Australia's Capital Allowance Regimes between 1915 and 1992: Tax Law Becomes an Instrument of Economic Policy

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The depreciation rules for tangible assets in Australian's income tax law have evolved in two distinct phases. From 1915 to 1992, legislative amendments sought to overcome the limitations of a rigid and limited depreciation system through gradual expansion of the depreciation regime to more and more types of tangible assets and at the same time develop the depreciation rules into a tool for economic intervention. A partial consolidation of the rules in 1992 marked the beginning of a shift in depreciation policy to become a tool in a broader neoliberal agenda. This article explores the evolution of the depreciation rules for tangible assets in the initial seven and a half decades. The history of depreciation rules in this period provides useful insights into the view of Australian governments on both sides of the political divided of tax law as a tool to achieve economic policy objectives.

I. Overview

Australia has experienced many changes in its tax depreciation regime as it has adapted to constant changes in the nation's economy. The original Commonwealth income tax legislation enacted in 1915 recognised only a narrow set of tangible assets for which deductions for depreciation were allowed. The rigid and limited depreciation system soon began experiencing gradual expansion, while concessional measures were introduced in the form of accelerated timing of deductions of active business assets. These measures included the doubling of ordinary depreciation rates, faster depreciation in the first year of depreciation periods, and the predetermined depreciation period of five or three years which applied to certain plant and articles. Structural assets such as buildings which can last for hundreds of years with good repair and maintenance could be depreciated for a period of 25 or 40 years. At times, the government allowed taxpayers to augment the cost base of assets.

Despite the complexity caused by many changes within the depreciation system, the evolution of depreciation rules for tangible assets can be characterised in two distinct phases. During the first, from 1915 to 1992, legislative amendments sought to overcome the limitations of a rigid and limited depreciation system through gradual expansion, while using it as a tool for economic intervention. A much-needed era of consolidation of the rules began in 1992, which marked the beginning of a shift in depreciation policy to become a tool in a broader neoliberal agenda.

Depreciation concessions provided in the initial seven and a half decades were primarily concerned with private sector investments. It is believed that investments, as the source of capital accumulation, enhance a nation's economic growth, as it has for many countries since the industrial revolution. They are relatively more volatile to alter the economy, compared to other elements in the national income identity, that is, private consumption, government spending and net exports. Thus, depreciation concessions were expected to improve the economy by targetting certain industries or supporting businesses during recessions or when a pessimistic economic outlook was forecasted to lead businesses to hold back decisions to invest at optimal levels.

However, the precise effect of depreciation concessions through direct and indirect chain reactions in the economy is unclear. Recently, the Australian Government introduced the ATO longitudinal information

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files (ALife) to allow access to tax and superannuation data,[1] This no doubt will open many doors to empirical studies of particular measures, but the starting point must be a thorough understanding of how the system developed and how the pieces of the puzzle we have today found their places in the law. This article seeks to provide this understanding, tracking the evolution of the depreciation system for tangible assets where repeated extension of the depreciation rules to more and more types of tangible assets was accompanied by depreciation concessions deliberately used to achieve economic policy objectives.

This article is structured as follows:

(1) The initial period. The first three decades of the Commonwealth income tax system, from its adoption during the World War I until the commencement of the World War II, was remarkably stable in terms of the depreciation rules.
(2) The second period. The period from the beginning of the World War II until 1952 involved a multistage expansion of the depreciation rules, seemingly without any overarching design or policy guidelines.
(3) The third period. From 1952 until the election of the Labor Government in December 1972, there was a growing appreciation among both Coalition and Labor politicians of the ability to direct economic benefits to specific sectors through tax expenditures.[2]
(4) The Fourth period. Initially, interest in this form of economic redistribution slowed in this period, when Labor came to power in 1972, but interest was renewed before Labor left office. It was substantially reinvigorated under the Coalition Government, which remained in power for almost a decade until 1983. The newly elected Labor Government delivered one of the most substantial tax reform packages in Australian history and, for the first time, began publishing annual tax expenditure statements providing details of the cost of depreciation concessions, data needed for critical evaluation of the many concessions that had been introduced into the tax legislation.

The history of depreciation rules in this period provides useful insights into the bipartisan view to use the tax law as a tool of economic management. Although broadening the depreciation system to cover a comprehensive set of assets was a welcome development, the ever-changing, stop-start use of the depreciation rules not as an internally coherent and necessary part of the income tax system but rather as a subsidy tool to direct economic resources into specific industry sectors chosen by politicians produced mixed results, and many policy decisions raised questions about the need for structural tax reform by the early 1990s.

II. The Development Period: 1915–1939

As it does today, Australia's first federal income tax applied to taxable income, the amount remaining after subtracting all allowable deductions from gross income.[3] On its face, the principal deduction provision in the legislation was very broad, allowing deductions for all losses, outgoings or expenses incurred to produce gross income without explicitly excluding capital expenses, which in retrospect, was peculiar.[4] However, the legislation implicitly treated capital expenses incurred to acquire an asset as a payment other than a deductible loss, outgoing or expense.[5] There was a separate depreciation regime that allowed an annual deduction for decline in the value of machinery, implements, utensils,

[1] See *The ATO Longitudinal Information Files* <https://alife-research.app/>.

[2] A tax expenditure refers to a government spending program through tax legislation. The late Professor Surrey is credited for setting out the concept of tax expenditure. See, eg, Stanley S Surrey, "Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures" (1970) 83 *Harvard Law Review* 705; Stanley S Surrey, *Pathways to Tax Reform* (Harvard University Press, 2014 ed, 1973); Stanley S Surrey and Paul R McDaniel, *Tax Expenditures* (Harvard University Press, 1985).

[3] *Income Tax Assessment Act 1915* (Cth) s 10(1).

[4] *Income Tax Assessment Act 1915* (Cth) s 18(a).

