Mr Dwyer, you commented earlier that, on the whole, the industry is probably not profitable at this point. What of the actual expenditure in the industry is investment in the development of their operations, or even of the industry, and how much would be recurrent costs that are incurred because they are necessary to running of the operation?

Capt. Dwyer—I suppose the land cost and then the animal cost are the first two major costs, and the development of the land. Typically, alpaca enterprises use multiple small areas because there is separation of stud males, weathered males and females. There are two types of alpaca, the huacaya, which has the merino like fleece, and the suri, which has goat like fleece. It is not crimped but it has a very high lustre. Also, you would possibly have separations for the two breeds. So those three areas, the land, the animals and the investment in the development of the land.

Senator BUSHBY—And those would all be normal set-up costs, to some extent?

Capt. Dwyer—Yes.

Senator BUSHBY—What would set the alpaca industry apart in terms of its development as a profitable industry as a whole?

Capt. Dwyer—One of the largest is getting the genetic development by going for the progressively larger size that has become available.

Senator BUSHBY—And that is done by careful selection of animals and breeding?

Capt. Dwyer—Yes. In the last few years we have had quite a successful ET program as well.

Senator BUSHBY—Earlier we had a discussion about how long taxpayers should support the industry until such time as it becomes a profitable industry in the overall scheme of things. Personally, I do not accept that, in essence, the taxpayers are supporting the industry. It is more that the current tax laws just do not create an obligation in these particular circumstances for you to pay tax on that.

Be that as it may, I also support Senator Eggleston's view that, even if you do provide deductibility and, as such, do not add to the tax base, activity such as yours and similar industries such as hobby farms in general are promoting economic activity and paying wages. We have heard evidence of this today. They are supporting community incomes and activities and generally adding to the economic and social strength of communities, whilst at the same time, particularly in cases like yours and the Margaret River case that we heard about

before, increasing products and services that might otherwise be available to the Australian or even the international markets. I presume you would agree with all of that?

Capt. Dwyer—Yes.

Senator BUSHBY—To what extent would these positive outcomes be possible or even likely—and in this case I would expect you to talk about the industry that you know—without the tax treatment that is currently in place?

Capt. Dwyer—I think it would be very difficult, but I do not suppose it is impossible. I could not have done it because I just cannot earn enough extra funding to keep it going, to have those disbursements and to pay tax.

Senator BUSHBY—The current tax treatment renders it possible for people, particularly those who have higher net incomes, who are probably in general more likely to be the people who have higher net disposable incomes to invest in this type of activity, to actually invest in what people refer to as hobby farms which have those positive outcomes that we just mentioned a minute ago.

Capt. Dwyer—I have not been involved in a discussion in the industry with members, which would tease out some of those issues, and I do not feel really competent to give any reasonable response.

Senator BUSHBY—If the changes that are being proposed are enacted, would that be a disincentive to new investors in the industry?

Capt. Dwyer—I am very certain of that because of the choices.

Senator BUSHBY—What do you mean by ‘the choices’?

Capt. Dwyer—It would be easier for people to go for something like negatively gearing a residential property than getting involved in farming.

Senator BUSHBY—I asked the question of the tax advisers earlier but this is not so much a tax advice question, it is more for somebody who actually goes through this process such as yourself. If you are thinking about what to invest in in the future, will tax minimisation be part of your suite of factors that you will look at when making that decision?

Capt. Dwyer—Under current circumstances for us it would have to be. I would love to be earning a great profit and paying all the tax that is due. I would then be very successful.

Senator BUSHBY—Absolutely, but in the meantime you cannot and you made a decision to invest in alpacas. Would the absence of tax deductibility, if your circumstances were actually captured by this and you could not convince the commissioner that you qualified for an exemption, which I doubt you would under the way it is written, have acted as a disincentive to you from investing in this industry as opposed to elsewhere?

Capt. Dwyer—Absolutely.

Senator BUSHBY—What about people who are currently in the industry, like yourself. I do not know what your personal tax circumstances are and I do not want to know. If somebody, who has invested in the alpaca industry, may have been involved for many years and has an income which is above the \$250,000 threshold, applies to the tax commissioner and does not get an exemption, what do you think they would be likely to do in terms of their current investment in the alpaca industry?

Capt. Dwyer—I was talking to one of our board members yesterday about this. She had had a company—they had been in landscaping or something like that—moved to alpacas with a B&B, and the accountant said it was not worth the expense of maintaining the company; just her husband and herself in partnership would be adequate. When we talked about this yesterday she was really worried that she is going to be in a very difficult position in the future, so she is going to have to consider whether she might want to become a company again.

Senator BUSHBY—In that particular circumstance, the other form of income was the B&B or did they have other income?

Capt. Dwyer—She is one of the most successful marketers of alpacas in Queensland, so she would be getting up there.

Senator BUSHBY—In general you think that there would be some tendency or incentive, if this was enacted, for people who are currently involved in the industry to look elsewhere?

Capt. Dwyer—Certainly to review their position.

CHAIR—Mr Dwyer, thank you for giving us that on-the-ground perspective of the industry.

Capt. Dwyer—I am very grateful for the opportunity, thank you.

Proceedings suspended from 12.05 pm to 1 pm

JOHNSON, Mr Tim, Vice President, Thoroughbred Breeders Australia**TIMS, Mr Adam, Director, Thoroughbred Breeders Victoria, Thoroughbred Breeders Australia; and Director, Stable Financial**

CHAIR—Thank you for coming in this afternoon. Do you have an opening statement that you would like to make?

Mr Johnson—I would like to introduce Adam Tims to you. Adam is a director of Thoroughbred Breeders Victoria, of which I am president, and is also an accountant who specialises in the equine industry, so he is dealing with taxation and accounting issues in our industry on a daily basis. He is the expert from that point of view. I am a horse breeder. I have a horse stud here in Victoria and see the impact that horse breeding has in our local community of Euroa, which is in the north-east, near Shepparton. It is very much a regionally based industry, even though the glamour that you see in the race meetings is city based come cup week—maybe Sydney and Perth at different times. Fundamentally the industry is very much regionally based. That is where all the horses are bred, reared and, more often than not, trained. From that point of view, it is a very important industry for regional investment and for regional jobs. In certain areas, depending on what part of your respective state you are in, it is the major industry in the local area. So any impact that taxation issues have as far as investment goes ends up flowing back to employment and investment levels in regional Australia. I will hand over to Adam. Thank you very much for hearing us.

Mr Tims—Thanks for the opportunity to appear before you. I understand that you already have our submission dated 2 November 2009. If it is okay with you, I would like to run through a few of those key points. Our main concern is about the arbitrary \$250,000 adjusted taxable income figure. Obviously, this is the main change to the existing non-commercial loss provisions. When the measures were announced in this year's budget in May, it appeared that the Treasurer intended to tighten the rules, because taxpayers with higher incomes were able to meet the tests advantageously. In other words, there was a perceived loophole around hobby farms or, if you like, your Collins Street farmer. I quote his media release:

Many of these activities do not have a commercial purpose or character and are no more than hobbies or lifestyle choices.

Thoroughbred Breeders Australia asserts that this legislation has cast a much wider net than intended and will adversely impact larger commercial and legitimate businesses, including many breeding businesses. The breeding industry is significant—big bucks. There is huge investment and a significant amount of capital is tied up in the industry. We are not talking about hobby amounts. Typically, a horse breeder on the lighter side would have five to 10 brood mares and would normally serve most of those brood mares on an annual basis. Service fees alone for five to 10 brood mares, if I can offer an average or typical amount, would be in the vicinity of \$200,000 per annum. So that is one cost item, albeit a major cost item, that should indicate the investment that goes into the horse industry, particularly in regional areas.

There are a number of examples in our submission of these larger commercial enterprises being caught under the proposed new rules. Many of these people may be viewed as higher income individuals, but they should also be viewed as entrepreneurial and as contributing significantly to the economy. Many of these individuals, including many of our clients at Stable Financial, have worked tirelessly for many years and have got to a stage in their lives when their other adjusted taxable income may be over \$250,000. They are spending a significant amount of time, let alone capital, in these new breeding ventures. In most cases these are businesses that have strong business plans and have a lot of time dedicated to the enterprise.

