October 2001

The Tax Value Method (TVM)

Why make the change?

(Attachments)

This paper has been prepared by the TVM Legislation Group and the ATO TVM project team. The paper reflects development of TVM to September 2001. It has not been endorsed by the Government, Board of Taxation, Treasury or ATO.

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Attachment A

Myer Emporium Case

What this tells us about TVM

- The many, often overlapping and inconsistent, mechanisms that can apply to a single transaction under the current law would be replaced by a single mechanism under TVM
- The time and money spent in understanding, explaining and disputing the current law will be less under TVM
- The single, integral approach to treating transactions under TVM may well reduce the effort devoted to tax minimisation under the current law

Facts

1. Myer Emporium entered into 2 transactions in March 1981. The point to the arrangement was to borrow $45 million to finance a group reorganisation but to do so in the most tax effective way.

6 March 1981

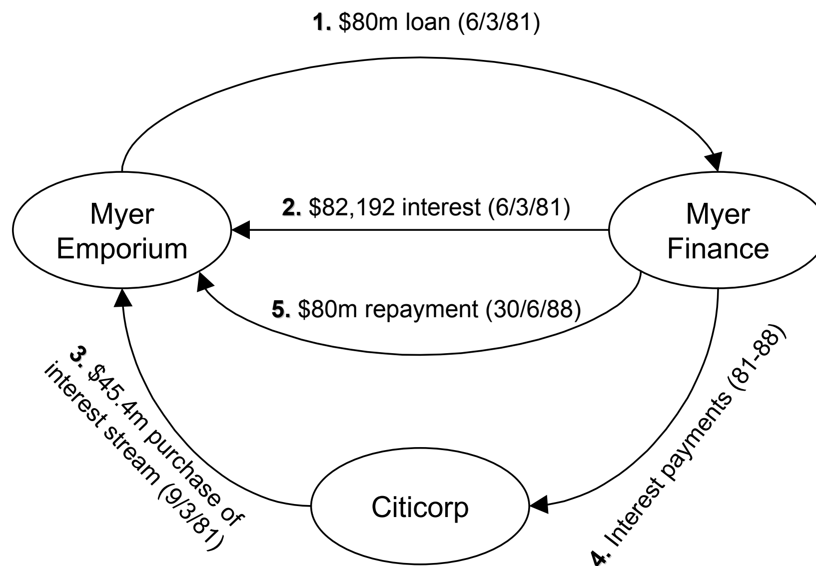
2. It lent $80 million to its subsidiary, Myer Finance, repayable on 30 June 1988, at an interest rate of 12.5%pa.

3. On the same day, Myer Finance paid $82,192 to Myer Emporium as interest for the first 3 days of the loan.

9 March 1981

4. Myer Emporium assigned its right to interest under the loan to Citicorp Canberra for $45.37 million payable immediately. It notified Myer Finance of the assignment and all future interest was paid directly to Citicorp.

5. The transactions can be mapped like this:



Outcome under current law

6. Myer hoped to benefit from this arrangement by converting the interest stream that it would receive over the term of the loan into an immediate capital receipt (this was pre-CGT). The tax-free capital receipt would have been more than the total after tax interest receipts and would be immediate rather than spread over time.

7. Myer won at first instance and on appeal to the Full Federal Court. The High Court, however, upheld the Commissioner's appeal, rejecting the claim that the $45 million lump sum was capital. In its view, the receipt was income; a revenue profit made on the transaction.

Outcome under TVM

8. When Myer Emporium entered into the loan with Myer Finance, Myer Emporium would begin holding a financial asset, consisting of a right to repayment of the $80 million principal in 1988 and a right to interest over the course of the loan. When it entered into the agreement to assign the right to interest to Citicorp, TVM would split the financial asset into the right to the principal that Myer Emporium retained and the right to interest that it transferred. The split would be done by apportioning the tax value of the original financial asset between the two new assets in accordance with their relative market values.

9. TVM would bring to account the lump sum Myer Emporium received for the transfer but over the period of the loan rather than immediately. It does that by balancing the receipt with a decline in the value of the assets it holds. In accordance with the RBT recommendations on financial arrangements, the tax value of the remaining right to repayment of the principal would rise gradually towards the face value of the principal sum, effectively bringing the gain to account over that time.[1]

[1] This proposal implements an economic point that the High Court noted in the *Myer* judgment (87 ATC 4363 at p.4371):

"If economic equivalence were the appropriate accounting basis, the debt would be brought to account at the beginning of the period in an amount less than the amount of the money lent and

10. The transactions would look like this:

Date	Receipts – Payments		Closing tax value of assets – Opening tax value of assets		Closing tax value of liabilities – Opening tax value of liabilities		
06/3/81	0.1m[2]-80.0m[3]		79.9m[5]-0		0-0		0
09/3/81	45.4m[4]-0		31.3m[6]-79.9m		0-0		-3.2m
30/6/81	0-0		32.6m[7]-31.3m		0-0		1.3m
	45.5m-80.0m	+	32.6m-0	-	0-0	=	-2.0m
30/6/82	0-0	+	37.0m-32.6m	-	0-0	=	4.5m
30/6/83	0-0	+	42.1m-37.0m	-	0-0	=	5.1m
30/6/84	0-0	+	47.9m-42.1m	-	0-0	=	5.8m
30/6/85	0-0	+	54.4m-47.9m	-	0-0	=	6.6m
30/6/86	0-0	+	61.9m-54.4m	-	0-0	=	7.4m
30/6/87	0-0	+	70.3m-61.9m	-	0-0	=	8.5m

would increase day by day until it equalled the amount of the money lent when the period expired."

2 This is the $82,192 interest received on that day.

3 This is the $80m lent to Myer Finance.

4 This is the amount received from Citicorp for transferring the right to interest on the loan.

5 This is the tax value on 6 March 1981 of the rights to principal and the remaining interest.

6 This is the tax value on 9 March 1981 of the right to repayment of the principal. It is a proportionate share of the original financial asset's tax value at the date of transfer. The rest of the original financial asset's tax value is attributed to the right transferred. It is no longer an asset held by Myer Emporium.

7 This is the tax value on 30 June 1981 of the right to repayment of the principal. It has increased since the transfer on 9 March and will continue to increase as the time for repayment gets closer.

30/6/88 [80.0m[8]-0] + [0[9]-70.3m] - [0-0] = 9.7m

11. The key observation here is that the $45.4 million gain is brought to account, not on receipt, but over the period of the loan to which it relates.[10] In conjunction with the RBT recommendations on financial arrangements, TVM makes it possible to recognise financial gains on an appropriate economic basis.

Alternative treatments of Myer arrangement under the current law

12. The $45.4 million would be brought to account under the current law as ordinary income in accordance with the High Court's decision in the *Myer Emporium* case. However, there are also a significant number of other provisions in the law that could also apply to the Myer arrangement. This part of the paper examines some of them.

Profit-making plans

13. The first of these is section 15-15 of the 1997 Act. This provision assesses profits made from the carrying out of profit-making undertakings or plans. We know this applies to Myer arrangements because the High Court held in the Myer case that its predecessor (paragraph 26(a) of the 1936 Act) applied as an alternative to the ordinary income provisions. However, the scope of the provision was limited by the TLIP rewrite. Today it would only apply to any part of the profit that was not ordinary income and, even then, only if the right to the income was acquired by the transferor before 20 September 1985 (the operative date for CGT purposes).

Capital gains

14. And that brings us to the next provision - the capital gains regime. The original financial asset is probably a 'CGT asset' (within section 108-5 of the 1997 Act) that was split into 2 assets – the right to repayment of the principal and the right to interest – on 9 March. An alternative possibility is that it was always 2 CGT assets. The difference between the 2 possibilities is probably minimal. One caveat is that, if there were always two assets, it is possible to argue that the cost base of the right to interest was nil because the $80 million Myer Emporium lent to Myer Finance was fully devoted to the right to have that money repaid.