[5] It was understood that, under the general law, no allowance was available in respect of wasting assets unless specified otherwise. See, eg, JAL Gunn et al, *Gunn's Commonwealth Income Tax: Law and Practice* (Butterworth & Co (Australia) Ltd, 3rd ed, 1951) [855], [1073].

rolling stock and articles due to wear and tear if they were used by the taxpayer to produce income.[6] An amending Act enacted a few months after the original income tax legislation subsequently excluded losses or outgoings of a capital nature.[7]

The depreciation rule made the Commissioner[8] responsible for establishing the extent of depreciation and set out two acceptable cost recognition bases: the "diminished value per centum" method and the "fund method". Both were subject to the Commissioner's approval and operated as conventional depreciation regimes, with the former providing for declining balance depreciation based on the cost of an asset and the latter available to businesses with accounting records attributing depreciation to a notional "sinking fund" to reduce distributable profits.[9] The reference to a fund alternative was eliminated from the legislation in 1924 when the straight-line depreciation option was added to the depreciation measures.[10] A balancing charge measure was also added to the legislation in 1924 to recapture excess depreciation when an asset was sold for more than its depreciated value or to provide a deductible loss when an asset was disposed of for less than its depreciated value (including involuntary disposals due to theft or accident).[11]

The depreciation rule was originally narrow in scope, limited to movable assets not connected to land, leaving assets such as buildings, fences and dams outside the scope of the depreciation regime. These omissions were significant given the importance of such assets in the agricultural sector at the time. The first recognition of acquisition costs for wasting capital assets in the agricultural sector, other than machinery, was in the form of a separate regime for wire fencing, prompted by an ecological crisis. By the early 1920s, infestation by European rabbits had reached plague proportions in Victoria,[12] and farmers in Queensland were surrounding their tomato or banana plantations or cotton crops with wire netting to protect them from wallabies.[13] These pressed the need for a new provision in 1924, allowing an outright deduction for the cost of wire netting.[14] The concession was extended the following year to include wire and any other cost involved in altering existing wire fences.[15] Three years later, a broad range of agricultural assets – fences, dams and other structural improvements on land – were added to the list of depreciable assets,[16] with the immediate write-off for wire and wire netting remaining in place. At the same time, to assist the farming sector, generous new tax concessions, in the form of various immediate deductions, were provided for the cost of long-lasting and, in some cases, permanent benefits, including clearing land and eradicating plant or animal pests.[17] However, this was not driven by the policy to help agricultural or pastoral activities. Rather, the government noted that before producing income, rural lands would require clearing timber and other obstacles that prevent the effective use of the soil, unlike urban lands only used as sites for buildings or factors.[18] Allowing deductions for the cost to

[6] *Income Tax Assessment Act 1915* (Cth) s 18(e).

[7] *Income Tax Assessment Act (No 2) 1915* (Cth) s 6(a), amending *Income Tax Assessment Act 1915* (Cth) s 18(a).

[8] The Commissioner was defined as the "Commissioner administering this Act" in the *Income Tax Assessment Act 1915* (Cth) s 3; *Income Tax Assessment Act 1922* (Cth) s 4. This was redefined to mean the Commissioner of Taxation in the *Income Tax Assessment Act 1936* (Cth) s 6; *Income Tax Assessment Act 1997* (Cth) s 995–1(1).

[9] *Income Tax Assessment Act 1915* (Cth) s 18(e), which was rewritten as *Income Tax Assessment Act 1922* (Cth) s 23(1)(e).

[10] *Income Tax Assessment Act 1924* (Cth) s 8(c), replacing *Income Tax Assessment Act 1922* (Cth) s 23(1)(e).

[11] *Income Tax Assessment Act 1924* (Cth) s 8.

[12] Agriculture Victoria, *European Rabbit* <https://agriculture.vic.gov.au/biosecurity/pest-animals/priority-pest-animals/european-rabbit>.

[13] Commonwealth, *Parliamentary Debates*, House of Representatives, 30 September 1924, 4880 (Forde).

[14] *Income Tax Assessment Act 1924* (Cth) s 8(g), inserting *Income Tax Assessment Act 1922* (Cth) s 23(1A).

[15] *Income Tax Assessment Act 1925* (Cth) s 6, amending *Income Tax Assessment Act 1922* (Cth) s 23(1A).

[16] *Income Tax Assessment Act 1927* (Cth) s 14(b), replacing *Income Tax Assessment Act 1922* (Cth) s 23(1)(e).

[17] *Income Tax Assessment Act 1927* (Cth) s 14(f), inserting *Income Tax Assessment Act 1922* (Cth) s 23(1)(q).

[18] Commonwealth, *Parliamentary Debates*, Senate, 7 December 1927, 2712 (George Pearce).

prepare lands for agricultural or pastoral activities was considered an adaptation of the principle allowing deductions for the costs associated with buildings or factors in the context of urban lands.[19]

Prior to the World War II, the most significant change made to the Australian tax legislation more broadly was the legislative revision undertaken in 1936 in response to the recommendations of the Ferguson Royal Commission.[20] Like its predecessor, the *Income Tax Assessment Act 1936* (Cth) made the Commissioner responsible for determining depreciation rates[21] while retaining declining balance depreciation (described in the current legislation as the "diminishing value method") as the default rule, with an option to use straight-line depreciation in certain circumstances.[22] The original list of depreciable assets, "machinery, implements, utensils, rolling stock and articles", was recast as "plant or articles",[23] with the term "plant" defined to incorporate the remaining non-farming items in the former list of depreciable assets[24] as well as fences, dams and other structural improvements on land used for agricultural purposes.[25]

From a policy perspective, one of the more striking recommendations made by the Ferguson Royal Commission was its proposal to extend the depreciation rules to buildings used in generating assessable income. It acknowledged that historically, many buildings had enjoyed long lives, sometimes hundreds of years. However, this was not the case for modern buildings constructed to house operating plant. These buildings, the Commission concluded, depreciated along with the plant they housed, albeit not at the same rate. Accordingly, it called for the extension of the depreciation rules to buildings that housed plant.[26] However, the government did not implement the building depreciation proposal,[27] and the depreciation system remained narrow in scope.

