COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Reference: Tax Laws Amendment (2010 Measures No. 2) Bill 2010

THURSDAY, 29 APRIL 2010

MELBOURNE

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SENATE ECONOMICS

LEGISLATION COMMITTEE

Thursday, 29 April 2010

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, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Sterle, Troeth, Trood, Williams and Wortley

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

Terms of reference for the inquiry:

To inquire into and report on:

Tax Laws Amendment (2010 Measures No. 2) Bill 2010

WITNESSES

Committee met at 2.24 pm

CHAIR (Senator Hurley)—I declare open this second hearing of the Senate Economics Legislation Committee’s inquiry into the provisions of the Tax Laws Amendment (2010 Measures No. 2) Bill 2010. The bill was referred to the Senate Economics Legislation Committee for inquiry on 18 March 2010. In referring the bill for consideration, the Senate requested that the committee ensure that there would be no unintended consequences as a result of the bill, particularly as a result of the amendments set out in schedule 1. The committee is due to report on 11 May 2010.

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.

[2.26 pm]

HOLLOWAY, Mr Christopher James, Taxation Manager, Equity Trustees Ltd and Trustee Corporations Association of Australia

CHAIR—Welcome. Thanks for coming, Mr Holloway—I understand, at short notice.

Mr Holloway—That is fine.

CHAIR—Would you like to make an opening statement?

Mr Holloway—Yes, I would. Thank you, Senators, Acting Secretary and Secretary. Once again I appreciate the opportunity to come here today. Basically, I speak to you today as a tax practitioner who specialises in trustee tax compliance. I represent the Trustee Corporations Association of Australia. I am an employee of Equity Trustees and a former employee of Perpetual, who are both members of the association, and I have over 10 years tax experience in this industry.

I come today to speak to you on two parts of the proposed tax amendment bill, one being the definition of 'extended closely held trusts' and the other being the methodologies of collecting taxation and reporting of the TFN withholding tax that this bill represents. In summary, for the definition of the extended closely held trusts, we believe that the proposals in the bill should be the way that they are. I hate to say the word 'vibe', but the vibe is what we are looking for. However, we believe there may be a few side-effects with regard to this bill—particularly for trusts that the Trustee Corporations Association of Australia and their associated companies deal with primarily, and that is testamentary trusts.

Testamentary trusts are basically trusts that originate from somebody's will. To paint a picture of what a testamentary trust is, it is officially called a life tenancy situation: for example, a husband passes away and leaves the income of his assets to his wife and then leaves the physical assets to his children once she passes away. So the trust will run for the time that the widow or widower is alive. And what we see in the trustee company industry is that most of these beneficiaries are elderly spouses of folks who have passed away.

The trusts are not usually that large. We use what the tax office currently has as the senior Australian tax offset, which allows a woman over 63 or a man over 65 to earn an income of around $29,000 and that precludes them or, on anything less, they do not have to lodge an income tax return. The only reason they would lodge an income tax return at the moment is to receive a refund of franking credits that their investments may earn from dividends through either direct shares or managed funds or the like.

What we feel about the rules coming in for the TFN withholding of these trusts is that a lot of these older Australians may not even have a tax file number. There are two reasons for that. Having a tax file number is not a compulsory part of receiving an aged pension from Centrelink and there are exemptions through the share registries for aged pensioners and the like to not have to quote their tax file number to the share registry, so they do not have withholding tax taken from their dividends that they have directly. We feel that the testamentary trusts being caught up in this will directly affect many, many beneficiaries, particularly widows and widowers who currently qualify for the senior Australians offset and/or the age pension.

We feel that the tax compliance measures put in place through the seniors offset have reduced the compliance necessities for the senior Australians, and we believe that the current withholding rules may ramp that back up again if they do not have tax file numbers if they are not required and it will push them into an accountant's office either to apply for a tax file number or to regain their withholding. So that is one part of what we think when you talk about fairness of the bill. To start with we think that it may be not quite catching it. It is designed to catch high-net-worth individuals and the tax that they should be paying. We do not argue with that, but we think there may be just a little bit of a side effect that it may catch up a lot of Australians who may not really need this requirement in their trust distributions.

The second part of the bill is really the taxing and reporting methods for the TFN withholding tax itself. The bill proposes that if beneficiaries do not register their tax file numbers, that the trust move into the PAYG system, similar to our own wages and the like. We feel that there is an existing methodology in place for the collection and the reporting of the TFN withholding tax, and that is through the trust returns itself. The trust return provides a beneficiary statement at the end of it. Naturally the beneficiary details are placed in the trust return and then, from that, once that is lodged, that flows on into their personal tax return.

By merging this method into the PAYG system, we are looking at all trust returns requiring calculations to be done by the end of September where the current tax return lodgement program runs through to the end of

May. We feel that there are current methods—for example, we have a separate taxing method for minors and nonresidents. The tax office isolates this money and will tax it separately through separate notices of assessment that the trustee must look after and pay. We feel that the TFN withholding tax could be used through this system. The tax agent portal that practitioners use tracks this very well—it makes it very clear; it notes which beneficiaries it relates to—and so we feel that the methodology is there already and we feel that moving from one system to another would almost destroy the lodgement program that is currently in place when the system is already there. Again, I look at costs. Naturally clients, trustees will all pay for their time for a tax practitioner. Most of them charge on a per hour basis. Unfortunately, I can see that by extending the work required for every trust tax return the costs are going to be borne by the trusts and naturally the beneficiaries will be disadvantaged by that. That is not quite a brief synopsis, but that is how we feel.

Senator BUSHBY—The testamentary trust angle is not something I had heard anything about up to this point, so it is interesting. Do you see this as an unintended consequence?

Mr Holloway—Yes, I do. I speak about testamentary trusts and I speak about various other trusts. The point of the legislation is to ensure that the high-net-worth trustees—people who are funnelling funds through a trust network—are declaring and the tax office knows about that income. Basically, I see the proposed legislation as being for those folks who are in the trust system and know about it through the setting up of deeds, family trusts and the like. We have no complaints about that set-up at all. But we think that the folks who are involved in the trust system who have not voluntarily entered into it, who have been forced into the beneficiary position through a will—and just from experience those testamentary trusts are usually not large; on average, the income falls within $20,000 at the most—if the bill progresses as is, will be forced into almost a tax compliance area, where they have not had it before. They will almost be forced into that.

Senator BUSHBY—What will the practical consequences be? What would the impact be on people who qualify for the senior Australian tax offset or age pension, to use your example?

Mr Holloway—Say a typical person receives $15,000 on an age pension and they receive a few extra dollars from their testamentary trust. They may not have a tax file number because they have really never needed it. If they hit 1 June and they still do not have a tax file number—let us say they are 90 years old—what will happen is that, with the 46½ per cent of the trust income that they receive every quarter or the like, half of it will disappear.

Senator BUSHBY—Could they fix that by getting a TFN?

Mr Holloway—That is right. They would then be almost forced into the position of getting a TFN, getting a tax return lodged and moving that way.

Senator BUSHBY—Would there be any net benefit for the government at the end of that?

Mr Holloway—I do not think so.

Senator BUSHBY—In that scenario you outlined, would there be any tax payable to the government as a result of their having a TFN?

Mr Holloway—As a result of their having a TFN, there would be no tax payable to the government. If they did not quote their TFN at the time and got a TFN later, the government would receive the withholding tax and then it would go back to the beneficiary in the end.

Senator BUSHBY—If withholding tax were being paid, then whoever is looking after their financial affairs would say, 'You need to make a claim back because there is money there that is yours that the government should not have.'

Mr Holloway—That is right.

Senator BUSHBY—How are people who fall outside of those sorts of exceptions and low-income people under testamentary trusts currently dealt with? If they already have a TFN, presumably it will not affect them.

Mr Holloway—That is exactly right. If they earn more than $30,000 or they are under 63 or 64, they would already have a tax file number. That would be quoted in the trust. It would just be a matter for the trustees to almost chase the beneficiaries up and regain contact.

Senator BUSHBY—As it applies to testamentary trusts, there is nothing in there that means this change will actually lead to catching revenue that the government should be getting that it is not. It is just going to complicate things, with no net revenue addition.

Mr Holloway—That is right. The only net revenue position would be if they do not ever get their tax file number together and it is never declared.

Senator BUSHBY—But that is not money that the government necessarily should be getting.

Mr Holloway—No. That is right.

Senator BUSHBY—It would be a windfall.

Mr Holloway—That is right. They are not receiving it at the moment, so—

Senator BUSHBY—And under the current laws they should not be.

Mr Holloway—That is right, yes.

Senator BUSHBY—On the second issue, we had representations yesterday basically saying that it unnecessarily complicates things and there are better ways that the objectives that the government is trying to achieve could be reached.

Mr Holloway—I definitely agree.

Senator BUSHBY—I think you mentioned that there are existing things that trusts do that would be a better way of tapping into—

Mr Holloway—That is right. I have an example here. What I am showing you is the beneficiary statement out of a trust income tax return. It is the final page of this little document.

Senator BUSHBY—I have seen those before.

Mr Holloway—Naturally you will see beneficiaries 1, 2, 3. There is a space for a tax file number. Basically it is a statement of their taxable income that the trust lodges with the tax office and then those beneficiaries will reflect those numbers in their own personal tax return. You will see the J and K code boxes, which are third and fourth from the bottom. When I spoke about non-resident and minor beneficiaries currently have their own separate tax methods, where the trustee will pay the tax through the income tax return. We feel that if there were an availability through this measure in order to pay TFN withholding tax—it is something that the software providers do very well; if there is no tax file number it will jump from one to the other automatically—what would happen then is that this would get lodged, the tax office would then automatically issue an assessment to the trustee. What would also happen is that, as the tax office knows about this, they could incorporate this in what they call their ‘pre-filling’. It has been mooted as part of the Henry tax review that pre-filling will be the be-all and end-all if people will not have to lodge income tax returns.

