



The Institute of
Chartered Accountants
in Australia

**THE TAX VALUE METHOD
(AND RELATED PROPOSALS)**

Submission to the Board of Taxation

By

The Institute of Chartered Accountants in Australia

May 2002



The Institute of
Chartered Accountants
in Australia

6 May 2002

The Secretary
The Board of Taxation
C/- The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir

Submission re Tax Value Method and Related Proposals

It is with pleasure that the Institute of Chartered Accountants ("ICAA") submits its comments to the Board of Taxation for consideration in making its decision on whether or not to recommend to the Treasurer to proceed with the development of the "Tax Value Method".

The ICAA is strongly in favour of beneficial reform of the Australian taxation system and has been actively involved in the entire consultative process on TVM to determine whether the TVM can deliver a superior taxation system, where the benefits outweigh the transitional and ongoing costs.

The ICAA is the peak Australian accounting body, with over 36,000 members in practice, commerce and academia. We consider that the most important implementation issues of TVM would fall upon our members in practice and we therefore urge you to carefully consider the contents of our submission.

Yours sincerely

STEPHEN HARRISON AO
Chief Executive Officer



Executive Summary

- The ICAA is strongly in favour of beneficial reform of the Australian taxation system and has been actively involved in the entire consultative process on TVM to determine whether the TVM can deliver a superior taxation system, where the benefits outweigh the transitional and ongoing costs.
- The ICAA congratulates the Board of Taxation and the personnel engaged on the TVM Legislative Group for the open manner in which the consultative process has been conducted. Without question, it has been the most open and successful model for tax reform consultation undertaken in the last 20 years of tax reform in Australia and should be used as a model for future tax reform consultations.
- In our view, the arguments as to the purported benefits of TVM cannot be sustained and have not been substantiated by the TVM Legislative Group. There are certainly elements where it can be argued that there may be more consistency, less complexity, simpler law and a sturdier platform for future changes. On the other hand, there are also areas where such criteria are not met and the outcomes are instead potentially negative.
- Based on past experience with tax reform measures, we envisage major disruption would result from the introduction of TVM and that the costs of such disruption would fall on both the practitioners and the business community. Our concern is that, as with GST, the practitioners would not be able to recover such transitional costs from their small and medium sized business clients. These costs should not be borne again by the community and the accounting profession, and instead should be a cost to Government.
- If a decision is made to recommend further development of TVM as a medium term (5 years) objective, then this should only take place if the Government and the ATO fundamentally commit to ensuring that adequate resources are devoted to the critical reform areas that require attention right now. The worst outcome would be for the TVM project to get the lion's share of resources while other, more pressing, projects are "starved". If the Government is not prepared to commit this level of resources, then work on TVM should cease forthwith.
- Given that further work would take many years and involve significant cost on the part of all involved, we have to ask whether it is even worth considering further development when the resources would probably be better spent on fixing other more pressing problems with the current legislation. Even without competing issues and the resourcing issue, on our evaluation of the pros and cons of TVM, there seems a good case for not supporting any further development of TVM. Put into the equation the competing issues to be dealt with, the lack of adequate resources to deal with all these issues in the medium term, and the general tax reform fatigue in the community, and the Institute of Chartered Accountants recommends that all further work on TVM cease forthwith.



The Tax Value Method and Related Proposals

1 The Consultative Process

The Institute of Chartered Accountants ("ICAA") congratulates the Board of Taxation and the personnel engaged on the TVM Legislative Group for the open manner in which the consultative process has been conducted. Without question, it has been the most open and successful model for tax reform consultation undertaken in the last 20 years of tax reform in Australia and should be used as a model for future tax reform consultations.

We commend the openness in which the consultations have been conducted, the responsiveness of the Legislative Group to questions and ideas and the preparedness of the Legislative Group to consider changes and implement them wherever possible.