III. The World War II and Post-war Recovery: 1939–1952

The second significant period started with the breakout of the World War II. Australia's tax policy was shifted, initially, to compensate for the loss or rapid depreciation of industrial assets used in connection with the war while introducing new building depreciation rules subject to conditions. After the war, the government actively supported businesses, especially manufacturers, through investment-related tax incentives during the post-war recovery period. The experiments with the depreciation system during and after the war set a stage for the long practice of using depreciation rules as a tool for economic management in the following decades. Seemingly absent of any overarching design or particular tax policy guidelines, this period also provided a foundation for a new tax policy that would progressively expand the narrow set of tangible assets covered in the depreciation system.

[19] Commonwealth, *Parliamentary Debates*, Senate, 7 December 1927, 2712 (George Pearce).

[20] Undoubtedly, the Ferguson Royal Commission's most significant outcomes were its recommendations on addressing the inconsistencies between state and federal income tax laws. Two and a half years after the publication of the Commission's second report, which recommended adopting "uniform" income tax legislation across the country, the Commonwealth Government enacted the *Income Tax Assessment Act 1936* (Cth), which quickly became a model for state laws. See Parliament of the Commonwealth of Australia, *Second Report of the Royal Commission on Taxation* (1934, DG Ferguson, chair).

[21] *Income Tax Assessment Act 1922* (Cth) s 23(1)(e), as amended in 1924, required the Commissioner to determine rates based on the "estimated total life" of assets, while the *Income Tax Assessment Act 1936* (Cth) s 55(1) required the Commissioner to determine rates that were reflective of the 'effective life' of assets.

[22] *Income Tax Assessment Act 1936* (Cth) s 56(1).

[23] *Income Tax Assessment Act 1922* (Cth) s 54(1).

[24] *Income Tax Assessment Act 1922* (Cth) s 54(2)(a).

[25] *Income Tax Assessment Act 1922* (Cth) s 54(2)(b). This subsection expressly excluded improvements used for domestic or residential purposes. The relevant case was *Beggs v Commissioner of Taxation (Cth)* [1931] VLR 8, in which the taxpayer used one of two cottages on the land as the residence of himself and his wife. Macfarlan J said the Commissioner would take this into account in fixing depreciation deductions: 14.

[26] Parliament of the Commonwealth of Australia, *Third Report of the Royal Commission on Taxation* (1934, DG Ferguson, chair) [569].

[27] The author was unable to find any resource showing why the government did not implement the proposal, but this may be explained by the lack of consideration given by the government.

A. Wartime Measures

On 3 September 1939, Prime Minister Robert Menzies announced Australia's alliance with the United Kingdom in the war against Germany. It was the beginning of a six-year conflict that would see Australian Territory bombed, ships torpedoed in Australian harbours and Australian soldiers deployed to Europe, Asia, Africa and Oceania. The wartime need for tax revenue soon led to a dramatic expansion of Commonwealth income taxes levied on employees and businesses. It also led to the demise of parallel federal and state income taxes. The Federal Government appropriated parts of the states' income tax field in 1942 as a temporary wartime measure but never reversed it.[28] Important changes were made to the deduction and depreciation rules the same year. Among the most significant changes was the recognition of building structures as wasting assets, separate from the land on which they were constructed. Six and a half months after the Japanese bombing of Darwin, amendments were made to the legislation to provide an immediate deduction for the cost to protect employees, business premises and business assets in the event of enemy raids.[29]

Three other changes were made to the depreciation rules in the Act at the same time. The first was an optional rollover where the taxpayer could apply a balancing charge to involuntary disposal of a depreciated asset that was "for use primarily and principally in, or in connexion with, the prosecution of" the war, which applied to assets lost or destroyed during the war.[30] The rollover allowed taxpayers to avoid recapturing excess depreciation and instead reduce the cost base of replacement assets or any other assets for depreciation purposes by the amount of unrecognised recapture.

Similarly, the second change adopted in 1942 was the option to accelerate depreciation for any plant or article that was acquired or installed for use in or in connection with the war. The rule applied broadly to machinery in various sectors of the economy, which had shifted to a wartime footing by that time.[31] To utilise this option, taxpayers had to first obtain a certificate from one of three authorised government ministries, confirming that the asset was sufficiently connected to the war effort. Arguably, the accelerated depreciation measure allowed under the new rule was not concessional, as it only applied where the taxpayer could show, or a specially appointed Board of Referees ruled, that the item would, in fact, depreciate at a faster rate than the ordinary rate prescribed by the Commissioner.

The third 1942 change was also significant: buildings were recognised as depreciable assets for the first time.[32] This measure included the nexus requirement of the two previous wartime rules requiring that the relevant building be used primarily in or in connection with the prosecution of the war. Significantly, and in contrast to the general depreciation rule, the depreciation measure for buildings adopted a two-limb operative condition test, which applied where the building was used to produce assessable income or used for carrying on a business. The mechanics of the building depreciation rule were similar to those of the accelerated depreciation rule, requiring taxpayers to first obtain a certificate of eligibility from an authorised government ministry confirming the requisite nexus between the building's use and the war effort, then apply to the Board of Referees for an assessment of the building's depreciation rate from the date of acquisition until the date of disposal or until the end of the income year coinciding with the end of the war, whichever was earlier. Those three tax measures were not intended to increase the tax revenue but to allow special depreciation of plant, machinery and buildings acquired or erected after

[28] SJ Butlin and CB Schedvin, *War Economy 1942–1945* (Australian War Memorial, Series 4: Volume IV, 1977) 331–338 (and the improved growth of total tax collections at 570–578). See also Julie Smith, "Australian State Income Taxation: A Historical Perspective" (2015) 30(4) *Australian Tax Forum* 679; Richard Krever and Peter Mellor, "The Development of Centralised Income Taxation in Australia, 1901–1942" in P Harris and D de Cogan (eds), *Studies in the History of Tax Law, Volume 7* (Hart Publishing, 2015) 363.