Senator BUSHBY—We might find out about that on Sunday.

Mr Holloway—We may do, which will be quite interesting. We know that once the trust return is lodged, we know the final numbers, we will be able to calculate correctly the withholding tax from that. It would all go to the tax office at once. They would issue an assessment to pay it, they would then have it in their system, they could put it in their pre-filling, as the tax file number is already recorded—

Senator BUSHBY—How does that example, which you are suggesting would be a good way of dealing with it, differ from the obligation that would be created under the bill as it stands?

Mr Holloway—In the bill, what they are currently suggesting is that the trust register for the PAYG system—for our wages and the like—and what they are saying by the end of September that all calculations will be done and all withholding tax remitted and reported to the tax office at that time. What it is effectively doing is—this trust return could be lodged as late as the middle of May the following year—almost pushing forward six months—

Senator BUSHBY—Does it mean that all family trusts would have to be pushed forward six months?

Mr Holloway—Yes, it would only be those for beneficiaries that have not quoted a tax file number. For example, we may have six or seven beneficiaries. If one has not quoted a tax file number, that would push it into this September time—

Senator BUSHBY—If a family trust had your children on there and you were able to claim that amount as part of—

Mr Holloway—No, children do not fall under the scope of the bill. It is really only for—

Senator BUSHBY—Senior Australians—

Mr Holloway—Yes. It is really only for those people who can control their own affairs, and not children or bankrupts or incapacitated and the like.

CHAIR—Thanks very much, Mr Holloway.

[2.43 pm]

RILEY, Mr Peter Thomas, Executive Director, Pitcher Partners Advisors

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

Mr Riley—Firstly, when the invitation came through it referred to Pitcher Partners, so I was not sure whether I am making a Pitcher Partners submission or a personal submission. So if you will accept it as both—

CHAIR—Certainly. Please go ahead.

Mr Riley—I have taken the liberty of putting together a few notes which I would like to speak to. For completeness, the focus of my submission is in relation to schedule 1, which is colloquially amendments to division 7A. I apologise, Senators, if I am taking you through something that is already apparent to you—

CHAIR—Not much is apparent to us, I am afraid.

Mr Riley—I have moved to page 2 of the slides. If I can take a moment to set out conceptually what division 7A is intended to do, it is looking at a circumstance where a company which has profits makes a loan to a shareholder or an associate of a shareholder, as a consequence of which they are able to access those profits without having paid what we would commonly refer to as top-up tax. I have no fundamental difficulty with that policy; I accept that policy. I think it is fair to say that division 7A, which is now 38 pages of legislation, is very complex. The background to that is that there are now approximately 600,000 trusts, per the ATO recent reports, and most of those trusts would have their tax compliance undertaken by, relatively speaking, a small accounting firm. Meaning no disservice to those firms—they are trying to grapple with so much; Mr Holloway's example is something that they are trying to grapple with as well—they just do not have the technical skills that larger firms have, and the compliance is therefore a significant issue, for two reasons. It leads to excessive cost, borne by either the firm or taxpayers, and it leads to errors, whether deliberate or inadvertent. I suppose you cannot have a deliberate error. I retract that. It has the potential to lead to deliberate noncompliance.

If I could turn to the next page, this is where I start to focus on the specific aspect of this bill and schedule 1 that I would like to address. That is where there is a trust that has made a distribution to a company but has not discharged that distribution. As a matter of trust law, such a distribution is not a loan; it actually creates a new trust, a second trust. As a matter of conventional understanding of what a loan is, it does not bring into existence a loan.

The history of division 7A was that when it was first introduced, in December 1997, there was an unresolved issue as to how distributions by trusts to companies that remain unpaid should be treated. They were not actually believed to be covered by the bill as first legislated in 1997. A specific amendment was introduced in March 1998 to make it clear that an unpaid distribution could be brought within the regime where the trust, with the unpaid distribution, made a loan to a shareholder of the company or an associate of the shareholder—if I could use the expression more broadly, somebody common to both entities.

Senator PRATT—Could I interrupt you. Not being an expert by any means in this, what does 'unpaid distribution' mean? Sorry—

Mr Riley—No, that is a good question. A trust is not a legal entity; it is actually a relationship. I hope my other colleagues here will not get upset about the way I describe this. To give you a common example: I give you $10 and ask you to hold it for the benefit of my children and to pay the interest on that $10 to them. So you do that as trustee, you earn a dollar interest on that, and you determine, consistent with the deed, to distribute that to my children. It is closer to a gift—and that is my reference to bringing another trust into existence. It is not a loan. At 30 June you just say, 'I'm going to distribute this to the young Rileys'. The money may not have come in at that stage, so it is not until—I will make this up—August, for example, that you actually pay the cash. So there is a period of time when you have an obligation to them. That is the unpaid distribution concept.

Senator PRATT—I could not quite work out why it was unpaid—

Mr Riley—It is not at all uncommon. Because trusts are obliged to make their distributions by 30 June, it is not at all uncommon, because it then takes a period of time to calculate precisely what amounts are due. The earliest point when they could actually be paid is at a point in time—except where you may wish to make some advance. What has happened conventionally is that trusts, having made those distributions, have continued to hold the money and typically used it in their business or investment activities. It is in that context that you can see the logic in saying that if that trust then makes a loan to somebody, in a sense it is lending the money that belongs to the company and therefore it is proper that that loan should be governed under the general principles of division 7A.

That was first brought into legislation in March 1998. The legislation then introduced had significant anomalies in it and was completely repealed in December 2002 and replaced with some very substantial provisions from that point on. Those provisions remedied the anomalies and substantially extended the reach of the provisions—they were actually opening division 7A out, rather than narrowing it.

Schedule 1 in this bill extends those provisions still further. You will note from the previous slide that there was a trust which had an unpaid distribution to a company. On this slide there are two trusts. One trust distributes to a second trust; the second trust distributes to the company. That was a flaw in the original bill and this bill is designed to make sure that you cannot get around these provisions through this conduit mechanism. I do not have a problem with that. It is perfectly fair and proper.

The difficulty which has arisen is that these provisions were announced in May 2009. In December 2009 the Australian Taxation Office issued a draft ruling the effect of which is very broadly to cause the circumstance that it is the ATO view that an unpaid distribution is a loan almost from the outset, almost from the time it is made. It is not yet clear from the ATO as to when the loan comes into existence but it must come into existence soon after the distribution occurs.

The ATO in representations to the professional bodies through the National Tax Liaison Group in March 2010 set out the circumstances where the issues in division 7A relevant to trusts—and am trying to not be technical in this discussion—could still have operation, notwithstanding their view that these unpaid distributions are now more often than not loans. They presented three examples through the National Tax Liaison Group. It is fair to say that I have never seen one of those examples in practice. As young as I look, I have now been in practice 35 years and I have never seen one of those examples in practice. I have yet to speak to anybody—and I am now a senior member of our profession—who has also seen them in practice.

The flow-on effect of that is, if the ATO interpretation is correct, almost half the amendments in this bill, so far as they deal with specifically subdivision EA and subdivision EB, will have negligible operation. I find it hard to believe that provisions could be drafted to have negligible operation and I find it hard to believe that this has been the case since 1998. I have put here a question for the committee: is it intended that 50 per cent of the amendments in this schedule, schedule 1, is directed toward a set of circumstances which are, at best, rare? As I said earlier, I had never seen those circumstances in practice.

Our submission is that the answer to that seems to be no, it does not make sense that that would be the case, it does not make sense that there would be an extensive review in 2002 that brought in significant provisions in 2002 that were intended to have isolated operation. In our view, that must produce an unintended consequence so far as the bill is concerned. Our submission is that there should be an amendment in the bill making it clear that an unpaid distribution is not and cannot be a loan for the purposes of the bill, as a consequence of which the provisions that are there will have very substantial operation. They will not be an opportunity for taxpayers; they will have very substantial operation, and that is the essence. In my letter and in my firm's letter we raised a number of other points for consideration. However, those points drive off this one issue. We can move to those points if that is necessary but they drive off this one issue. That is the extent of my verbal submission.

CHAIR—Thank you very much, Mr Riley. Let me see if I have got this right: the basis of your submission is that the Treasury seem to be attempting to remedy something that is not a serious problem, or they are attempting to remedy something but in doing that they have done something else.

Mr Riley—No. In my view Treasury has done nothing wrong. Treasury has sought to remedy a problem that they think is there. However, the ATO is now saying to us that the problem is not there, and as a consequence the provisions in the bill are effectively neutered.

CHAIR—Have you had any discussions with Treasury or the ATO about this?

Mr Riley—I have had extensive discussions with the ATO. I was making a joke about my age before, but I was there for the consultation in 1997 and I was there for the consultation in 2002. I have tracked this right through. I still have minutes of meetings going back to 1997 and I am very confident that what Treasury is intending in this bill arises because of Treasury's view that an unpaid distribution is not a loan.

CHAIR—I guess we have an advantage in many senses, because we have not yet received a submission from Treasury. We have not heard from them, so your running through it so thoroughly has been of great use to me, in any case. You have suggested an amendment—or would you in fact suggest that it is not necessary at all?

Mr Riley—If you start from the premise, Senator, that these provisions are intended to have substantive effect, then it seems to me they can only have substantive effect if it is clear that an unpaid distribution is not a loan.

Senator BUSHBY—At least for the purpose of division 7A.