15. If it was a single CGT asset split into 2, its cost base must be divided between the 2 new assets in a reasonable way (subsection 112-25(3) of the 1997 Act). The most reasonable way is probably in accordance with their relative market values in this case. The cost base of the right to repayment of the principal would become $31.3 million and that of the right to interest would be $48.6 million.

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8 This is the $80m received when Myer Finance repays the loan.

9 There is no longer any right to either principal or interest.

10 Over that same period, Myer Finance would have been paying about $72.6 million in interest to Citicorp so that, overall, the Myer group would record a tax loss on the transaction.

16. When the right to interest was assigned to Citicorp, the capital gain or loss would be worked out:

- If the right to interest had no cost base, the capital gain would equal the full $45.4 million received. That amount would be included in the net capital gain that forms part of assessable income (section 102-5 of the 1997 Act) as an instance of CGT event A1 (section 104-10 of the 1997 Act).11

- However, if the cost base was $48.6 million, there would instead be a capital loss of $3.2 million. This would be counter balanced by the later gain on the discharge of the right to repayment of the principal as an instance of CGT event C2 (section 104-25 of the 1997 Act). That later gain would be $48.7 million.

17. The double counting rule in section 118-20 of the 1997 Act could apply when a CGT gain was made. That rule is designed to prevent an amount being included in a net capital gain to the extent that it was elsewhere included in assessable income. Whether it applies in this case is not obvious. The amount included in assessable income under the *Myer* decision was a different amount than that received for discharging the right to repayment of the principal. Since the CGT gain is worked out on a different event, it is likely that the double counting rule is not applicable. The Commissioner tends to take a tolerant view in these cases but, technically, that means that the gain could be assessed twice.

Alienation rules

18. The income tax law has had an anti-alienation rule in section 102B of the 1936 Act for almost 40 years. That rules applies the income tax law as if a short-term transfer of income rights had not occurred. In essence, it works to assess the transferor on the income that flows from those rights. Arguably, this provision could apply to Myer-type arrangements but there are 2 reasons why it wouldn't have applied to Myer itself.

19. First, 'short-term' means less than 7 years (subsection 102A(1) of the 1936 Act, definition of 'prescribed date') and the Myer loan was for over 7 years. The rule in 102B extends to cases where the term "may" be less than 7 years but there is nothing in the facts of Myer to indicate the possibility of a truncated loan term (indeed, the contract expressed the opposite intention).

20. Second, section 102B does not apply if the transfer was for an at least arm's length consideration (paragraph 102B(2)(c) of the 1936 Act). No doubt we could debate whether or not the $45.4 million was an arm's length consideration but it seems likely that it was, more or less.

21. On the day after the Commissioner's loss in the Federal Court (his appeal from which was ultimately successful), the Government announced remedial legislation backdated to that day. That legislation was section 102CA of the 1936 Act. In essence, it applies where 102B doesn't. When it applies, it includes the consideration for the transfer of a right to income in the transferor's assessable income. This provision would operate to include the $45.4 million in Myer's assessable income when the transfer occurred.

[11] Even if Myer Emporium had been an individual or a superannuation trust, there would not be a CGT discount because the right had not been held for at least 12 months.

22. There are some issues that can complicate the operation of section 102CA. For instance, it will not always be clear:

- what was the consideration for the transfer (e.g. if the transfer was in satisfaction of an option it is not clear if the price paid for the option is counted in the consideration); or
- when the transfer occurred.

Stripped securities

23. Section 159GZ of the 1936 Act operates to treat a security as always having been multiple securities for the purposes of Division 16E when some of the rights under the original security are transferred. A loan is a 'security' (see subsection 159GP(1) of the 1936 Act), so it seems clear that Division 16E could apply to a *Myer* arrangement.

24. Section 159GZ would divide the $80 million that Myer Emporium paid for the original security between the two securities that section 159GZ deems to have been issued, in proportion to their original market values. The issue price for the right to repayment of the $80 million ('the principal security') would become $31.3 million and the issue price for the interest stream ('the interest security') would be $48.7 million.

25. Division 16E would then assess the $48.7 million 'gain' on the principal security on an accruals basis over the term of the loan.

26. There is a doubt about how the law would treat the interest security. Because the amounts due under it seem to be periodic interest, the interest security may not be a 'qualifying security' (see subsections 159GP(1), (3) and (6) of the 1936 Act) and therefore, may not come within the double counting rule in section 159GR of the 1936 Act.

27. If that is correct, the $45.4 million lump sum received for assigning the interest security might still be assessable as ordinary income under the *Myer* decision even though $48.7 million was assessed under Division 16E as a gain under the principal security.

28. There is a possibility that the interest security is a 'traditional security' so that any loss on its assignment would give rise to a deduction under section 70B of the 1936 Act. It would first have to be a 'security', of course. The term has the same meaning in section 70B as it has in Division 16E. Although it doesn't seem to meet the Division 16E definition (see subsection 159GP(1) of the 1936 Act), it is arguable that, when section 159GZ deems the interest security to be a security 'for the purposes of the application of [Division 16E]', it also does so for the purposes of section 70B.

29. Even if it is therefore a traditional security, there still needs to be a loss to deduct. Unlike section 159GZ, section 70B contains no rules for working out the cost of this security, so any loss must be discernible on ordinary principles. There is an argument that the cost of the interest security is the same $48.7 million under ordinary principles that section 159GZ would produce. If that is correct, section 70B would allow a deduction for a $3.2 million loss.

Anti-avoidance measures

30. Finally, given that there were some scheme elements in the Myer circumstances, the possibility of the general anti-avoidance provision applying can't be ruled out. The

Commissioner had argued unsuccessfully that section 260 of the 1936 Act applied but didn't take that issue to the High Court so we can't know whether the argument might have succeeded.

31. It seems clearer that Part IVA of the 1997 Act could apply today. Had Myer been successful in its primary arguments, there would have been a 'scheme' (section 177A of the 1936 Act) and a 'tax benefit'; viz. the exclusion of an amount of interest that would have been assessable income but for the scheme (subsection 177C(1) of the 1936 Act). The issue would be whether Myer entered into the scheme for a purpose of obtaining that tax benefit (section 177D of the 1936 Act). Taking into account the factors listed in that section, there is a respectable argument that Part IVA would apply.

32. If Part IVA did apply, the Commissioner could determine that the amount that wasn't included in assessable income because of the scheme should be included (subsection 177F(1) of the 1936 Act). Presumably, the effect of that determination would be to include the amounts of interest due over the course of the loan in Myer's assessable income of the relevant years. The amount assessed ($72.6 million) would have been greater than the $45.4m lump sum but spread over the 8 income years of the loan.

TVM effect on legislative treatments

33. Because TVM brings all receipts to account, special regimes aren't necessary to do the job:

- There is no 'ordinary income', so the point of the Myer Emporium case would be irrelevant. Is there a receipt? If yes, bring it to account.
- The profit-making plans provision is only residual in the current law and would also have no place in the TVM system. The point of that provision was to assess receipts that were not ordinary income and, as already noted, that distinction is not relevant under TVM.
- Under TVM, the capital gains regime serves only to provide a concessional treatment in the hands of individuals and superannuation funds for some types of gain and to quarantine some types of loss. There is no need for it to perform the role of a backup in case the main assessing provisions don't apply. TVM draws into the tax net everything that CGT would.
- The alienation rules in section 102CA of the 1936 Act will not be needed. The consideration would be brought to account like any other receipt. Arguably, the short-term alienation rules in section 102B might still be necessary to prevent high taxed entities gifting income earning property to low taxed ones. Its scope might be more limited because of the rules about contributions of capital and arm's length dealings.
- The accruals regime, and the special stripped securities rules, in Division 16E of the 1936 Act would no longer be necessary, nor would the rules for losses on traditional securities in section 70B. The TVM rules about the tax value of financial assets would ensure that there was an economically acceptable treatment without need for special rules.