[29] Darwin was bombed on 19 February 1942, just over two months after the Japanese bombed Pearl Harbor. The immediate write-off was enacted on 6 October 1942 in *Income Tax Assessment Act (No 2) 1942* (Cth), inserting s 72B into the *Income Tax Assessment Act 1936* (Cth).

[30] *Income Tax Assessment Act (No 2) 1942* (Cth) s 8, inserting *Income Tax Assessment Act 1936* (Cth) s 59(2A). This must be read in conjunction with *Income Tax Assessment Act (No 2)* s 9 inserting *Income Tax Assessment Act* ss 59A, 59B.

[31] *Income Tax Assessment Act (No 2) 1942* (Cth) s 9, inserting *Income Tax Assessment Act 1936* (Cth) s 59A.

[32] *Income Tax Assessment Act (No 2) 1942* (Cth) s 9, inserting *Income Tax Assessment Act 1936* (Cth) s 59B.

30 June 1938 for war purposes in response to the altered conditions arising from the war.[33] The use of the Board of Referees was merely to overcome the difficulty in measuring the true extent of depreciation.[34]

B. Post-War Recovery

During the war, major personnel changes occurred in the Commonwealth public service, with a number of economists brought to Canberra to occupy strategic positions and the formation of the Financial and Economic Advisory Committee (F&E Advisory Committee).[35] The significant increase in the size of the Commonwealth public sector that occurred during wartime, in addition to the introduction of uniform income taxation in 1942, offered a new opportunity for policy change when the war ended.[36] By the end of the war, the F&E Advisory Committee fully supported the Keynesian idea of "a more equitable distribution of income" and "socialisation of investment",[37] where the incoming Labor Government was sympathetic about this idea.[38]

Following the end of the war, the Labor Government's attention quickly shifted to economic recovery and renewal of peacetime industries, supported by Keynesianism. The government made its first post-war changes to the depreciation rules based on recommendations from the Associated Chambers of Manufacturers.[39] The primary production sector was enjoying high export prices in response to world demand for raw materials and food after the war,[40] and significant changes in tax law occurred in favour of industrial activities.

One of the most significant changes was the adoption of an explicit tax expenditure to encourage new investment. This front-loading depreciation rule allowed taxpayers to augment the first year's depreciation deduction by 20% of the asset cost for assets acquired after 30 June 1945, whereas the value remaining after deducting the first year's front-loaded depreciation was then depreciated using the effective life of the asset as previously determined by the Commissioner.[41]

This new measure mirrored similar front-loaded depreciation mechanisms introduced around the same time in the United Kingdom, New Zealand and South Africa. It aimed to achieve three objectives: to offset the burden of the inflated post-war prices of equipment needed to retool commercial manufacturing operations, assist business startups in the post-war economy and help Australian manufacturers to reach overseas markets.[42] As enacted, the new concession was to remain in effect until and including the 1949–1950 financial year, but in its final year, it was extended and enhanced. The extended version provided an optional 40% front-loading (with normal depreciation of the asset's acquisition cost reduced by the amount of the front-loading depreciation) in the first year of depreciation for that year of income and the next two years.[43]

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[33] Commonwealth, *Parliamentary Debates*, House of Representatives, 11 September 1942, 275–278 (Chifley).

[34] Commonwealth, *Parliamentary Debates*, House of Representatives, 11 September 1942, 276 (Chifley).

[35] Greg Whitwell, *The Treasury Line* (Allen & Unwin, 1986) 65.

[36] Whitwell, n 35, 64.

[37] Whitwell, n 35, 59, 79.

[38] Whitwell, n 35, 79. The Australian Labor Party is generally credited with the introduction of Keynesianism to the Australian public finance. In particular, Ben Chifley – Treasurer under Prime Minister John Curtin (1941–1945) and later Prime Minister between 1945 and 1949 – was a significant figure (see Whitwell, n 35, 58). Also influential was John Curtin, Prime Minister of Australia between 1941 and 1945 (see John Curtin's Legacy, *The Economy* <http://john.curtin.edu.au/legacyex/economy.html>). The preceding Liberal–Country coalition government resisted the idea even though the F&E Advisory Committee advocated Keynesianism: see SJ Butlin, *War Economy 1936–1942* (Australian War Memorial, Series 4: Volume III, 1955) 196–197, 206–207.

[39] Explanatory Memorandum, *Income Tax Assessment Bill 1946* (Cth).

[40] Explanatory Memorandum, *Income Tax Assessment Bill 1946* (Cth) 83.

[41] *Income Tax Assessment Act 1946* (Cth) s 9, inserting *Income Tax Assessment Act 1936* (Cth) s 57A.

[42] Explanatory Memorandum, *Income Tax Assessment Bill 1946* (Cth) cl 9.

[43] *Income Tax Assessment Act 1949* (Cth) s 2, amending *Income Tax Assessment Act 1936* (Cth) s 57A.

Two changes were also made to the general depreciation rule to improve employees' working conditions and encourage hygienic facilities in workplaces. The first change recognised certain parts of buildings, which had been non-depreciable assets up until this point, as separate depreciable assets in their own right. The definition of depreciable plant was amended to include "plumbing fixtures and fittings, including wall and floor tiling, provided principally for the use of employees".[44] The second change, which was adopted to encourage business investment that would benefit employees, was accelerated three-year straight-line depreciation for plant and articles that were already depreciable, provided they were principally used to provide employees with clothing cupboards, first aid, restrooms, recreational facilities, meals or eating facilities.[45] This concession enjoyed remarkable longevity, remaining in the income tax legislation until 2001.