Mr Riley—With respect, Senator, it cannot be a loan. It is—I used the expression before—a 'gift'. My understanding is that it is never regarded as a loan; it is actually regarded as a second trust.

Senator BUSHBY—The chartered accountants made the same comment yesterday. They think this is a problem and referred to the ruling by the ATO. Their suggestion was that it should not be considered a loan for the purposes of division 7A.

Mr Riley—I understand where you are coming from. Yes, I agree with that. To me that is a one-paragraph amendment.

CHAIR—That answers my question.

Senator BUSHBY—I think you have made very clear what the issue is. In layman's terms—I do not think anybody here is an accountant—I certainly have a grasp of it, and it reinforced what the institute said yesterday. I probably understand it better now than I did when they said it yesterday and I think that you have said it well. I do not have any further questions. I understand what the issue is and what the proposed solution would be.

CHAIR—We will take it to Treasury tomorrow. Senator Eggleston or Senator Pratt?

Senator PRATT—I do not have any questions.

Senator EGGLESTON—I think that clarifies it. Thank you very much.

CHAIR—That is useful for us. Thank you.

Senator EGGLESTON—When you say 'undistributed', where does it remain?

Mr Riley—Typically the equivalent cash remains within the trust. It is a bit like me saying I will give you $10 but I do not actually hand it over for some further period of time.

CHAIR—Thank you.

[2.59 pm]

BEHARIS, Mr Noel, Director, Tax Technical Services, Dominion Private Clients

CHAIR—The committee welcomes Dominion Private Clients.

Mr Beharis—Thank you for inviting me to attend.

CHAIR—We have your submission. Would you like to make any opening remarks?

Mr Beharis—Yes, please. Just to begin with, I have also had the benefit of listening to Mr Riley's submission and I would like to wholeheartedly reinforce what he had to say in those particular comments. My written submission does not look into that aspect of division 7A because it did not seem to be covered by the amending bill directly. Just as an addition to what Mr Riley said, my dealings in relation to division 7A with Treasury have been with a particular Treasury official. I had been involved in discussing with Treasury, back in, I think, 2005, several amendments to division 7A to improve its efficiency, of which one included the section 109XA provisions. The relevant contact is also noted in the explanatory memorandum; I think his name is Raphael Cicchini. That may assist the committee.

My submission goes to four particular aspects of the bill. Something I imagine has been mentioned on many occasions is that division 7A is a very complex set of provisions and its scope is to prevent the use of funds that have been taxed only at the corporate rate and the usage of trusts as a mechanism to take advantage of the use of funds at that corporate rate. As a policy, I think that is quite appropriate.

I have taken the liberty of reprinting some of the diagrams I have had included in the submission. The point of schedule 1 to the bill is to expand the operation of division 7A to cover interposed entities and, in a vanilla case, my submission is, they work in an appropriate manner; however, there are cases where there are a multitude of trusts in a group. Just to illustrate, the first slide is a very vanilla case that is meant to be covered by proposed sections 109XF, XG and XH. In the diagram, you will see that there is a trust that distributes income to a corporate beneficiary—'distribute' meaning that the trust resolves to make a gift to the corporate beneficiary of $100. It generally remains unpaid for a period of time. Then that trust subsequently makes a loan to an interposed entity of $100, and then that interposed entity makes a loan to a shareholder. Sections 109XF, XG and XH are meant to say that the trust, by making the loans through the interposed entity to the shareholder, is actually deemed to have caused this thing called a notional loan between the corporate beneficiary and that shareholder of $100. And the reason for that is that that original $100 was ostensibly sourced from the distribution made by the trustees for the beneficiary. So that is what XF, XG and XH are meant to do, in a very vanilla case.

Then you get to something a little more complex—'complex' in the sense that there are a lot of entities; in terms of why it happens, it is probably not so complex. You tend to see this quite a lot—or, at least, I have seen it quite a lot—in practice amongst property development groups. But it is not confined to property development groups; it applies to any kind of business group that operates through a multitude of trusts. Typically, one trust holds investments and has a lot of money relative to all the other trusts. Every time some form of new business venture comes up, it is quite common to set up a separate, new [inaudible].

So, in the complex case, you have an investment trust and a property development trust. A property development trust buys a block of land, develops it and intends to sell it, and it borrows money from the investment trust. The investment trust generally is the group banker. As is typically the case, the investment trust will make distributions to a corporate beneficiary. In this particular example, I say it is $175; you can add as many as you choose to the end of that number but let us just say it is $175. The investment trust then props up the development trust by lending it $100, and that property development trust borrows another $50 from the ANZ Bank—

CHAIR—'Borrows' via the trust?

Mr Beharis—Just a straight, normal one—yes. If I can also bring your attention to the years and the sense of timing. The loan happens in 2010, the distribution happens in 2011 and then in 2012 there is a subsequent loan of $50 to a shareholder or an associated entity. That could happen for any number of reasons. For example, that associated entity could provide property management services or project management services and it needs an advance to continue its operations. What the provisions do in that particular case is allow the commissioner to assess anything from nothing to $175 to any of those entities in the group in such a manner as the commissioner determines. My view of taxation is that it is not meant to provide an open-ended discretion like that to any particular body. The taxpayer should at least be able to point to an amount and say, 'That amount is assessable or not.' I don't think the bill provides enough detail to enable a taxpayer to be able to work out what they are meant to be paying tax on. It leaves it open-ended to the commissioner to decide that such amounts he determines.

From a practical point of view—as I am preparing a tax return or as anyone in the profession prepares a tax return—it is no longer an exercise of looking at that particular year and seeing what has happened. The bill would require me to go back any number of years to see if this sort of similar fact pattern was there. As you will notice, all the years and the amounts are different. Someone has to make a determination as to whether the $50 loan from the property development trust, the shareholder, was actually linked to the distribution to the corporate beneficiary. This is in 2012 when the distribution happened to the corporate beneficiary in 2011. The bill allows the commissioner to ignore time altogether.

The bill also contains provisions that limits the commissioner's ability to amend assessments to four years in many cases. In theory these provisions give the commissioner the power to amend at any time over any time period these particular transactions take place.

Senator HURLEY—Can I interrupt, because otherwise I might forget my train of thought. Isn't that, though, because these kinds of structures have developed and it may not be possible to set down in legislation something that may take into account the myriad of trusts and structures that can be developed, and that this can be used as a way to avoid or least deferring for many years the payment of income tax? Isn't this exactly why the bill has been put in place?

Mr Beharis—I respect your view on the matter, but I think the bill's primary criteria just looks at the amount of the distribution to the company. There are other criteria that the bill could include that would be worthwhile and that would assist—for example, as to whether the funds that lent were actually put to some form of income-producing use; whether the funds that were lent could be traced through to the corporate beneficiary; and the period of time over which the transactions took place. They would all be relevant factors. The motivation of the parties concerned and I would have thought is also a relevant factor. The legislation does not make any form of description as to how this particular discretion is meant to apply. And when the commissioner or whoever will eventually apply this particular determination, what grounds can a taxpayer used to challenge that exercise of discretion, if the legislation does not prescribe at least some basic level of issues that need to be considered in exercising that discretion beyond just the distribution?

Senator HURLEY—I take your point.

Mr Beharis—I am not saying that the discretion should be narrow, but at least further elaboration in the legislation would be appropriate.

The other point is that in this type of structure, all the loans, had they come from an arms financier, or the interest on those loans, presumably would have been otherwise deductable. If that were a group of companies instead a group of trusts with a company in it, this would not be an issue at all, because companies can lend to other companies without having to worry about division 7A. There is a specific exclusion within the legislation. I do not consider that trusts should be disadvantaged just because they are trusts. That is a matter that minds might differ on, though, However, if the commissioner does find a tax avoidance motive in a sense similar to part 4A then, yes, the legislation would be appropriate.

The next two examples are variations on a theme. Instead of having an interposed entity where the loans take place, it is a situation, which was described earlier to the committee, where you have a first trust distributing to a second trust and subsequently to a corporate beneficiary. Then you get the more complex case, which is shown on the last slide. Again, it is quite common for trusts to distribute to other trusts in property groups to prop them up and support their debts. In the XI complex case, trust A, which has a $250 profit, distributes to trust B, which has a trading loss, and trust C, which has a trading loss, and the distribution would physically actually be paid across to support those trusts to pay their debts. That is quite common. The reason those distributions, rather than just a loan or ordinary payment, would take place is that if you did not actually prop these entities up they would be insolvent. Then you have trusts B and C distributing the balance of whatever has been distributed to them that they do not need off to a corporate beneficiary. I would add that it probably does not happen too often but it does happen.

The question then is: how much should the commissioner assess the controller or the associate of the controller if, in that example, they borrow money from trust A? Again, all the numbers are different. You could imagine all the years would be different. There has to be some criterion to benchmark this against. You cannot let the discretion be exercised potentially arbitrarily. I would like to think it would not happen that way but there is always the potential for that to happen.

The second part—

CHAIR—Sorry, can I interrupt again.

Mr Beharis—Please.

CHAIR—It is your view that the tax commissioner could tax anywhere from trust A to the controller, trust B or trust C?

Mr Beharis—Or trust D. Yes, that is my view. And on any amount ranging from zero to $250, when the amount of distribution that is unpaid to the corporate beneficiary is really only $140. Again, the more complex the structures get, the more difficult it becomes to apply this legislation. My submission is that further elaboration on the various factors the commissioner needs to take into account in making his determination would be appropriate. I have listed in my submission what sorts of facts I think would be helpful.