- The general anti-avoidance rule would still exist to counter tax avoidance arrangements. However, it would have no role in the Myer arrangement because the $45.4m would have been brought to account as a receipt.

34. Replacing all of these regimes with one standard treatment of gains and losses means that the tax effect of this (or any other) transaction would be much easier to work out. There are no overlaps and therefore no need for rules to cope with them. There are no differences in what triggers assessment. There are no differences in when an amount is assessed. There are no differences in what amount is assessed.

What would have happened under TVM?

35. The Myer litigation involved the considerable, and considerably expensive, time of three different courts and 9 different judges on what was essentially a trivial matter. Had Myer entered into its arrangement under TVM, there would have been no litigation. As now, Myer would know that the interest it received on its loan to Myer Finance would have to be brought to account. But, unlike now, it would also know that the $45.4 million it got for selling its right to that interest would have to be brought to account as well because it would know that TVM brings *all* receipts to account. There would have been no argument about whether the receipt was income or capital in nature – the distinction would be irrelevant. It would also know that, just like the interest it replaced, the $45.4 million would be brought to account over the period of the loan. The $45.4 million receipt would be matched initially by a decline in the tax value of its rights under the loan but, over time, the tax value of the remaining right to repayment of the principal would increase towards the full $80 million value. Those increases, representing the gain, would be accounted for as they arose.

36. Perhaps the most important consequence had TVM been in place is that Myer Emporium would never have entered into the transaction in the first place. The point to the arrangement was to borrow $45 million to finance a group reorganisation but to do so in the most tax effective way. The arrangement was sold to the Myer group on this basis.[12] If the law had clearly treated economically identical arrangements in identical ways, there would have been no incentive for the group to choose a more complicated form over the simpler straight loan. One of the more obscure, but nonetheless important, benefits of TVM may well be that less effort will be put into tax minimisation.

[12] See 87 ATC 4363 at p.4365.

Attachment B

Metal Manufactures case — sale and lease-back

What this tells us about TVM

The current law treats many transactions according to their legal form rather than their economic substance. For instance, the current law does not recognise sale and lease-back transactions according to their economic effect, which is that of finance. This example is illustrative of a wider systemic problem that has meant that, in a number of cases, the current law:

- recognises losses that will never occur; and
- has been amended in an *ad hoc* fashion to remedy these defects.

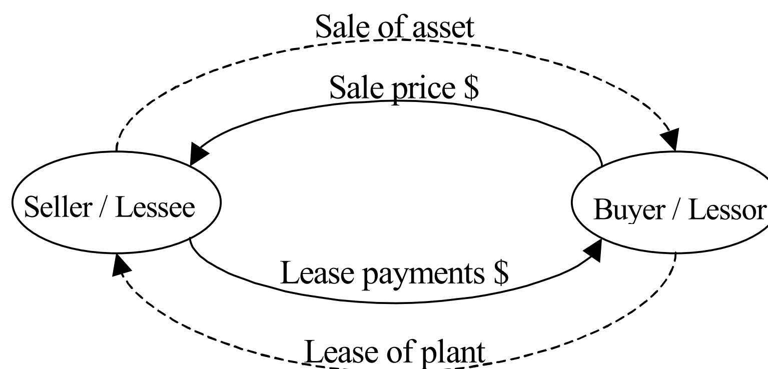
In contrast, it can be seen from the following example that the TVM platform for the TOFA rules better accords the tax treatment of transactions with their economic substance. This means that TVM:

- is more ***robust*** — as only actual gains and losses recognised; and
- is more ***durable*** — as it will not be in need of correction.

What is a 'sale and lease-back'?

1. A 'sale and lease-back' occurs when an asset owned and used by one entity is sold but the asset continues to be used by that entity as lessee. Sometimes, at the end of the lease the asset is sold back to the original owner.

2. The transactions can be mapped like this:



What is the economic substance of a sale and lease-back?

3. Sale and lease-back arrangements have the economic effect of providing finance to the original owner of the asset (who becomes the lessee). For this reason these transactions fall into a wider class of arrangements known commercially as 'asset-based finance'.

4. In a sale and lease-back the lessee receives a sum, and in return has an obligation to make regular lease payments to the lessor. For the term of the arrangement the lessee retains the use and enjoyment of the asset and commonly has either the right, or the practical opportunity, to repurchase the asset at the end of the lease.

5. In other words, the lessee receives the benefit of a lump sum that they will effectively repay (with interest) over a period of time. There is no change in the underlying beneficial user of the asset as the original owner continues to use the asset and is reasonably assured to become the owner again at the end of the lease.

6. In these transactions, an important tax issue is what part of the lessee's payments is deductible? The entire amount or only the notional interest component?

How does the current law treat sale and lease-back? *Metal Manufactures* case[13]

7. In April 1988, Metal Manufactures Ltd entered into arrangements with the State Bank of New South Wales to sell plant and equipment to them and lease it back.[14]

8. The initial agreement was for Metal Manufactures to receive a total of $50 million for the sale and lease the plant back for 5 years, making half-yearly lease payments of $5.265 million. Although Metal Manufactures had no *right* to reacquire the asset the effect of the agreement was to reasonably assure them that they would repurchase it at the agreed residual value of $18.75 million at the expiry of the lease. The agreement was subsequently re-financed twice.[15]

9. For the years of income ending 31 December 1988 to 31 December 1995 inclusive[16], Metal Manufactures claimed deductions for the lease payments under section 51(1) of the ITAA 1936. The Commissioner did not accept that there was a valid sale of plant and disallowed all amounts, but before the Court at first instance the Commissioner conceded that the interest component would be allowable subject to evidence.

10. The availability of balancing charge rollovers meant that there was no significant tax effect for Metal Manufactures as a result of the sale of the plant and equipment.

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[13] *F C of T v Metal Manufactures Ltd* (2001) 2001 ATC 4152.

[14] The arrangement was substantially the same in *Eastern Nitrogen v F C of T* (2001) 2001 ATC 4164, which was heard on appeal in conjunction with *Metal Manufactures*.

[15] At the end of that initial period, the lease was renewed for a further 5 years, with half yearly lease payments of $1.667 million and a residual value at the end being $7.03 million.
At the end of that period, the lease was again renewed with the new half-yearly lease payments of $599,117 and a residual value being $2.64 million.

[16] In lieu of 30 June 1989 to 30 June 1996.

What amount is deductible to the lessee?

11. The Commissioner submitted that the arrangement should be characterised as a loan. His argument was that the payments were in substance the making of a loan to the taxpayer of $50 million and the repayments of that loan together with interest and a balloon payment at the termination of that period. The payments were therefore to be deductible only to the extent that they represented interest.

12. The Court at first instance rejected the Commissioner's submission that the arrangement had all the characteristics of a loan and that the lease payments were partly capital.[17] The lease payments made by the taxpayer were, therefore, fully deductible.

13. The Commissioner appealed to the Full Federal Court, contending that the lease payments to the Bank were (at least partly) of a capital nature.

14. The Full Federal Court dismissed the appeal. Although it acknowledged that the arrangement was of the nature of finance, it followed the reasoning of the Court at first instance in not accepting that the transaction should be characterised as a loan. Therefore, the lease payments made by the taxpayer were fully deductible.

15. That is, despite reasoning along the lines of above, the Court found no basis for characterising the payments as other than to secure the right to use the plant under the lease. The Commissioner has sought special leave to appeal from this decision.

How does the current law treat a sale and lease-back with a right to reacquire? Hire purchase — Division 240 of the ITAA 1997

16. Sale and lease-back arrangements that include an option or other right for the lessee to acquire the asset will be treated as hire purchase arrangements. This is in contrast with the situation in *Metal Manufactures*, where the agreement gave the lessee no such right or option. That case demonstrates the operation of the current law distorts commercial decisions. In that case Metal Manafactures sought finance and the sale and lease-back was presented as a means to provide such finance. The choice of the sale and lease-back rather than a simple loan was coloured by the tax advantages afforded by that arrangement. In particular, the agreement did not give any right to the lessee to reacquire the asset, since that would mean the agreement would receive the less favourable tax treatment of a hire purchase.