The last set of concessions adopted based on the Associated Chambers of Manufacturers' recommendations were the predecessors to modern research and development concessions. The first of these was an outright deduction for otherwise non-deductible capital expenses incurred directly by a taxpayer for "scientific research", a term specifically defined to target "activities in the fields of natural or applied science for the extension of knowledge".[46] The second concession was a generous three-year straight-line depreciation deduction for the cost of acquiring plant and the cost of acquiring, altering or improving buildings, which were not treated as depreciable assets at that time if they were used to conduct scientific research.[47] The latter concession, although modified from time to time, lasted until 2011 before being converted into a tax credit regime.

The tax concessions above may be said to have contributed to the extraordinary growth of the manufacturing sector, with half of the country's labour force engaged in it.[48] Inflation was high from the overheated economy in this sector, thus it was possible for the government to increase taxes. However, the existing level of taxation was maintained, which was essentially the Keynesian message that taxation should be changed only when supply could cope with the excessive demand or that the government was keen to balance the budget by weighing tax cuts against resources available to itself.[49] In fact, the economic growth was uneven across different industries, and other sectors were suffering from labour shortages.[50]

When the export prices for wool and wheat fell due to a mild recession in the United States,[51] the Australian Government turned its attention to primary production. In 1947, concessional deductions were introduced for the cost of acquiring or modifying structural assets used to prevent soil erosion, convey or excavate water, or prevent flooding. As a result, structural improvements such as irrigation channels, bores, levee banks or such structural improvements on land used in primary production, which had been depreciable as plant and articles since 1927, became deductible outright.[52]

In 1949, the Liberal-Country party came to power under the leadership of Prime Minister Robert Menzies and Treasurer Sir Arthur Fadden. The party saw that high inflation was due to the supply side problems

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[44] *Income Tax Assessment Act 1946* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 54(2)(c).

[45] *Income Tax Assessment Act 1946* (Cth) s 8, inserting *Income Tax Assessment Act 1936* (Cth) s 55(2).

[46] *Income Tax Assessment Act 1936* (Cth) s 73A(6), inserted by *Income Tax Assessment Act 1946* (Cth) s 11. The outright deduction also applied to payments for scientific research outsourced to approved research institutes (s 73A(1)(a)).

[47] The three-year depreciation rule for plant was set out in s 73A(5), and for buildings in s 73A(2), with both provisions inserted into the *Income Tax Assessment Act 1936* (Cth) by *Income Tax Assessment Act 1946* (Cth) s 11.

[48] Whitwell, n 35, 84.

[49] Whitwell, n 35, 85, 91.

[50] The immigration policy to bring in workers from overseas was insufficient to meet the demand for domestic workers in Australia: see Whitwell, n 35, 86, 96.

[51] Whitwell, n 35, 86.

[52] *Income Tax Assessment Act 1947* (Cth) s 12, inserting *Income Tax Assessment Act 1936* (Cth) s 75(g)–(i). Underground pipes were added to the immediate write-off rule in 1961 by *Income Tax and Social Services Contribution Assessment Act (No 3) 1961* (Cth) s 7, adding s 75(1)(j)–(k) to the *Income Tax Assessment Act 1936* (Cth).

and was even more enthusiastic about developmentalism that the previous government had initiated.[53] Although the government ended the concessions for manufacturers in the 1950–1951 financial year,[54] the final change in this era was made in 1952 to extend the categories of buildings eligible for depreciation US deductions to include accommodation for employees, tenants or share farmers engaged in primary production.[55] High inflation was not reversed, and inflation rose to run at over 20% by early 1951.[56]

While many wartime and post-war measures had expired by the formal end of the war or soon after, some concessions enjoyed longer lives, with a few even stretching into the 21st century. Two legacies of the tax changes made during the wartime period proved particularly important. The first was the deliberate use of depreciation concessions to advance the government's economic policy. Arguably, the wartime and in particular, the post-war tax measures, were the beginning of the long practice of using tax expenditures to subsidise capital investment in Australian industries. The second was recognising buildings as distinct assets, separate from the land on which they were built. While it would be another seven decades before depreciation deductions could be claimed on all buildings used to produce assessable income, the foundation for gradually widening that category was established in the wartime and post-war era.

IV. Increasing Economic Intervention: 1952–1972

The third significant period in the history of depreciation in Australia began in 1952, with the signing of the Treaty of San Francisco, the formal end of the World War II. This marked the beginning of a new era as Australia moved from post-war recovery into a period of relatively balanced economic development.[57] The changes to the depreciation system made under the conservative Coalition Government, which held power for over two decades, fell into three broad camps. First, following the advice of a committee tasked with reviewing Australia's depreciation rules, the government legislated long-overdue technical changes to the basic depreciation system. Soon afterwards, the government initiated a second depreciation reform program, adopting new depreciation rules for the forestry and fishing industries. The third stage of depreciation reforms came in the early 1960s when the government, following a decade of sustained lobbying by industry groups, enthusiastically adopted the use of tax concessions as a tool for economic intervention and, shortly afterwards, formally recognised concessions as being equivalent to direct subsidy programs.

A. The Hulme Committee

As the economy stabilised after the turbulence of the war and post-war recovery periods, the government turned its attention to questions of long-term economic and tax policy. Reform and modernisation of the depreciation rules were high on the agenda, and in 1954, the government appointed an ad hoc committee chaired by Alan S Hulme to advise on reforming the depreciation rules. The committee included stakeholders from the manufacturing, commerce and primary production sectors, as well as the accounting profession.