This week in Keeneland in America there is a big brood mare sale. With the relatively strong Australian dollar and also a weaker US economy, I know of a large number of Australians heading to that sale after the carnival to buy brood mares. It costs them A\$20,000 to bring those mares back to Australia. If the mares are in foal, they also need to leave the mares there to foal down and perhaps sell those foals in America and bring the mares back to Australia to be served at Southern Hemisphere time. The reason I bring that up is that these are individuals that are going to be caught under this net. They are going to America with experts, bloodstock agents et cetera. They are spending a significant amount of their capital and they are now being caught under this net of non-commercial business losses.

The main concern that Thoroughbred Breeders Australia have for our members, the breeders, is the uncertainty around these rules. We welcome the amendments to the exposure draft that require the application to be made to the commissioner in an approved form, and we acknowledge that there have been endeavours to try and clear up what the process will be in terms of applying to the commissioner for his discretion. However,

as Mr Johnson alluded to, the horse industry is very diverse in its mix of participants. In our application to the tax commissioner we would need to demonstrate objectively, with the use of experts and evidence, that their business activities are considered commercially viable for the industry concerned. In other words, we need to be able to demonstrate that it fits within a certain typical range for the industry. In our submission we mentioned a suggested lead time of five to 10 years for the horse industry, but I preface that by saying that, because of the diverse nature of the participants and the way they go about their businesses, it would be very difficult to come up with a typical lead period. Naturally, in those early years the use of tax deductions and the assistance with working capital are quite often necessary to make sure that these viable businesses remain viable and continue.

The resources need to be committed at a time that is significantly earlier than when you would get the commissioner's decision on the discretion. For instance, my understanding is that somebody starting a breeding business today would at best be able to apply to the commissioner in July 2010. That process may take many months; we are not sure. So possibly we have a situation where new participants are entering the horse industry, investing millions of dollars, let alone hundreds of thousands of dollars, and having that capital tied up with the uncertainty of whether or not that enterprise would fall under the new rules. It would definitely fall under this new \$250,000 rule if they did not pass the new income requirement, but the problem is that the certainty around that investment is lost because they would need to wait for some period afterwards to get a decision as to whether or not those losses would be allowed. In the earlier years, because of the nature of the industry and the breeding cycle et cetera, there will inevitably be losses.

We have a situation where existing breeders and potential breeders cannot trade with any real confidence. They cannot go to their banks with any real confidence. They are already being scrutinised by the tax office as we speak, and the new rules are casting a far wider net than was envisaged in the May budget. We do have solution, I am happy to say, which is set out in our submission. It is a reasonably simple solution—that is, remove the \$500,000 real property test rather than introduce this arbitrary \$250,000 income test. The real property test is one of the existing four tests of the non-commercial loss provisions and is, in our view, the one that would be passed by, if you like, your Collins Street farmer or the individual that the government is looking to target in these proposed changes. So our No. 1 solution is to remove that \$500,000 test.

We also refer to a business passport in our submission. The real frustration for horse industry participants is having to go cap in hand to the tax office on a regular basis to argue the point that they are an enterprise or a business, whether it is about GST refunds, the significant tax audit that the industry endured from 2005 to 2009 or now these non-commercial loss provisions. The problem is that a horse breeder might have to go to the tax office on numerous occasions to justify their existence as a commercial enterprise.

It is a very emotional time. I have been involved in 50 audits recently. We have legitimate regional breeders who are being questioned about the viability of their commercial enterprise. They spend countless hours in those businesses and to say that it is a frustrating process is an understatement. At Thoroughbred Breeders Australia we fear that these new rules will create not only uncertainty for breeders but also significant cost in having to justify independently, with the use of experts, that they are a legitimate business and the time involved in going through that process.

In summary, the new rules really do cast a wider net. The breeding industry is a significant industry, as set out in our submission. We believe that a large number of individuals will fall under these new provisions and there is no certainty as to the outcome of their tax position.

CHAIR—Thank you, Mr Tims. You talked about businesses involving viable businesses but which are obviously not profitable. You talked, too, about a period by which breeding businesses should expect to be profitable.

Mr Tims—Yes.

CHAIR—When you are talking about those businesses that are viable but not profitable, are you talking about that start-up period or are you talking about a longer term than that?

Mr Tims—No. I am talking about the start-up period. As I said, we mentioned a lead period of five to 10 years. It seems a very long period, but it is realistic. For instance, you can have a breeding business that commences with barren mares. So the cycle is that they would be served between the months of, say, September and November, and they then foal down from August to November of the following year. They are not selling those foals until they are one year of age. So there is a three-year cycle and, then, there is another 12 to 18 months before they hit the racetrack. So that is how we get the five to 10 years to give that barren

mare a chance to be commercially viable, and that progeny will then have an opportunity to race and further the bloodlines of the mare.

CHAIR—But this legislation does make allowances for that kind of period. Have you had any discussions with the tax office about the kind of period that would be allowed by the Tax Commissioner? Have you had any consultation with him?

Mr Tims—In relation to these non-commercial loss provisions?

CHAIR—Yes.

Mr Tims—No, not in relation to these provisions.

CHAIR—The examples given in the explanatory memorandum certainly contemplate that there would be periods before a business could be expected to make a profit and they allow for an exemption for that time.

Mr Tims—Yes.

CHAIR—Are you not confident that—

Mr Tims—Sorry to interrupt.

CHAIR—Go ahead.

Mr Tims—The example that relates to the horse industry in that memorandum is at page 108 example 2.4, or section 2.34. It says:

Karen carries on a business of horse breeding, training and selling horses in partnership. The partnership commenced a breeding program which will, in time, enable the breeding of high quality, sought-after animals.

With respect, that example, that circumstance of somebody training horses and breeding them to sell, would be a very rare case indeed. I do not know of many horse trainers who would do that. It really just highlights that there is a lot of misunderstanding about the industry. It is such a diverse industry. The example that is used at the moment in the explanatory memorandum would be a very rare case indeed.

CHAIR—Nevertheless, isn't it a salient point? The example says:

This period ... supports a lead time of six to seven years for the industry.

Mr Tims—Yes.

CHAIR—So, certainly in the explanatory memorandum, there is a contemplation that there would be something like the period you are talking about, between five and 10 years, when you could apply for an exemption and be reasonably confident of getting it.

Mr Tims—I am not sure about being 'reasonably confident'. It says:

... the Commissioner may exercise the discretion ...

The horse industry was targeted by the tax office in 2005, and through to 2008 there were extensive audits. In the early part of that audit process a large number of legitimate horse businesses were being denied. The tax office argued that they were not enterprises. We had to object to a number of objections. The tax office in some cases go higher. I am very confident that there is still a lot of uncertainty as to how this application process will eventuate. As a minimum, there can be a 12- to 24-month lag between investing or tying up your capital in the industry and actually getting a firm decision from the tax office. Some of my clients have stopped sending their brood mares to studs this season for that reason—that there is this uncertainty. I know of others, some listed in the examples in our submission, who have decided not to enter the industry because of this uncertainty. For a lot of horse breeders it is almost the straw that breaks the camel's back. They have been scrutinised for so long. This is another example of where they have to go cap in hand, spend a lot of money and say, 'Even though we're going to America and buying brood mares or we're engaging specialists, we have a detailed business plan and we spend 30 to 40 hours a week in this enterprise we are still not viewed 100 per cent as a business.' These provisions are non-commercial loss provisions. It is a very emotional time assisting a taxpayer to argue the case that they are actually a commercial enterprise, when they spend so much time in and put so much effort into their businesses.

CHAIR—You say you have just been through that extensive audit period. Do you have any idea then of what percentage of your breeders would be profitable and what percentage would not be?

Mr Tims—Of the members of Thoroughbred Breeders Australia?

CHAIR—Yes.

Mr Tims—I will just quote from the Australian stud book. There are approximately 11,500 breeders in Australia and approximately 27,000 brood mares. Of those breeders, 58.9 per cent have five mares or fewer. Generally speaking, I would regard any breeder with five mares or fewer as being a hobby breeder or not a business enterprise. In other words, approximately 40 per cent of those breeders would be legitimate businesses.

CHAIR—So they are legitimate businesses but not necessarily making a profit at this time.