17. Division 240 of the ITAA 1997 was recently legislated to give effect to the administrative practice of treating hire purchase transactions as a means of finance. Under Division 240, hire purchase transactions are treated as a ‘sale and loan’. That is, the arrangements are recast as a sale of property by a financier to a buyer, financed by a loan. The purchaser is then deemed to be the owner of the asset and to make instalment payments that notionally have components of:

- non-deductible principal; and
- deductible interest.

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[17] *Metal Manufactures Ltd v F C of T* (1999) 99 ATC 5229 at 5273.

18. This change has brought the treatment of hire purchase agreements in line with their economic substance, as finance. However, the decision in *Metal Manufactures* demonstrates the incongruity this creates between hire purchase agreements and the economically equivalent sale and lease-back.

TVM treatment of sale and lease-back transactions

19. In contrast to the current law, which treats sale and lease-back and hire purchase agreements differently, TVM treats *all* asset-based finance according to the *economic effect* of the transaction, that is, as a loan. TVM applies to the actual receipts, payments, assets and liabilities that are involved regardless of the legal form and characterisation of the overall arrangement. The result is a principled treatment that accords with the economic substance of the agreement.

20. The 'sale and loan' paradigm is not used under TVM. Instead, the Division 45 tax value rules apply to give the same effect. This means that the rules in Division 240 of the ITAA 1997 would probably not be required under TVM. As a corollary, this should mean that under TVM, further amendments would not be required to appropriately treat the various types of asset-based finance.

What amount is 'deductible' to the lessee?

21. According to the *Metal Manufactures* case, the lessee would continue to hold the plant and equipment.[18] However, the tax value of the plant and equipment would be zero, since they had been fully depreciated prior to the arrangement. The lessee's *right to use the asset* under the lease is ignored since they hold the asset itself.[19] Therefore, the opening and closing tax values of the lessee's assets is zero throughout the agreement.

22. The lessee has a liability, being the present legal obligation to make the future lease payments.[20] Initially the tax value of the liability is the proceeds of assuming it, which is what the lessee receives in return for taking on the obligation, the right to use the plant.[21] When the parties are dealing at arm's-length the lessee's liability has a market value equal to the present value of the future lease payments[22].

23. The tax value at a later time is that amount increased by the rate of return, less any payments that have been made under the liability.[23] This means that the lease payments will be partially matched by the decrease in the financial liability. The extent to which they are not matched, and so reduce net income, is the interest component on the outstanding liability.

24. That is, the repayments of principal will not reduce net income but payments of interest will. This means that TVM achieves the bifurcation of the notional interest and principal repayments that aligns the tax treatment of the arrangement more closely with its economic substance. Importantly, TVM does so without relying on a characterisation of the

18 Sections 6-20 and 6-21, TVM Prototype 2.
19 Section 6-21, item 11 of the table, TVM Prototype 2.
20 Section 7-20; Prototype 2.
21 Section 7-75, item 8 of the table and section 45-40; Prototype 2.
22 The net present value is calculated by using the interest rate that is implicit in the overall agreement, that is 13.79%. This is approximately the same as the prevailing market interest rate at the time the arrangement was entered into.
23 Section 45-75; Prototype 2.

transaction as a loan, but instead by analysing the transaction according to the receipts, payments, assets and liabilities involved.

25. For instance, assume that the initial agreement in the *Metal Manufactures* case was completed (5-year lease with resale for agreed residual). Metal Manufactures would have a \$50 million receipt (on the sale), and annual payments of \$10.53 million (lease payments) with a final payment of \$18.75 million (the residual value for buying the plant back). For the term of the lease the lessee would also have a financial liability, being the present legal obligation to make the lease payments over the term of the lease.

26. The effect on Metal Manufactures' (the lessee's) net income is[24]:

$$\left[\text{Receipts} - \text{Payments}\right] + \left[\begin{matrix}\text{Closing} \\ \text{tax value} \\ \text{of assets}\end{matrix} - \begin{matrix}\text{Opening} \\ \text{tax value} \\ \text{of assets}\end{matrix}\right] - \left[\begin{matrix}\text{Closing} \\ \text{tax value} \\ \text{of liabilities}\end{matrix} - \begin{matrix}\text{Opening} \\ \text{tax value} \\ \text{of liabilities}\end{matrix}\right]$$

Year	Receipts – Payments		Assets		Liabilities		Result
1988-1989:	90.05m[25] – 50.58m[26]	+	0–0[27]	-	32.68m[28] – 0	=	**\$6.79m[29]**
1989-1990:	0 – 10.53m	+	0–0	-	26.02m – 32.68m	=	**-\$3.87m**
1990-1991:	0 – 10.53m	+	0–0	-	18.44m – 26.02m	=	**-\$2.95m**
1991-1992:	0 – 10.53m	+	0–0	-	9.81m – 18.44m	=	**-\$1.91m**
1992-1993:	0 – 10.53m	+	0–0	-	0 – 9.81m	=	**-\$0.72m**

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[24] Based on an internal rate of return of 13.79% on the stream of lease payments.

[25] Receipt of \$50m on sale of plant and equipment plus deemed receipt of \$40.05m (market value of the right to use the asset, which is equal to the market value of the future lease payments) under section 8-28.

[26] Lease payments of \$10.53m and deemed payment of \$40.05m (equal to the deemed receipt).

[27] The asset had a written down value of zero at the time the arrangement was entered into.

[28] Initial tax value of the liability is the proceeds of assuming it, which is the \$40.05m deemed receipt referred to in footnote 25. The tax value of the liability at a later time is worked out according to the formula in section 45-75:

[Last tax value x (1+interest%) - cash flows at that time]

[29] This recognises the gain that Metal Manufactures makes on the 'sale' of the plant and equipment. They receive \$50m from the sale, of which they pay \$10.53 as lease payments. At the end of the year they have a liability with a tax value of \$32.68m. The difference between the net cash flows and the change in the tax value of their liabilities is the gain of \$6.79m.

1993-1994: $\left[0 - 18.75m \right] + \left[0 - 0 \right] - \left[0 - 0 \right] =$ **-$18.75m**

27. Taken together, these amounts of net income are the notional interest paid on the loan of $50 million (i.e. the 13.79% internal rate of return).

Attachment C

What are the potential benefits of TVM in the day to day interaction between taxpayers and the ATO?

Overview

1. This attachment gives a general overview of the potential benefits of the TVM by trying to put the potential benefits into perspective and giving a general view of what the potential impact on rulings, cases and taxpayer interactions with the ATO may be.

2 From this analysis, some very general and preliminary examples of potential benefits in the number and complexity of rulings, cases, telephone calls and correspondence to the ATO on technical issues have been made.

3. This analysis is based on an examination of:

- Taxation Rulings (TRs), Taxation Determinations (TDs) and Income Tax Rulings (ITRs);[30] and
- recent cases (High Court, Federal Court and AAT) over the period 1996 to 2001.

NOTE: The analysis is not complete and should be seen as preliminary information only. Significantly more analysis is needed before more detailed and accurate information can be provided.

4. Potential benefits of TVM include a reduced need for:

- rulings and determinations;
- Private binding rulings (PBRs);
- litigation; and
- taxpayers to contact the ATO for advice.

The big picture - what are the areas of confusion and dispute in the current law?

5. Two indicators of uncertain and inconsistent law are that the Commissioner has been:

- required to publicly state the ATO position in relation to an issue or issues by way of ruling or determination; and
- involved in litigation concerning an issue or issues.