The second issue I wish to raise in relation to the bill concerns the use of company assets by shareholders. Again, division 7A is focused on ensuring that company profits or company assets are not used in such a way that they only bear 30 per cent tax—at least, that is a very broad overview of division 7A. The bill contains various valuation rules but the key one says ‘an arm’s length valuation’. My submission is that it creates two different fringe benefits tax regimes. The first one is the current one we have in relation to benefits provided to employees and the second fringe benefits tax regime is benefits provided to shareholders, and all the valuation rules are different. FBT actually has very detailed valuation rules in it whereas the bill only has very cursory evaluation rules in the sense that it says only what an arm’s length value in relation to the benefit would be. The FBT legislation also has concessions, statutory fractions and statutorily determined valuation rules. My submission is that the FBT valuation rules be incorporated into the valuation rules for division 7A, rather than having to contend with two different types of valuations for different benefits or for the same benefit.

The third aspect of my submission relates to the tax file number regime, which has been described earlier in quite some detail by previous witnesses. The only things I want to add on the tax file number withholding regime are, first, that a beneficiary does not always choose to be a beneficiary of a discretionary trust or a family trust. I am sure that point has been made earlier to the committee but, just to reinforce that fact, if I set up a trust of which all the members of parliament were beneficiaries, I do not think that the members of parliament would have a say in the matter. I could write them a letter to say, ‘Look—

Senator PRATT—You are going to have a tax liability against that.

Mr Beharis—you have may have a tax liability unless you provide me with your tax file number.’ The tax file number is a very key piece of identity information. It should not be given out lightly and it should not be given out unless there is some certainty that there is a legitimate need to give out that tax file number. It is potentially capable of being used in an improper way.

The other thing is that the bill assumes that the beneficiary is actually willing to give their tax file number to a trustee. Families are families and they can have acrimonious relationships. You can have estranged spouses who are beneficiaries of the same trust where one is a trustee and one is a beneficiary. I think it is inappropriate to penalise beneficiaries for the fact that they do not get along with the trustee. The proposal that I have put in my submission is for a mechanism where that tax file number is given to the Commissioner of Taxation, with the beneficiary saying, ‘Look, I have received this notification for trust. I do not want to give them my tax file number. Will you take it instead and direct them not to withhold?’ I would have thought that would be quite an appropriate way of dealing with those sorts of relationships.

The other aspect of the regime is that what a beneficiary gets taxed on and what they actually receive from the trust can be two entirely different amounts. I am sure that that has been made clear by previous witnesses. It is especially so in relation to capital gains. The extreme example is that a dollar of income gets distributed to beneficiary A and a million-dollar capital gain gets distributed to beneficiary B, and in theory beneficiary A is taxed on $1,000,001. That is a very extreme example that division 6 can lend itself to in a particular set of circumstances. The case of Bamford v Commissioner of Taxation, which concerned something like that, has recently been heard by the High Court. It was not as extreme in facts but was very similar in concept. The suggestion is that the tax file number withholding should be based on the amount the beneficiary can actually call to be paid to them—that they should be credited with that amount of tax withholding in their tax return. To take my extreme example, what TFN withholding credit do they put in their tax return? Is it the TFN withholding on $1,000,001 or is it the TFN withhold on $1? And what does beneficiary B put in their tax return? That is my primary concern with the TFN withholding legislation, aside from the timing and the fact that it is meant to happen pre 30 June, which in practice will be very difficult to achieve.

CHAIR—Thank you. In terms of the issue of evaluations and the FBT regimes and so on, on page 21 of your submission you talk about instances where you may have to get valuations and you mention the minor benefit test. I think that Treasury's response to a lot of the things that you describe and say might happen would be that they would be described as a minor benefit.

Mr Beharis—Minor benefit exemption has a valuation attached to of it $300. I do not know what the value of private use of a laptop is or what the value is of the private use of a safe in my client's office. I do not know how I would substantiate it, and as the taxpayer I have the burden of proving that it is worth less than $300. In those particular examples they are quite obvious, but in other examples they might be a little less obvious. What value do you place on the use of assets that exist in premises of a client? I do not know. As to the occupation of the space in the office that the company uses for its business purposes and that the controller uses for private purposes, I do not know if you would consider that to be excluded from division 7A because that private use is provided in a capacity of an employee or that they are wearing their shareholder hat.

If it were an employee it could be straightforward because there are specific exemptions in the FBT rules that exclude it from fringe benefits tax. Because those rules are absent in division 7A, we have to now go through and check all of them, one at a time. We have to make inquiries to see if they exist. It is a lot of work for very little benefit, if any at all. So I would have thought that, from a compliance perspective, all those issues would be swept away by just aligning the valuation rules and the concessions between division 7A and FBT to make them equal. I do not think it is too hard.

CHAIR—The examples that have been given are things like boats and holiday houses, rather than laptop computers.

Mr Beharis—They are very obvious.

CHAIR—If you are going to tie down in legislation all these things, then maybe you create unnecessary complexity in the legislation. Large benefits like that—a holiday house or a boat—would be a clear case of where the beneficiary is getting a significant advantage.

Mr Beharis—I am not disagreeing with you. I am just pointing out that the valuation rules and all those particular issues concerning the provision of benefits are already there in legislation, in the Fringe Benefits Tax Assessment Act. Using those rules would be relatively convenient because employers use those rules on a day-to-day basis. There is a plethora of information about fringe benefits, how it applies, how you value it and what is in and what is out. That is produced by both the professions and the tax office.

In the case of leisure items like boats, they would be equally taxable under both regimes, and on the same value. But in the case of day-to-day items, which are not particularly meant to be caught by division 7A, motor vehicles are the key one. I cannot see a reason why the valuation rules between division 7A and FBT should be different. I do not see the benefit in it. To take motor vehicles as an example, FBT has a statutory fraction. Say the car travels less than 15,000 kilometres a year and the statutory fraction is 0.26. You take that, multiply it by the cost of the car, multiply it by an uplift factor and then multiply it by the FBT rate to find the amount of fringe benefits tax you have to pay. Division 7A says that it is the arms-length value of the provision of the car. How do I work out what the arms-length rental is of something that is not rented by Hertz car rental—for example, an Alfa Romeo? I am just plucking that make of car out of the air. Do I go out and value it? Do I get the finance company to tell me how much the day-to-day rent of this car is? Do I rely on the exclusion? Why should I have to go through that process? I should have the ability to say, 'The FBT value is X. I am happy to be taxed on X.' It is there.

CHAIR—Thank you.

Senator BUSHBY—I do not profess to be an accountant. It was interesting being led through that. It gives us something to mull over. You did a reasonable job of explaining it to us in a way that a layperson can understand.

Mr Beharis—I tried.

Senator BUSHBY—You have raised issues regarding the use of company assets by shareholders. You have come with a suggestion for how the accounting of that could be addressed. Nonetheless, the change will impose significant new burdens on small business and their tax advisers in terms of compliance. Is that true?

Mr Beharis—Yes, it would be true.

Senator BUSHBY—We have had a number of representations in that respect from the Law Council of Australia and the Institute of Chartered Accountants. Yesterday the Institute of Chartered Accountants were of the view that this takes things a long way away from the original intent of division 7A. It goes much further.

Mr Beharis—Yes, it does.

Senator BUSHBY—One of the biggest concerns that they raised—which also concerned me and pressed my button—was the issue of retrospectivity. The fact is that there are an awful lot of companies that have structures under which they hold assets, some of which are active enterprises and some of which are just held assets. They are currently held in structures on the basis of professional tax advice they have received over the years. They are holding that for a reason. In most cases they were held happily in the knowledge that the laws of Australia applied as they did and that the structures in which they were held were fine. This change, without any opportunity for rollover relief in terms of being able to get out of things with stamp duty relief or capital gains tax reliefs or whatever it might be, means that those structures may now be entirely inappropriate ways of holding things and have very little option for people to cost-effectively change those structures. That seemed to me to be a fair concern to be raising.

Mr Beharis—I would agree with that concern, and I have heard that concern being raised before by the professional bodies. There is not very much to add to that. Again, this is one of those policy decisions that I try to stay away from as best I can. The decision is made that either you tax these assets or you do not. Trying to move them out of their structures is going to be costly for anybody and inconvenient. Your average taxpayer will choose the path of least resistance and either get some form of valuation and just live with it or take the pain and move them out of these particular structures. Again, that is all I can add to those types of submissions.

Senator BUSHBY—That is true: the law changes and, once it is changed, you will take the best advice and find the least costly alternative to address that. But at this stage the law has not changed and we are doing an inquiry into what the consequences of this change might be. If the intention of the government in introducing this bill is—as I understand it to be—to ensure that the shareholders of businesses that make profit do not enjoy the dividends without appropriate tax being paid, then this potentially goes a long way beyond that. We have an opportunity at this point to look at those consequences and hopefully try and come to a conclusion that might mean that we have the intention more accurately met rather than having unintended consequences.

Mr Beharis—Of the assets that have been typically put in companies, the biggest one is real estate. The real estate assets may have been put in a company historically for lots and lots of reasons.

Senator BUSHBY—Most of which probably do not exist now.

Mr Beharis—That is correct. The introduction of the 50 per cent capital gains tax discount made it disadvantageous to put capital appreciating assets in companies after 1999, when it was introduced. When the CGT legislation only provided indexation relief, placing assets in companies was quite a common thing, something easy for clients to understand—a company is a company; you lodge your forms with ASIC; and a separate legal person provides you with separate asset protection. Those structures grew up over time. A lot of farmland is included in companies, as I understand it. I have seen it happen quite often with primary production real estate. There is a carve-out in the legislation for assets in primary production—for residences in companies. But it is not just confined to residences. It extends to any kind of real estate that is kept in a company.

Senator BUSHBY—You say that the carve-out extends to any real estate?

Mr Beharis—No. It extends to residences.