The Hulme Committee focused on four apparent shortcomings in the depreciation system: (1) the rate of depreciation used for calculations under the diminishing value method; (2) the excessively high amounts of depreciation being recaptured when depreciable assets were disposed of in conditions of high inflation; (3) the cash flow dilemma faced by taxpayers replacing depreciating assets after involuntary disposals; and (4) the lack of depreciation rules for buildings, as well as other industry-specific issues.[58] One of the

[53] Whitwell, n 35, 96–100.

[54] *Income Tax and Social Services Contribution Assessment Act Assessment Act (No 2) 1952* (Cth) s 6, repealing *Income Tax Assessment Act 1936* (Cth) s 57A, subject to a transitional rule retaining the concession for the 1950–1951 income year.

[55] *Income Tax and Social Services Contribution Assessment Act (No 2) 1952* (Cth) s 4, amending *Income Tax Assessment Act 1936* (Cth) s 54(2)(b).

[56] See Whitwell, n 35, 104 (and the background at 100–104).

[57] For example, the government began to control high inflation while cautiously designing tax concessions although inflation was heightened again towards the end of this era. See Whitwell, n 35, Chs 5–7.

[58] Commonwealth Committee on Rates of Depreciation, *Report of the Commonwealth Committee on Rates and Depreciation* (9 June 1955, AS Hulme, chair) (*Hulme Report*).

first legislative changes resulting from the Hulme Committee's report came from its recommendation that a wartime rollover measure be reinstated to enable taxpayers to defer recognition of balancing charges arising in respect of involuntary disposals (due to loss or destruction of assets). For depreciation purposes, taxpayers could reduce the cost base of replacement assets by the amount of unrecognised balancing charges.[59] Legislation reinstating this rollover was adopted soon after the Hulme Committee's report.[60]

At the time, the depreciation system gave taxpayers the option of using straight-line depreciation (known as "prime cost depreciation") or the diminishing value method. Both methods used the same rate, which was based on the estimated effective life set by the Commissioner. As a result, the decline in value was often grossly underestimated when applying the diminishing value method if the cost of an asset had been fully recovered using the prime cost method. The book value of the same asset, if depreciated using the diminishing value method, reflected only one-third of its original cost.

The committee noted that tax systems in jurisdictions such as the United Kingdom, Canada and the United States commonly used diminishing value rates higher than (often double) the 100% straight-line rate used in Australia,[61] a formula that essentially stretched declining value depreciation out well past the end of an asset's effective life. Using higher rates produces significantly higher deductions upfront and much lower deductions in the second half of an asset's expected effective life, particularly in the last third of its life, when repair costs typically rise. The Hulme Committee recognised the inequity of the 100% formula being used in Australia for tangible assets that lose their value more rapidly in earlier years of their effective life, whereas the way in which the tax law was drafted permitted deductions of only about two-thirds of the total cost of assets using diminishing value rates.[62] The committee recommended that the declining balance rate be increased to 150% of the prime cost rate for an asset[63] while noting that rates up to 200% were being used in other countries.[64] The committee said, "as a general rule, it would be recognised as good practice to effect replacement at the expiration of approximately two-thirds of the estimated life."[65] The diminishing rate of 150% was expected to achieve in the roughly depreciated value as the asset depreciated on the prime cost method at two-thirds of the estimated life.[66] The government accepted the Hulme Committee's recommendation and raised the diminishing value rate to 150% of the prime cost rate. The new rate was made available to taxpayers in respect of both future purchases and plant held at the time of the change, including plant that had previously depreciated on a straight-line basis.[67] It would be another half a century before the rate was raised to 200% of prime cost rate as a concessional measure in Australia.[68]

The second and third issues considered by the Hulme Committee reflected the country's high levels of inflation. One of the legacies of the post-war recovery was exaggerated income gains in many instances, including the notional gains realised by taxpayers who sold used depreciable assets into a market in

[59] *Hulme Report*, n 58, [32]–[40].

[60] *Income Tax and Social Services Contribution Assessment Act (No 3) 1956* (Cth) s 7(b), replacing *Income Tax Assessment Act 1936* (Cth) s 59(2A).

[61] *Hulme Report*, n 58, [25].

[62] *Hulme Report*, n 58, [24].

[63] *Hulme Report*, n 58, [28].

[64] *Hulme Report*, n 58, [25].

[65] *Hulme Report*, n 58, [27].

[66] *Hulme Report*, n 58, [28] containing the forecast of the estimated values after depreciation for plant with an effective life of 10 years and 20 years.

[67] *Income Tax and Social Services Contribution Assessment Act 1957* (Cth) s 6, replacing *Income Tax Assessment Act 1936* (Cth) s 56(1).

[68] *Tax Law Amendment (Personal Tax Reduction and Improved Depreciation Arrangements) Act 2006* (Cth) Sch 5 cl 1, inserting s 40–72 into the *Income Tax Assessment Act 1997* (Cth). This provision is coded "B80 Simplified Depreciation Rules" in the Treasury, *Tax Benchmarks and Variations Statement 2019* (Australian Government, 31 January 2020) 81 <https://treasury.gov.au/publication/p2020-51153>.

which prices were augmented by substantial inflation. In these cases, real economic losses might be reflected as depreciation balancing adjustment gains when the proceeds of disposal were calculated using inflation-adjusted consideration. The Hulme Committee appeared to appreciate that it was not in a position to deal with the overall effects of inflation on depreciation.[69] However, it did conclude there was a strong case for providing some relief to taxpayers who acquired replacement assets and were forced to recognise phantom inflationary gains as a result of involuntary disposals (due to loss or theft).[70] These taxpayers had not chosen to dispose of their assets and, after receiving compensation in the form of insurance or damages, only used the proceeds to return to the position they were in before the involuntary disposal.