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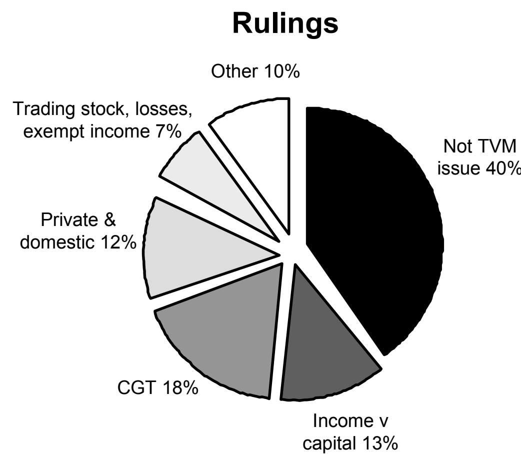
[30] The TRs, TDs and ITRs that are used in this paper are those dealing with income tax assessment and are in force at 1 August 2001. Procedural issues, archived and withdrawn rulings are excluded.

For this reason TVM has been analysed in relation to possible impacts on these areas.

What do we rule on?

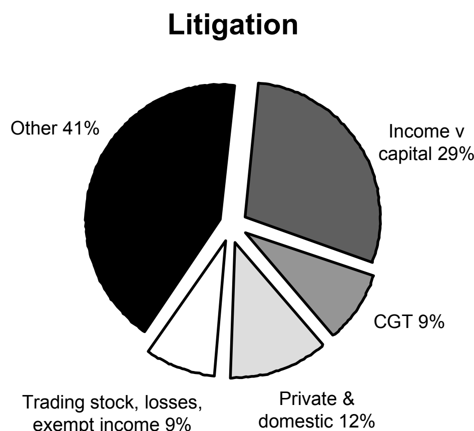


6. At 1 August 2001, there were approximately 1,430 rulings and determinations that apply to income tax matters. Of these, approximately 40% will not be directly affected by TVM as they deal with issues not involved in working out taxable income (e.g. penalties or administrative issues).

7. Approximately 250 rulings and determinations deal with Capital Gains Tax (CGT) issues, which represents 18% of all TRs, TDs and ITRs. A further 185 rulings and determinations deal with the distinction between income and capital (13%).

8. The potential impact of TVM on CGT rulings is examined in more detail later in this attachment.

What do we litigate?



9. In the case of litigation, since 1996 about 290 cases have been litigated in the High Court, Federal Court and administrative tribunals. Again, at the current stage of development of the TVM draft legislation, there are a relatively large number of litigation cases that are not likely to be affected by TVM. These cases deal with issues such as penalties, onus of proof, general administrative issues, etc.

10. There have been around 25 cases in various venues on CGT in the last 5 years. This translates to about 9% of the total cases. A further 29% of total cases dealt with the distinction between capital and income (including deductions).

11. The potential impact of TVM on CGT litigation is examined in more detail later in this attachment.

What is the potential impact of TVM? CGT as an example

12. The preceding charts indicate that 18% of rulings and determinations and 9% of litigated cases dealt with CGT issues.

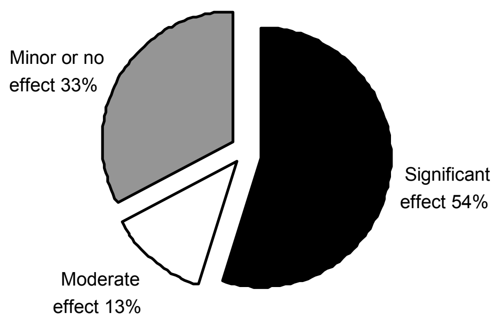
13. A preliminary analysis of the currently drafted 'investment asset' rules, that replace the current CGT regime, indicate that there may be substantial reductions in the need for rulings and litigation.

Potential impact of TVM on litigation and rulings on CGT issues

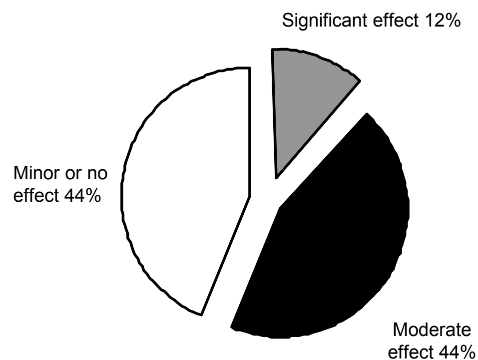
14. For this analysis, the terms 'significant effect', 'moderate effect' and 'minor or no effect' are used. They mean:

- *Significant effect* – The major issue in the ruling or litigation would not arise or would be significantly reduced. For analysis, it is estimated that there is a potential reduction in rulings and litigation on the issue at hand of 75%.
- *Moderate effect* – The major issue in the ruling or litigation would be reduced, but would remain in a reduced form. The potential reduction of issues is taken to be 50%.
- *Minor or no effect* – Little or no impact is likely as often the issue is factual (such as when a contract is entered into, etc). The potential reduction of issues is taken to be 10%.

Rulings - potential impact of TVM



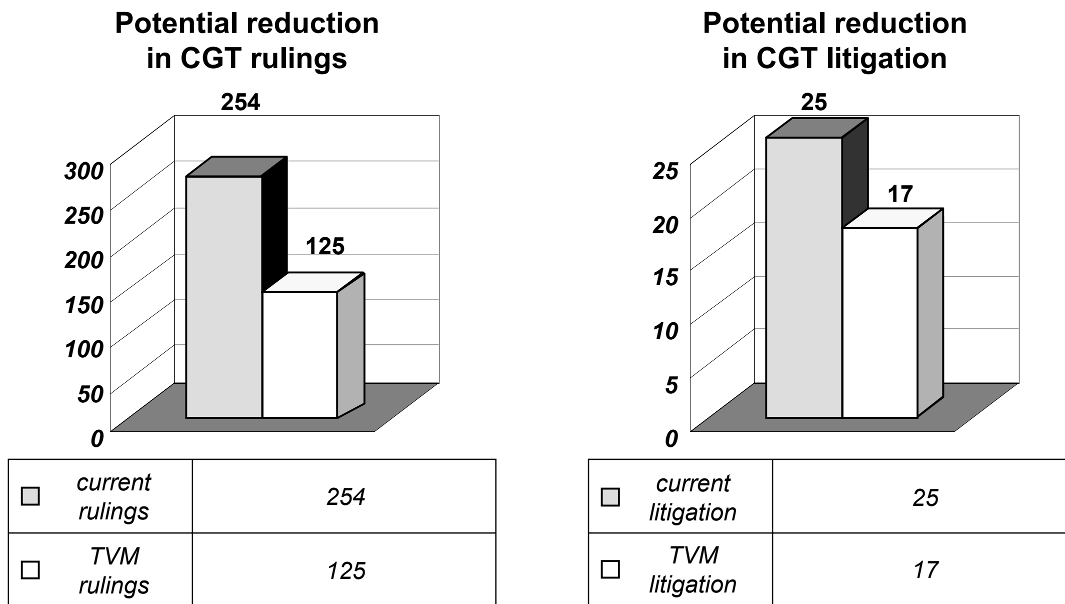
Litigation - potential impact of TVM



15. A case-by-case review of CGT rulings and determinations indicated that about 51% of these products would no longer be required. Also, litigation could potentially be reduced by 32%.

16. It is recognised that there will be a need to issue new rulings etc. to explain some aspects of TVM. However, the number of rulings products required will potentially be lower

as the new rules will be clearer and better structured than the current law. Accordingly, it is possible that the reduction in rulings products may be lower than identified.



How can TVM impact on the practical administration of the law?

17. Can these benefits flow to the general public? They should. If we assume that the general reduction in the need for rulings and determinations flows through to the areas of general advice (telephone and mail) as well as rulings, there are significant potential benefits to both the ATO and the community.

18. The ATO for all income tax matters handles:

- over 10 million income tax returns a year, of which around 10% include CGT;
- over 480,000 items general correspondence;
- over 13,000 requests for PBRs;
- almost 6 million general phone enquiries;
- over 24,000 objections; and
- over 600,000 amendments.