Senator BUSHBY—Does it have to be the primary residence?

Mr Beharis—It applies that it is the primary residence.

Senator BUSHBY—So it might be a property that you owned that you were not living in. An example yesterday was used of somebody with an adult disabled daughter who they looked after during the week but they gave her some time on her own in her own unit at weekends, and it was paid for by putting after-tax money into a company, and the company did nothing but own that real estate. Under this, once it starts, they would actually incur a liability to pay up to the value of the use of that property.

Mr Beharis—Potentially, yes.

Senator PRATT—Is it the disabled daughter that has the liability, because she got the benefit?

Mr Beharis—Yes. It is the shareholder or the associate of the shareholder that is deemed to have been paid a dividend.

Senator PRATT—Can I just interrupt this line of questioning. It strikes me that there are a few other scenarios. You might have children that have purportedly been disbursed benefits—or other people might have been disbursed benefits—which really they would never have chosen to spend their own personal income on should they have had it. But they then acquire a tax liability for it. In a sense, whether you choose or not to consume that asset and therefore assume the liability is not necessarily your choice under all of those circumstances.

Mr Beharis—No, it would not in some cases. That is a fair comment to make because the company might make the asset available to a person and that person may not know (a) that it is owned by a company and (b) that they are in breach of the legislation by occupying it. Further, it might be made available to them for six months on weekends. Is it the six-month period that it is made available to them, or is it the weekend that they actually occupy it that is the amount that they get taxed on? The legislation is not as clear as I would like it to be on that particular topic. The inference is that if it is made available to you, whether you use it or not you are caught by the legislation, you are subject to tax on it.

CHAIR—That is the available for use—

Mr Beharis—Correct. So if you only use it on weekends then you do not get taxed on your actual use, you get taxed on the potential use.

Senator BUSHBY—Or even if you are a plumber and you drive your company owned ute home every night, park it in the garage but do not drive it until the next morning, theoretically it is available for use.

Mr Beharis—The ute is an interesting example, Senator, because under the fringe benefits tax legislation that would be an exempt fringe benefit, where as under division 7A it is taxable. So if you have your contract plumber who operates through a company who uses the ute and you query whether the ute is given to them in their capacity as employee of their company or as shareholder, if it is as a shareholder, they are subject to tax under division 7A, if it is as an employee, they are not subject to tax under the fringe benefits tax legislation. Which one is it, Mr Commissioner? FBT or division 7A? I guess the answer depends on hindsight, because the commissioner comes in and reviews a taxpayer two, three or four years after the event and we have to make—

Senator BUSHBY—A long time after it is possible to fix the arrangement.

Mr Beharis—Correct. Hence the reason I am suggesting to align the rules. If you are going to put this in—and, again, that is a policy decision of government—at least align the rules so shareholders and employees are taxed in exactly the same way and do not tax people by ambush, which is, ‘I don’t know this thing is held by a company but I’m using a company asset and I’m deemed to have been paid a dividend.’ That would be helpful.

Senator BUSHBY—The other issue that was raised yesterday was a very specific example of property that is held through company title. It was pointed out that theoretically, because your use of a particular unit in a company title development is associated with your shareholding, but it is a company asset, that theoretically you will incur a liability as a result of your use of that as a shareholder. We have since got some advice that indicates that if you held that before July last year, because it is your principle residence, you will probably be okay.

Mr Beharis—What if it is an investment property that you have—

Senator BUSHBY—If it is an investment property it is another issue. Similarly, if you held it before 1 June last year, that is fine, but what if you sell it? Whoever you sell it too will have acquired it after 1 July 2009 and you have no other option other than to sell it as a company unit title unless everybody in the whole development gets together and converts it to strata title.

Mr Beharis—This is one of those things where—yes, I agree with you, Senator, and you are potentially putting those particular owners to additional cost, assuming they all realise the implications. As I said, taxpayers generally take the path of least resistance. The next person who comes along, if they are astute enough to realise that this is an issue, will do one of a couple of things: (a) discount the value upon which they are going to buy it and the vendor, realising that the value is discounted, will try to work out why, they will get advice and they may try and do something to change the situation by converting that title, or (b) they will be totally unaware of it until two or three years after the event, then you will get the purchaser saying, ‘You should've told me this and should've disclosed it to me in the vendor statement, so therefore I am suing you for breach.' That is another possibility.

Senator BUSHBY—And they could see the government for compensation.

Mr Beharis—Not the government. It would not be the government they will go after; they will go after the vendor. Again, I am not particularly keen on taxation by stealth or by ambush, and that is—

Senator BUSHBY—Traditionally something like this, you would normally have announced it on that day and said that retrospectively it did not apply to you, but it will for transactions that occur from this time forward.

Mr Beharis—The commissioner's defence to that kind of argument, if I am wearing the Commissioner of Taxation's hat on those particular titles, will be to say that division 7A only taxes the shareholder or associate in relation to the distributable surplus, meaning the accumulated profit of the company. That is not quite a fair comment, because a distributable surplus allows the commission to revalue the assets of that company to their full market value.

Senator BUSHBY—As in company title. You might have bought it 20 years ago for $20,000 and it is now worth $700,000.

Mr Beharis—Then the distributable surplus would be $680,000-odd, which you are potentially taxable on. And it is tax dollars and unfranked dividends, so, yes, I would agree, it is one of those unintended consequences of the legislation.

Senator BUSHBY—Thank you.

Mr Beharis—You are welcome.

CHAIR—Thank you very much, Mr Beharis.

Mr Beharis—Thank you.

[3.36 pm]

GARDINER, Mr Andrew James, spokesman, National Tax and Accountants Association

CHAIR—Welcome. Thank you for coming in this afternoon.

Mr Gardiner—My pleasure.

CHAIR—Would you like to make an opening statement?

Mr Gardiner—I would. Our observations on these proposed changes have been predicated on the basis that they are going to be introduced in some form, modified or as they may be. What we have really focused on are the changes that relate to the use of company assets, regarding amendments to division 7A. There are amendments to 109C and 109CA. Some of the concerns that we have go to the retrospectively of the changes. They are meant to apply from 1 July 2009, but to me and to our association they are rather problematic in that, yes, they are meant to apply from 1 July 2009, but there is a tremendous amount of uncertainty out there about the rules, the record-keeping and what needs to be done, and we are almost at the end of the financial year.

The feedback we are receiving from our members—I would suggest from the peak lobby groups for small to medium sized accounting practices—is incredible frustration. They are coming to us and saying, ‘We know the rules are there. We’re certainly not enamoured with those rules. We appreciate that we have to deal with this as part of the fabric of our tax system, but what do we do? What do we advise our clients?’ One of the cornerstone aspects of our thoughts on this would be a deferral of the commencement date of these measures to appease the uncertainty and to appease the frustration. Not only that; it would give practitioners the ability to advise their clients about what they need to do now, what is problematic, what is not and how the exceptions apply, so that moving forward everybody has certainty. One of the most unfortunate features of any tax system is uncertainty. The worry we see with these measures is clearly that.

CHAIR—Thank you, Mr Gardiner. The ATO released an advice in December last year. You do not believe that covers all of your questions?

Mr Gardiner—There are aspects of this that I can certainly run through. I can explain to you why they attempt to deal with very specific situations. But when you get to the coalface of applying them on a day-to-day basis to clients, the questions they ask are very much about the nuances. The problem is that we do not believe the guidelines give people enough certainty on what they should be doing moving forward. We therefore see that those challenges need to be certainly recognised—and we hope they will be recognised—so that we can defer them. It is not going to be a big cash cow for government based on the Treasury estimates. I think it will be well received in the event that there is deferral. It gives people time to absorb the changes and implement the necessary structures, agreements and possibly changes in ownership from 1 July. If they do not, they will realise the implications of what that all means. At the moment there is a lot of uncertainty. That is best illustrated by when the measures were first introduced. There was an exception, say, in relation to dwellings. There were very limited circumstances. There is what we refer to as the 10 per cent rule. Then the second raft was released. We are talking about the removal of the 10 per cent rule. We are looking at pre 1 July 2009 dwellings. That change of itself might be seen as rather minor in the scheme of what we are referring to, but there is a problem.

Some of you will be well familiar with the debt to equity rules. We refer to them as reverse division 7A. They were renounced and they were originally meant to apply unilaterally, whether it be to small business or large business. We had many members come to us on this, frightened about the impact this would have on mum and dad businesses, businesses which were doing nothing wrong, with no evasion and no exotic or synthetic finance products occurring. They had just lent money to their entity and they were petrified of what these rules might mean. So accountants skilled up. They implemented changes and started to understand agreements. Lo and behold, there was a de minimus rule introduced—and I think a very good measure at that. I think the turnover figure was about $20 million. Instantly all these businesses were out. Really they did not have anything to worry about. The problem that created is that many accountants now say, ‘I’m not worrying about this until it’s law because history now has shown me that these rules change and evolve. So why would I advise clients now? Why would I implement agreements now? Why, in the case of these rules, would I organise or reorganise the ownership of assets in or out of a corporate-based entity? Who knows what their final fabric will be?’ The problem that has created is huge scepticism. People are waiting and saying, ‘Until such time as I know what those rules will be, I’m going to wait.’

Yes, there have been changes and they are favourable, which is great. However, the problem that has created is this scepticism with people saying, ‘They’re evolving. I think they’ll evolve even further. And look, this is in effect retrospective. Let’s wait and see what the measures will be.’ The problem is that, as it stands, they apply today. That, to me, is a situation which has not been treated very well at all.

CHAIR—But Mr Gardiner, if we defer the bill six months, you might as well say they will wait another six months until the implementation. I think that is a very circular argument. That is an argument for introducing it now, surely, so that everyone does know where they stand.

