Evaluation of the Tax Value Method

A Report to the Treasurer and
Minister for Revenue and Assistant Treasurer

The Board of Taxation

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EXECUTIVE SUMMARY

In taking up the task of further developing and evaluating the Tax Value Method (TVM), the Board of Taxation determined that it should pursue an open and inclusive community consultation process. The process was designed first, to develop further the facts about the TVM and second, to progressively test and evaluate the relative merits of the idea. It involved the Board drawing on the expertise of the Australian Taxation Office and other experts in tax law and legislative drafting to develop a body of TVM demonstration legislation and explanatory materials. A cross section of non-government taxation experts drawn together in a TVM Working Group voluntarily contributed their expertise also to this task and in more generally assisting the Board with its testing and evaluation of the TVM.

All outputs from the foregoing were exposed publicly, including at a major conference and a ‘Stakeholder Briefing,’ to facilitate broader community input. The Board also separately commissioned research and analyses on specific issues.

The Board’s processes, including its approach of exposing for public comment the preliminary drafts of the TVM demonstration legislation, were warmly welcomed by stakeholders, with some suggesting that it offers a model for the way in which future changes to tax law are developed and evaluated. The processes did not, however, elicit any appreciable community support for adopting the TVM concept.

Most submissions received from the community recommended against further development work being undertaken on the TVM. While there was general acknowledgment that the current income tax law is overly complex and in need of substantial restructuring and simplification, the overwhelming view was that adoption of the TVM was not the means to achieving these ends.

In essence, the concern is that, while offering benefits in some areas, the TVM would generate greater complexity and uncertainty in others. As such, most stakeholders believe that the on-going benefits of adopting the concept are, at best, uncertain and certainly unproven. Adding to this is the prospect that adopting the TVM would result in substantial transitional costs, most notably for tax advisers who would both lose substantial human capital invested in the current system and be required similarly to invest in their knowledge and understanding of TVM based law.

All key interest groups acknowledged, nevertheless, that the work involved in further developing and testing the TVM had given valuable insights into how aspects of the current tax law might be amended and restructured to deliver many of the benefits that the TVM promised.
The Board considers that there is merit in a further process aimed at exploring possibilities for improving the current law. There are, in particular, strong national interest reasons for pursuing a more coherent and simpler income tax law.

It is evident from the TVM process that there is no single or ‘silver bullet’ solution to the problems of the current income tax law, especially one that is likely to gain broad based acceptance in the community. Any approach likely to succeed, therefore, will need to be multifaceted. Fundamental to the success of any further process, or processes, moreover, will be whether a consensus can be achieved among relevant stakeholders as to what the problems with the current law in fact are, and as to the priorities by which they should be addressed.

In particular, the TVM was conceived principally as a way of addressing problems inherent in the ‘assessing provisions’ of the present law: those that basically prescribe what is taxable, how much is taxable and in what income year. While there was a consensus among stakeholders that aspects, at least, of these provisions need to be improved, many argued that problems of equal or greater importance lie in other parts of the law. As such, any further process should focus initially on facilitating a dialogue among the main interest groups aimed at exploring, and hopefully achieving, a consensus on the problems with the present law that need to be addressed and the priority with which they should be addressed. Once these matters have been determined, and subject to the Government’s endorsement, processes could then be set in train for identifying the solutions, for implementation in a context of merging the present two Acts.

In the interim, and assuming the Government agrees not to proceed with the TVM concept, priority should be given to implementing under the current law several measures recommended by the Ralph Review, and endorsed in principle by the Government, which were intended to be dealt with in a TVM framework. Most important among these are the need to address fully the problem of deductible expenditure ‘black holes’ in the present law and to implement the further Ralph recommendation regarding the taxation treatment of rights.

Achieving sustained improvements to the income tax law (and other aspects of the tax system) inevitably requires a multifaceted approach. The Board’s proposal to commence a new tax law improvement process would seek to achieve improvements needed to the current law. The Board believes that there should be processes for more systemic on-going review of the tax system and its operation with a view to identifying and implementing needed change as it emerges. The objective would be to avoid or reduce the need for periodic major tax reform which has tended to characterise processes in Australia to date, and which arguably impose higher transitional costs on the community than would be the case under a more incremental, gradualist approach. The Board considers that, consistent with its Charter, it is well placed to play an important ‘catalytic’ role in achieving such a process.
Recommendations

The Board recommends that:

(a) The Government cease further work on the TVM concept.

(b) The Government accord priority to implementing, within the current legislative framework, the Ralph Review recommendations intended for introduction under a TVM framework, most importantly those relating to black hole expenditure and the taxation treatment of rights.

(c) The Government review the recommendations contained in Section 4 of A Tax System Redesigned with a view to deciding whether to proceed with them at this time. The process outlined under Recommendation (d) below could provide a forum for business to raise any such matters it considers important to improving the income tax law.

(d) The Board be authorised to initiate a further process of exploring with key stakeholders the scope for making improvements to the current income tax law in a context of merging the two present Acts. The process, to be developed in consultation with interest groups likely to be most involved, would:

   (i) initially establish agreement among stakeholders as to the problems with the current law that need to be addressed and the priorities by which they should be addressed; and

   (ii) subject to endorsement by the Government, develop solutions to problems agreed, for implementation in a context of merging the 1997 and 1936 Income Tax Assessment Acts.

(e) The Government note the Board’s intention, consistent with its Charter, to:

   (i) promote processes of continuous review of the tax system, with a view to facilitating more gradual and manageable changes needed in the light of changing economic, social and other circumstances; and

   (ii) continue to monitor the adequacy and effectiveness of community consultation in the course of the development and implementation of taxation laws.
**INTRODUCTION**

1. In announcing on 7 August 2000 the Government’s decision to establish the Board of Taxation, the Treasurer indicated that the Board would be given an initial task of overseeing a further process of community consultation aimed at further developing and evaluating the Tax Value Method (TVM) of calculating taxable income. At the time, the Treasurer noted the Government’s view that, if implemented properly, the TVM ‘has the potential to underwrite the development of a stable, less ambiguous and more understandable income tax system, and in particular, one more readily conducive to the manageable, ongoing development of the tax system into the future.’ The Government recognised, however, that there were many detailed issues that would need to be resolved to determine the feasibility of legislating the concept and that this would require consultation with all sectors of the business community and tax practitioners, especially.

2. Adoption of the TVM was a key recommendation of the 1999 Review of Business Taxation (RBT). The Review recommended the TVM as a way of achieving simpler, more transparent and more certain tax laws. One of the core objectives of the Review was to move the (business) tax system towards greater commercial reality. Its stated aim was to accomplish a robust structure based on explicit principles so that the architecture of tax legislation would be durable and capable of future modification without doing damage to the framework on which it is based.

3. The Review discussed two options for determining taxable income under a framework of changing tax values of assets and liabilities. The choice was between introducing the framework in the existing assessable income and allowable deductions dichotomy or directly adopting the framework under which taxable income is based on cash flows and the changing tax value of assets and liabilities.

4. The Review noted that both options would produce the same outcome as existing methods of calculation. However, it recommended the second (viz ‘Option 2’) in the belief that this would provide greater structural integrity to the law. It considered that the TVM could replace the disparate rules of the current law with new core rules that would provide greater legislative uniformity and a superior framework for future development of the law.

5. Following release of the report of the Review of Business Taxation there was an extensive, but inconclusive, public debate on the relative merits of adopting the TVM. At the time, there were many, particularly within the business community, who saw merit in the idea but were still to be convinced that the ongoing benefits would outweigh the more obvious transitional costs involved. Others, especially among the professional advisers on tax law, strongly opposed the idea, inter alia, on the grounds it was ‘untried’ anywhere else in the world, was ‘untested’ and therefore, was ‘unproven.’
6. Against that background, the Board determined to pursue an evaluation and consultation strategy of broadly two parts:

- the first was focussed on further developing the facts about the TVM and its promised benefits, including a package of draft legislation and associated explanatory material sufficient to demonstrate how the concept would apply in practice.

- the second was focussed progressively on commissioning or otherwise sponsoring testing and evaluation of the concept, with emphasis on road testing the draft legislation and associated ‘compliance products’ in association with companies, other taxpayers and their tax advisers.