We acknowledge the process has been an evolving one, where legislation and successive changes have been released progressively over the consultative period for consideration and comment. This has led to criticisms from time to time, but overall it has been a positive change to past practices.

2 Separating the revision of the basic income and deduction structure from the other proposals which are bundled with this revision

Our evaluation of TVM commences by addressing some popular and fundamental misconceptions as to what "Tax Value Method" is all about, and might achieve. It has been used, inappropriately, as a package solution to deal with a number of tax reforms, but in fact they are all capable of separate identification and separate solutions. There are at least five reforms in this category:

1. The final resolution of business "black hole" expenditure, to ensure that business expenditure which enhances the business and revenue generation is tax deductible.
2. Capital Gains Tax (CGT) reform, to streamline the myriad of special cases present in the CGT law, which lead to excessive complexity.
3. Taxation of financial arrangements, to replace the current highly complex interplay of many different rules. A security or a loan arrangement is currently subject to many rules including the traditional securities rules, Division 16E spreading, various loss rules, forgiveness rules, revenue rules, CGT rules, etc, which mesh together very poorly and which still result in inadequate coverage of the field. The Ralph RBT recommended that this be resolved by a unified mechanism for taxation of financial arrangements.
4. Amortisation of contractual rights, in a manner consistent with the CGT laws. Again, the RBT recommended a process here, which for convenience of drafting and policy was integrated into the final piece of this package. The RBT recommended that treatment of leases and some government contracts be aligned with these rules too.
5. Revising the treatment of ordinary income and deductions (we refer to this "Ordinary Income and Deductions part of TVM" in this submission as OID/TVM). The OID/TVM proposal involves altering the current core concepts of the income tax law – which involve an income and capital distinction, the concept of "losses



and outgoings" being "incurred" leading to income tax deductibility – to a concept which is closer to that used commercially.

The key elements of the first four measures have the potential to deliver real economic benefit to the Australian community. Significantly, most of them actually do involve a concept of setting tax values in the selected areas.

In that light, there is a need for clarity in setting the way forward.

The Institute is supportive of the need to continue to develop these measures in a disciplined consultative process. The Institute supports the Board of Taxation progressing:

1. Resolution of non-deductible black hole expenditure;
2. Development of a system for taxation of financial arrangements;
3. Exploring the potential for a wholesale streamlining of the current highly complex CGT law;
4. Introducing a mechanism whereby contractual rights (such as franchise rights paid to franchisers, rights paid to Government bodies for access to particular concessions) have some coherent amortisation process – such as was developed decades ago in relation to the minerals industry.

However the cornerstone issue is the approach to be taken in relation to the OID/TVM (ordinary income and deductions) rules.

Here, the entire cost-benefit issues, and in particular the economic and community benefit issues, are less clear, as discussed below.

We have been asked to consider and make submissions on the OID/TVM, as a methodology, separate from the many other policy changes that have been incorporated into the package of prototype legislation and related material. However, it is impossible to separate some of those policy changes from the evaluation of OID/TVM. In particular, as you have noted in some of the material released on 6 March, "The rights reforms, which are designed to give a comprehensive treatment for intangible assets and rights, are important to the underlying structure of the TVM and are being considered with the TVM."

The other policy changes have not been subjected to the normal consultative treatment and we consider that they must be as well, before any of them are introduced, either in the OID/TVM legislation or as amendments to the existing law.

Our comments in this submission will be restricted to the OID/TVM methodology and the proposed treatment of leases and rights.

3 Basis of Assessment of OID/TVM

We have attempted to base our assessment of OID/TVM on the criteria of simplicity, certainty, consistency, robustness and endurance. We have also attempted to measure this assessment against the potential for additional compliance costs, both for taxpayers generally but also (and especially) for the many tax practitioners in Australia who have the responsibility for implementing these proposed tax changes.



In this assessment, we have had to use the current law as a benchmark, although we are aware of alternative reforms being developed, using some of the proposed changes coming out of the OID/TVM process.