Mr Gardiner—No. I will explain to you why. I appreciate your comment but the point I raise is this. I am looking at this at an application level. These measures apply, as it stands, from 1 July 2009. As they have evolved—and they have changed from what people originally understood—there have been greater levels of exceptions. The problem we have is that the revenue we are talking about recovering, as per the Treasury estimates, is only about $10 million, but the disruption that this will cause if these measures are passed, say, in the next four or five weeks, or whatever the timeframe, will be that accountants will then have a very short period of time to implement changes, possibly, or to implement documentation which might be demanded of these new measures. I will give you an illustration.

In these measures there is an otherwise deductible exception. So a company provides me with the use of an asset, let us saying typically a car—a classic example. I am the shareholder, I am not an employee of any fabric whatsoever, so we are only looking at these measures. Let us say I use that car 70 per cent for business use. In prior years it had never been problematic because I am not an employee, there is no FBT exposure, I have never been concerned by the dichotomy between business and private use. So I have just moved along merrily. Come 1 July these changes are introduced and I now think, ‘ Hold on, if I use it 70 per cent for business, 30 per cent is private, so my technical exposure is 30 per cent. Lo and behold, we are almost at the end of the year. The one thing which is bereft of any guidance thus far is what documentation do I, as the shareholder, need to maintain? Is there the expectation of a log book? And is that for a 12 week period? We are almost to the end of the year. That is problematic. What do I do? Do I need to provide guidance on my journeys? What do I need to do to ensure I can reduce it by my business use percentage?’

That is why I am saying to you that I appreciate the challenge from a Senate point of view but looking at it from a government point of view I am saying that you could actually get to a situation, say, where the shareholder has used the car 100 per cent for business purposes. We get to 30 June and because nothing has occurred—they have had no guidance, they do not know what they have to maintain—the legislation is passed to be effective from 1 July 2009 and, by the way, the tax office required documentation. If you do not have a logbook or similar records to verify your business use, it is zero. Suddenly, we are in a situation—where we would all, I hope, agree that there would not be nor should there be a tax impost based on the otherwise deductible exception—of substantial exposure from a shareholder perspective. I appreciate what you are saying, but I am looking at this from very pragmatically and at a grassroots level.

CHAIR—Have you been in touch with the ATO or the Treasury about these issues?

Mr Gardiner—We have been speaking to the tax office regularly. We are part of all of the forums and everything else. In looking at this, we have not as yet received clear guidance, nor has it been released broadly—

CHAIR—So you have asked for guidance about this specific issue?

Mr Gardiner—Not on the specific issue, because at the moment nothing has been passed. On other proposed legislation invariably the clear response from the tax office has been that it is not law yet—and rightly so. They say, ‘We can’t provide you with a set of guidelines.’

CHAIR—But they have already released an advice.

Mr Gardiner—They have released some advice, but they have not released detailed advice on documentation and their expectations of what would be necessary to demonstrate business use. That is the classic example from my perspective, to be able to then benefit from that otherwise deductible exemption. That is where I think the uncertainty becomes such a challenge and such a frustration. This is pretty much about small- to medium-sized businesses. It is more about the microbusinesses and small businesses. They are the people who are going to be subjected, potentially, to these measures. I understand your point about why then implement it at all. I am saying make it 1 July 2010, then everybody will understand what the fabric of the measures is. They will undertake action if they deem it appropriate. If they do not, then they are exposed and they will have to be proactive in whatever they decide to do. At the moment I see that as being very, very challenging moving forward.

Senator EGGLESTON—I am just surprised that there has not been a response from the Tax people to your practical examples.

Mr Gardiner—There are others, if you would like me to highlight them for you. I am very happy to do that.

Senator EGGLESTON—Just for the record, you might like to do that.

Mr Gardiner—Let us look at the concept of an arms-length amount with respect to the use of an asset. The legislation and the explanatory memorandum make repeated reference to the arms-length amount. I will give you a very straightforward and common example, and then we need to find out which way this works. Say my company provides me with a car. Clearly, I am not an employee, so there is no FBT exposure. Therefore, we are at the mercy of these measures. I have the car, or it is available for my use, for 365 days of the year. On the basis of these measures it would appear that I therefore have a problem under division 7A. Let us say we do. When establishing what the arms-length amount is, is it based upon what a daily rental charge would be in relation to the vehicle, extrapolated over a 365-day period? Alternatively, is it based upon the annual lease costs of a similar or commensurate vehicle over a 365-day period? That is pretty much a garden variety situation.

I will take it a step further. Let us say that I do not use the car every day. But, under the availability rules, as I call them, it is available to me as a shareholder, to the exclusion of the company. So the car sits there. I do not use it, but it is available. When valuing that from an arms-length perspective, is it valued on the basis of the same arrangements—that is, whether it is available or used, we just have this notional value? Or is the figure slightly discounted because it is available but I have not used it? They are the really practical sorts of situations. When you roll up your sleeves and look at it, you say that arms-length seems straightforward—that is, what you have to pay for the use of the car. But there are dimensions associated with that that are not as easy as they may seem.

We have a solution for this. Not only do we highlight the problem but I have a suggestion as to how we deal with it. I think one way of dealing with this, possibly—and it is already part of the fabric of these measures—is to say that when valuing a benefit that is provided to a shareholder, reliance could be had on the FBT rules. We are not saying it is subject to the FBT, but there would be reliance on the FBT rules. As a classic example, we have under the FBT rules the statutory formula and the operating cost method. So in those circumstances where it is available or is used 365 days, it is irrelevant. We then go to the valuation rules that are contained under the FBT measures. We apply those to this in a notional sense and that forms the basis for working out what the arms-length amount is.

The reason that has merit as a suggestion is that the rules at the moment already make reference to the minor benefit exemption when looking at the minor benefit exception under these rules. That links back to section 58P, the FBT minor benefit exemption, and makes the comment that if notionally you would have satisfied that exemption then it can equally apply in relation to the use of an asset from a division 7A perspective. Why, if we have already got that relationship in place, make it a broader relationship and say that for cars—and that is going to be the biggest one; in our experience boats are probably less likely but cars will certainly be big—should we not use the same rules? They have flexibility over operating costs or stat formula. Notionally that value then translates and, so long as they pay that amount or they pay no amount and have a distributable surplus, we then have a deemed dividend issue. Not only that, the FBT rules equally have other valuation rules that apply for an array of benefits, whether they be tangible use of assets or whatever they may be. That allows us to rely upon all of that background, and all of the legislation and all of the rulings can then form the basis for the application of these rules. It does take away, in our minds, a vast degree of uncertainty.

Senator BUSHBY—Thank you very much for what you have said. I think it highlighted some of the practical realities of how this legislation will impact. We have also had a lot of evidence, including from the Institute of Chartered Accountants and the Law Council, highlighting some of the other perceived flaws and the administrative burden that is going to be placed on small business and their advisors, the requirement to record the use or exclusive availability for use and all of those sorts of things on all sorts of assets, the obligation to prove that the value of the use of those assets—which could be anything, such as use of a safe, that are assets that belong to the company and that are being used by shareholders—is $300 or less. It is also fairly prescriptive in terms of how it applies. If you cannot show that it is under the value of $300 then you are liable.

I have one additional question that I do not think has been addressed at all. If a private company is now required to receive payment for allowing the use of assets in order to stay outside of division 7A and the deemed income rules, is it possible that that income could push some small companies that do not otherwise have that obligation—companies that are operating with a small turnover or companies that do not have a turnover at all but are just passive holders of assets to be treated as carrying on an enterprise for the purposes of GST and associated additional insurance and things like that—into areas where they do not want to be?

Mr Gardiner—What you would find with that is that when looking at the obligation to register for the GST, it is turnover based.

Senator BUSHBY—Yes.

Mr Gardiner—I think the turnover at the moment is $75,000. So if you have an entity that is really only an asset-rich or an asset holding entity but is passive in all other aspects, I would think it would be unlikely that it would create a situation where assets are so significant and the arms-length amount that might be payable is such that it then takes you to that threshold.

Senator BUSHBY—What about, say, a plumber, or a small tradie-type of business running through a company which does use assets, such as a ute and things like that, and is running close to the $75,000 but is quite deliberately avoiding going over that in terms of the work that they do but find that this pushes them over in terms of that obligation, meaning they either have to reduce the amount of work they do to keep themselves under or take on those additional obligations that exist?

Mr Gardiner—In that situation, if you are borderline then the obligation to make the payments will, from what I understand, form part of your turnover. Hence, even though the person would regard it as their own income—and, rightly or wrongly, that is the perception—they would then be making a payment which ultimately potentially crystallises GST liability on the payments that they make to the company in respect of the use of the company assets and it would also have this cascading effect because you would not have an isolated GST registration for one of your businesses to the exclusion of the others. It would therefore be the entity that would be obligated to register, so potentially you are right; it could certainly create a GST obligation that previously was not in existence.

Senator BUSHBY—And, if you were a single tradie-type of person who does not really want to take on the paperwork involved in going over the threshold, the only alternative would be to do less work and have less of an income.

Mr Gardiner—Ultimately that is really a fair disincentive for people. At the moment we are talking about governments—it is irrelevant, really, whichever governments they are—trying to establish a tax system that actually encourages people to work to be successful. This is a classic situation, possibly, and I do not know—

Senator BUSHBY—It is not going to affect everybody.

Mr Gardiner—No.

Senator BUSHBY—It is not an unrealistic scenario.