7. The Board also determined that it would pursue an open and inclusive public consultation process, including by releasing publicly on its website all draft legislation and other relevant information as and when it was developed.

8. The remainder of this report provides further details of the Board’s evaluation criteria and processes, highlights the key outcomes from those processes, and provides the Board’s conclusions to the issues raised.

**What is the Tax Value Method?**

9. The TVM is a way to work out taxable income. It deals with the assessing rules in the income tax law. It does not affect the other basic elements of income tax liability, such as income years, tax rates, tax offsets, taxation of particular entities, exempt entities, residency and tax administration.

10. The TVM endeavours to apply one set of rules to the calculation of all forms of taxable income and losses. The concept views taxable income as the annual change in the tax value of a taxpayer’s assets (including cash) and liabilities:

\[
\text{Change in tax value of assets} - \text{Change in tax value of liabilities}
\]

11. Under the TVM, the tax value of an asset or liability (as recognised in the current law) is its value for tax purposes under the law. As a general rule, an asset’s tax value would equal its cost, not its market value. One important exception is a depreciating asset, whose tax value would decline over time, just as it does under the current law. Assets whose tax value corresponds to cost will only be taxed when they are sold or otherwise realised, again consistent with the current law.

12. The TVM basically seeks to capitalise on the fact that, particularly once the relevant Ralph Review recommendations are implemented, business taxpayers face a ‘universal’ tax base, in the sense that essentially all revenues and all expenses are recognised for tax purposes.
Accordingly, a single set of core rules dealing with changes in the tax value of assets and liabilities can be applied to all non-private transactions to include them in net income. Particular transactions such as exempt receipts are then excluded in working out taxable income by applying taxable income adjustments within the TVM framework.

13. In contrast, the current law recognised the tax base within the structure of assessable income less allowable deductions. This structure does not provide rules that bring within the tax base all revenues and all outgoings. Rather it sets out that certain amounts effectively increase taxable income whilst other amounts decrease taxable income. Detailed rules are then necessary to set out what all those amounts are and how they are calculated.

14. The characterisation of amounts as assessable income or allowable deductions is achieved by a series of separate regimes. These different regimes have been added progressively from the relatively narrow concepts of ordinary income and general deductions that originally comprised Australia's tax base. These regimes have generally been developed independently and do not fit easily in the earlier framework in the tax law.

Problems that the TVM sought to address

15. The TVM would leave significant areas of the income tax law unchanged. This is because the TVM would impact principally on the assessing provisions of the tax law while having minimal impact on areas of the law that deal with, for example, different types of entities or with the tax administration and collection provisions of the law. This should not, however, preclude an evaluation of TVM's potential to improve the tax law as it needs to be recognised that no one reform can be expected to benefit all areas of the income tax law.

16. The TVM was developed to address a range of issues and problems that exist in the assessing parts of the current income tax system and which, among other things, result in the law being unnecessarily complex and long.

17. Since its introduction in 1915, the scope of the Australian income tax law has been expanded enormously from its initial focus on the narrowly defined concept of 'ordinary income' to now include virtually all realised gains and losses of a non-private nature. This has been done, however, in a largely unstructured manner, through the addition of new 'taxing regimes' each with their own structure and set of rules.

18. The result is a patchwork of discrete regimes, some of which potentially overlap in their application to particular transactions with each containing their own set of rules which, while trying to achieve many of the same things, are often expressed differently. This lack of a coherent structure leads to unnecessary complexity in the tax law. Conflicts and overlaps between regimes are sought to be addressed through additional legislation, but such an approach inevitably leaves continuing gaps and ambiguity in the law's application.

19. One consequence is that the law is much more difficult to understand and apply than it should be. Understanding the core principles for one regime does not necessarily lead to an
understanding of the core principles of another. Knowledge of the uniform capital allowances regime, for example, will not help in working out when a capital gains tax (CGT) asset is sold or what its cost base may be.

20. A further consequence is that the law is a lot longer than it ought to be: both because of the need to provide for interfaces between the various regimes and because of the duplication of rules and concepts within each of the regimes. By offering a single conceptual framework and a single set of core assessing rules, the developers of the TVM believed the concept would address many of these problems with the present law.

21. The TVM also sought to address concerns that the current income tax law lacks durability and needs constant amendments to deal with areas of the law that are subject to exploitation. The current structure of the law also does not easily facilitate changes to the tax law to introduce new policy initiatives.

22. The historic development of the income tax system meant that the current tax system specifies what income and expenses are included in the tax base. Accordingly, expenses that do not fall within these regimes are excluded by default. This gives rise to black hole expenses which are legitimate business expenses that cannot be claimed as tax deductions because they do not fall within the boundaries of current regimes.

23. The developers of the TVM considered that the integrity of the current tax system is also hindered because of the emphasis that the current income tax system places on the legal form of a transaction in establishing the appropriate characterisation of transactions such as whether a transaction is on revenue or capital account. Accordingly, they considered it inappropriate that transactions with the same economic substance may receive different taxation treatment if the legal form of those transactions differs.

24. A further problem identified in the current income tax law was that certain asymmetric treatments exist. An example of such a situation is where a lump sum payment for granting, say a restrictive covenant is taxed as a capital gain when the grantor receives it but tax relief is only given to the grantee in the form of a capital loss when the right terminates. Such asymmetric problems can give rise to tax planning opportunities between the parties to such transactions.

25. Further details on the TVM, the problems it seeks to address and other relevant information are provided in the Board of Taxation’s ‘Tax Value Method Information Paper’ issued on 6 March 2002.
DEVELOPMENT AND EVALUATION PROCESSES

The Processes

26. As noted, in progressing its remit from the Treasurer, the Board’s focus was first, to further develop the facts about the TVM, including a body of draft legislative and explanatory material sufficient to demonstrate the concept and second, to progressively test and evaluate the idea. To assist it in these tasks, the Board established two formal groups:

- A TVM Legislative Group: This small Group was charged with developing the TVM prototype legislation and associated explanatory material. It was led by Mr Andrew England, an Assistant Commissioner at the Australian Taxation Office (ATO) and advised by two private sector members, Mr Paul Abbey a partner of the firm Shaddick and Spence and Mr Kevin Stevenson, a director of the firm Stevenson McGregor\(^1\). The team also included Mr Tom Reid, a consultant legislative drafter to the ATO and former second Parliamentary Counsel at the Office of Parliamentary Counsel. Remaining members of the group were drawn from the ATO and Treasury.

- A TVM Working Group: This larger group was responsible for providing technical commentary and other assistance on the draft legislation produced by the Legislative Group and for otherwise assisting the Board in its evaluation task. Its membership included the key Legislative Group members and 19 non-government sector tax experts drawn from the accounting, tax advising, corporate and academic spheres. Attachment A provides a full list of the non-government TVM Working Group members.

27. The Board acknowledges the significant efforts of the TVM legislative group in developing the TVM prototype legislation and explanatory material and also of the project team led by Mr Michael Smith an Assistant Commissioner at the ATO. The latter team developed case studies and other material and consulted with taxpayers, tax practitioners and software developers to allow the practical aspects of working out taxable income under the TVM to be considered.

28. The input of the private sector consultants to the TVM legislative group was also very important. Mr Abbey, especially, provided invaluable input throughout the process. The involvement of such consultants in the development of the TVM is considered by the Board to represent a potential model for future significant legislative projects.

29. The Board also thanks the TVM Working Group members for their participation and input at Working Group meetings.

\(^1\) Mr Stevenson gave input in the earlier stages of the development of the TVM. He left the TVM legislative team in October 2001 following his appointment to an overseas position.
30. From the outset the Board of Taxation sought to ensure that the development and evaluation of the TVM prototype legislation was an open and inclusive process. The Board viewed such a process as crucial to the effective development and evaluation of the TVM. In the course of the process, the Board released publicly for comment 4 prototypes of its demonstration TVM legislation and explanatory material, each successive prototype refining and expanding on the earlier versions.

31. There were a significant number of workshops conducted with business taxpayers, tax practitioners, individual taxpayer representatives and representatives of the software industry and the Board convened two major stakeholder consultative events, viz:

- **A TVM Consultative Conference**: The Conference was convened in July 2001 and was attended by approximately 100 senior business and tax practitioner representatives. As an integral part of the Board’s strategy for advancing the development of the TVM and gaining input from the community, the goal of the conference was to promote a better understanding of the TVM concept and the objectives in pursuing it, and to elicit views on the critical issues that would need to be addressed or tested to determine the TVM’s relative merits.