We have also sought to address the specific issues enumerated in your documents titled "Tax Value Method – an Overview" and the "Tax Value Method Information Paper".

As you are also aware, the ICAA has undertaken some objective and focussed testing of the OID/TVM methodology with 17 Chartered Accountants in practice right around Australia. We have used their feedback to assist us in compiling this submission, together with some direct feedback from members who were not part of that testing trial.

4 The Purported Benefits of OID/TVM

The Board's "Overview" and "Information Paper" documents list the following purported benefits:

- Consistency in the income tax law is improved;
- The length and complexity of the law is greatly reduced;
- Simpler law under the OID/TVM – CGT and others; and
- Australia has a sturdy platform for future tax changes.

The issues listed above are consistent with the criteria by which we have sought to assess OID/TVM, as set out in 3 above.

In our view, the purported benefits of OID/TVM cannot be sustained and have not been substantiated by the TVM Legislative Group.

It is clear that the achievement of TOFA, and CGT streamlining, can drive significant reduction in length in the tax law. But these advantages do not require the OID.TVM proposal.

There are certainly elements where it can be argued that the OID/TVM proposal may create more consistency, less complexity, simpler law and a sturdy platform for future changes. On the other hand, there are also areas where such criteria are not met and are potentially damaging.

(a) Consistency

In relation to consistency, the first purported improvement is in relation to default treatment of business gains and expenditure, especially "black holes". We support the measure. In our view, this measure could have been (and should have been) dealt with under the current law many years ago.

But to rely on OID/TVM as a means of dealing with the issue (and even making the solution dependent upon OID/TVM) is a weak argument. This anomaly or inequity can be easily dealt with under the current law.



The second listed benefit relates to the characterisation of transactions to supposedly ensure consistent treatment. This is a worthwhile goal. The legislation attempts to do this through grouping certain rules in one area of the law, so that the rules apply consistently, irrespective of their particular application. The simplicity that this may appear to deliver is attractive but does TVM deliver?

Professor Robert Deutsch has analysed the impact of these rules on the investment asset provisions of the prototype legislation and has concluded that - "The concept of having common rules throughout the entire legislation is a welcome reform as it aims to reduce and simplify the operation and volume of the income tax law. The current version of the OID/TVM does not achieve these aims and it may well be it is not possible to draft legislation as complicated as Australia's income tax law in a simpler form, in which case the whole concept of the OID/TVM must be questioned as to whether it can offer any benefit from the existing regime."

The third stated element of consistency relates to the removal of asymmetric treatments between different taxpayers. We accept that this may be an ideal objective from a pure economic viewpoint and from a Government revenue viewpoint. However, it is a truism that different taxpayers have different circumstances and it may be more relevant and appropriate to treat those taxpayers differently. For example, a property developer who pays a sub-contractor for work on a development (where the developer is taxed on a profit emerging or profit realised basis) should not be allowed a deduction for what he pays to the sub-contractor, even though the sub-contractor is currently taxed on the payment.

The final stated element of consistency relates to the supposed reduction in the volume of legislation addressing specific situations, anomalies and avoidance opportunities. We accept that in some circumstances there will be reductions in the volume of legislation and this can selectively be applauded. It is also arguably unfair to compare the volume and complexity of the current system with the skeletal, untested TVM legislation. Also, it is often not the volume of legislation that is important - it is the way it is written. Improvements in this area require a significant mindset change by the drafters, and we are yet to see that in the recent drafts on the Consolidation measures, or Value Shifting measures.

(b) Alignment with accounting concepts

The Institute agrees with the statements at your launch of Prototype 4 of the legislative approach, given by your consultant drafters and the TVM legislation group, confirming that the OID/TVM approach would maintain a divergence between accounting and tax values in relation to assets.