Mr Tims—Not in the initial years—unless you are pinhooking, where you buy a weanling, which is less than one year old, and sell it as a yearling, typically. So you buy a very young horse, keep it for nine to 12 months and sell it to trade at a profit. The other situation is to, say, buy a yearling and sell it as a two-year-old. If there is some of that happening, then there is an opportunity to make a profit perhaps in the first or second year. Because of the gestation period and the nature of the industry, we do not expect to see profits in the first few years at least.

CHAIR—Again we are back to talking about that period where you are building up your business, and again it does seem to me that the provisions allow for that. So I guess what you are saying is that you just lack confidence in the tax commissioner in terms of the severity, given your experiences with the auditing.

Mr Tims—Yes, you could put it that way.

Mr Johnson—Our industry is somewhat mystical to some parties in this country, in that it is deemed to be a rich man's sport. It comes across like that from what you see in the newspaper, on television and everything else. But behind the scenes people are working tirelessly with their horses. Some people are purely investing and having them looked after the horsemen, so to speak. But there is this misconception—and certain elements of the tax office certainly held this view when they did the audit, because you were getting different interpretations, depending on which audit team came to your premises—that horse breeding is an industry that you would struggle to make a livelihood out of and really it was just an indulgence. For the majority of people who own horses, it is the opposite. It is hard work, it is time-consuming, it is dealing with livestock so you need luck, and because it is a racehorse you need even more luck. Unfortunately, the industry is seen as an elite sport ultimately, which means an elite industry, and it is far from that.

CHAIR—Thank you. Just a quick question, because I will move on to other senators. Thank you for your submission and for suggesting possible alternatives for us. It is very useful. I am particularly interested in the real property test. Were you able to do any calculations of what it would mean? Do you feel that this might be an equivalent amount of income for the government with the removal of the real property test rather than the income test?

Mr Tims—My understanding is that we have not done any modelling on it. My gut feeling is that that test is the one that would be satisfied most by your hobby-type farmer. Again, with respect to somebody with a few head of cattle or whatever, who has a property, \$500,000—especially with the way property prices have gone in the last five to 10 years—I would not think would be too difficult to achieve as a test.

The non-commercial loss provisions I think do work reasonably well, in that generally non-commercial businesses will not satisfy the \$20,000 income, \$100,000 in other assets or half a million dollar real property test. Many horse breeders have now been brought into this regime and to us it just seems unnecessary.

Senator EGGLESTON—Thank you very much for your submission, which I read through last night. I agree with you about the real property test. It is very hard to find a house anywhere or even a unit that is not around \$400,000 or \$500,000 in a good suburb or a bigger regional area, so I agree that that property test value should be put up substantially or done away with altogether. What do you think the real point of this legislation is, though? You talked about income generated for the government. Do you think this is really an income-generating measure?

Mr Tims—When I first saw the announcement in the papers I thought it was political point scoring more than anything else. We have not even spoken about the flow-on effects—the loss of employment et cetera that might happen.

Senator EGGLESTON—That is what I would like to ask you about in a minute.

Mr Tims—I have mentioned those examples anonymously, but there are some real examples of breeders who will exit the industry. Some of them will exit the industry and take with them two or three small trainers, some farriers and stable hands. I do expect there to be a follow-on effect of a loss of jobs. In terms of the revenue forecasts, I wonder whether the modelling has taken that into account.

Senator EGGLESTON—Usually they assume that everything remains equal when they do this modelling. I think it is a fair point that in fact there may be a lot of adverse flow-on effects on employment, income generated and, I suppose, taxation income to the government as a result of that. You talk about uncertainty and the extra compliance costs. Do you want to add anything to that?

Mr Tims—It is really a matter of how far the taxpayer has to go. I could easily see \$10,000 plus needing to be spent to go to the tax office to justify that this is legitimately within the nature of the industry, that the business is one that would be regarded as typical in the horse industry. But to do that you need to go armed with a business plan, projections and expert advice. That does not come cheap.

Senator EGGLESTON—No, that is very true. You talk about the thoroughbred breeding business relying on tax deductions to fund the operations in the start-up phase, and this morning we talked about the wine industry and the alpaca industry as examples of where things start slowly and build up. I think this is another example of an industry which might be put in jeopardy by provisions such as this, because fewer people will go into it and Australia will end up being economically poorer, in a sense, for these industries not getting off the ground.

Mr Johnson—What we have found in the past is that whenever taxation changes happen across our way New Zealand will change the taxation laws for their thoroughbred industry for depreciation et cetera. That happened some 18 months or two years ago now, and all of a sudden there was an influx of New Zealand money buying our best stock to take to New Zealand to support their taxation position and investment in their industry. The same had previously happened prior to Bob Hawke coming in and changing the taxation legislation depreciation regime in our industry back in the seventies. We found a mass exodus of our livestock going to New Zealand then because they had a preferred taxation system.

So our industry is very sensitive to whatever the position is at the time in another country, particularly our major competitor in export markets. The money moves. As I said earlier, our industry is somewhat fickle and not the easiest to make a successful business out of, but luckily people are endeavouring to. Anything adverse does affect it and affects it very quickly.

Senator EGGLESTON—How much is your industry worth overall? You might have mentioned that but I missed it, I am sorry.

Mr Tims—In our submission, on page 7 at A1 ‘Size and scope of the Australian thoroughbred industry’, we have a quote from Bill Shorten from *Hansard* where he says:

The economic activity generated by thoroughbred racing and breeding alone contributes more than \$5 billion to the national GDP and is the fourth largest industry in Australia.

Senator EGGLESTON—One of our major competitors, if not the major competitor, is New Zealand. Do you want to compare and contrast the tax regimes in New Zealand and Australia—just expand on that a little bit for the record. Is there any legislation like this applying to the horse-breeding industry in New Zealand?

Mr Tims—Absolutely not, no.

Senator EGGLESTON—Are there tax incentives in the New Zealand taxation regime?

Mr Tims—I will give you an example with stallions, which are regarded as the area where there is most likelihood of making significant profits in the horse-breeding industry. In New Zealand they are able to write down or depreciate their stallions at 75 per cent in the first year. In Australia our write-down is 25 per cent over four years.

Senator EGGLESTON—That is a massive difference.

Mr Tims—We have seen some Australians go and set up in New Zealand for that reason alone.

Senator EGGLESTON—Do you think that is a trend that will become more accentuated with this legislation?

Mr Tims—This legislation applies to individuals, so Australian resident individuals.

Senator EGGLESTON—But they still have to declare their tax situation in Australia. It seems to me to be legislation which is having an adverse impact on a lot of industries. I am just a little surprised that the government is going down this pathway, because it seems to have few tangible benefits to redeem it.

Mr Johnson—I might just say the timing of it, if nothing else, is probably poor—even if one might argue that it is good legislation—for the mere fact that it is coming on the back of the drought or still in the drought. Anything that impacts primary production is exacerbated at the moment because of our climatic conditions.

Senator EGGLESTON—Okay. Thank you very much.

Senator BUSHBY—Thank you, Mr Johnson and Mr Tims, for assisting us with this inquiry. You mentioned that the actual legislation before us is different to that envisaged when it was announced at budget time and casts a wider net. What did you actually expect after the announcement? How did you think the government might go about implementing what it announced in the budget?

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

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

Mr Tims—And that is not fair.

Senator BUSHBY—It is not fair—exactly. Then you thought that they might try and implement an approach that was a bit more targeted to try and get those people rather than those who are involved in the industry in the way that you have been talking about today.

Mr Tims—The nonsense is that you could have somebody on \$260,000 who asks for a pay cut of \$20,000 and then continues on in their merry way. We talk about the integrity and fairness of the tax system. I fear that you have some really hardworking people who are at a stage of their career where it is not too difficult to get to the \$250,000 with those adjustments for superannuation, reportable fringe benefits et cetera. I just think it has brought in some entrepreneurial types that have chosen at that stage of their careers or lives to dedicate a fair whack of their time and capital to an industry that they see as being one that they can make money in. It is labour intensive, it is capital intensive and it has, because of the size of the industry, huge follow-on benefits.