- **A TVM Briefing**: This briefing was convened on 6 March 2002 and was again attended by more than 100 senior business and tax practitioners representatives. Its purpose was to disseminate and explain the substantial package of final material the Board had prepared to demonstrate how the TVM could operate in practice and what costs and benefits were likely to be involved if it were adopted. The package included a brief TVM Overview document, a more detailed TVM Information Paper, and prototype 4 of the TVM Demonstration Legislation and TVM Explanatory Material. The material was intended to assist interested parties in their assessment of the relative merits of the TVM and formed the basis on which the Board sought, by 30 April 2002, submissions on the TVM from the community.

**Commissioned Analyses**

32. In initial scoping of the testing and evaluation that would be required to determine the TVM’s relative merits, the Board identified a need to address three broad propositions:

- Does the TVM work (ie can it be effectively applied and does it deliver intended taxing outcomes)?

- If TVM does work, does it work better (relative to the current law or some alternate benchmark)?

- Will it generate winners or losers or have other positive or adverse impacts?
33. These propositions effectively guided subsequent commissioned analyses and other evaluation work sponsored by the Board.

Initial testing — May-June 2001

34. Some initial testing of the TVM was commissioned by the Board in early 2001. This work was coordinated by the tax advising firm A J Baxter & Associates, and involved the voluntary participation of Telstra Corporation Ltd, Australia Post and BHP Ltd (as it then was). At the same time, the Board also commissioned the firm of chartered accountants, Pitcher Partners, to similarly test the TVM across a number of its small and medium sized business clients.

35. The key objectives of the testing were:

- to determine at an early stage whether the TVM contains any conceptual flaws so that it could not be effectively applied;
- to identify key issues that would need to be addressed in developing the draft legislative framework; and
- to identify any early compliance issues, for example, whether existing accounting and financial systems generate, or can be readily adjusted to generate, the information required for TVM based taxable income calculations.

36. The testing involved analysing in detail more than 60 relatively complex transactions drawn from the 1999-2000 financial accounts of the three major companies, and some from small and medium enterprises (SME). Australia Post, BHP Ltd and Pitcher Partners (in relation to four SME clients) also performed re-calculations of actual 1999-2000 taxable incomes based on the TVM. Taking into account the subsidiaries included in BHP’s analysis, the testing embraced activities in the manufacturing, mining, petroleum, telecommunications, finance (corporate treasury) and services sectors.

Testing compliance aspects

37. Commencing in the latter part of 2001, the Board commissioned or sponsored a range of further studies and analyses designed to test potential compliance aspects of adopting the TVM.

38. Beginning in November 2001, an on-going series of workshops were conducted with the assistance of the ATO, with tax practitioners from large and small accounting firms, business and the legal profession. Their purpose was both to educate participants about the TVM and to consider and test possible methodologies (or ‘worksheets’) by which TVM taxable income calculations might best be derived. In total, more than 70 tax practitioners participated in the workshops which considered four potential calculation methodologies.

39. The Board in January 2002 also engaged Professor Chris Evans and Dr Binh Tran-Nam from the Australian Taxation Studies Program (ATAX) at the University of New South Wales to
do specific further work on evaluating the potential transitional and on-going compliance cost impacts of adopting the TVM. Where possible, those involved in the workshops were invited to also participate in this study in order to capitalise on their familiarity with the TVM concept.

40. With a view to further testing compliance aspects and conceptual practicalities based on the latest, Prototype 4, legislation, the Board funded another road testing study, this time in association with the Institute of Chartered Accountants in Australia (ICAA). In this study, the ICAA commissioned 17 accounting practitioners to apply the Prototype 4 draft in calculating the taxable incomes of a range of different taxpayers utilising 2000-2001 financial year information. One particular objective of this exercise was to test issues that might exist in identifying assets and liabilities and whether they are 'held' etc. In other words, issues that could emerge in compiling from 'raw' accounting and financial data the information needed to feed into the TVM calculation worksheets developed by the ATO. The results were captured by way of a questionnaire participants were asked to complete.

**Benchmarking the TVM**

41. In addition to road testing compliance aspects, the Board commissioned two further sets of analyses directed to the questions of 'does the TVM result in better, more certain law?' and 'is there an alternative model for legislative reform against which the TVM should more appropriately be benchmarked?'

42. The first of these analyses was commissioned from Professor Graeme Cooper of Melbourne University and Dr Michael Wenzel of the Australian National University. It involved testing with groups of students who had little or no exposure to tax matters, their understanding of the tax outcomes of transactions or propositions explained in terms of a sample of TVM based law and in terms of a sample of the existing law. The hypothesis was that the TVM would prove superior to the current law if it facilitated the students getting the right tax result more often than the current law, and with greater certainty.

43. The second of these analyses was commissioned from Mr Geoffrey Lehmann and associates of the firm PricewaterhouseCoopers. The purpose of this work was to develop demonstration legislation and associated explanatory information to test claims made that some or many of the benefits promised by the TVM (e.g. common core rules etc.) could be more easily achieved by simply restructuring the current law, without adopting the TVM’s core assets and liabilities framework.

44. Further details of all the Board’s commissioned analyses, and of the outcomes are provided at Attachment B.

45. In addition to these commissioned analyses, considerable work was also done by the TVM Legislative Group in applying the TVM concept to some important existing case law to test the extent or relevance of the issues they raise in a TVM context and to exploring some of the
administrative implications of adopting the TVM for the Australian Tax Office. This work is
further explained in the Board’s TVM Information Paper.
**Evaluation outcomes**

46. In its evaluation of the relative merits of the TVM, the Board determined to assess the issues, including the views presented in submissions and the outcomes of the Board’s commissioned analyses, against five broad criteria, viz:

- **Simplicity**: would the TVM result in simpler legislation that is easier to comply with?

- **Integrity and durability**: would the TVM result in legislation that is less easily circumvented or manipulated to achieve outcomes contrary to the Government’s policy intent, and would it provide a better basis and framework for the future development of the law?

- **Cost effectiveness**: would the TVM result in reduced compliance costs for the community and administration costs for the Government in the longer term, sufficient to outweigh the expected significant costs of transition for both taxpayers and the Government to the new regime?

- **Revenue neutrality**: would the TVM be overall, revenue neutral and would the incidence of taxation for different groups of taxpayers be largely unchanged?

- **Feasibility**: could the TVM be effectively implemented; that is, is the task physically possible?

**Views from submissions**

47. The Board received 34 public submissions addressing the TVM, 15 from tax practitioners and other individuals; 12 from business representative bodies; 3 from professional bodies; and 4 from companies. All submissions were published on the Board’s website. A list of the parties that made submissions is included in Attachment C.

48. Most submissions did not support further development work being undertaken on the TVM. While there was general acknowledgment that the current income tax law is overly complex and in need of substantial restructuring and simplification, the overwhelming view was that adoption of the TVM was not the means to achieving these ends.

49. Most stakeholders were of the view, in particular, that the TVM, while potentially offering some benefits, would not result in any overall, appreciable simplification of the current law.

50. In their joint submission the Business Council of Australia (BCA) and the Corporate Tax Association (CTA) did acknowledge that the ‘net income formula’ at the heart of the TVM does have the potential to deliver reductions in complexity, uncertainty and compliance costs in a variety of areas of income taxation. These include the taxation of financial arrangements the tax treatments of prepaid expenses, trading stock, rights and of capital gains in certain respects.
51. Against these potential benefits, however, the BCA and CTA suggest that the TVM approach is likely to introduce new areas of complexity and instability to the law. They suggest, in particular, that the TVM’s approach of initially capturing all potentially taxable amounts and then negating or reversing those not relevant, or not applicable to the income year, is in many instances more convoluted than is presently the case, where irrelevant amounts are simply ignored to begin with. They also suggest that the TVM would bring liabilities into the tax equation to a far greater extent than is currently the case and that this potentially would result in new sources of complexity and instability, including a potential to create new scope for tax avoidance. The BCA and CTA are also concerned that the TVM would add to the complexity of complying with the already highly complex taxation treatment of the foreign source income of Australian companies.