OID/TVM will not see an alignment of accounting and tax calculations. They will differ for many reasons:

- a) Tax calculations have no notion of materiality as do financial statements.
- b) Tax values require different approaches, for reasons which include divergence of Government policy from ordinary accounting amortisation concepts. There are



many such divergences - even as simple an issue as prepayments involves a tax amortisation which differs from accounting acceptable treatments.

- c) Depreciation and amortisation rates on adjustable assets, intangibles etc. differ as between tax and accounting purposes.
- d) The very definitions of assets and liabilities for accounting and tax purposes differ, and it is significant that your drafters have not merely adopted accounting concepts in this area.

So it is clear that OID/TVM is not a means of delivering alignment between accounting and tax concepts. It is also clear to the Institute that the tax and accounting concepts will never be aligned perfectly. To do so would involve the Government losing control over management of its tax base.

The Institute is always supportive of measures for streamlined compliance. As you know we have been providing input to the Government and the Australian Taxation Office on a range of issues. We remain committed to streamlining the law and, wherever possible, a better alignment of accounting and tax concepts. We note for example that the UK is introducing amortisation of certain intangibles using accounting write-off rates.

But it clear that the OID/TVM proposal does not achieve an alignment of accounting and tax compliance or recording approaches. That cannot be used as support for OID/TVM.

(c) Length and Complexity

Supposedly under OID/TVM the length of the law would be reduced and much of the complexity would be removed, leading to greater certainty and transparency in the law so that business decisions could be made more reliably.

Once again, this purported benefit is not substantiated.

Certainly a substantial amount of the existing legislation could be removed, but as we have stated above, that simplification can be achieved under TOFA and CGT reform. But the replacement of the current ordinary income and deduction rules by the OID/TVM proposal sees legislation being replaced by other legislation, in many cases more complex and uncertain than what we have today.

This is already evident in the complex newly created definitions of assets and liabilities, rights and obligations, routine and non-routine rights and obligations and the issues of useful lives of intangible assets.

Many of the definitions and concepts contained in the OID/TVM prototype legislation are worded in "fuzzy" language, based on economic and/or accounting terminology. Economic and accounting concepts are not exact sciences and each relies on a substantial degree of judgement to fit the circumstances. The determination of market values of future economic benefits, for example, could lead to a high degree of uncertainty and potential litigation. This particularly applies in the area of both routine and non-routine rights and obligations. With a series of new definitions that



are untested by litigation, there is a very high risk that progressive development of case law will lead to a period of considerable uncertainty for practitioners.

Our testing of the OID/TVM compliance with practitioners has identified that a significant majority of practitioners concluded the OID/TVM concepts were less understandable than under the existing system. In any event, the OID/TVM does nothing at all in relation to the vast array of areas under the existing law which are not going to be amended by the OID/TVM, and which give rise to tax adjustments, such as foreign tax credits, the CFC and FIF regimes, the taxation of trusts, thin capitalisation, debt & equity definitions, R&D, partnerships of all types, etc.

There will also be added complexity due to the requirement to account for assets and liabilities that have not been accounted for, for tax purposes, up to now, such as rights, leases and obligations.

In an ongoing sense, practitioners who participated in the ICAA's testing trial of OID/TVM identified that they presently worked from their financial accounts for clients as a basis for preparing tax returns. The current system permits this. Under OID/TVM, this would not be possible because of the far wider definition of assets and liabilities. Effectively, accounting practitioners would have to recast financial accounts to arrive at an OID/TVM balance sheet that incorporates all the assets and liabilities that were not included in the financial accounts. This would undoubtedly involve additional compliance costs. Examples could include the value of intangible property rights, rights and leases.

The risk is that practitioners would start to use the tax balance sheet as the financial balance sheet, so that tax becomes the driver of accounting practices. This should be avoided at all costs.

If anything, the supposed benefit of reduced length and complexity would only be marginal.

(d) Simpler Law

The supposedly simpler law example that has been held up for some time as a prime example of the potential benefits of TVM is in relation to capital gains tax. We agree that TVM has the potential to deliver a dramatic improvement and removes the need to identify where there is a CGT Event.