Senator BUSHBY—We had evidence this morning, before lunch, from a number of witnesses that suggested that in a lot of cases the deductibility that exists at the moment has actually contributed, not just in this industry but in other industries ranging from wine to alpacas and goodness knows what else, to actually promoting economic activity. It helps activity that pays wages, supports community incomes and activities, and generally adds to the economic and social strength of communities, particularly outside urban areas. In that circumstance we have also heard evidence that it helps transfer money from urban areas to regional areas, where it is probably needed. At the same time it actually helps promote the development of products and services that might not otherwise have been as effectively promoted. I presume that you would agree with all of that.

Mr Tims—Certainly.

Senator BUSHBY—Particularly in terms of the thoroughbred industry?

Mr Johnson—The thoroughbred industry is probably even more labour intensive than some of those other agricultural enterprises that you mentioned.

Senator BUSHBY—So the benefit in terms of employment, particularly outside of the cities, is probably even more poignant—

Mr Johnson—Certainly. Far more.

Senator BUSHBY—in your industry than it might be in some of the others.

Mr Johnson—Yes.

Senator BUSHBY—To what extent would these positive outcomes have been possible or even likely in the thoroughbred industry without the tax treatment that is currently in place? Would it have developed in the same way, do you think?

Mr Johnson—Those tax changes in the seventies stimulated the Australian thoroughbred industry to the degree now where we match anyone in the world. Without tax assistance we would be, perhaps, 15 or 20 years behind where we are today, whereby we export our horses throughout the world, particularly to Asia. Asia has traditionally been a large buyer from Europe and America. We have been able to access those blood lines from Europe and America and then have them bred to Southern Hemisphere time. The same so-called product, because they are from the same blood lines, are then competing in Asia against each other, some having been

bought from the Northern Hemisphere and some having been bought from Australia. The Australian product has proven to be superior.

Senator BUSHBY—To clarify, that could have happened with a business that is operating in a normal way and is not necessarily dependent on somebody living in the city or somewhere else who has an income of \$250,000 or more. To what extent has the input of high-net income individuals who have invested in the industry helped make all of that possible?

Mr Johnson—I would not know exactly. It is significant. There is no doubt it is significant. When you purchase a stallion these days, they are a minimum of \$1 million for something semicommercial. For the truly commercial ones, unfortunately, we are now competing with Sheikh Mohammed and Coolmore, the Irish organisation who have breeding operations in our own country. Their tax regimes that they operate under are very different to those that we Australians are operating under. But we do not say no to their investment, and they have created enormous employment, and they have also brought the blood lines to Australia that they currently hold in the Northern Hemisphere. To be able to depreciate a stallion is the only way you can afford to go into the horse, because the likelihood of return on your capital without depreciation is negligible because the odds of getting a successful stallion are very small.

Senator BUSHBY—I appreciate that. I know you provided some examples in your submission but, of those people who currently invest in the thoroughbred breeding industry, what impact would the change, if enacted, be likely to have on them? Obviously it is really only going to impact on those high-net-income individuals, but how do you think that they will be likely to react?

Mr Tims—I am seeing signs of breeders that are not sending their brood mares to stud this year because of the uncertainty.

Senator BUSHBY—Once the certainty is there and it is enacted, what do you think they will do?

Mr Tims—If there were more certainty, they would stay in the industry.

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

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

Senator BUSHBY—So there is an uncertainty in the lead-up to that, but at some point this legislation may well become law. If it becomes law, then presumably your members who are caught within the various thresholds will make an application to the commissioner. So you have got two different periods, including the period before then, in terms of what you were just talking about. If they make an application to the commissioner and they are not successful—the discretion is exercised against what they hope to achieve—what impact would that have?

Mr Tims—I think that they would either exit the industry or downsize to the point where it is a hobby.

Senator BUSHBY—Presumably the industry has new players who come into it and people who retire. What about the impact on being able to attract new players to the industry once this becomes law?

Mr Tims—I think it becomes exceedingly difficult. There is an example in there of somebody who has been racing and learning a lot about the industry on a hobby basis—just cutting their teeth and looking to enter the industry significantly. Now this is just another reason for them to defer that next level of investment.

Senator BUSHBY—You mentioned the fact that some of them, rather than choosing to exit the industry, may choose to scale back to being a hobby farmer. I presume, from what you just said, that one impact may well be that those people who get into it for lifestyle reasons and are prepared to pay after-tax dollars to fund it as a hobby are not likely, if they have got an income over \$250,000, to look to scale up significantly unless they are very confident that they will get a favourable ruling from the tax commissioner. So it may actually act as a disincentive for hobby farmers to expand.

Mr Tims—Definitely.

Senator BUSHBY—You raised in your opening comments—and there was something about it in your submission—the idea of getting more certainty from the tax commissioner in terms of the interaction of your members with them on tax rulings. You raised in your submission the idea of a business passport. You talked about the idea of private rulings and how they might interact with decisions of the tax commissioner under these proposed provisions. Would you like to expand on that a little bit?

Mr Tims—If you are commencing a breeding business today, you do have the option to go to the tax office and apply for a private ruling. I do not think it is clear in the legislation as to whether or not that private ruling would mean that it could be used at a later date for the purposes of these non-commercial loss provisions. We have a number of clients that, for instance, might have a GST refund and, because of the seasonality of the industry, where they might spend half a million dollars on purchasing horses, that is \$50,000 worth of GST. Then there is a refund that gets held up because somewhere in the tax office they are saying, ‘It’s not normal to have a refund of that size.’

Then there is a GST questionnaire that will come out to them. They will need to complete that and send in the business plans and projections. They are trying to run a business and, potentially, they have external funding, so they are needing to plan for cash flows and all of a sudden the GST refund that they had planned for is frozen and that can be frozen for many months. The reason I bring it up is that it is not dissimilar to this situation where they are investing money and not finding out whether they are going to have the commissioner’s discretion until maybe 12 months or two years after they have invested the money.

Senator BUSHBY—Why do you say that? You said it before and you said it in your submission. You mentioned a minute ago that as a start-up business you could seek a private ruling. Could you not at same time apply for the commissioner’s discretion or are you saying that you need to have a bit of a track record before you can justify that your operation is actually commercial?

Mr Tims—My understanding is that with the commissioner’s discretion with these non-commercial loss provisions the earliest you can apply for it is at the end of a financial year and so the first relevant financial year is 30 June 2010. The earliest that you could apply for that would be July 2010.

Senator BUSHBY—You also noted in your submission that in this particular business a lot of the value is in the horses and that may not be realised for some years in which case it actually impacts on your profit and loss in those years until that profit is actually realised. Could you just expand on that little bit and how that might impact on your ability to convince the commissioner that you are a commercially viable operation?

Mr Tims—That is a good point because there is a lot of deferment of tax which is allowable. At some point there will be tax to pay. But legitimately in the horse industry there is deferment of tax in that you are allowed to value your horses at cost. There are various tax write-downs that are allowable so that, for example, your stock might be worth \$300,000 for tax purposes but, in reality, the market value might be nearer to \$2 million. You are not going to realise that until you sell the animals and you are not going to realise that properly until you liquidate or finish but at some point there is a serious profit there that would be taxable.

Senator BUSHBY—Presumably, when you go to your independent person or entity to have a look at whether you are commercially viable then they would look at those sorts of things.

Mr Tims—Yes.

Senator BUSHBY—That comes to my last question. What sort of body or individual would be capable of independently certifying that a breeding business is actually commercial? Clearly, I would have thought an organisation such as yourselves could actually provide such a role. There does not appear to be any direction from what I am aware of in the legislation as to who could do that. Similarly, I would have thought, say, if you have an individual with 20 years experience in the breeding industry, they might be able to set themselves up to do it. It is pretty unclear to me.

Mr Tims—I know of an accounting firm that specialises in the horse industry that could do it!

Senator BUSHBY—And I am quite sure that there would be an industry that would develop around providing these sorts of independent certifications for individual businesses in all sorts of industries. I have asked questions earlier as to what impact that would have. If you have a very broad range of background and experiences in terms of the people who might be writing reports to assist taxpayers to make an application for an exemption from the commissioner then if there is a lack of distinct qualifications or consistency in qualifications of the people putting those reports together, what impact would that have on the commissioner in terms of the weight that he actually gives those reports?

Mr Tims—It is very difficult to communicate how diverse the industry is and how it operates. In those audits that we went through, we were meeting with tax officers all the time. There were 20 tax officers involved and, of those 20, most of them would have different views on the industry.