Mr Gardiner—That is right. It certainly could happen. The issue is that it would be very much at the small business end. They are the sorts of situations that will go unnoticed in many cases. People will say, ‘Well, that is a unique situation. We will put it aside.’ But, for the person involved, the bigger concern will be that they will possibly be unaware of the situation they have created where the payments that they are making in order to alleviate this division 7A exposure have now taken them above $75,000. Let us say the accountant is right on the mark, very savvy, and says, ‘This is what you should do. We’ve got this situation in place. You need to start making payments.’ Well, lo and behold, the turnover flips through $75,000. In the meantime clients are coming in and being billed. Clients are making payments and the taxpayer involved is completely unaware that they now have a 1/11th obligation for those income amounts that they have been generating as well.

Senator BUSHBY—Exactly. So it could actually have quite severe consequences for the individuals concerned.

Mr Gardiner—And if somebody is earning around that $75,000 figure—it is not a king’s ransom—they would be doing it tight, one would think, in a financial sense, and this could really be a huge impost for somebody who confronts that situation.

There are a couple of other things as well—and please fire questions as needed. There is a comment in the explanatory memorandum. I will read from the paragraph and then highlight a situation about which, to this point, I am still a little bit uncertain as to where we are. There is an availability provision I referred to, which is that if an asset is provided to me and is available to me to the exclusion of the company, then regardless of whether I use that asset or not there is potentially a deemed dividend issue to the market value of the asset being available. The explanatory memorandum says:

A payment may also occur when the asset is available for use to the exclusion of the company.

That is a classic situation that would occur probably 99 times out of 100—probably 999 times out of 1,000. The example in the explanatory memorandum is a boat, so let us say that I have a boat. The boat is moored and I have the keys to the boat. Let us not worry about clothing being stored on it; let us keep it very simple. I am the director but also the shareholder of the company. In those circumstances, if I have those keys, do we say that I have it in my capacity as shareholder and that I am excluding the company or do we say I am a shareholder and I am a director? So which capacity takes priority? Or do we acknowledge that they both have an existence and therefore it is not to the exclusion of the company and hence the availability rules have no application?

We have had some seminars on this and people looked at us, quite rightly, and said, ‘Hang on. If I am one and the same—‘ and, as I said, 99 times out of 100 that will be the case—‘all we will say is I am holding the keys as a director.’ How does that work? What if mum and dad are both shareholders and directors? They will both hold keys, whether it be for a yacht, a car or whatever. So do they hold the keys as a director or as a shareholder? What is their capacity? The difficulty I see with this is how one makes a distinction. When people in practice are sitting in the suburbs doing their returns and offering risk assessment for clients, they need certainty on how to advise their clients. They may not like what the answer is—and I hope the answer is a pragmatic one, where if you are both it is still available to the company—but they need to know that answer.

But it becomes worse again. I do not know if anybody has raised this with you thus far, but the agent standards that have been introduced place significant responsibility upon a tax practitioner to get this right to advise clients correctly. Those measures are now in. They are part of the fabric of the advisory and the professional services that are being offered by tax agents and tax practitioners. In those circumstances, how can they advise a client with certainty, when we are here and our discussion—

CHAIR—Surely the easy answer would be to make a certainty about ownership of the boat. If the company needs a boat, for whatever reason, put it in the company name and do not let the shareholders use it. If the company director as an individual and his family want to use a boat, let them buy a boat.

Mr Gardiner—The point is that we have a car that is sitting in the company.

CHAIR—No, let us talk about boats. You raised boats.

Mr Gardiner—I raised both.

CHAIR—Let us talk about boats.

Mr Gardiner—I think the type of asset becomes academic to the issue we are referring to. Let us say it is a boat or a car; I am not worried what type of asset it is. If I have the keys of the car but I do not use the car—

CHAIR—If the company needs the car, leave the car with the company. If any of the shareholders and their families need a car, let them buy a car out of their dividends.

Mr Gardiner—Here is the problem though. You are saying, ‘Let them use it,’ but these provisions made the comment. Let us say we do that. Let us say that I am the director and I am simultaneously a shareholder. I say that this car sitting in that garage is going to be used exclusively for business and for no other reason. We have our own family car outside, registered in my name. If however the ATO run the argument that because I am a shareholder, whether I use that car or not because I hold the keys in my hand I have it in my possession. If they run the argument—

CHAIR—That is an extreme example. Let us get back to the boat and the holiday house, which is what this legislation, I think, is about.

Mr Gardiner—But the legislation does not make a distinction.

CHAIR—No, I realise that, but we can fix these things about cars. Let us talk about boats and holiday houses.

Mr Gardiner—I am happy to do that too. In effect you are saying to me that we can fix the problem of cars. This takes me back to a point I made earlier.

CHAIR—Where it is possible.

Mr Gardiner—I am saying to you that I am dealing with what the rules say as of today. You are saying that we could possibly offer a rectification solution to overcome this. I am now saying to you that is great, fantastic but, given these measures apply from 1 July 2009, what do people do in the interim?

CHAIR—Yes, but let us get back to this boat issue. Tell me why a company should be able to have a boat. The shareholders may be busy and only use it one day a week, but no-one else in the company uses it. If the company needs a boat why don't they have it in their own hands? If the family use it they can rent it or whatever. Let us clarify the ownership.

Mr Gardiner—I will deal with that by example. Let us say the boat is held in a company and let us say the boat is used exclusively on company business regardless of what it is. But let us say I have the keys to the boat and I have the keys to get to the jetty so that the boat can take off, but I am both a director and a shareholder. The boat is never, ever used for private purposes. As per these measures, what I am saying to you is the asset here is irrelevant.

CHAIR—No, because the ATO can make a ruling that the director can hold the keys providing that the boat—

Mr Gardiner—They can. The point I am raising is that at the moment this is an unresolved issue.

CHAIR—Yes, at the moment. It is fine for you to raise it but I am saying that there are variations here and there are times when shareholders use assets of a company for their private and personal use, if they are available to them. They are a wonderful benefit to have and they are not being taxed in the ordinary course of events.

Mr Gardiner—That is what these measure are meant to overcome. But the point I am highlighting to you is: if it is isolated to the use of the asset, then the philosophy you have just highlighted would be, without doubt, a very comprehensive way to solve it. But these measures not only say, 'Did you use the asset?' They are also saying, 'Was it available to you to the exclusion of the company?' I am saying to you: let us go with both. Let us go with whatever asset you would like and let us say that it is used exclusively for business but I hold the keys. Then the worry that we have is: do I hold the keys as a shareholder or do I hold them as a director?

CHAIR—We will take that and will ask Treasury tomorrow about their interpretation of that.

Senator CAMERON—Isn't this about accessing a tax-free dividend? It is not just about holding the keys. There is another test as well and that is that you get a tax-free dividend.

Mr Gardiner—You have a distributable service in the company. I appreciate that, but the point—

Senator CAMERON—Do you agree that it is a fair and reasonable proposition that legislation should be in place to prevent a shareholder of a company accessing a tax-free dividend for the use of company assets?

Mr Gardiner—That is the most leading question I have seen in a while.

Senator CAMERON—It is not a leading question. It is a question that says, basically: is it a fair proposition for the government to enact this legislation because that is what it does? If you say, no, just tell us that.

Mr Gardiner—It is not for me to comment on the broader social issues at play. My understanding is I am here to comment on our observations regarding the legislation. Whether I agree or disagree with what these measures are fundamentally trying to achieve, to me, is by and large irrelevant to what we are highlighting to you as concerns about these measures.

Senator CAMERON—So you are just a gun for hire and it does not matter.

Mr Gardiner—No, I am very passionate about tax. I am sure that has come through.

Senator CAMERON—If you are passionate about it, is it fair enough to—

Mr Gardiner—I do not see that my answer to that is at all relevant.

Senator CAMERON—It is because you are saying the legislation is going to create all these problems. The legislation is designed to do one thing: prevent the access of tax-free dividends.

Mr Gardiner—One of my opening remarks was that I am operating on the basis that this legislation will be introduced and will be passed in some form. So, to me, whether I am philosophically in agreement or disagreement is very much an irrelevant issue. I am operating on the basis that these will be part of our tax fabric moving forward. What I am here to do is to point out to people that, in our experience, these are some of the challenges that these measures currently create. In light of the fact that it is a given that the measures will form part of our tax legislation, we are hoping to make some changes. Let's remove uncertainty and doubt so that, moving forward, people will be able to apply the measures. If they make mistakes, it will be at their own peril, but we will have a very clear set of guidelines. People will either satisfy them or not, and if they do not they risk the wrath of the new legislation. That is very much what we are about and that is what all these comments are objectively designed to highlight. They are problems that people are already seeing out there and have highlighted to us, and hence we need to make people aware of them moving forward. That is what this is all about, from our point of view. I appreciate your question, but I am not concerned about what my view on the rules is. I think that is what it is all about and that is why I wanted to outline from our point of view the worry and the concerns behind the rules.

Senator CAMERON—But it is legitimate for me to ask you if the intent of government legislation is fair and reasonable. That is not an unusual question to ask witnesses to inquiries.

Mr Gardiner—I do not see the relevance of answering the question, because—

Senator CAMERON—The relevance to me is that, if you see that the fundamental intent of the government's legislation is wrong, that would suggest why you would be going down a certain path to oppose it. That is a reality. If you are saying, 'I'm okay with it,' that has a different weight with me in terms of your arguments.

Mr Gardiner—My point, and this is not answering the question and I do not see the importance of it, is: has anything I have said thus far indicated that we are attacking the underlying existence or the implementation of these measures? The short answer clearly has to be 'No'. I have highlighted facets of these rules that we see as being problematic and that therefore we need to resolve. I have not at any point attacked the underlying existence of the rules.