Whilst the current law on capital gains tax is complex, those complexities do not in themselves justify a major change to the fundamentals of the tax system. The 1997 rewrite of the CGT provisions is generally well understood and accepted, but undeniably there are numerous issues that have not been adequately dealt with from an administrative and policy/legislative viewpoint. These are capable of resolution outside the framework of TVM.

If there is an area of CGT that is complex and unfair, it is in relation to the eligibility to the discount capital gains tax concessions and the small business CGT concessions, particularly where existing business structures do not permit access to the concessions.



that might automatically flow to individuals. Unfortunately, this problem will not be solved by the OID/TVM proposals for CGT, but will endure.

Yet the CGT provisions are but one of the myriad of provisions that make up the current law and would be in the proposed new law. The greater complexities in our existing law are contained in provisions such as:

- the trust rules in Divisions 6, 6AAA, 6AA, 6A, 6B, 6C and 6D;
- the controlled foreign corporation (“CFC”) rules in Part X;
- the foreign investment fund (“FIF”) rules in Part XI;
- the foreign tax credit provisions;
- the franking/imputation provisions;
- the various anti-avoidance provisions;
- the new personal services income provisions;
- the transfer pricing rules and regulations;
- the thin capitalisation rules

and the many other provisions that will not be affected by the proposed OID/TVM provisions. But they would – each and every one of them – need to be reviewed, altered and harmonised into OID/TVM notions.

The CFC and FIF provisions will be affected by the OID/TVM proposals, if introduced, and yet no one has demonstrated how those rules will have to be amended under an OID/TVM regime. Intuitively it is going to mean more complex law in order to calculate the attributable income under OID/TVM concepts (especially with regard to non-routine rights and obligations of CFCs), compared to the current provisions.

The OID/TVM rules would potentially require reassessing the income of overseas subsidiaries and investments into OID/TVM concepts – a major compliance overhead, which would follow a major commitment of legislative time and attention from the community and the professions to get the complex rules right.

In any event, where the OID/TVM rules may provide what appear to be simpler rules for capital gains tax, there are many other complex provisions being introduced at the same time. And here we particularly refer to the proposed treatment of rights, obligations and leases.

Additionally, we refer to the issue of the proposed restriction of CGT treatment to “investment assets”, which excludes many assets that were previously within the CGT net. In some cases, there will be carry-forward capital losses from assets that are now to be excluded from the definition of investment assets. Dealing with those carry-forward capital losses will add enormous complexities. The issue could easily be fixed, but we see no evidence of proposals to do so.

(e) A Platform for Future Changes

The supposed “sturdy platform” argument is not one that we can fully comment on. What does that really mean? Would the hybrid of a TVM plus the “old law” really be a better platform? Maybe it is an issue for parliamentary draftsmen to debate rather



than for accounting and tax practitioners. We fail to see that this can or will provide any benefit to such practitioners.

5 The Compliance Costs

The Board acknowledges that there will be additional compliance costs at the time of transition and has sought to determine whether there will be more or less compliance costs as a result of OID/TVM in the future. We recognise that this is an almost impossible task to determine.

Therefore the real question has to be whether the purported benefits of the OID/TVM can outweigh the additional transitional costs for taxpayers generally and the accounting and tax profession. This test should be applied across all potential stakeholders and not just in a global sense.

6 The Real Issue – Is the Economy-Wide Cost Justified by the Benefit?

In the view of the ICAA, the issue is whether the costs are outweighed by the benefits. We know that this is the approach of the Board, too. The magnitude of the TVM changes have been readily conceded by the Board, so it is not unreasonable to assume that the community would be faced with transitional costs of the same scale as the GST/BAS changes, and possibly larger. Does TVM promise the type of long-term benefits to the tax system to warrant a re-run of those costs? The ICAA remains unconvinced.