19. If CGT accounts even for 10% of these issues,[31] the potential benefits of TVM through simplification of the CGT regime and general simplification of the income tax law could result in substantial reductions in the need for taxpayers to seek clarification and advice from the ATO.

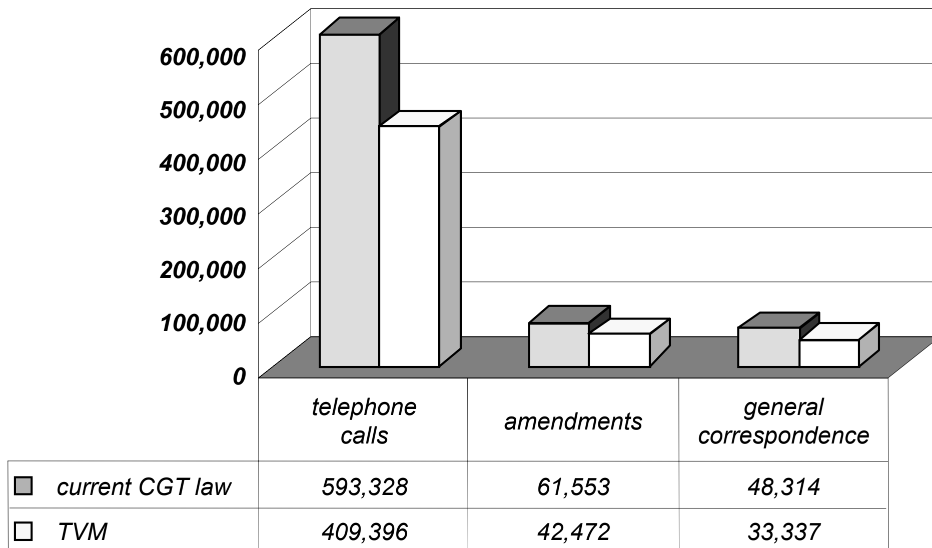
[31] Based on the 1998.1999 year where approx 10% of income tax returns included CGT. Note that for private binding rulings about 20% are CGT issues.

Less need to contact the ATO on CGT issues

20. The following charts show the potential benefits of TVM on the taxpayers that need to interact with the ATO.

21. This chart uses the potential 51% benefit shown in the above rulings analysis to show what is possible if these benefits flow through to the community at large by clearer ATO products such as *TaxPack* and other guides. It shows the potential benefits on CGT per year as over 180,000 less phone calls, 19,000 less amendments and almost 15,000 less letters.

> **NOTE:** The potential benefits of a 51% reduction in CGT issues has been reduced to only 31% for the purposes of these forecasts. This reflects the general nature of correspondence etc.

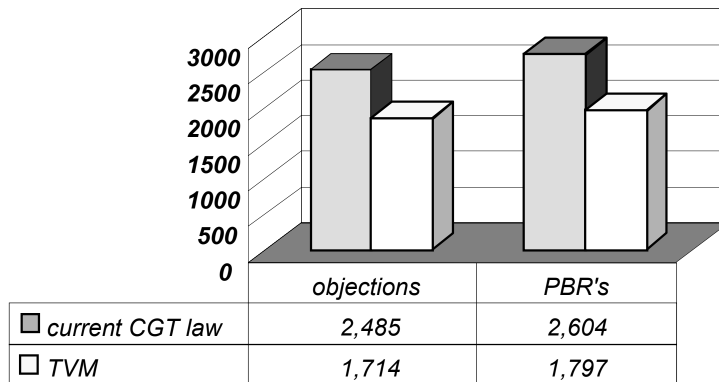


	telephone calls	amendments	general correspondence
current CGT law	593,328	61,553	48,314
TVM	409,396	42,472	33,337

Objections and PBRs would reduce

22. Similar outcomes could be achieved for private binding rulings and objections. Potentially, there could be 770 less CGT objections and 800 less private binding rulings per year.

> **NOTE:** The potential benefits of a 51% reduction in CGT issues has been reduced to only 31% for the purposes of these forecasts. This reflects the general nature of correspondence etc.



	objections	PBR's
current CGT law	2,485	2,604
TVM	1,714	1,797

Conclusions

23. The above is incomplete and needs significantly more development before reliable forecasts could be made. Nonetheless, it is clear from the work done to date, particularly on the impact of TVM on CGT rulings, determinations and litigation, that there is great potential for real benefits to flow to the community at large and the ATO.

24. It is likely that the benefits in other areas would not be as high as detailed above for CGT. General inquiries and correspondence will continue under TVM. However, given that the ATO deals with almost 6 million telephone enquiries, the potential benefits of clearer law (expressed through guides and general advice products) are tangible.

25, Even a 10% reduction in such calls would save 600,000 taxpayers the need to contact the ATO. The potential savings to the community in time and money are demonstrably significant.

> **NOTE:** The assumptions in this attachment are based on limited information and project the potential benefits on the basis that TVM is bedded down. No attempt has been made in this attachment to specifically measure the need for new rulings, or the information requirements for the introduction of TVM.

Attachment D

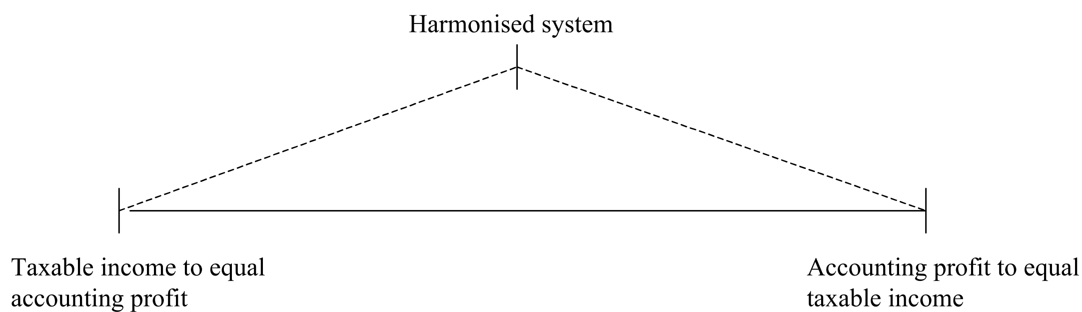
Should taxable income equal accounting profit?

1. If it should, there are 3 means of achieving this outcome (as illustrated below):

- adopt accounting profit as the calculation of taxable income – this has been proposed previously to the Government in 1950[32] and again in 1975 to the (Asprey) Taxation Review Committee;[33] or

- adopt taxable income as the calculation of accounting profit – this is prevalent among countries in continental Europe;[34] or

- move to a harmonised system where a new profit calculation can be used for both tax and accounting purposes – this was proposed by the Australian Labor Party in the lead-up to the 1998 election as a possible business taxation reform that should be evaluated.[35]



[32] This was a joint representation to the Treasurer by the Associated Chambers of Commerce of Australia, the Associated Chambers of Manufacturers of Australia, and the Institute of Chartered Accountants in Australia. As noted by Dr Tran in his 1997 thesis "Relationship of Tax and Financial Accounting Rules – An Empirical Study of the Alignment Issue" for the Degree of Doctor of Philosophy of The Australian National University, which was submitted to the Committee for the Review of Business Taxation on 3 March 1999.

[33] Tran, ibid., noted that the (Asprey) Taxation Review Committee received submissions suggesting that net income for tax purposes should be determined according to generally accepted accounting principles, but with some specific provision in the tax legislation.

[34] Tran, ibid., noted that in continental European countries, uniform financial reports are reported for credit provision, taxation, and economic planning purposes, and that taxation is an important consideration in setting accounting rules.

[35] Their policy included a review "of business tax arrangements, including an evaluation of the pros and cons of moving to a harmonised system of profit calculation for both tax and accounting purposes, and the implications of this for existing exemptions and concessions and the company tax rate". Reference: Australian Labour Party policy document "*A fairer tax system with no GST*", not dated, page 11.