Senator BUSHBY—Presumably the taxpayers will shop around to get independent reports that back—

Mr Johnson—Assess the report that they require.

Senator BUSHBY—That is right, in the same way that you have law firms that specialise for plaintiffs or defendants. I am sure you will develop a whole range of people who will put together reports who specialise in maximising your prospects of getting an exemption and putting the right spin on everything.

Mr Tims—How far do you go? How big does the business plan need to be?

Senator BUSHBY—Exactly.

CHAIR—Thank you for appearing this afternoon and thank you for your submission.

Mr Tims—Thank you.

[1.51 pm]

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

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

CHAIR—Would you like to make an opening statement?

Mr Willcock—Yes, thank you. The government announced in the 2009-10 budget that it would introduce a \$250,000 income requirement limiting high-income earners from accessing the current exemptions to the non-commercial losses rules. The non-commercial losses rules were introduced in 2000 following recommendations from the Ralph review of business taxation. They were aimed at improving the integrity, fairness and equity of the tax system by addressing the opportunity for individuals to avoid tax by carrying on unprofitable business activities and claiming deductions for losses arising from such activities against their other income.

Under the existing non-commercial losses rules, an individual taxpayer carrying on a business activity could only claim a loss from that activity against their other income in an income year if they satisfy at least one of four objective tests in that year. The four tests are: the assessable income test, where the assessable income generated from the activity must be at least \$20,000; the profits test, where the activity must have produced a profit in three of the last five income years, including the current income year; the real property test, where the reduced cost based value of real property or interest in real property used on a continuing basis to carry out that activity is at least \$500,000; and the other assets test, where the reduced cost base of any other assets used on a continuing basis to carry on the activity is at least \$100,000. These rules will continue to apply for people with an adjusted taxable income less than \$250,000. If a business activity does not pass any of these tests, the commissioner has a discretion to allow a taxpayer to offset the losses against other income when the business is assessed as commercial or when there are exceptional circumstances. The latter category covers things like floods, fires and drought—those sorts of problems that arise.

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

Amendments made by schedule 2 to the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009 remove access to the four statutory tests in division 35 of the act for all taxpayers with an adjusted taxable income in excess of \$250,000. Instead, those taxpayers will need to apply to the commissioner if they want to apply losses from their non-commercial business activity against their other income—salaries and wages—demonstrating that the business will become profitable within a period of time that is viable for the industry concerned. Rather than preventing high-income earners from applying losses from a non-commercial business activity against their other income, the proposed new rules place an onus on the taxpayer to demonstrate that their business is commercial in nature before being allowed to apply non-commercial business losses against their other income.

Finally, on the consultation involved in this measure, the government conducted public consultation on the proposed measure from 26 June to 26 July this year. The government received 16 submissions and also around 10 representations outside the consultation process. Both the submissions and the separate representations were considered as part of the consultation process. Following that consultation, the government agreed to three changes: carving out of investment allowances under division 41 of the 1997 act, the grandfathering of the discretions that the commissioner has exercised in relation to the commerciality of businesses and provision for a formal application. That concludes my opening statement. My colleague and I are here to assist the committee with answers to questions.

CHAIR—Thank you, Mr Willcock. First of all, can you tell us about the \$250,000 income limit? How was that arrived at? Also, is there any indication of how many people earn more than \$250,000 a year?

Mr Willcock—On the latter part of your question, I understand that roughly 11,000 taxpayers have been identified by the ATO as being above that threshold.

Mr Leggett—They are affected by this measure at that threshold.

CHAIR—They will be affected by this measure?

Mr Leggett—Yes, there are 11,000 taxpayers that will be affected by this measure.

Mr Willcock—That number was put forward in media release No. 067 of 12 May 2009, released on budget night by the Treasurer and the then Assistant Treasurer.

CHAIR—How was it arrived at? Are you aware of why the limit was set at \$250,000?

Mr Leggett—It is effectively just a policy choice of government. In the end it is for the government to determine where they think most of the abuse is levelled at. Ultimately it is a government decision as to where they set the number.

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

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

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

Mr Leggett—On a monetary basis?

CHAIR—Yes.

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

CHAIR—A theme that was coming through in a number of submissions here today was the uncertainty and the desirability of the tax commissioner making rulings on the basis that people could not make investment without some more certainty about what the tax commissioner would decide. There was a view that perhaps people would not be able even to apply until July 2010.

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

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

CHAIR—So if someone had a business plan in, say, the thoroughbred breeding area and that plan estimated it would take eight years to achieve profitability, that person could apply to the tax commissioner to know whether that was within the kind of industry standard.

Mr Leggett—That is right; they can apply in advance of the investment.

Mr Willcock—Could I interpolate there too. There are obviously a range of activities where it will take some time, if you like, for the business to develop and reach the stage where it is truly a business where there are profits et cetera. This is not uncommon, especially in rural or agricultural arrangements—things like tree farms et cetera. So the tax law and the tax commissioner are aware of those sorts of circumstances and seek to cater to them as best they can. As my colleague highlighted, it is usually a matter of the commissioner looking at what might be—I was going to say 'standard practice'—the sort of experience in a particular industry in terms of starting the development of a business in that industry and how long it will take for it get beyond the initial development stage to a stage where it is indeed a commercial undertaking.

Senator BUSHBY—Is that what you need to get independent advice on or will the ATO have its own assessment of that?

Mr Leggett—I am sure the answer is both. The law seeks that you provide independent advice as to what the viability in the particular industry concerned is. It is not expert; it is independent advice and usually it is from industry associations and groups. If you look at a range of product rulings in which the commissioner routinely exercises his discretion, you will see that there will be references to particular tree industry associations that deal with particular tree growth. They will set down that, in usual circumstances, with usual soil conditions, the tree will take seven years in order to mature, and that will be the independent source that has been put forward and used by the commission as justification for the viability period.

Senator BUSHBY—But if a taxpayer engaged an independent consultant to look at his or her particular circumstances and to provide comment on the norm in the industry, that would constitute something which they would be entitled to submit to the commissioner and the commissioner should consider it?

Mr Leggett—That is right, yes. The commissioner's decision is appealable, so he does not make his decision completely subjectively. It is always appealable to the AAT and then through to the court system. So he has to have reasonable grounds for his decision and it has to be made on an objective basis.

Senator EGGLESTON—This morning we heard from a witness from the alpaca industry. They talked about the fact that they have a long-term objective of seeing broadacre alpaca herds being used to produce wool, but that the time frame there is very long. So does your system accommodate that kind of industry with a very long time frame? There is genetic modification of the crop.

Mr Leggett—The system does not put a time limit on it. It is what the commercially viable period is for the industry concerned. So it will be dependent on industry-by-industry assessments.

Senator EGGLESTON—Thank you.

Mr Willcock—And, for example, Senator, I would imagine that with forest plantations, if you were just now planting seedlings, again, depending on the type of wood, a number of those forest farm arrangements could be waiting for a considerable period of time—up to 20 or so years—before they have a mature crop that can start to be harvested.

Senator EGGLESTON—It might be 30 years, in the case of pine. Blue gum is seven or eight, I think.

Mr Willcock—Indeed.

Senator BUSHBY—I have a question on the ruling. If you went to the tax commissioner and you put a plan together and said, 'On the basis of this and the industry norm I expect to be profitable in six years time,' and as it turned out you were not profitable in six years time, what impact would that have on the ruling, if any?

Mr Leggett—It will have no impact. It is what is expected at the time the decision is taken. With hindsight, you cannot change your mind about that.

Mr Willcock—Bearing in mind that the point of this is to seek to distinguish between non-commercial and commercial activities. If something actually turns out not to be profitable in six or seven years time from the time that you initially made that assessment—obviously, a whole lot can happen in the surrounding business environment that might particularly affect that outcome in seven years time—that is not the point.

Mr Leggett—But the commissioner is only likely to exercise his discretion on a go forward basis for that commercial viability period. If the normal practice is six years, the commissioner will exercise his discretion for the six years. So if in the seventh year you are unprofitable—

Senator BUSHBY—That actually answers the questions that have been raised in some of the submissions. If you make an application in 2009 and you say, 'I hope to be profitable in 2015,' then that discretion will hold until that point?

Mr Leggett—The commissioner has flexibility. He can exercise it year by year, but normally in the case of those sorts of arrangements—

Senator BUSHBY—There is no necessary requirement that you have to go back and ask every year?