52. These observations of the BCA and CTA were broadly supported by other major stakeholders and in particular the Business Coalition for Tax Reform (BCTR). The BCTR and others also argued that the TVM concept does little to align tax law with accounting concepts and practice. They took the view that, to the extent the TVM might realise benefits in some areas, for example, in remedying problems with ‘black hole’ expenditures and in rationalising the current array of cost and realisation rules etc, such benefits could similarly be achieved by amending the current law, without having to adopt the TVM net income formula.

53. A number of submissions also pointed out that the TVM would only address the assessing provisions of the law (ie around 40 per cent of the income tax law) and that, in fact, most of the complexity and other problems lie in the other parts of the law. Key examples cited were the numerous integrity provisions relating to the deductibility of losses, the thin capitalisation and the debt/equity rules all of which would be unaffected, or largely unaffected, by the TVM.

54. Virtually all submissions claimed that there would be very substantial transitional costs involved in adopting the TVM. The Institute of Chartered Accountants in Australia (ICAA) and others identified that for accounting and other tax advising professionals, transitional costs mainly related to learning the new law (and implicitly, the loss of learning and knowledge invested in the current law), and of acquiring new software and of other office ‘retooling.’ Many saw a change of this magnitude as also prompting large scale early retirement from the professions, adding recruitment and further training costs to the costs of transition.

55. The BCA and CTA and others were of the view, furthermore, that it would take perhaps 10 years to fully implement a change to the TVM, including to address the inevitable spate of unintended consequences and for the courts to settle key definitional issues and so forth. The lack of certainty in the interim would impose major costs on taxpayers. Indeed, many submissions argued that the loss of certainty surrounding the present law which some 70 years of case law and other precedent has provided would in itself also be a major cost in adopting the TVM.

56. In essence, therefore, the overwhelming view from submissions received was that the likely benefits were simply not sufficient to warrant further consideration of the TVM concept.
There was, in fact, only one substantive submission in support of adopting the idea, received from Mr. Wayne Mayo who was a principal architect of it in the Ralph Review context. His arguments broadly mirrored the expected benefits of the TVM outlined earlier in this report.

57. All key interest groups acknowledged, nevertheless, that the work involved in further developing and testing the TVM had given valuable insights into how aspects of the current tax law might be amended and restructured to deliver many of the benefits that the TVM promised. Among those cited include the removal of the ‘nexus test’ and the ‘capital exclusion from the general deductibility provisions’, as well as the development of common rules and definitions.

58. The main stakeholder groups therefore argued that the momentum for much needed tax reform should not be lost if the TVM is abandoned. The BCTR, in particular, recommended that in tandem with implementing and bedding down the recent and prospective business tax reforms, including those initially linked to the TVM relating to black holes, rights and financial arrangements that a new process should be established aimed at obtaining early external input to identifying and assessing problems with the current tax system and options for addressing them. The BCTR indicated that it would be keen to work with the Board to develop such a process and was generally supported in that notion by others.

59. All major stakeholders were also highly complimentary towards the Board’s processes for developing and evaluating the TVM. They welcomed, in particular, the openness and inclusiveness of the process, including the Board’s approach of exposing for public comment the preliminary drafts of the TVM demonstration legislation, suggesting that it offers a model for the way in which future changes to tax law are developed and evaluated.

**Outcomes from commissioned analyses**

60. A disappointing feature of many submissions received was that the concerns they raised about the costs and lack of benefits of the TVM tended to be generally couched, without significant supporting information or analysis. As a result, in some respects the Board had to rely more heavily on its own commissioned analyses and research in reaching its conclusions than might otherwise have been necessary.

61. The initial testing of the TVM concept conducted in association with A. J. Baxter & Associates and Pitcher Partners gave early comfort to the proposition that the TVM does work; in particular to the proposition that it can be applied to essentially replicate the intended tax outcomes of the present law. Importantly, this proposition was also not subsequently challenged in any of the submissions received. While the transactional analysis did point to a potential for some tax timing and other differences relative to current law, Baxter and Pitchers concluded that these generally could be addressed in the legislative drafting or otherwise were not fatal. Indeed, from this perspective, the analysis was extremely useful in assisting and guiding the further development of the draft TVM legislation.
62. In respect of identifiable compliance issues, the essential conclusion of the testing was that ‘...the practical side of compliance would seem to be capable of being dealt with. Existing data will generally be sufficient but new software would be necessary for different forms of calculation.’ A number of potential TVM calculation methodologies also were tested with varying results in terms of simplicity, but all generally confirmed that the required information was already available. This testing also showed that in some cases existing data might in fact be more easily manipulated to calculate taxable income under the TVM (e.g. when working from a balance sheet).

63. Highlighted in A J Baxter’s report also was that the experience of the 20 or so people involved in the testing program ‘...would suggest that the basic structure of the TVM is quite easy to understand and to assimilate. The calculation methodologies also were found to pose no difficulties in comprehension for a group that probably comprised a majority of accountants.’

64. Against this, however, the analysis also provided an early pointer to the potential for greater legislative and practical complexity in some areas, for example, in cases where transactions might give rise to a number of different assets and liabilities, each of which has to be separately treated.

65. The further road testing, of the prototype 4 version of the draft legislation, which the Board sponsored in association with the ICAA also suggested that there were no fundamental flaws in the TVM concept. The overwhelming consensus among the 17 practitioners who participated, however, was that the TVM would not lead to overall simpler law or processes for preparing tax returns, although 7 suggested that it would overcome some anomalies and complexities in the current system. All of the practitioners, moreover, considered that adopting the TVM would involve significant transitional costs for them, and a majority felt that this would also be the case for their clients.

66. The more specific assessment of potential transitional and on-going compliance cost implications commissioned from ATAX also suggested a potential for significant transitional costs for both firms and practitioners in most circumstances. While estimates of actual transitional costs provided by firms participating in the study varied widely, even within the ‘large,’ ‘medium,’ and ‘small’ grouping categories applied, most felt the transitional cost for them would be high. Most felt, moreover, that their recurrent costs of complying with the TVM would be little changed compared to the current system. In addition to also expecting high costs of transition, most practitioners felt that they would have to spend more time preparing tax returns under the TVM even after the transition. Many believed, furthermore, that they would not be able to fully pass on these transitional and on-going costs to their clients, given that there would be no ‘benefit to business’ in adopting the TVM.

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3 Ibid, p58.
67. It should be emphasised that the outcomes of the ATAX study were little more than indicative in that, in addition to a small sample size, the study was only able to elicit participants ‘impressions’ of likely transitional and on-going costs. Apart from a number who had also participated in the ICAA study, it seems that very few participants actually applied the TVM to their or their client’s data in an effort to inform their estimates or suggestions of likely costs.

68. The study the Board commissioned from Professors Cooper and Wenzel also failed to elicit any convincing evidence that the TVM would result in better law. It found, in particular, no statistically significant evidence to suggest that the TVM would lead to greater consensus on answers to income tax problems compared to the current law. Similarly the study found that there was no greater likelihood that the TVM would result in the correct methodology being applied to solve income tax problems and that it would be likely to lead to less accurate answers to tax problems. As acknowledged by the authors, however, the study contained a number of limitations that could have had a bearing on the findings of the study. These including the level of instruction given to participants in the testing of the current law and the TVM prototype legislation and the sorts of transactions tested. Notwithstanding that both aspects were subjected to independent appraisal to minimise any unintended bias.

69. The further ‘benchmarking’ analysis which the Board commissioned from PricewaterhouseCoopers suggested that it may be possible to achieve some of the benefits promised by the TVM through more incremental, and less radical, change to the present law, including by incorporating some of the standard features of the TVM. Significantly more development work would be required, however, in order to confirm these possibilities.

70. Overall, it is apparent that the outcomes of the Board’s commissioned or sponsored analyses broadly mirrored the views of submissions, at least to the extent that they failed to provide any convincing evidence that, for taxpayers and their advisers, the on-going benefits of adopting the TVM are unlikely to be sufficient to warrant incurring substantial transitional costs involved.