A significant portion of the Hulme Committee's report was devoted to the question of depreciation for buildings.[71] In the second half of the 20th century, the Australian economy was very different from what it had been in the colonial era when state income taxes were first introduced. As the Ferguson Royal Commission had explained in its 1934 report, whereas buildings had once been made to last hundreds of years, one of the features of the modern economy was the speed at which working assets, including buildings, became obsolete or in need of substantial renovation. While this was an accurate observation in the 1930s, the depreciating nature of buildings was even more pronounced in the post-war environment. Different types of hotels and motels were built to accommodate newly mobile travellers; entirely new types of buildings, such as cinemas, sports halls, radio and later, television studios and broadcast facilities, were constructed to house new activities; older commercial buildings including factories and offices were often rebuilt or replaced with new industrial facilities; and new commercial practices took hold. The secondary industries had expanded and were continuously evolving to keep abreast of technological changes, for which the Hulme Committee noted that "obsolescence has become as important a factor for buildings as for plant".[72]

The United Kingdom, Canada, New Zealand and the United States all allowed depreciation deductions for buildings, and it was not surprising that the Hulme Committee recommended Australia should follow these precedents. It suggested setting a 66-year effective life for brick, stone or concrete buildings (equalling an annual depreciation of 1.5% of the cost) and a 40-year life for timber, fibro or iron buildings (equalling an annual depreciation of 2.5% of the cost).[73] The Hulme Committee envisaged a single depreciation calculation for every type of building with the base being all construction costs incurred in the erection of the building and structural improvements and transfers deemed to take place at the notional book value to avoid the need for balancing charges and the consequent cash flow implications for taxpayers acquiring replacement buildings.[74] However, it also suggested that balancing adjustment deductions should be provided where the proceeds received from the sale of a building were less than the notional book value.[75] Thereafter, the purchaser could deduct the price paid for the building for the number of years of its remaining life or in the event of demolition.

While the government took the Hulme Committee's recommendations on board concerning modifying the diminishing value formula and reinstating the rollover for involuntary disposals, it balked at the prospect of a universal depreciation rule for buildings used in a business or to produce assessable income. Soon after the release of the Hulme Committee's report, the government embarked on a path it would follow for the next three decades, adopting a piecemeal approach to depreciation rules for different types of buildings on an industry-by-industry basis.

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[69] *Hulme Report*, n 58, [34].

[70] *Hulme Report*, n 58, [38]–[39]. The committee suggested this principle be "suitably widened to cover the proceeds of sales of plant, as well as insurance and other recoveries on their loss or destruction": [39].

[71] *Hulme Report*, n 58, [68]–[134].

[72] *Hulme Report*, n 58, [73].

[73] A summary of the proposed plan can be found in *Hulme Report*, n 58, [100].

[74] See the discussion about the cost base in *Hulme Report*, n 58, [104]–[115] and transfers in [118]–[120].

[75] *Hulme Report*, n 58, [116]–[117].

B. Forestry and Fishing

The first industry to benefit from the government's industry-based approach to depreciation was the forestry and timber industry. The Hulme Committee, in addition to analysing the general depreciation rules, had examined industry-specific issues, one of which was that access roads used in forestry and timber operations were not allowed to depreciate. These structural assets, used for planting and tending new trees and removing felled trees, might be costly to build but only enjoyed a limited life; once the trees had been removed, the access roads had no further value. The Hulme Committee recommended depreciation deductions be extended to timber access roads while also suggesting that buildings used in timber operations should be brought into the proposed depreciation regime for all buildings.[76]

The government accepted the proposal to allow depreciation deductions for access roads. New measures were enacted the following year, which applied to both existing and new access roads, including ancillary and substructures such as bridges and culverts that were part of roads.[77] The new rules applied to access roads used in forestry operations and transporting felled timber to mills or other processing plants. Depreciation of access roads was based on an effective life equal to the anticipated duration of timber operations (defined to include forest planting as well as felling and milling) or 25 years, whichever was less. Separately, some taxpayers' attempts to categorise timber mill access roads as depreciable plant were rebuffed by the Commissioner and the Board of Review, leaving those structures classified as non-depreciable improvements under the tax laws.[78] The proposal to allow depreciation deductions for forestry and timber industry buildings died with the government's rejection of a general depreciation rule for buildings.

Following the forestry industry's experience and, in particular, its failure to secure depreciation deductions for buildings, the fishing industry (including pearling) tried a different approach. Traditionally, primary production had been understood to involve rearing domesticated animals and harvesting planted crops. Hunting, fishing and activities based on catching wild animals or harvesting from them (like in pearling) fell outside the scope of primary production.[79] Rather than seeking to create a set of industry-specific rules, as had been done for timber operations, the fishing and pearling industries sought recognition as a subset of primary production in the tax legislation. In 1958, two years after the depreciation rules for timber access roads were enacted, fishing operations, including pearling, were added to the definition of primary production.[80] At the same time, the depreciation rules were extended to include industry-specific structural improvements, including employee accommodation for pearling operations.[81]

Five years later, in response to lobbying by the forestry industry, the government also added forestry to the definition of primary production[82] and added forestry-specific structural improvements to the definition of depreciable assets.[83] Timber access roads, which had been subject to a separate depreciation regime since 1956, were excluded from the expanded definition of depreciable structural improvements.[84] In the

[76] *Hulme Report*, n 58, [152]–[155], [156].

[77] *Income Tax and Social Services Contribution Assessment Act (No 3) 1956* (Cth) s 20, inserting *Income Tax Assessment Act 1936* (Cth) Pt III Div 10A.

[78] See *Case 17* (1956) 6 CTBR(NS) 106.

[79] Catching wild buffalos to harvest buffalo hides, for example, was confirmed as being outside the scope of primary production in *Burnside & Marrakai Ltd v Commissioner of Taxation (Cth)* (1957) 11 ATD 181.