Mr Leggett—No, you can do it all upfront and that is the usual practice.

Mr Willcock—From the investor's point of view they would probably only want to have one engagement with the commissioner, rather than having to go back. They are perfectly understandable reasons that we

would all understand, without having to go into. But also from the commercial point of view, they would like to understand what the outcome will be and to have a degree of confidence about that outcome.

CHAIR—Could I just clarify a matter that arose during questioning. If an enterprise is found not to comply it can, nevertheless, quarantine those tax losses against a future time when it is—

Mr Willcock—We do not disallow them; they are just quarantined to the business activity. So that, effectively, means that if you invested through a company or a trust structure where the losses are quarantined within the vehicle, it happens in exactly the same way. We quarantine it to that business activity. We just carry it forward and when you do make a profit you start using the losses in those years. So the impact is to prevent you offsetting those deductions against other income.

CHAIR—Not the business itself.

Mr Willcock—Not the business income from that related activity.

CHAIR—Finally, have you had an opportunity to look at the submission by Marline Ciganovic about her client who was a medical specialist who bought a dairy property which he is in the process of upgrading to make more viable. She says:

The result of the legislation being passed will be devastating for the farm. As my client could no longer fund the farm, it would need to be sold this financial year. Potential buyers would be scarce ...

Have you had an opportunity to look at that? Do you have any comment?

Mr Leggett—No, it was not available on the website, so we did not have an opportunity to have a look at it.

CHAIR—If you could take that on notice, I would be interested in any general comments you have about that particular case and what your response to that would be.

Mr Willcock—Could I just make the point—and I have not read the submission—because the words jump out. She refers to a large, legitimate business. Prima facie, if it is a legitimate business, if that is the case then that is the sort of situation I mentioned whereby the commissioner would be able to look at the whole arrangement quite favourably. To the extent it is a large business and it has a business plan, it has employees, it has books and it has records relating to the carrying on of that business, those are all factors which I think would be quite powerful in allowing the commissioner to come to a view that it is a legitimate business undertaking rather than a so-called hobby or a lifestyle choice or something else which is really just an excuse to allow an individual to access deductions to subsidise a lifestyle choice rather than a real business activity.

Senator EGGLESTON—Going back to the Marlene Ciganovic submission, she says:

The proposed \$250,000 income requirement test is ill devised, as many legitimate and genuinely commercial business structures owned by individuals and partnerships will be forced to exit those businesses.

How was the figure of \$250,000 chosen? Many professional people in partnerships could easily have that income.

Mr Willcock—As we mentioned earlier, that effectively was a policy choice of government. I am not quite sure how many individual taxpayers earn \$250,000 or more. I do know that roughly only two per cent of taxpayers earn in excess of \$180,000 a year. Obviously \$250,000 is a substantial step up from \$180,000. Relatively speaking, it is a very small number of the total pool of taxpayers who will be above the threshold of \$250,000 adjusted taxable income.

The only other point that I would make is that, wherever one seeks to place a threshold in the tax-transfer system and in any other arrangement where government decides to provide benefits or impose costs on people, there will always be arguments about the appropriateness of the fixed line in the sand that government chooses.

Senator EGGLESTON—I accept that it is a policy decision so it is difficult for you to make more comment in terms of why. But one 'why' question is, as one of the submitters said this morning: in 10 years time \$250,000 may not be regarded as a high net income. So why is this not indexed?

Mr Leggett—As you are probably aware, none of the amounts in division 35 are indexed. The \$20,000 test is not indexed; the \$500,000 test is not indexed. That is consistent with a lot of the thresholds in the tax system, and it is ultimately the government of the day that decides whether or not it is affordable to index the amounts at that time or not, just like any tax scale. Indexed arrangements are being considered by the Henry review and they could ultimately change.

Senator EGGLESTON—Indexation is often undertaken because it actually generates higher taxation income. But that is a matter for another arena, I guess. We have heard evidence today about adverse local impacts if many of these types of businesses, these so-called hobby farms, are forced to close, because many of them are legitimate businesses. They do employ people, they do generate capital expenditure in local communities and they do result in viable businesses. One really wonders how much consideration was given to adverse local impacts.

Mr Leggett—On the first point, as to the extent that the businesses are legitimate and genuine, they are unlikely to be affected by this measure because they will get the commissioner to exercise his discretion. On the second point, the secondary impacts are not normally costed for the reason that it is just too difficult to come up with those sorts of figures. We do not know whether money will be reinvested in other areas or whether people will drop out of the particular industry concerned, so it is normally too difficult to calculate flow-on effects.

Mr Willcock—I certainly would not want to be accused of downplaying or underestimating the impact of this measure, because, after all, the measure is forecast to produce savings of \$700 million over the forward estimates. However, as indicated earlier, we understand from the ATO that there are roughly 11,000 taxpayers who potentially fall within the ambit of this. We do not have any information to suggest that those 11,000 taxpayers are highly concentrated in one particular part of the country in one particular rural setting or that they are all focused in one particular industry/pastime/activity so that the impact of this would be, if you like, disproportionate or would have a particular impact in one regional setting or affect one—

Senator BUSHBY—But it may well be. We do not have the information.

Mr Willcock—We do not have that information. We would be surprised if that were the case. Because of the fact that the pool of people potentially to be affected is 11,000, we would consider that, all things being equal, those 11,000 people would be roughly evenly distributed across the country and that the nature of their interests and activities that might be affected by this would, again, be roughly well distributed. There will be people who are interested in racehorses, alpacas, olive growing, tree growing—

Senator BUSHBY—You would have an idea where those individuals are located. I would imagine that they would be in Melbourne, Sydney, Brisbane and Perth to a significant extent.

Mr Willcock—The Australian Taxation Office would no doubt know better than us.

Senator EGGLESTON—One of the other issues that were raised relating to this \$250,000 income level was the example of, say, five lawyers buying a wheat farm. How would you handle that? How would you determine the \$250,000 threshold?

Mr Leggett—It is per individual, so it is a loss relating to that individual and will be tested per partner.

Mr Willcock—Again, it would depend on the business structure that those particular people might decide to construct for the purpose of that undertaking.

Senator EGGLESTON—One of the other issues that have been raised is that sometimes hobby farms are set up in industries which at the time do not seem to have much prospect of success. The Margaret River wine industry was quoted as the example of that. The department of agriculture in Western Australia produced a report saying that Margaret River had certain characteristics like parts of France and that maybe a wine industry could be developed, so some doctors around Busselton and Bunbury invested in putting in vineyards. At that time nobody would have dreamt that industry could have turned into what it is today. Doesn't this measure have the potential to inhibit the development of new and different industries? We have heard from the alpaca people and also from the horse breeders association that it could have significant inhibitory effects on the development of these industries. In the case of the horse breeders, Australia's industry would perhaps be less competitive with that of New Zealand. Do you wish to make any comment on that? This is a negative outcome, potentially.

Mr Willcock—This of course goes way wider than this particular piece of legislation, but obviously people who wish to develop a completely new and innovative line of business often face considerable difficulties in terms of attracting finance, for example, from banks and getting planning approvals from councils. There are a whole lot of things—finding a market et cetera. I would not say, however, that the bill is necessarily going to be a new and decisive factor which is suddenly going to tip the scales for a lot of those sorts of business undertakings. When it comes to an individual seeking to establish and develop a completely new and innovative industry which is either completely unknown or unknown in a particular area because of factors such as you mentioned in relation to Margaret River—that is, it has never been done in that area because no—

one ever realised that the soil types, climate et cetera were conducive to that sort of industry—those sorts of individuals invariably, I would imagine, would want to be fairly careful about their consideration of the prospects for going into that line of work, would develop their own business plan, would presumably consider the factors that the naysayers would point to and would therefore have to be on fairly certain ground that, despite the naysayers, they felt confident that there was every chance of success. If they do that type of thinking, if they go through the process themselves of trying to test the robustness of the idea that they are wanting to get behind, they will indeed have gone a long way towards developing the types of information that the commissioner would be interested in to assess whether or not this is the sort of arrangement that the commissioner would be willing to say is a commercial activity. The fact that it might not produce a profit straightaway and might take some time to develop and grow is a separate thing. But it is possible to be done. As I said at the beginning, there are a set of other obstacles that those sorts of people face as well.