**Implications for policy and legislative development**

71. While the potential impacts on taxpayers and their advisers is clearly very important any overall assessment of the TVM must also include its potential implications for future tax policy and legislative development. A significant amount of work was done to assess and explain the potential impacts in these areas by the TVM Legislative Group.

72. The TVM could be expected to provide improved process and shorter cycle times for making and implementing new income tax policy and legislation. This reflects the fact that the TVM has core rules that recognise the tax base and bring transactions to account. Accordingly, the assets and liabilities of a taxpayer are recognised and given tax values.
73. If, therefore, a policy measure sought to alter the default treatment provided under the TVM core rules then the TVM would provide a transparent structural approach (taxable income adjustments) by which the default treatment could be modified. Because the underlying transaction would be recognised by the TVM core rules, there would be no need to develop rules to first recognise the nature of the transaction and also its tax value. Amendments would only focus on rules needed to allow for departures from the default treatment.

74. The TVM conceptually, has the potential to enhance durability from a policy and legislative perspective because it provides a clear structure that potentially imposes a discipline on future policy makers when introducing policy changes in the tax law. At a conceptual level, the TVM core rules would provide benefits to tax administrators and policy makers because they could be expected to be easier to learn than the range of different regimes that currently perform their function. Having a single unifying core concept would be expected to assist in the administration of the income tax law, for example, in facilitating easier development of rulings and information products. This is because the products could concentrate on explaining any departures from the default treatment, whilst separate generally applicable products would explain the application of the core rules.

75. A key demonstration of the benefits of the TVM from a policy and legislative development perspective was the work done in rewriting key areas of the CGT provisions in the current law in the TVM prototype legislation. This showed that a 70 percent reduction in the volume of key CGT provisions could be achieved by leveraging off the TVM’s core rules.

76. Work done by the TVM legislative group in analysing the Metal Manufactures case\(^4\) shows that the TVM has the potential to tax transactions more in accordance with their economic substance, in contrast with the current law that treats many transactions according to their legal form.\(^5\)

77. A further potential benefit of the TVM from a policy and legislative perspective is that the TVM would apply in a uniform way to tax particular transactions. Only one set of tax rules would apply to a particular transaction. In contrast, a number of often overlapping mechanisms can apply to a single transaction under the current law. This was highlighted by the TVM legislative group’s analysis of the Myer case\(^6\). This potentially simplifies any legislative changes required to alter the incidence of taxation to such a transaction under the TVM.

78. Of course, legislation which is easier to learn, shorter and potentially more certain, would also be of considerable benefit to taxpayers and their advisers. However, while acknowledging the TVM’s potential in some of these respects, those who would be confronted with using TVM


\(^5\) See page 69 of the Board of Taxation’s Tax Value Method Information Paper.

\(^6\) Commissioner of Taxation v Myer Emporium Ltd (1987) 163 CLR 199; 87 ATC 4363 and see page 61 of the Board of Taxation’s Tax Value Method Information Paper.
based tax law generally considered that the benefits offered would to be more than offset by other considerations more relevant to them. It also has to be acknowledged that there would be transitional costs for policy and legislative developers and administrators in adopting the TVM; for the ATO especially.

**Summary of findings**

**Simplicity**

79. The overwhelming consensus among key non-government stakeholders is that the TVM would not result in simpler law. The Board's own analyses was also, at best, inconclusive in this respect. While there is a good deal of theoretical and conceptual logic in a proposition that legislation having a single conceptual framework et al would be easier to comprehend and apply, perhaps most with tax law, the devil inevitably lies in the detail. A key conclusion of most stakeholders was that new concepts introduced by the TVM, such as is there an asset, is it held and what is its tax value, would result in new sources of complexity in the law, sufficient to negate the promised 'higher level' benefits.

80. Compounding the difficulties in making any definitive assessment against the simplicity criterion, was the fact that the Board was only able to commission a fairly limited amount of TVM demonstration legislation. Prototype 4 of the draft TVM legislation, in particular, was limited principally to the TVM core rules and adjustments required to replicate key elements of the current taxation treatment of capital gains.

81. A key difference between the TVM's core rules and the basic assessable income less allowable deduction high level framework of the current law is that the TVM's core rules are more detailed and perform a much greater role and function. The core rules have an effect, moreover, of making more transparent many of the complexities that exist in the present law, but which tend to be hidden by the fact that they are spread throughout its various regimes. There is, therefore, likely to be an inherent bias in comparing the prototype 4 draft with the current law, or indeed, some other potential benchmark, and one that probably could not be eliminated short of a complete legislative re-write in the TVM format.

82. Even allowing for such bias, nevertheless, it is still not possible to conclude that the TVM would result in simpler law.

**Integrity and durability**

83. As with simplicity, there is theoretical and conceptual logic in the proposition that the TVM would improve the integrity and durability of the income tax law; for example, by eliminating the potential for overlapping regimes to apply to any given transaction, improving the symmetry of treatment of taxpayers on either side of a transaction, and allowing for departures from the application of the core rules to be more readily and transparently enacted.
Many stakeholders doubt, however, whether the benefits claimed in these regards would, in fact, be realised.

84. Many stakeholders again point to the new concepts that the TVM would introduce as not only potentially introducing new complexity to the law, but also potentially opening up new avoidance possibilities. Several cite, for example, the greater recognition of liabilities under the TVM and the potential this might open them up to be ‘manufactured’ in order to defer the realisation of income.

85. Some also argue that the sheer scale of change implied by the TVM means that the risk of avoidance loopholes emerging is greatly magnified. They suggest, moreover, that the requirement progressively to close the loopholes as they emerge runs the risk of reintroducing complexity in the income tax law that the TVM may initially have removed.

86. Again, the balance of argument is impossible conclusively to assess.

**Will TVM provide greater cost effectiveness?**

87. Highlighted in the submissions and suggested by some of the Board’s own testing and analyses was that implementation of the TVM would potentially result in significant transitional compliance costs for tax practitioners over a lengthy period. These costs would, at least in very large part, be passed on to taxpayers. There would also be separate transitional costs imposed on taxpayers, particularly those carrying on business. Costs would, furthermore, be incurred by the ATO and other relevant areas of Government as, for example, information and processing systems were adapted and human capital invested in the present law was replaced through relearning and retraining.

88. Some, for example, who were involved in the ICAA testing, also suggested that the TVM would result in higher on-going costs for tax practitioners, while most others involved in that study thought there would be little difference between the TVM and the present law in this respect. Overall, the consensus among non-government stakeholders was that they could perceive little or no on-going compliance cost benefits in adopting the TVM.

89. As is the case with many areas of public policy, the cost effectiveness of a proposition such as the TVM is notoriously difficult to accurately assess or quantify. Generally, the costs of major change tend to be more concentrated and visible, whereas the gains often are diffuse and thinly spread. One result is that those who would, other things equal, bear the costs of a change will have greater incentive and ability to quantify them, whereas those who stand to benefit may have little incentive individually to quantify those benefits. Such asymmetry is even more pronounced in the case of the TVM, since very few taxpayers actually deal directly with the law.

90. There is little doubt that this asymmetry in incentives has pervaded the debate over the TVM. Exacerbating the situation also is that the large amount of tax reform over recent years
has meant that there is now considerable resistance among taxpayers and the tax advising profession to even a suggestion of further major change.

91. These considerations, notwithstanding, it is very difficult to discount the majority of opinion among non-government stakeholders that the potential benefits to them of adopting the TVM are simply not sufficient to warrant incurring the significant transitional and other costs that would be involved. To the extent that there may be net benefits in adopting the TVM from a tax law development and administration perspective, moreover, these too are impossible to quantify and are unlikely to loom large when considered against the interests of taxpayers.

Neutral impact upon taxation revenue

92. The TVM was intended as a platform reform, in that it would change the legislative framework for working out taxable income. The aim was not to collect more (or less) revenue. However, the TVM’s effect of standardising concepts, introducing greater symmetry to the treatment of assets and liabilities and standardising the different cost rules in the income tax law, would have resulted in minor changes to revenue, mainly by altering the timing of tax collection.

93. The work undertaken by the TVM legislative team\(^7\) suggested that a minor overall reduction in revenue could arise from these changes. It did not suggest, however, that the changes would favour or disadvantage certain industries or groups.