The Board clearly recognises the important role that accounting and tax practitioners would have to play in implementing this proposed new tax system. That is why the Board accepted the ICAA's proposal to field trial the OID/TVM system on a range of taxpayer clients and with a wide range of accountants in practice, right across Australia. The Board has received a copy of the ICAA's report of the results of the trial.

One of the questions we put to the practitioners was "Would introduction of TVM involve significant transitional costs – For your clients – For your practice?" A substantial majority believed there would be significant transitional costs for their clients. More importantly, 100% of the practitioners who participated in the trial considered there would be significant transitional costs for their practices.

The areas of most transitional costs identified were training of partners and staff, software costs, the potential for reworking clients' accounts and tax returns and retooling (texts, legislation, computers and paper). More significantly, accountants identified that the potential time it would take to undertake the necessary training, for partners and staff, would be prohibitive for most practices. Unlike GST, where GST was regarded as an adjunct to existing services, to be learned by some in the practice but not necessarily all, OID/TVM is seen as a new system that every one of the accounting staff in the practice offices would have to learn in detail.

Clearly, this would involve a major disruption to offices, clients and workloads, especially when such practices have had enormous additional compliance loads forced



upon them in recent years with income tax return lodgement timetables, BAS and IAS and FBT deadlines. The ATO specialist groups looking at compliance deadlines are now conceding that the old compliance models are not working and need to change. Too much is being asked of the dwindling pool of accountants prepared to do this work, and university graduates are not attracted to specialisations that involve this sort of tedious work.

In that climate, and based on past experience, we can only envisage that major disruption, costs and further severe strains would result from the introduction of OID/TVM. The workload frustrations would fall on the practitioners and the costs on the community but, as with GST, we fear that it would be unlikely that the practitioners would be able to recover such transitional costs from their small and medium sized business clients.

If TVM were to be implemented, the ICAA would be looking to the Government to provide a satisfactory level of compensation to practitioners and the community to cover these very real costs. The government cannot expect the community to meet the costs of these major measures that offer no identifiable contrasting benefit in the foreseeable future.

We should not forget that since OID/TVM would apply to all taxpayers, including individuals (many of whom will be preparing their own tax returns), a totally adequate education program would be very difficult to roll out. To suggest that the return forms and guides will do the job is specious as that has not been the past experience.

7 Conclusions

The Board's Overview and Information Paper documents ask for those making submissions to address one or more of several questions.

We feel that many of the above comments indirectly address most of the specific questions, but the following comments are directed at the specific questions:

1. Do you consider there is a need to address the complexity, inconsistencies and volume of Australia's current income tax legislation and related materials?

And

2. Does the TVM concept have the potential to deliver the improvements needed in Australia's present income tax system?

It is appropriate to answer these two questions together.

Clearly, our answer to this first question is an unequivocal yes. That is why the ICAA has so actively participated in the Government's tax reform program since before the introduction of the ANTS document and the Ralph Review of Business Taxation.

And, as stated above, we support the streamlining of the tax law, in an open and consultative manner, to deal with such issues as:



- Resolution of non-deductible black hole expenditure;
- Development of a system for taxation of financial arrangements;
- Exploring the potential for a major streamlining exercise of the current highly complex CGT law;
- Introducing a mechanism whereby contractual rights (such as franchise rights paid to franchisers, rights paid to Government bodies for access to particular concessions) have some coherent amortisation process – such as was developed decades ago in relation to the minerals industry.

Do we consider that the OID/TVM is the way to address these issues? The answer has to be no.

The OID/TVM would seek to rework approximately 40% of the existing tax legislation. The major complexities, we believe, are in the remaining 60% of the legislation.

The OID/TVM proposals could, in some limited areas, remove some of the complexities and inconsistencies, but would replace those complexities with others, as set out in the above comments.