Senator CAMERON—Let me come back to this issue of the accessing of tax-free dividends. Is the holding of the keys if the asset is not used accessing a tax-free dividend?

Mr Gardiner—In my mind it is not. If I simply have the keys in my pocket and I am both a director and a shareholder and I never, ever use that asset, to me I have not accessed any benefit or any value out of the entity involved.

Senator CAMERON—If you were providing taxation advice to a client and you were asked the question, 'Have you accessed tax-free dividends?' you would answer, 'No,' wouldn't you?

Mr Gardiner—I would have responded in such a way at my peril. If the tax office view comes down or the legislation is passed, the view will be that, if you are both a shareholder and a director and you hold those keys in your hand—you hold them and control them to the exclusion of the company because you are a shareholder—regardless of whether you use them, the availability measures, as I have dubbed them, would potentially create a deemed dividend problem under the rules, despite the fact that I have never used the asset.

Senator PRATT—Why would you own the asset if it never gets used?

Mr Gardiner—That is the point. You could have a company that holds a boat that is moored and is never used or is exclusively used for business or a car that is garaged and equally is never used.

Senator CAMERON—Let me ask this question: is there a tax advantage for a company to own a high-end car or an expensive boat that is not directly linked?

Mr Gardiner—If the asset is never used by taxpayers, I find it very hard to identify a benefit that is flowing to the person.

Senator CAMERON—So where does the benefit come from?

Mr Gardiner—If they do not use the vehicle, the only possible advantage that they might secure is a non-tax one. It may relate to issues associated with asset protection. That might be a reason behind this occuring. If a person does that and holds the asset in a company, which is a passive investment entity, they may do so for reasons of asset protection. Say I am a surgeon, a plumber, a doctor or whatever. It is a litigious environment and I am subject to litigation. Say I make a mistake. All my assets are held in this entity in the name of my spouse. Let us ignore the bankruptcy changes and everything else at the moment; let us say that all of that is a kosher structure. Under these rules I am an associate of my spouse. I hold the keys. I never use the asset, even potentially, yet if I am a director of the company I have potentially got exposure.

Senator CAMERON—And so you should if that company's operations have allowed that valuable asset to be created.

Mr Gardiner—But if I have paid tax on money and then ultimately there is a situation where the asset makes its way into a company, we are dealing with aftertax income that has been taxed in a normal manner, in a manner which is prescribed and which we all agree with. I then have this asset. If I never use it, if I have never used it for a moment privately, but it is available to me, then I have a tax exposure.

Senator CAMERON—That would be mainly for protection of assets against litigation.

Mr Gardiner—That is where it could be very problematic. We are not talking about people who have been motivated in any form from a tax perspective; they are more concerned about our litigious environment. These are the people who potentially can be exposed, even though they do not use the asset. I understand what you are saying. You are saying that fundamentally these measures are designed to tax people who have assets housed in companies and who are stripping the value out of the entity by using the assets but not paying any tax liability as they come out. I can understand why these measures are being introduced, but I am saying that they go a quantum leap further because they say that even though you never use the asset—

Senator PRATT—Or you have already paid tax on it?

Mr Gardiner—correct; any of those situations—and even though you have not ripped the entity as a value-add to the entity indirectly, because the asset is available then potentially you have a problem.

Senator CAMERON—Just explain to me why that asset would be in the company name. Why wouldn't it be in the name of the spouse?

Mr Gardiner—This could be a hangover, if I could use that word loosely, from years gone by, when people looked at companies as being the preferred course of asset structuring and holding assets and thought maybe that was the best way to go. Ignoring dwellings just for a moment, these measures apply from 1 July 2009, by and large regardless of when the asset was acquired. So imagine I have had the structure in place, everybody has been happy, I have never used the assets—never touched them for anything from a private perspective and held them there as part of the advice I received many years ago. Whether it is still appropriate or not is irrelevant, really. We get to 1 July 2009, we tick midnight and suddenly we now have an exposure.

Senator CAMERON—The antique Ferrari could be sitting as an asset of the company. Because it is an antique Ferrari it is worth a lot of money.

Mr Gardiner—Any antique asset, whatever it may be.

Senator CAMERON—It gains value over time and it is an asset of the company.

Mr Gardiner—Yes.

Senator CAMERON—It is in the company for what reason?

Mr Gardiner—As I was saying to you, possibly in years gone by people were very bullish in the use of companies for asset protection for those people who were operating in environments where they had a large legal exposure. Therefore, the asset is housed in that not for tax but for some other reason. Come 1 July 2009, suddenly the motivation for it being there is completely disregarded and we are saying, 'Once you're a shareholder or an associate, if you hold those keys'—and of course they are going to hold the keys; they are the director and the shareholder—'then potentially you now have a liability.' I can understand your philosophy on these matters. I have no problem with that at all, but I do have concerns about the breadth of circumstances in which it can apply.

Senator PRATT—There are a wide range of circumstances under which you might chain an asset. Maybe you have done some estate planning and there are certain children that you do not want to get hold of your Ferrari. There could be any number of different—

Senator BUSHBY—And once it is in there there is a cost in getting it out. If you take your antique Ferrari and transfer it into your own name you have to pay stamp duty. You might have put it in there a long time ago for reasons that are largely historical and have since ceased.

Mr Gardiner—Precisely.

Senator BUSHBY—But there is a cost in changing it over, even though you paid for it in after-tax dollars when you did buy it.

Mr Gardiner—You have highlighted it. It could be a form of—it is not a great thing to hear about—protecting your assets in the course of a matrimonial issue.

Senator BUSHBY—And all of those sorts of issues may or may not be doubtful things to be doing, but they are not tax issues.

Mr Gardiner—Exactly.

Senator PRATT—It is a good way of discharging people from hiding their assets for other reasons—

Senator BUSHBY—If you are hiding assets for other reasons, that should be addressed in other legislation, not in this, because this is a tax bill addressing tax avoidance rather than inappropriate hiding of assets from spouses and claimants.

Mr Gardiner—That is right. Although this is not that common, maybe it has been put in there as a form, say, of estate planning, and the concern is that you might have spendthrift children. Maybe you have children that have problems with money and, with the society we have, you have housed it in there, they never touch it and it is never used but you want it in there so that you know they are not going to drain the family wealth in a very short space of time. Suddenly, if they hold the keys, come 1 July we now have a problem.

The bigger issue is the example you used with the Ferrari. I am happy to use any example but let's go for the Ferrari—it is extreme. From my understanding, by and large, antique Ferraris appreciate in value. This becomes even more problematic because, as the value of the assets rise, you are then creating distributable surplus issues in the entity and hence the use of the asset by the shareholder or the associate—or the availability, and the use becomes a completely moot point because it is available. Therefore we have an issue.

Senator CAMERON—Let's go to another example involving a car. You referred to somebody out in the suburbs. Say there is a $100,000 a year small company with a ute. That is a completely different ballgame again, isn't it?

Mr Gardiner—In the case of the ute, invariably I would think that we are talking about a person who is going to be employed in the company. In the vast majority of cases they will be. Hence we do not have to worry about division 7A. We have an existing regime that applies not at 31.5 per cent, not at 39.5 per cent but at 46.5 per cent. So, if we are talking about inappropriately extracting value out of the entity, I would say that is not a problem at all because the private use will be attacked from an FBT perspective at 46½ per cent.

Senator CAMERON—That is what you see is the answer to this.

Mr Gardiner—Correct.

Senator CAMERON—So you apply FBT to the antique Ferrari or the yacht. I cannot understand how that would work.

Mr Gardiner—I am saying that, if they are using the asset as per the way these measures operate, your comment is, 'Well, by using it I am indirectly instructing equity out of the entity and therefore I am doing so in a tax-free environment.' I am saying that, if I use it, these measures attack that because they say, 'I am using the asset.' Do not worry about availability—I am using it; I am driving it. I am driving it around Melbourne, Sydney, Brisbane—wherever it is—and, in those circumstances, what is the arm's length amount, and therefore we potentially have a deemed dividend. I see that as situation No. 1. That is the purpose of the rules. I am then saying situation No. 2 is that I do not use it. It sits there, it is not used for private purposes and I am not ripping tax-free equity out of the company; it is simply housed there, maybe for asset protection—whatever it might well be—and in that situation I equally have, as it stands, potentially the same liability. I see a real disparity in those situations.

Senator CAMERON—If you want to use the company, in your example, to house an asset to save it from your wife or your husband getting it in a divorce—

Mr Gardiner—Your words, not mine.

Senator CAMERON—That is the example you used.

Mr Gardiner—Yes, it is, but I am saying asset protection—

Senator CAMERON—Why should the taxpayer give support to that proposition?

Mr Gardiner—They are not though, because if the asset is housed in the company and it is not being used, as you highlighted earlier, philosophically these measures are designed to attack arrangements where people are extracting equity or value out of the entity. If I am not using that asset—whether it be a yacht, an exotic car, artwork—and I am not extracting value out of it in any way, shape or form, I am now being taxed on something that I am not receiving any benefit from whatsoever, but I have made the fundamental mistake of putting it in a company.

Senator PRATT—Maybe you were hiding assets in order to avoid being declared personally bankrupt—

Mr Gardiner—Your comment earlier on, Senator, is a very valid one. The possible shortcomings or the areas that people have been utilising from an asset protection point of view for bankruptcy, matrimonial law, estate planning—whatever it is—are one issue.

Senator BUSHBY—That is considered the mischief and there are other ways of dealing with that.

Mr Gardiner—Correct. This is a tax issue.

CHAIR—All right. I think we have had a long discussion of this issue and we will now bring it to an end. Thank you, Mr Gardiner, for coming in this afternoon.

Committee adjourned at 4.20 pm