94. Importantly, this analysis excluded the revenue impacts of explicit proposed policy changes that were incorporated into the TVM prototype legislation. Those changes, recommended by the Ralph Review, included tax relief for black holes, an improved treatment of rights and changes to the taxation of financial arrangements. In the absence of the TVM, implementing these policy changes in the present law would have similar revenue impacts.

95. Ultimately, and consistent with the intent of the Ralph Review, it would be a policy question for the Government to decide whether any unintended net gain to revenue arising from implementation of the TVM would be returned to affected taxpayers. The overall conclusion remains, however, that the TVM could be implemented without materially altering the current incidence of taxation for all categories of taxpayers.

Feasibility of implementation

96. The implementation of TVM would be a very large legislative task to complete. It would be necessary concurrently to rewrite and merge the remaining relevant parts of the Income Tax Assessment Act 1936 into the 1997 Act. As such, a very large volume of income tax law would need to be rewritten and introduced to Parliament. The resources required would be very

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\(^7\) See pages 57-58 of the TVM Information Paper.
substantial and a long timeframe would be needed to complete this task. In essence, it would require a commitment from the Government and key non-government stakeholders over an extended period of time.

97. As large as the task would be, there are ways in which it could be managed to minimise resource demands. For example, the law could be drafted and enacted in progressive tranches, to take effect from some future date by which time the entire law will have been redrafted. Alternatively, it could be redrafted in an open, consultative process such as that utilised by the Board to date, for introduction to the Parliament as a single Bill. Parliament’s consideration would then be facilitated by the assurance given via the consultative process that the policy intent of the current law was being preserved.

**Ralph recommendations associated with the TVM**

98. The development of the TVM has involved consideration, to varying degrees, of a number of other closely related Ralph recommendations. Of particular significance are the rights recommendations contained in Section 10 of *A Tax System Redesigned* and many of the recommendations in Section 4 of that report, sometimes referred to as ‘high level rules’, which included the treatment of black hole expenditure. These recommendations were developed in the context of the TVM, with many of the high level rules relating to the valuation of assets and liabilities within that framework. A platform for a comprehensive treatment of rights formed an important underlying structure to the TVM demonstration legislation, as was a means of dealing comprehensively with the issue of black hole expenditure.

99. Some submissions received on the TVM specifically pointed to the need to pursue the Ralph recommendations relating to rights and black holes, in the absence of the TVM. Submissions were generally silent with respect to the other high level rules.

**Conclusions**

100. There is unanimous agreement among all major stakeholders that the present income tax law is too complex and voluminous relative to what it is required to achieve. All agree that efforts must be made to achieve a simpler more coherent and robust tax law, including in the context of the need to complete the integration of the *Income Tax Assessment Act 1936* into the 1997 Act. There is, however, no significant support from business or the tax advising profession for continuing with the testing and development of the TVM as the possible means for achieving these objectives.

101. There is some acknowledgment that the TVM does offer the potential for significant improvements to the law in particular respects; for example, in standardising concepts and simplifying the CGT regime. However, there is no support for generally adopting changes in tax values of assets and liabilities as the primary basis on which taxable income is calculated.
102. In essence, the concern among many stakeholders is that, while offering benefits in some areas, the TVM would generate greater complexity and uncertainty in others. As such, most stakeholders believe that the on-going benefits of adopting the concept are, at best, uncertain and certainly unproven. Adding to this is the perception among many stakeholders that adopting the TVM would result in substantial transitional costs, most notably for tax advisers who would both lose substantial human capital invested in the current system and be required similarly to invest in their knowledge and understanding of TVM based law. Many are also concerned that much of the certainty provided by some 70 years of precedent and case law would be lost in adopting the TVM.

103. Against these taxpayer and tax practitioner concerns must also be weighed the potential costs and benefits of the TVM in terms of taxation policy and legislation development and administration. From a tax policy perspective there would be clear and unequivocal benefits in having an income tax law based in a single core concept such as would be provided under the TVM. With such a structure, it would, for example, be unnecessary, to develop separate new assessing rules each and every time a new policy initiative is implemented. Having a single unifying concept, arguably, would also assist in the administration of the law, for example, in facilitating easier development of rulings and information products.

104. Evident from the Board’s commissioned case study analyses, and contrary to a suggestion made by one major industry group, is that the fundamentals of the TVM concept are relatively easy to explain and can be quite readily understood, especially by people with general taxation and accounting knowledge. In the initial analysis conducted with the assistance of BHP, Telstra and Australia Post, for example, some 20 tax and accounting advisers previously unfamiliar with the TVM were, within a matter of some five to six weeks, able to grasp the concept and to correctly apply it in analysing some 60 complex ‘real life’ transactions. Similarly, the consultant who organised the ICAA testing was, in a period of less than two weeks, able to develop a guide (‘TVM Tutor’) to allow practitioners participating in the exercise to effectively apply the TVM to client’s data. The practitioners themselves were then able to apply the TVM after studying the Tutor and the draft demonstration legislation for between five and twenty hours.

105. This suggests that the underlying concepts, at least, of TVM based law would be a lot easier to learn for policy developers and administrators, giving unequivocal benefits in these areas. The Board recognises, however, that such benefits are impossible to quantify and thus a net gain is impossible to conclusively and tangibly demonstrate when ranked against the potential transitional and on-going impacts on taxpayers (but which also are impossible to comprehensively quantify).

106. Given the lack of support, particularly from within the business community, for adoption of the ‘net assets’ concept and the likely impossibility of being able conclusively to prove its

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8 There would also be potential long term benefits to taxpayers and advisers.
relative merits one way or the other, the Board believes that there is nothing to be gained from pursuing further the development and evaluation of the TVM.

107. Most key stakeholders have emphasised, nevertheless, that notwithstanding their lack of support for the TVM concept, impetus needs to be maintained for exploring alternative means for reducing the complexity, instability, uncertainty and costs of compliance associated with the present income tax law. A number have suggested, moreover, that the work done to date in developing the TVM has identified a number of ideas and concepts which might be applied to simplifying the existing law, without the need to jettison its current core concepts. Adopting some of the standard rules and aspects of the simplification of the CGT rules developed in the draft TVM legislation into the current law are examples which several have cited.

108. Key stakeholders, including the BCTR, have therefore suggested that a further process should be commenced aimed at exploring these and other possibilities for improving the current law, and have offered to work with the Board in this respect.

109. The Board considers that there is merit in this proposition. There are, in particular, strong national interest reasons for pursuing a more coherent and simpler income tax law. Complexity, for example, leads often to uncertainty as to possible taxation outcomes and this in turn can be detrimental to investment decision making, and the international location of investment, among other things.

110. Evident from the TVM process, nevertheless, is that there is no single or ‘silver bullet’ solution to the problems of the current income tax law, especially one that is likely to gain broad based acceptance in the community. Any approach likely to succeed, therefore, will need to be multifaceted. Fundamental to the success of any further process, or processes, moreover, will be whether a consensus can be achieved among relevant stakeholders as to what the relevant problems with the current law in fact are, and as to the priorities by which they should be addressed. A good deal of effort was made by the TVM Legislative Group to explain the problems of the current law that the TVM was intended to address. It is apparent from their submissions, however, that many stakeholders do not consider these to represent the most important sources of difficulty with the law. It was suggested by several that more significant problems of complexity etc arise from aspects of the law which would not have been materially impacted by the TVM, such as its various anti-avoidance provisions, the trust provisions of Division 6 of the Income Tax Assessment Act 1936 and the foreign source income rules.

111. The Board, therefore, considers that there would be merit in it being authorised to commence a further process aimed at exploring the potential for improvement of the current income tax law, in the context of merging the two present Acts. This process would focus initially on facilitating a dialogue among the main interest groups aimed at exploring, and hopefully achieving, a consensus on the problems with the present law that need to be addressed and the priority with which they should be addressed. Once these matters have been determined, and subject to the Government’s endorsement, processes could then be set in train for identifying the solutions for implementation in a context of merging the present two Acts.
In proposing such a further process, several stakeholders have nevertheless cautioned that it would need to be progressed in a way which recognised, and was sympathetic to, the continuing heavy demands that current and prospective tax reforms are imposing on taxpayers, their advisers and the Government. They have argued, in particular, that any further process should not be conducted at the expense of timely introduction of more immediate reform priorities, including those arising out of the international tax review. As such, planning of any further process should be done in close consultation with those interest groups likely to be most involved.