Senator EGGLESTON—This legislation seems to have the great potential to be an inhibitor rather than a positive developer. What is the real rationale for it? Is it to deal with tax avoiders or is it really just a revenue raising program?

Mr Willcock—The rationale of the original provisions—the provisions that are currently in the legislation—went, I suppose, to the notion of integrity and fairness. Also, the report of the Ralph review of business taxation, at page 296 of that report in 1999, highlighted the fact that at that stage—that is, prior to the enactment of the current non-commercial loss rules—there was:

A significant revenue leakage from unprofitable activities carried out by individual taxpayers ...

So there is a revenue leakage concern. There is the integrity and fairness concern. I think the concern that the government has, as I mentioned in my opening comments, was that these rules were put in place in 2000 for integrity and equity reasons. It just so happens that, in particular, high-income earning individuals have more capacity, if you like, to avoid the operation of those rules. It is plainly easier for someone who has significant financial means to buy, for example, a piece of real estate that costs more than \$500,000. It is therefore possible for such people to then engage in activities which allow them to access some deductions against their other income. That is a concern that the government has and that is why the government has acted as it has in the budget measure.

Senator EGGLESTON—I know that policy does not concern you, but I must say I have a great deal of difficulty accepting that kind of rationale. I think the fact that people have high incomes and invest in other areas is a good thing for Australia and leads to development, creates jobs and expands our economy. I think this is very negative legislation. I will leave my comments at that.

Mr Willcock—I am sure the government would also be very keen to see people invest in the creation of jobs et cetera too, Senator.

CHAIR—Senator Pratt, are you there?

Senator PRATT—Yes, I am. The questions I had have been asked.

CHAIR—Thank you. Senator Bushby.

Senator BUSHBY—I want to come back briefly to the definition of ‘commercial in nature’ that you talked about. You seem to have a lot of faith that the tax commissioner will be able to accurately assess those enterprises that are commercial in nature, and fairly and appropriately make a decision as to which ones are and sort the chaff out from the wheat. But what concerns me, just looking through the explanatory memorandum, is that there was an example in there about a fellow who was trying to grow nuts on land that was not particularly fertile and, as a result, it was going to take a couple of extra years to become profitable. That fellow may be the owner of that land for all sorts of reasons—it might have been a family farm—and he has gone into the city and is earning some good money. He may well be trying to add value to land that is not productive in other ways. In that particular example, it did not save that he was not going to be able to come up with a crop of nuts in due course; it was just going to take a little bit longer. It may add value to the land and turn otherwise relatively unproductive land into quite productive land, but over a longer period of time. I am just using that particular example because it was in the explanatory memorandum as one that would not qualify. It seems to me that the circumstances around that may well—quite clearly in my mind at least and, I would imagine, in the mind of your average person—actually qualify that venture as commercial in nature. Yet the Treasurer—we presume it was the Treasurer—has outlined in the explanatory memorandum that that would not be commercial in nature.

Mr Leggett—I will just make the comment that these examples are based on the existing discretion in the law that was put in after the Ralph recommendations. We have not changed the nature or the tests involved.

Senator BUSHBY—But the failure of this one was the commercial in nature aspect.

Mr Leggett—This one would fail under the existing law. We have not changed anything in that respect.

Senator BUSHBY—In what way—which of those four rules?

Mr Leggett—It would not make a profit in a commercially viable period. That is a bit it fails.

Senator BUSHBY—Okay.

Mr Leggett—None of that is a change from the existing position. I guess the examples just illustrate how it would operate with someone with \$250,000 in the test, but the actual discretion, the elements of the discretion, have not changed from the existing law.

Senator BUSHBY—Even if the land value was \$500,000?

Mr Leggett—Other than he may have passed for some other reason.

Senator BUSHBY—That is right. So that is where it is different.

Mr Leggett—But to the extent that he failed the existing tests, that is how it would have still applied.

Senator BUSHBY—But, currently, without the proposed laws being enacted, if that land were worth more than \$500,000, that person would be able to develop it and claim the costs of doing so against his otherwise assessable income and turn that land, which by definition in the example is relatively unproductive, into something productive and actually add to the community. Under the changes, that would not be possible.

Mr Leggett—The test has to be a balance, and we look at the commerciality and the viability of the period.

Senator BUSHBY—It just seems to me that, despite the assurances you have given us today, it is quite possible that enterprises that to the layman would seem to be commercial in nature, for reasons such as the lack of fertility in the soil meaning that it would take a couple of years longer to become productive than it might otherwise be, would be rendered not commercial in nature. That does not give me the same degree of satisfaction you were trying to impart to us earlier. It concerns me.

Mr Leggett—There are a number of factors when the commissioner has to consider these issues. The examples are based on some assumptions being made and some not, so it is very circumstantial.

Senator BUSHBY—That is an example. I am sure there are other real examples out of there of people who have commercial enterprises that the average person in the street would think are commercial in nature but which appear could possibly fail, and that is a concern. Currently, how many applications requesting the commissioner's discretion does the ATO receive?

Mr Leggett—Under the new rules?

Senator BUSHBY—Under the current rules.

Mr Leggett—I do not have that information and will have to take the question on notice.

Senator BUSHBY—Yes, please. Currently, what is the average time for the resolution of applications by taxpayers requesting the commissioner's discretion to allow the deduction of non-commercial business losses?

Mr Willcock—We will take that on notice.

Senator BUSHBY—Okay. What is the ATO's target time for processing these applications?

Mr Leggett—I suspect that it would be the normal 28-day turnaround, but we will confirm that. It is normally done in a private-ruling scenario, which would be the 28-day turnaround. That is subject, of course, to the taxpayers providing all the information within the time periods.

Senator BUSHBY—Does Treasury expect the ATO to receive more applications from taxpayers as a result of the government's changes to non-commercial business losses?

Mr Leggett—Yes, we would expect more applications.

Senator BUSHBY—How many additional applications requesting relief from the government's changes to non-commercial business losses does the ATO expect to receive as a result of the government's changes?

Mr Leggett—We will have to take that on notice.

Senator BUSHBY—You have not made an assessment of how many of the 11,000 are likely to apply?

Mr Leggett—The tax office may have. I do not have that information with me so I will have to take that on notice.

Senator BUSHBY—Okay. When you do that could you also ask whether the ATO will need to employ any additional staff or resources to process the additional applications?

Mr Leggett—The ATO will not be receiving any additional resources and have not asked for any.

Senator BUSHBY—Okay. I will have to ask them at the next estimates hearings, then, whether they actually needed it. The application of the legislation will extend further than just to hobby farms, as I understand it. It does not just apply to people involved in rural and regional activities. It applies to businesses which may well be conducted within a city. If an individual were carrying on the business of rental properties, under which they are negative gearing—I do not know the exact definition but I believe that if you have one or two you are just investing, but at a certain point it actually qualifies as a business.

Mr Leggett—If you are just passively renting stuff out?

Senator BUSHBY—If you are passively renting, I do not think it is. But there is a point at which—

Mr Leggett—You become Westfield, for example?

Senator BUSHBY—That is an extreme example, but I think there is a point where, and I think there are some tax rulings on it, you become the operator of a business.

Mr Leggett—It would have to change the structure. Usually the number of properties you have for rent does not affect whether you are carrying on a business of renting properties out. Usually, passive rental makes no difference as to the number, unless you are doing something else on top of passive rental. Conceivably there could be a situation in which that happens.

Senator BUSHBY—Conceivably there could be a situation where this happens. In that case, presumably the benefits of negative gearing would be lost to an individual if they were earning over \$250,000 and could not justify to the commissioner that it was a commercial operation?

Mr Leggett—There is an exception within the existing rule about rental properties—

Senator BUSHBY—Okay. I was using that as an example of the fact that people may be running other enterprises that are not necessarily hobby farms.

Mr Leggett—They are carrying on a business, yes.

Senator BUSHBY—You touched on this in terms of the second-round effects. But there is a \$700 million predicted boost in revenue out of the measure. You say that you did not take into account third-round effects in terms of the impact on—

Mr Willcock—Could I just interrupt there. We are not from the area that is responsible for the costings or the other work that looks at the behavioural impacts et cetera of measures such as those.