The greatest issue we have with the existing law is the lack of adequate care and maintenance – the very reason we are now looking for a fix and alternatives. There has simply been too little willingness by successive Governments, Treasury or the ATO to amend bad law. Who is to say that OID/TVM would not also fall into disrepair as its unintended consequences are left unfixed and the ATO has to “manage its way out of the mess”. When parliament can demonstrate its desire to constantly review and fix bad law without regard to who benefits, except to make the change retroactive where taxpayers have been disadvantaged, then we will get the kind of rigour in the law that we have not had for some decades.

Whilst the current trend in consultation is positive, there is no process that can guarantee perfect law, so amendments will need to be made.

3. What specific benefits or costs, including transitional costs, might the TVM have on taxpayers or tax practitioners, or both?

We consider that most smaller businesses will have their tax returns prepared by their tax accountants, so most of those smaller businesses will mainly incur additional compliance costs as a result of increases in charges sought to be billed by the accountants. The increases in accountants' charges will be a reflection of the additional costs they will have to bear. However, it is intuitively expected that many smaller businesses would have to amend the way in which they prepare information to give to their accountants, especially in relation to new contracts and agreements, which could incur additional ongoing costs.

For accountants in practice, the training costs are expected to be substantial. This extends to the external costs of training courses as well as the opportunity cost of time spent in external and internal seminars and workshops. For an accounting firm,



training would have to be given to all professional and semi-professional staff and partners.

In addition, it is expected that accountants would have to incur additional software costs and retooling costs.

The cost of reworking clients' accounts and tax returns following such a change is expected to be substantial as well.

Practitioners who participated in the trial exercise also identified the cost of the ATO interface to be a potentially large compliance cost area. This issue relates to attempts to obtain information from the ATO where (as happens at the moment) practitioners can be left on the telephone for considerable time periods waiting to get answers to their tax problems.

Some practitioners also identified the cost of replacing staff or retiring staff members who could not handle the change, or who choose to retire, as being costs of the transition that would be incurred.

In the year of transition, it is expected that many practitioners would also incur additional costs of obtaining specialist tax advice to solve ongoing problems that were not dealt with in formal training sessions.

In an ongoing sense, practitioners identified that they presently worked from their financial accounts for clients as a basis for preparing tax returns. The current system permits this. Under OID/TVM, this would not be possible because of the far wider definition of assets and liabilities under OID/TVM. Effectively, accounting practitioners would have to recast financial accounts to arrive at an OID/TVM balance sheet that incorporates all the assets and liabilities that were not included in the financial accounts. This would undoubtedly involve additional compliance costs.

4. Are there areas in the prototype legislation that would require adjustment to ensure consistent outcomes with the current law (apart from those areas where other policy initiatives propose variations to the existing law)?

We have not identified any such issues, other than some outstanding issues discussed within the Working Group.

5. What would be the most efficient method and most appropriate timeline, if the TVM were to be implemented?

The ICAA supports continued and focused consultation on developing:

- Resolution of non-deductible black hole expenditure;
- Development of a system for taxation of financial arrangements;
- Exploring the potential for streamlining massively the current highly complex CGT law;
- Introducing a mechanism whereby contractual rights (such as franchise rights paid to franchisers, rights paid to Government bodies for access to particular



concessions) have some coherent amortisation process – such as was developed decades ago in relation to the minerals industry.

Turning to the OID/TVM, if it were to be implemented, then the proposed date of 1 July 2003 should be abandoned forthwith. The implementation date should be deferred for at least a further 5 years. It has taken at least 2 years to get to where we are today with OID/TVM and we are aware of enormous issues that have not yet been commenced, in order for those issues to be integrated with OID/TVM, such as international (transfer pricing, CFC and FIF) issues, tax treaty issues, superannuation and the finalisation of TOFA.

Before OID/TVM could be implemented, there would have to be considerable testing of all possible situations to ensure a minimum of disruption and to ensure it achieves what it is supposed to achieve.