Issues of concern with adopting accounting profit

Accounting profit is calculated for a different purpose

2. Accounting profit is calculated to provide information useful to users for making and evaluating decisions about the allocation of scarce resources.[36] Whereas "taxation law is designed to raise revenue for the government or to encourage investment in specified areas which the government sees as socially desirable…".[37]

3. There is a disincentive for entities to provide relevant information to users if taxable income were based on accounting profit. A criticism of accounting is that it allows for entities to 'manage' results[38] – one reason for doing this is to "reduce exposure to increased regulation and taxation".[39] So, such a shift would be to the detriment of the users of general purpose financial reports – such as shareholders, creditors, employees and suppliers – as it might compromise their ability to make informed resource allocation decisions.

4. This was recognised by Professor Malcolm Gammie. He used the example of revaluing assets held for use, where if the revaluation:

> …were not a requirement, and if there were tax consequences, then we would expect to see a reluctance to recognise such changes on value in the accounts with a consequent loss in information value.[40]

Accounting profit can be used as a starting point, but it can't provide the end result

5. The current practice of reconciling taxable income from accounting profit highlights that accounting can form the basis of a taxation system. It simply then becomes an issue of the number of adjustments required to bring accounting profit to taxable income. The adjustments will remain necessary for reasons including the following:

- to protect revenue – for instance, by quarantining certain losses such as 'capital', foreign income and film income losses, and disallowing certain expenses as 'deductions', such as most accounting provisions and payments for entertainment; and
- to encourage investments in certain areas of the economy – for instance, the 125% deduction for research and development expenditure and the 50% capital gains discount; and
- to compensate certain taxpayers – for instance, replacement asset roll-overs on destruction of assets.

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[36] This actually reflects the broader notion of the purpose of 'general purpose financial reports', as stated in SAC 2.

[37] Lehmann, G. & Coleman, C. *Taxation Law in Australia: 4th Ed*, LBC Information Services, Sydney, 1996., page 515

[38] This is discussed in more detail later on.

[39] Tran, op. cit., page 47

[40] Gammie, M. "*TVM and the relationship between taxation and commercial accounting methods*", presented to the ATAX / Board of Taxation TVM Conference on 23 July 2001., page 23

Most taxpayers do not need to comply with accounting standards

6. Basing taxable income on accounting profit for all taxpayers will impose a compliance burden on the majority of taxpayers that do not need to comply with the accounting standards.

7. For individuals and many trustees, the accounting standards hold minimal relevance to the calculation of taxable income, which suggests that a separate regime would be required for those groups of taxpayer. And for most small businesses (whether they operate as sole traders, partnerships, companies or trusts), mandating compliance with accounting standards would impose on them an equivalent (or, because of unfamiliarity with accounting practice, possibly greater) compliance burden.

8. The only taxpayers required by law to comply with accounting standards are:[41]

- public companies;
- large proprietary companies;
- registered schemes; and
- any other entity that is likely to have significant investor interest – these entities may be listed or unlisted and may be incorporated or unincorporated.

9. Further, a small proprietary company is exempt from these requirements unless otherwise directed by its shareholders or by ASIC.[42]

10. If the Corporations Law does not require an entity to comply with the accounting standards, then the professional accounting bodies[43] can exert professional sanctions to encourage members to comply with the accounting standards. However, this is only where the entity is a 'reporting entity' or holds out their financial statements to be 'general purpose financial reports'.

Accounting is moving away from determining profit on a realisation basis

11. An historical cost taxation system does have imperfections, including the taxing of nominal gains, not calculating true economic depreciation and biases towards capital gains generating assets (Gammie, 2001). With regard to the latter point, he states:

> The failure to tax accruing business income biases companies towards projects that give returns in the form of capital gains. It can also create "lock-in" effects, where tax considerations make it more worthwhile for a company to keep an asset than to realise it and pay tax, even where more profitable investments – tax considerations aside – are available. [44]

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41 The Corporations Law, at sections 292 and 296
42 The Corporations Law, at sections 293 and 294
43 CPA Australia and the Institute of Chartered Accountants in Australia
44 Gammie, op. cit., page 9

12. This illustrates that the historical cost taxation system allows for taxpayers to 'manage' their taxable income. However, a shift to accounting profit will not overcome this problem as the same criticism has been levelled at accounting practice.[45]

13. Minimising these imperfections instead requires a change to the measurement base used, which in turn may move the tax system away from being a realisation-based system. Already, contemporary accounting practice is probably best viewed as comprising a 'modified historical cost' system with several accounting standards moving away from a historical cost and realisation basis.[46]

14. In a tax environment, however, replicating such a shift brings with it the practical problems of taxing the 'paper' gains of a taxpayer as they accrue, which (as Gammie points out) "merely begs the question of when value truly accrues and can be taxed"[47]. Furthermore, the liquidity problem that such a move may generate provides a noticeable and immediate compliance impact on the taxpayer.

15. With respect to revaluations, Gammie notes that "the trend in accounting practice towards revaluation of assets held on a continuing basis with a view to use in the business is at variance with the needs of the tax system".[48] This is because a gain or loss calculated on revaluation (in accordance with AASB 1010 *Accounting for the Revaluation of Non-Current Assets*) does not affect accounting profit. Instead, it directly affects the amount of owners' equity in the entity and is recorded in an account called the Asset Revaluation Reserve.

16. So, equating taxable income with accounting profit will encourage the revaluing of all non-current assets that are expected to have rises in value. The result is that taxable income will record reduced gains or maximised losses on any subsequent disposal of the asset because the actual revaluation is not recognised as profit or loss. Allowing revaluations on this basis will exacerbate losses to the revenue because AASB 1010 does not require all non-current assets to be revalued. Rather, it provides entities with the flexibility to choose which assets to revalue.[49]

Applying the concept of materiality in a tax system is at the expense of fairness

17. Materiality is a relative concept. Materiality is "a test concerned with the magnitude of relevant and reliable information to assess whether its omission, misstatement or non-disclosure would affect the users' economic decision making, based on financial reports

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[45] For instance, Australian Accounting Research Foundation, *Measurements in Financial Accounting*, Accounting Theory Monograph No. 10, AARF, 1998 (at paragraph 5.33) notes that historical cost measurement "…enables 'cherry picking' of gains from within the portfolio, resulting in the reporting of information that does not faithfully represent the performance of the investments for the reporting period".

[46] Examples includes Accounting Standards AASB 1008 *Leases*, AASB 1012 *Foreign Currency Translation*, AASB 1023 *Financial Reporting of General Insurance Activities*, AASB 1037 *Self-Generating and Regenerating Assets*, AASB 1038 *Life Insurance Business* and AASB 1041 *Revaluation of Non-Current Assets*.

[47] Gammie, op. cit., page 11

[48] Ibid., page 23

[49] However if an asset within a particular asset class is revalued, all other assets in that class must be revalued also. The measurement basis for revaluation is fair value (which is largely equivalent to market value).

of a particular entity".[50] However, this concept would introduce inequity into the tax system. Furthermore it would be an inequity that favours large taxpayers more so than small taxpayers.

18. Contrasted with the accounting treatment, an item that satisfies the definition and recognition of an asset should be reflected in taxable income calculations regardless of the size of the taxpayer because the tax system looks to the fair and equitable treatment of all taxpayers.

19. Gammie also recognises the problem with the concept of materiality:

> What is at issue in the context of accounting standards is whether particular transactions are significant enough in the context of the entity being reported on to require application of an accounting standard or an accounting policy. In the context of taxation the issue is different; it is a matter of calculating a tax liability according to the statutes and it cannot be appropriate that the taxpayer be the sole judge of whether the treatment of a transaction in the accounts is material to the final tax liability.[51]

20. However he does note that:

> …materiality is not an unknown concept in tax administration, but it is a facet of administrative discretion rather than a principle of law governing rights as between the taxpayer and the state.[52]

Accounting is not as 'certain'

21. Statement of Accounting Concept (SAC) 4 *Definition and Recognition of the Elements of Financial Statements* requires for assets and liabilities to be recognised it must be 'probable' that the future economic benefits will eventuate or that the future sacrifice of economic benefits will be required. 'Probable' is interpreted to mean greater than 50% likelihood.[53] This reduced threshold can be seen as increasing the subjectivity in financial statements in an attempt to provide more relevant (but still reliable) information to the users of general purpose financial reports. This however conflicts with the tax system's need for certainty, given that "…the certainty threshold is probably now one of the clearest differences between accounting and taxation".[54]

Accounting brings losses forward

22. The matching process of "recognising expenses by associating costs incurred with revenues recognised", along with the principle of conservatism, explains the difference in treatment of bad debts between accounting and tax practice.