Senator BUSHBY—Okay. I will ask the questions. Answer them to the extent that you can then take them on notice if you cannot.

Mr Willcock—Yes. We will take them on notice and refer them to our colleagues.

Senator BUSHBY—I would be interested in knowing how the \$700 million was calculated—the assumptions and the basis on which you worked that out.

Mr Willcock—I can help you a little on that. I have in front of me a copy of an answer to a question on notice, question BET-137, which was asked by you. It says:

Treasury can confirm that the measure will have an ongoing gain to revenue which is estimated to be \$700 million over the forward estimates period. These estimates have been calculated by Treasury (in consultation with the ATO) using Treasury's personal income tax microsimulation model. This model is based on confidentialised sample unit record tax return data provided by the ATO and contains information about non-commercial business losses claimed by each taxpayer.

Senator BUSHBY—That is a general statement of how it was done. I am interested in knowing what assumptions were made about how many people would be affected, maybe the average.

Mr Leggett—We know that. We said 11,000.

Senator BUSHBY—Are you assuming that all 11,000 would contribute towards the \$700 million? Is there an assumption that some people will withdraw from the industry et cetera? How did you take it from 11,000 people and arrive at the \$700 million?

Senator EGGLESTON—That 11,000 is not the number of taxpayers earning over \$250,000.

Senator BUSHBY—No, that is how many people—

Mr Leggett—That is how many people are affected by this measure. There are a number of taxpayers earning above \$250,000 who have a loss-making business.

Senator BUSHBY—The other thing is that, quite clearly, behavioural changes will result from this tax. Any change in tax distorts the economy and introduces behavioural changes. I explored this with witnesses this morning.

Mr Willcock—I could point out that this is, if you like, an unwinding of a tax concession, so, if anything, this is reducing a distortion rather than increasing distortions.

Senator BUSHBY—It may well be reducing a distortion but it will cause changes to current behaviour.

Mr Willcock—It will have behavioural impacts, but we would say it is minimising.

Senator BUSHBY—I tested this this morning with other witnesses and they thought this was true—including the tax institute and chartered accountants. By making this change you will make investing in these types of enterprises less attractive in terms of tax minimisation for some of the people who will be affected than other forms of investment which might also have tax minimisation benefit. I asked them whether they thought it would be significant or marginal. They said that they could not say whether it would be significant but it would be real and there would be a move from people, when they receive their tax advice, into areas other than this. I am interested in knowing whether any consideration of that likely impact was taken into account in the \$700 million.

Mr Leggett—I can confirm that the \$700 million includes a behavioural assumption of people moving into different investment types as a result of this, but we would have to take it on notice as to what the detail of that is.

Senator BUSHBY—Has there been any consideration of what impact changes to other investment types might actually have on those? For example, if there was a notable move from hobby farm type activities into residential tenancy property or commercial property, what impact might that have on prices, availability and demand?

Mr Willcock—We would have to take that on notice.

Senator BUSHBY—You mentioned earlier, in response to a question, that it is possible to apply to the tax commissioner at any time, so you could do that at the beginning. What ability would a person have who is looking to start out to make their case, if they had no data upon which to base it?

Mr Leggett—You would probably find that the commissioner often makes these assessments on a prior basis. Most managed investment schemes, regardless of whether or not the people investing in them are above 250 or below 250 would meet the tests or would not meet the tests. The commissioner nonetheless grants his discretion up front, on the basis prior to investment and based on the business plan.

Senator BUSHBY—If you were a net high-income earner, an individual, with the ability to get good advice, what is to stop you from going off and drawing up the best business plan in the world and saying that you will make profits within the time, if you do not actually have any hard facts upon which to base how well it will go? Five or six years into that period, you could find: ‘Whoops, we didn’t make it. What a shame. We’ve been making losses all the way through and it’s been offsetting against my income.’

Mr Leggett—The commissioner’s rulings are structured so that they have to implement their investment as they have indicated to the commissioner. Provided that they do that, they are fine for the period of the commercial viability. It is like any other investment. They move into it on a genuine basis. We are not going to stop them offsetting it; we are only looking at attempting to affect those that are not legitimate.

Mr Willcock—Senator, effectively you are saying: how can we stop people who have the resources from ever pulling the wool over the tax commissioner’s eyes and—

Senator BUSHBY—People have paid a lot of money to provide advice to stay ahead of you and the tax commissioner.

Mr Willcock—Indeed. That has ever been so and ever will be so.

Mr Leggett—That goes to the commissioner’s administration and no doubt he will look at those sorts of factors in exercising his powers.

Senator BUSHBY—Following up from the Senator Hurley’s question, I would have thought that may be playing with the asset value rule—removing that as one that you can use to qualify; even just raising the value in that significantly would probably provide a better avenue to guarantee that people are not going to be able to get around it.

Mr Leggett—That depends. If you are looking at it, it has a larger effect on smaller taxpayers than larger taxpayers. In fact, it has a discriminatory effect, when it comes to smaller taxpayers versus larger taxpayers, because larger taxpayers would have the financial capital to pass the existing tests, even if we up them.

Mr Willcock—In other words, if we were to jack the real estate test from \$500,000 to \$1 million, there would be a number of people, including a number of people who do not have an adjustable taxable income of \$250,000 a year, who are currently—

Senator BUSHBY—I understand the point. There is no reason why you could not, say, introduce a \$250,000 threshold, but remove the asset value test for people above \$250,000, which is still a fairly simple thing to do, but it would protect the lower income earners while still ensuring that those people with greater resources are not abusing the system.

Mr Leggett—You could do that. The real property test is not the only one that is problematic in that respect.

Senator BUSHBY—You would probably adjust the others too—I would agree with that.

Mr Leggett—Ultimately, every one of these is arbitrary in some particular manner and you can—

Senator BUSHBY—It may well increase the complexity in some respects, but I am always in favour of a more sophisticated approach that delivers a more targeted outcome, in terms of what you are trying to achieve, than a blanket approach which potentially may catch people who really should not be caught. That comes back to my concern about—

Senator EGGLESTON—The horse breeders in particular were interested in the property value. You seem to be rejecting their suggestion, in effect.

Mr Willcock—It is not up to us to reject or endorse—

Senator EGGLESTON—I know it is not, but in effect that argument—

Mr Willcock—It is a matter for the government. It is a policy call—

Senator EGGLESTON—It is a policy issue, but you are arguing against the validity of it, aren’t you? That is the theoretical proposition.

Mr Willcock—I was just commenting on, if you like, the plain vanilla version of that, which would be to simply increase the test from, say, half a million dollars to \$1 million. Senator Bushby has put a variant of that by saying that you could perhaps have a half-a-million-dollars test for people in certain income ranges—

Senator BUSHBY—Leave it as it is for lower income earners, rather than removing the—

Mr Willcock—There may be different versions.

Senator BUSHBY—A little bit more sophisticated in trying to hone in on the people you are really trying to target and keep the others out. I will have to go because I have a plane to catch, but I have a final question: did Treasury provide advice on alternative options other than the one that is before us, in terms of closing the loopholes, such as the sorts of things we were talking about? Obviously I do not want to know what the advice is, but was any advice provided on alternative options? Did the government seek your view or did they ask you about that?

Mr Willcock—In what time frame?

Senator BUSHBY—In the lead-up to the budget, in developing this, was advice provided in a general sense as to how the objective of ensuring that high net income individuals were not abusing the tax system?

Mr Willcock—In a general sort of way, we provided advice to government in the lead-up to the budget. The government was plainly interested in a series of issues across the tax system where the government believed that there were equity and integrity concerns. The operation of the non-commercial loss rules was one such area. The government then made a decision in the budget statement, and the issue of how to translate that decision into legislation was one that we then took forward, releasing that exposure draft legislation. Then, as I mentioned in my opening statement, there were some subsequent changes agreed to by government.

ACTING CHAIR (Senator Eggleston)—There being no further questions, we thank Treasury for appearing and close this hearing.

Mr Willcock—Thank you very much. We will try to get the answers we took on notice back to you as soon as possible.

Senator BUSHBY—Thank you. We report on Monday.

Mr Willcock—In that case, we will try to get them back in extra quick time so that you can take account of them.

ACTING CHAIR—Thank you very much indeed.

Committee adjourned at 2.41 pm