There would have to be introduced a variety of measures to minimise the compliance aspects of OID/TVM, including consideration of who would pay for the real costs of education and training, how to deal with uncertain issues such as the useful life of renewable intangible property rights, are there benefits at all for practitioners that outweigh the compliance costs and how to measure the assumption values of liabilities.

Also in that period, it would be incumbent upon the Government to fully “sell” the supposed net benefits of the OID/TVM package to taxpayers and to tax practitioners in particular.

An adequate period for training would also have to be given, so that tax practitioners were fully up to speed well before commencement.

In our opinion, this timetable would take at least a further 5 years, with full commitment from all sides.

However, we are very concerned that there would not be full and adequate commitment and resourcing through this period. There are other more important tax issues to which the Government has committed itself in coming years, including the international tax review. Additionally, there are other policy issues that should be implemented immediately, without waiting for OID/TVM, such as adequate relief for black hole expenditures, merging the two separate income tax Acts and other positive initiatives that have emerged from the OID/TVM consultative process (eg, conformity of cost rules and disposal rules). There are numerous outstanding legislative and policy issues in relation to CGT as well. These issues need to be advanced rather than deferred until the OID/TVM is ever introduced.

We are therefore of the view that a further period of between 5 and 10 years is the minimum before OID/TVM should even be contemplated to be introduced into the Australian tax system.

6. Overall Conclusions



The consultative process on OID/TVM we have all been involved in, and the results of our survey of members participating in a trial evaluation of OID/TVM in practice, clearly showed that there is no evidence for unequivocal support for OID/TVM. This is particularly so in relation to the case for "implementation without further evaluation".

At the very best, there is the suggestion that once the transitional costs associated with the change and uncertainty are overcome, there may be some long term benefits overall, but this case can only be substantiated by further development and testing work.

The case for carrying out further work has to be evaluated against the immediate needs for solutions to existing problems in the current legislation. In our opinion, further work on OID/TVM can only be justified if adequate resources also exist to be applied to address the more pressing, immediate problems. Equally, we must be assured that there is sufficient evidence that there are still opportunities for the OID/TVM to make the reform breakthroughs that the critics of the current system are seeking. If a decision is made to recommend further development of OID/TVM as a medium term (5 years) objective, then this should only take place if the Government and the ATO fundamentally commit to ensuring that adequate resources are devoted to the critical reform areas that require attention right now. The worst outcome would be for the OID/TVM project to get the lion's share of resources while other, more pressing, projects are "starved". If the Government is not prepared to commit this level of resources, then work on OID/TVM should cease forthwith.

Our testing trial of the OID/TVM system with our Chartered Accountants in practice, together with the results of the surveys with those practitioners, has shown us that there is virtually no support for immediate introduction of the OID/TVM. In isolation, there is less than 50% support from those practitioners for a deferred implementation of between 3 and 10 years. More than 50% have indicated their preference for all further work on OID/TVM to be abandoned immediately. Given that further work would take many years and significant cost on the part of all involved, we have to ask whether it is even worth considering further development when the resources would probably be better spent on fixing other more pressing problems with the current legislation.

The ICAA supports continued and focused consultation on developing:

- Resolution of non-deductible black hole expenditure;
- Development of a system for taxation of financial arrangements;
- Exploring the potential for streamlining massively the current highly complex CGT law;
- Introducing a mechanism whereby contractual rights (such as franchise rights paid to franchisers, rights paid to Government bodies for access to particular concessions) have some coherent amortisation process – such as was developed decades ago in relation to the minerals industry.

These issues are of much greater significance to the development of Australia than the OID/TVM.



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Even without competing issues and the resourcing issue, on our evaluation of the pros and cons of OID/TVM, there seems a good case for not supporting any further development of OID/TVM. But once we also consider the competing issues to be dealt with, and the lack of adequate resources to deal with all these issues in the medium term, and also the general tax-reform fatigue in the community, the ICAA recommends that all further work on OID/TVM cease forthwith, and that the Government instead implement a program with similar resources and disciplines, to address the problems with the current law.