In the interim, and assuming the Government agrees not to proceed with the TVM concept, priority should be given to implementing under the current law several measures recommended by the Ralph Review, and endorsed in principle by the Government, which were intended to be dealt with in a TVM framework. Most important among these are the need to address fully the problem of deductible expenditure 'black holes' in the present law and to implement the further Ralph recommendation regarding the taxation treatment of rights. The Board notes, and strongly endorses, the Governments recent announcement that it will also be progressing the implementation of the new regime for the taxation of financial arrangements, also initially linked to the TVM framework.

The Government should also give further consideration to whether to proceed with the associated high level rules contained in section 4 of A Tax System Redesigned. These recommendations were developed within the framework of the TVM and primarily relate to the valuation of assets and liabilities. While it would be possible to implement some of these recommendations within the context of the current law, any further consideration might best be done within the broader context of the proposed process for reviewing the scope to improve the income tax law.

As noted, achieving sustained improvements to the income tax law (and other aspects of the tax system) inevitably requires a multifaceted approach. The Board’s proposal to commence a new tax law improvement process would seek to achieve improvements needed to the current law. In order to ensure that such improvements are sustained, however, it would need to be supplemented by other processes of a more perpetual nature. In particular, the Board believes that there should be processes for more systemic on-going review of the tax system and its operation with a view to identifying and implementing needed change as it emerges, for example, due to evolving economic, social and environmental changes and pressures. The objective would be to avoid or reduce the need for periodic major tax reform which has tended to characterise processes in Australia to date, and which arguably imposes higher transitional costs on the community than would be the case under a more incremental, gradualist approach. The Board considers that, consistent with its Charter, it is well placed to play an important ‘catalytic’ role in achieving such a process.

The Board also believes that adherence to its recommended processes for community consultation in developing and implementing taxation laws, which the Government has
endorsed, will also greatly assist in avoiding future unnecessary complexity being introduced to the law.
## ATTACHMENT A: LIST OF NON-GOVERNMENT MEMBERS OF TVM LEGISLATIVE GROUP

<table>
<thead>
<tr>
<th>TVM Working Group member</th>
<th>Representing</th>
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<tbody>
<tr>
<td>Mr Chris Jordan</td>
<td>Chairman of the TVM Working Group – Member of the Board of Taxation</td>
</tr>
<tr>
<td>Mr Paul Abbey</td>
<td>Shaddick &amp; Spence</td>
</tr>
<tr>
<td>Mr Tony Baxter</td>
<td>AJ Baxter &amp; Associates</td>
</tr>
<tr>
<td>Mr Peter Burn</td>
<td>Business Council of Australia</td>
</tr>
<tr>
<td>Mr Graeme Cooper</td>
<td>University of Melbourne</td>
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<tr>
<td>Mr Frank Drenth</td>
<td>Corporate Tax Association</td>
</tr>
<tr>
<td>Mr Paul Drum</td>
<td>CPA Australia</td>
</tr>
<tr>
<td>Mr Michael Dirkis</td>
<td>Taxation Institute of Australia</td>
</tr>
<tr>
<td>Prof Chris Evans</td>
<td>University of NSW</td>
</tr>
<tr>
<td>Mr Paul Hooper</td>
<td>Lend Lease Ltd</td>
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<tr>
<td>Mr Geoffrey Lehmann</td>
<td>PricewaterhouseCoopers</td>
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<tr>
<td>Ms Joycelyn Morton</td>
<td>CPA Australia</td>
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<tr>
<td>Mr Luigi Mottolini</td>
<td>Wesfarmers Ltd</td>
</tr>
<tr>
<td>Ms Su McCluskey</td>
<td>National Farmers Federation</td>
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<tr>
<td>Mr Romano Nenna</td>
<td>Centro Properties Ltd</td>
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<tr>
<td>Mr Brian Richards</td>
<td>BDO Kendalls</td>
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<tr>
<td>Mr Miquel Timmers</td>
<td>Corporate Tax Association</td>
</tr>
<tr>
<td>Mr Ken Traill</td>
<td>Institute of Chartered Accountants in Australia</td>
</tr>
<tr>
<td>Mr Kel Wall</td>
<td>BHP-Billiton Ltd</td>
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ATTACHMENT B: DETAILS OF THE BOARD’S COMMISSIONED ANALYSES AND OUTCOMES

Parties contracted to undertaking TVM evaluation work for the Board

<table>
<thead>
<tr>
<th>Party</th>
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<tbody>
<tr>
<td>AJ Baxter &amp; Associates</td>
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<tr>
<td>Institute of Chartered Accountants in Australia</td>
</tr>
<tr>
<td>Melbourne University (Professor Cooper) and Australian National University (Dr Wenzel)</td>
</tr>
<tr>
<td>PricewaterhouseCoopers (Mr Lehmann and associates)</td>
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<tr>
<td>University of New South Wales (Professor Evans and Dr Binh Tran-Nam)</td>
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</table>

AJ Baxter & Associates work

The testing program, which was coordinated by AJ Baxter & Associates, examined the 30 April 2001 prototype TVM legislation, and involved Telstra Corporation Ltd, Australia Post, BHP Ltd (as it then was) and Pitcher Partners. In total 6 TVM tax calculations were prepared from 1999-2000 year accounts and approximately 66 transactions (and variations to transactions) covering a wide range of issues were tested. Pitcher Partners prepared 4 of the TVM tax calculations on small to medium enterprises that were clients of the firm. The others were prepared by BHP and Australia Post. In each case the taxable income of entities had already been worked out under the current tax system. Accordingly the testing mainly focussed on the process to be adopted under TVM to achieve that same outcome.

The testing program established that the early TVM prototype legislation worked very well in some areas. The study found that:

- the TVM facilitates emerging profits being brought to tax and depreciating assets giving rise to taxable income reductions;
- the treatment of a whole range of assets such as plant and equipment and prepayments of revenue outgoings under a single set of rules under TVM; and
- trading stock is easily accommodated within the TVM framework.
Some areas that were identified that needed further work in later prototype legislation included:

- the treatment of losses of cash;
- multiple assets and liabilities arise in some transactions;
- potential for different outcomes to occur under the TVM compared to the current law.

**The study by the Institute of Chartered Accountants in Australia**

The Board commissioned ICAA to test the practicalities of applying the TVM to calculating the taxable incomes of a range of taxpayers, and to evaluate the cost and other compliance aspects of doing so. The study was undertaken as follows:

- the ICAA developed a methodology and guidelines ('TVM tutor') that was given to approved practitioners to calculate taxable incomes consistent with the Tax Value Method (Prototype 4) legislation and associated worksheets;
- the ICAA developed a questionnaire that participating practitioners used to record testing and evaluation results from applying the legislation, methodology and guidelines to client data for the 2000-2001 financial year to work out taxable income.

Most of the ICAA members who participated in the study had little or no knowledge of the TVM before becoming involved in the study. On average the members participating in the study took between 5 and 20 hours to become familiar with the broad concepts underlying the TVM.

The study found that one member was in favour of introducing the TVM as soon as practical, whilst 5 members supported further development and 7 members considered that further work on the development of the TVM should cease. Most members who participated in the survey considered that it would take between 2 months and 6 months for them to gain proficiency in the TVM.

**Certainty testing — Melbourne University and Australian National University**

The aim of the study was to identify if it could be demonstrated that there was any measurable difference in the certainty of the TVM prototype legislation compared to the current law. The study tested the hypotheses that compared to the current law TVM led to greater:

- consistency in reaching answers to common tax problems;
- subjective confidence in the correctness of answers to tax problems;
- subjective confidence that the steps used to determine the answers to tax problems have been followed correctly;
• frequency in reaching the intended answers to tax problems;

• consistency in applying the steps intended to be applied in order to determine answers to tax problems.

The study was conducted by testing four groups of students with 15 to 20 students in each group. The group was chosen to ensure that they had little or no experience with tax issues. Each group was given an oral presentation on either the current tax law or the TVM prototype legislation and extracts of the relevant law were provided. After the presentation the students completed a questionnaire and answered 20 tax problems.

