

**COMMENTS ON ISSUES RAISED IN YURI GRBICH'S PAPER
PRESENTED AT TAX BOARD/ATAX CONFERENCE OF 23-24
JULY 2001**

BY

BOARD OF TAXATION'S TVM LEGISLATIVE GROUP

STATUS OF THE REJOINDER

1. This rejoinder reflects the proposed TVM legislation as developed to July 2001. Readers should note that the legislation is still under development.
2. The rejoinder has not been endorsed by the Treasurer or any other Minister, nor does it reflect the official views of the Treasury, the Australian Taxation Office, the Office of the Parliamentary Counsel or the Board of Taxation.
3. Comments on the rejoinder and/or the paper which it addresses are welcome. Comments in writing should be addressed to:

The Board of Taxation
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4. Alternatively, comments can be e-mailed to the Board of Taxation Secretariat at taxboard@treasury.gov.au.

1. Grbich, Y.; ‘Tax Value Method – The Problem, The Proposed Solution and the Outstanding Issues’

Overview

- 1.1 Professor Grbich makes a number of observations in his paper about the fundamental policy that should underlie the recognition of income and expenses in our income tax system. Many of the views he expresses are contrary to the policy that underlies our existing income tax law and TVM. As such, most of the issues he points out in his paper go to his views about a reshaping of the income tax system as we currently understand it.
- 1.2 While it is not our place to comment on the appropriateness of such fundamental policy, it is worth setting out the main underlying principle that is guiding our drafting of the TVM draft legislation in this area. In broad terms this is as follows.

Tax recognition of expenditure

- 1.3 The policy being applied in this area is that tax relief for non-private expenditure should be afforded when the economic benefits the expenditure brings are received or consumed by the taxpayer.¹ The benefits we are talking about here are not necessarily income generated by the expenditure, although sometimes that is the case,² but rather the direct benefits the taxpayer acquires from the expenditure.
- 1.4 So, for example, the future benefits from expenditure on plant are consumed as the plant is used in the manufacturing process, even though income from the goods produced may not be seen for some time.
- 1.5 Similarly, the economic benefits from expenditure on a right to services are consumed when the services are received even though the services may be an input into the business that does not generate income immediately. The question is always whether that expenditure itself should form part of the cost of another asset to which the services may have contributed.
- 1.6 This basic policy is always subject to compromise for policy reasons, as pointed out by Professor Grbich in his paper and by the RBT.³ So, for example, immediate tax relief is given for expenditure on mining exploration even though the benefits the expenditure brings may not be realised for some time.⁴
- 1.7 The policy outlined above can also be seen in the current income tax law in the way expenditure is recognised under, for example, the general deduction rule (section 8-1 of

¹ *A Tax System Redesigned*, p. 157.

² Most notably with financial assets where the future benefits of expenditure are cash flow that is income.

³ *A Tax System Redesigned*, pp. 157-158.

⁴ See subsection 6-40(3) of TVM Prototype 2.

the 1997 Act), the trading stock rules, the prepayment rules, the capital allowance rules and the CGT rules.

- 1.8 Professor Grbich seems to suggest in his paper that tax relief for expenditure should be afforded only to the extent that it is recouped from cashflow attributable to that same expenditure in the relevant year.⁵ The paper suggests that such a principle exists in the current law (in section 8-1), or at least has the potential to exist there. But its proposition⁶ that section 8-1 ‘requires [temporal] matching of an outgoing to the income it is spent to generate’ seems untenable, at least as a general proposition.⁷ For these reasons, we do not agree with the paper on this point.

Tax recognition of income

- 1.9 Because a key feature of TVM is a symmetrical treatment of income and expenses, the main policy being applied here is that income should be recognised for tax purposes when the future economic benefits that generate the income are provided. So, the mere fact that you receive cash is not enough. If the cash is in return for you promising to do something in the future, the cash should only be recognised when you do those things, or at least when your liability to do them ceases to exist.
- 1.10 This basic principle can be seen in the existing law in the ‘derived’ concept. The classic example comes from the *Arthur Murray* case.⁸ But the paper expresses distaste for the outcome of that case⁹ on the basis that the taxpayer receiving the cash has use of the money. But, of course, the fact that cash has been received ‘up front’ will be recognised in the income that the taxpayer will be able to generate using the cash (in the most obvious case the interest the taxpayer earns if the cash is put in the bank).
- 1.11 As with his concerns with the treatment of expenditure, Professor Grbich’s concerns here seem to be associated with how the existing law recognises income rather than TVM *per se*.

⁵ Professor Yuri Grbich, ‘Tax Value Method – The Problem, The Proposed Solution and the Outstanding Issues’, p.15.

⁶ *Ibid*, p. 7.

⁷ See *Tooheys Ltd & Sydney Ferries Ltd v C of T (NSW)* (1922) 22 NSW SR 432; *Moffatt v Webb* (1912) 16 CLR 120; *AGC (Advances) Ltd v. FC of T* 75 ATC 4057; *C of T (NSW) v Ash* (1938) 61 CLR 263; *Amalgamated Zinc (de Bavay's) Ltd v. FC of T* (1935) 54 CLR 295; *Ronpibon Tin NL and Tongkah Compound NL v FC of T* (1949) 78 CLR 47; *FC of T v. Finn* (1961) 106 CLR 60; and *Fletcher & Ors v FC of T* 91 ATC 4950; 22 ATR 613. (See also, *Taxation Ruling* TR 94/26, paragraphs 16 and 39).

⁸ *Arthur Murray (NSW) Pty Ltd v FC of T* (1965) 114 CLR 314

⁹ Grbich, *op cit*, p. 2.