23. While these 'provisions' do not meet the definition of a liability, they're included as a contra-asset in the Statement of Financial Position (the balance sheet) to provide an estimated net realisable value for an entity's accounts receivable. And (by virtue of double entry

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50 Hogget & Edwards, *Accounting in Australia 4th Edition*, John Wiley & Sons Ltd, Brisbane, 2000., page 621

51 Gammie, op. cit., page 19

52 Ibid., page 18

53 Godfrey, J., Hodgson, A., Holmes, S., & Kam, V., *Accounting Theory: Second Edition*, John Wiley & Sons Ltd, Brisbane, 1994., page 368

54 Gammie, op. cit., page 21

accounting), the estimated bad debts expense that is charged to this contra-asset is recorded in the entity's profit or loss calculation.

24. Anticipating the percentage of credit sales that might go 'bad' assists with the provision of relevant and reliable information to the users of financial reports. However, allowing taxpayers to recognise such a loss before there are indications that such a debt may in fact go bad, provides taxpayers with the ability to 'manage' (and reduce) their taxable income for an income year.

Concessions that are currently available to taxpayers will be removed (or limited)

25. If accounting profit were adopted as the measure of taxable income and the existing concessions were to be maintained, the special rules and associated anti-avoidance provisions would need to be incorporated into the accounting standards or added to legislation modifying the accounting result. With this approach, it is worth noting that if accounting standards are modified:

- It will not aid compliance or simplify the rules; rather it becomes a problem that is associated with accounting and tax rather than just tax. In fact, if the taxpayer has to prepare financial statements quarterly, the compliance burden increases.
- It will distort the financial performance and financial position of the taxpayer. So, to provide relevant and reliable information to the users of general purpose financial reports, taxpayers will have to include detailed notes to their financial statements that disclose a 'truer' measure of their financial performance and position. Thus, it would seem that approximately the same degree of recalculating would be required as currently exists.

26. These difficulties that would be encountered suggest that concessionary treatment could no longer be included in the domain of the tax system. This fits with Tran's conclusion that "alignment of tax rules with (generally accepted accounting practice) means that the government has to use means other than the income tax system to achieve its policy objectives".[55]

The international harmonisation of accounting standards may influence the tax base (or itself may be at risk)

27. Australia is, where it deems it appropriate, endeavouring to harmonise its accounting standards with the International Accounting Standards. The importance of this harmonisation program is evident in paragraph 225(2)(f) of the *Australian Securities and Investments Commission Act 1989* requiring the Financial Reporting Council to "monitor the development of international accounting standards and the accounting standards that apply in major financial centres, and to further the development of a single set of accounting standards for world-wide use with appropriate regard to international developments…."

27. At face value, it would seem that this would move control of the tax system away from Government and reduce the concessions available to special interest groups. Instead, it is probable that the accounting standard setters, both in Australia and overseas, would be subject

55 Tran, op. cit., page 34

to increased lobbying which may slow down the release of new standards. More critically, if the lobbying proved effective at the domestic level but not at the international level, the ability of Australia to harmonise its accounting standards would be greatly reduced. One of the benefits of international harmonisation, which would then be forgone, is greater access to global capital markets and thus lower costs of capital. This is because harmonisation aids in the comparability of financial reports from country to country. In turn, this reduces the assumptions that a user has to make to compare the performance of different companies that use different bases for calculating profit and financial position. Thus, it would be expected that many taxpayers who would want access to these markets would need to prepare an additional set of accounts that accord with the international standards – this then becomes as added compliance cost.

28. Furthermore, it should also be noted that the development and introduction of new accounting standards is not completely divorced from the political process. The Corporations Law[56] states that section 46A of the *Acts Interpretation Act* 1901 applies to accounting standards as if they are disallowable instruments. One instance where part of an accounting standard was disallowed was on 17 February 2000, when the Senate passed a resolution disallowing paragraphs 6.3 and 6.4 of AASB 1015 *Accounting for Acquisitions*.[57]

The accounting profession will be placed under added pressure

29. Auditors of company accounts may assume greater responsibility if accounting profit is used to measure taxable income. This would increase audit fees given the expanded work schedule and greater liability exposure.[58]

30. The issue of liability exposure is significant. With the subjectivity involved in accounting, if the taxpayer and the Tax Office took differing views of a transaction and the issue were decided by the Courts in the Tax Office's favour, the shareholders might pursue civil action against the auditors. Such scenarios could lead to fewer accountants being willing to provide auditing services, with shareholders not being able to review the stewardship of management using audited (and thus somewhat independent) accounts.

31. An associated complication is that if tax policy concessions were reflected in accounting standards, auditors may have difficulty stating that the financial statements give a true and fair view of the financial performance and position of an entity. If that were the case, then additional information must be disclosed in the notes to the financial statement to give a true and fair view.[59] Company directors are also required to declare that the financial statements and notes give a true and fair view.[60] So, both company directors and auditors will be insisting that companies provide additional information in their financial statements – this then becomes an added compliance cost.

Management may resist the shift

32. There is considerable literature that highlights that managers appear to 'manage' accounting results through a selection of accounting methods. These reasons include: to

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56 At subsection 334(2)

57 ASIC Media Release '*Effect of disallowance of clauses of AASB 1015 "Accounting for Acquisitions"*' of 7 March 2000

58 Tran, op. cit.

59 This is in accordance with paragraph 295(3)(c) of the Corporations Law.

60 This is in accordance with paragraph 295(4)(b) of the Corporations Law.

reduce costs of foreign trade regulation, to smooth income, to avoid breaking debt covenants, to affect bonus payments and compensation, to reduce exposure to increased regulation and taxation, and to improve future financial results of new management.[61]

33. Management's appreciation of these techniques means that they would be likely to oppose using accounting profit to measure taxable income because of self-interest factors (particularly if their remuneration package is tied to accounting profit).

The compromise

34. The "…alignment of tax rules with accounting rules presupposes suitability of accounting rules to achieve the objectives and criteria of the income tax system. Unfortunately this is not the case."[62]

35. Given the difficulties expressed above, it would seem that the further alternative of aligning taxable income with accounting profit where possible and appropriate (which recognises each system has competing purposes that prevents a complete alignment) has been suggested by:

- the Joint Committee of Public Accounts, in 1993;[63] and
- the Government[64] and the Review of Business Taxation,[65] in 1998 and 1999; and
- Gammie and Tran.

36. TVM, which provides the tax system with a framework for calculating taxable income that is similar to that used for calculating accounting profit, provides a starting point to further align the tax system with accounting practice. This was the intention of the Review of Business Taxation, which recommended that:

- accounting principles should be reflected in the development of taxation legislation for the Australian Tax Code;[66] and
- that divergent treatment of transactions in tax and accounting should be addressed if that difference is deemed to be inappropriate.[67]

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61 Tran, op. cit.
62 Ibid., page 30
63 Ibid.
64 In *Tax Reform not a new tax a new tax system*, August 1998, page 126
65 In *A Platform for Consultation*, February 1999, pages 45 – 47, and *A Tax System Redesigned*, July 1999, pages 203 – 205
66 Recommendation 4.23 of *A New Tax System Redesigned*, July 1999
67 Recommendation 4.24 of *A New Tax System Redesigned*, July 1999