The study found that the draft TVM legislation did not result in greater certainty. In particular, overall the students tested did not have a higher level of correct answers or consensus about the answers to tax problems when applying the TVM. Similarly the subjects of the study did not express more confidence that the answer to a tax problem was correct when applying the TVM.

A number of limitations of the study that were identified were that the number of students tested was limited and therefore further work would be necessary to establish if the findings of the study generalise to other groups. It was possible that the findings of the study could have differed if subjects with more tax experience had been tested. Other limitations included the sample of problems on which students were tested and the limited instructions on each tax system may have influenced the result.

**Compliance cost study — Australian Taxation Studies Program**

The Board engaged Associate Professor Chris Evans and Dr Binh Tran-Nam from the Australian Taxation Studies Program at the University of New South Wales to evaluate the level of:

• transitional compliance costs that might arise from the implementation of the TVM; and

• the impact of the TVM on the longer term (recurrent) compliance costs or benefits.

The study was carried out based on structured interviews with 40 business people and tax practitioners with knowledge of the TVM. The respondents provided information about their perceptions of the transitional and recurrent compliance cost implications of the TVM for 58 different businesses and three professional associations. The study also obtained information about respondent’s level of knowledge of the TVM and the demographic background of the businesses.

The study found that based on the views of respondents that there would be significant transitional compliance costs for many taxpayers. However, the majority of respondents thought that there would not be any significant change in recurrent costs of complying with
the TVM compared to the current income tax system. There was no significant variation in views expressed by respondents in relation to small, medium and large businesses.

Constraints upon the study included the fact that a complete and fully developed model of the TVM does not exist and therefore there is not actual experience on which respondents could base estimates. The knowledge base about the TVM in the business community is very low and even tax practitioners had a low and variable knowledge of the TVM. A further constraint was that the sample was not randomly selected or stratified to include an appropriate representation of businesses of sectors. Finally, the study did not address the administrative costs and benefits of the TVM from the perspective of the Australian Taxation Office and others involved in administering the TVM.

**Legislative benchmarking — PricewaterhouseCoopers**

The Board commissioned Mr Geoffrey Lehmann and associates of PricewaterhouseCoopers to develop prototype draft legislation and explanatory material that would provide a benchmark against which the prototype TVM draft legislation could be compared. The objective of the legislation that was produced was to replace the existing two separate tax acts with a single tax act, and to eliminate where possible the income capital test in the current tax law. As part of this process, the legislation used some of the common architecture of the TVM (but not the changing tax values of assets and liabilities).

The prototype legislation developed by PricewaterhouseCoopers includes in assessable income all amounts derived during the income year subject to exceptions and modifications. It allows a deduction for all outgoings incurred and properly referable to the income year, subject to, for example, amounts that are deductible under the capital allowances rules or are included in the cost base of assets that come within the CGT rules.

The full reports of all the commissioned studies are contained on the Board's website at www.taxboard.gov.au.
**ATTACHMENT C: LIST OF THOSE WHO HAVE MADE SUBMISSIONS**

The Board invited submissions following the release of prototype 4 of the draft TVM legislation. The Board received 34 submissions.

**Parties making submissions**

<table>
<thead>
<tr>
<th>Party</th>
<th>Contact</th>
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</thead>
<tbody>
<tr>
<td>Australian Chamber of Commerce and Industry</td>
<td>Lee, T</td>
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<tr>
<td>Australian Institute of Company Directors</td>
<td>Mayo, W</td>
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<tr>
<td>Baxter, A J</td>
<td>McLaren, D C</td>
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<tr>
<td>BHP Billiton Ltd</td>
<td>Minerals Council of Australia</td>
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<td>Business Coalition for Tax Reform</td>
<td>National Farmers Federation</td>
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<tr>
<td>Chandrasegaran, S</td>
<td>Nixon, M</td>
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<td>Clubs Australia and New Zealand</td>
<td>Pike &amp; Skinner</td>
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<td>Dowdeswell, J</td>
<td>Robins Harris P/L</td>
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<td>Everall Merrett Mann DFK P/L</td>
<td>Small Business Coalition</td>
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<td>Gregory &amp; McCarthy</td>
<td>Smith, A W J</td>
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<td>Harvey, H</td>
<td>Software Developers Consultative Group</td>
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<td>Institute of Chartered Accountants in Australia</td>
<td>Taxation Institute of Australia</td>
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<td>International Banks and Securities Association of Australia</td>
<td>Telstra Corp Ltd</td>
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<tr>
<td>Insurance Council of Australia</td>
<td>Travers, G</td>
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<td>Joint submission CPA Australia, Law Council of Australia, National Farmers Federation and Taxation Institute of Australia</td>
<td>Trustee Corporation of Australia</td>
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<tr>
<td>Joint submission Business Council of Australia and Corporate Tax Association</td>
<td>UBS Warburg Australia Ltd</td>
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<tr>
<td>Lawry, J K</td>
<td>Zipform P/L</td>
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ATTACHMENT D: MEMBERS, CHARTER OF THE BOARD OF TAXATION AND CONFLICT OF INTEREST DECLARATION

Members

The members of the Board of Taxation are:

Chairman

Richard F E (Dick) Warburton

Members

John Bronger
Tony D’Aloisio
John Harvey
Brett Heading
Chris Jordan
Alison McClelland

Ex officio members

Michael Carmody (Commissioner of Taxation)
Ken Henry (Secretary to the Department of the Treasury)
Hilary Penfold QC (First Parliamentary Counsel)

Secretariat

Members of the Board’s Secretariat who contributed to the conduct of the Board’s TVM development and evaluation processes and in preparing this report were, Mr Murray Edwards (Secretary), Mr Brad Archer, Ms Fiona Spry, Mr Jon Adler, Mr Phil Bignell, Mr Robert Patch and Ms Jodi Wood. Mr John Griffin of Griffin Interlink P/L also assisted the Secretariat in developing the Board’s TVM communication and education strategy.

Charter

Mission

Recognising the Government’s responsibility for determining taxation policy, and the statutory role of the Commissioner of Taxation, to contribute a business and broader community perspective to improving the design of taxation laws and their operation.
Membership

The Board of Taxation will consist of up to ten members.

Up to seven members of the Board will be appointed, for a term of two years, on the basis of their personal capacity. It is expected that these members will be appointed from within the business and wider community having regard to their ability to contribute at the highest level to the development of the tax system. The Chairman will be appointed from among these members of the Board. Members may be reappointed for a further term.

The Secretary of the Department of the Treasury, the Commissioner of Taxation and the First Parliamentary Counsel will also be members of the Board. Each may be represented by a delegate.

Function

The Board will provide advice to the Treasurer on:

- the quality and effectiveness of tax legislation and the processes for its development, including the processes of community consultation and other aspect of tax design;
- improvements to the general integrity and functioning of the taxation system;
- research and other studies commissioned by the Board on topics approved or referred by the Treasurer; and
- other taxation matters referred to the Board by the Treasurer.

Relationship to other Boards and Bodies

From time to time the Government or the Treasurer may establish other boards or bodies with set terms of reference to advise on particular aspects of the tax law. The Treasurer will advise the Board on a case by case basis of its responsibilities, if any, in respect of issues covered by other boards and bodies.

Report

The Chairman of the Board will report to the Treasurer, at least annually, on the operation of the Board during the year.

Secretariat

The Board will be supported by a secretariat provided by the Treasury, but may engage private sector consultants to assists it with its tasks.
Other

Members will meet regularly during the year as determining by the Board’s work program and priorities.

Non-government members will receive daily sitting fees and allowances to cover travelling and other expenses, at rates in accordance with Remuneration Tribunal determinations for part-time public offices.

The Government will determine an annual budget allocation for the Board.

Conflict of Interest Declaration

All members of the Board are taxpayers in various capacities. Some members of the Board derive income from director’s fees, company dividends, trust distributions or as a member of a partnership.

The Board’s practice is to require members who have a material personal interest in a matter before the Board to disclose the interest to the Board and to absent themselves from the Board’s discussion of the matter, including the making of a decision, unless otherwise determined by the Chairman (or if the Chairman has the interest, the other members of the Board).

The Board does not regard a member as having a material personal interest in a matter of tax policy that is before the Board merely because the member’s personal interest may, in common with other taxpayers or members of the public, be affected by that tax policy or by any relevant Board recommendations.