[80] *Income Tax and Social Services Contribution Assessment Act 1958* (Cth) s 3, adding fishing and pearling to the definition of primary production in s 6(1), *Income Tax Assessment Act 1936* (Cth).

[81] *Income Tax and Social Services Contribution Assessment Act 1958* (Cth) s 4, adding structural improvements wholly and exclusively used in pearling operations to the definition of plant in *Income Tax Assessment Act 1936* (Cth) s 54(2)(b).

[82] *Income Tax and Social Services Contribution Assessment Act (No 2) 1963* (Cth) s 4, adding forestry operations to the definition of primary production in *Income Tax Assessment Act 1936* (Cth) s 6(1).

[83] *Income Tax and Social Services Contribution Assessment Act (No 2) 1963* (Cth) s 10, amending *Income Tax Assessment Act 1936* (Cth) s 54(2)(b).

[84] See Explanatory Memorandum, *Income Tax Assessment Bill 1946* (Cth) 83, referring to *Income Tax Assessment Act 1936* (Cth) Pt III Div 10A.

definition of primary production, forestry operations meant activities up to the point at which timber was transported to its first processing site. As a result, timber milling remained outside the scope of primary production and its depreciation rules.

In 1963, while leaving all other buildings (apart from scientific research buildings) outside the capital allowance regime, the government introduced a new rule for depreciation deductions on timber mill buildings, including workers' accommodation situated in a forest or near felled timber. Timber mill buildings were placed on the same footing as access roads, with their depreciation period capped at the anticipated life span of the milling operations or 25 years, whichever was less.[85]

C. New Industry-based Tax Expenditures

In the late 1940s, wool remained Australia's single most important export item and the increased demand by the United States during the Korean War pushed the price to a peak in March 1951.[86] In 1952, the government moved to terminate its post-war front-end loaded depreciation concession for the manufacturing industry sooner and turn its attention to primary industry, specifically, to the agricultural and pastoral sectors. The first concession provided to the agricultural sector was a new five-year depreciation period for plant and structural improvements used exclusively for agricultural and pastoral purposes,[87] with a cap on the value of employee accommodation for which accelerated depreciation was available. The cost of employee accommodation in excess of the cap could be depreciated at the ordinary depreciation rate.[88]

Later that year, farmers in the Northern Territory were provided with an additional concession to offset the removal of an exemption for pastoral income, which had been adopted in 1923 to encourage settlement and industrial development in sparsely populated regions. At the same time, agricultural and pastoral taxpayers in the Northern Territory were also given the option to deduct the cost of depreciable plant and structural improvements upfront in lieu of the five-year depreciation available to farmers in other regions and to deduct the cost of employee accommodation without any cap on the deductible amount.[89]

The depreciation system, as it applied to both manufacturing and primary industry, remained stable for the next decade, but as the economic growth of the post-war recovery tapered off, manufacturers began lobbying intensely for more government assistance. During the same period, their competitors in the United Kingdom enjoyed the benefit of two depreciation tax expenditures: there, an accelerated deduction was available for 20% of the cost of new plant in the year of acquisition and the cost base was boosted to 120% of the actual cost for depreciation purposes.[90] When Australia faced another recession in 1961–1962, the government responded to lobbying and, in 1962, introduced a 20% investment allowance, which provided taxpayers with a deduction of 20% of the cost of new plant used in manufacturing processes

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[85] *Income Tax and Social Services Contribution Assessment Act (No 2) 1963* (Cth) ss 47–50 (*1963 Act*), reorganising the timber access road depreciation division in the *Income Tax Assessment Act 1936* (Cth) and, by s 51 of the *1963 Act*, inserting a separate Subdiv 10B to allow depreciation of mill buildings and mill employee accommodation.

[86] "From an Australian perspective, the Korean War (June 1950 to July 1953) was more important for its effects on the domestic economy than for the military contribution Australia made to the United Nations forces engaged there": Ian W McLean, *Why Australia Prospered: The Shifting Sources of Economic Growth* (Princeton University Press, 2013) 188.

[87] *Income Tax and Social Services Contribution Assessment Act (No 2) 1952* (Cth) s 5 inserting *Income Tax Assessment Act 1936* (Cth) s 57AA. Initially, the concession applied to plant and structural improvements first used or installed for use before 30 June 1955, and structural improvements for which construction commenced before 30 June 1955 and completed before 30 June 1956. It was extended for four more years in 1956, under *Income Tax and Social Services Contribution Assessment Act 1956* (Cth) s 3, for a further three years in 1958, under *Income Tax and Social Services Contribution Assessment Act 1958* (Cth) s 5 and then, for five more years in 1962, under *Income Tax and Social Services Contribution Assessment Act 1962* (Cth) s 6, before the time limit was removed. It became a permanent concession in 1967, under *Income Tax Assessment Act (No 3) 1967* (Cth) s 7.

[88] The cap was originally set at £2,000 per person. It was raised to £2,750 in 1956, under *Income Tax and Social Services Contribution Assessment Act 1956* (Cth) s 3, amending *Income Tax Assessment Act 1936* (Cth) s 57AA.

[89] *Income Tax and Social Services Contribution Assessment Act (No 3) 1952* (Cth) s 4 (*1952 Act*) removed the tax exemption in *Income Tax Assessment Act 1936* (Cth) s 23(m), while *1952 Act* s 9 provided the immediate deduction option, with the insertion of s 57AB into the *Income Tax Assessment Act 1936* (Cth).

[90] See, eg, Commonwealth, *Parliamentary Debates*, House of Representatives, 21 October 1954, 938 (Laught, Senator).

(including timber milling) in the year of acquisition, in addition to the ordinary depreciation deduction.[91] Unlike the 1952 downturn, it was not possible to pinpoint the cause of the early 1960s recession.[92]

The following year, a similar investment allowance was provided to the primary production industry, ostensibly to place the primary production sector on an equal footing with manufacturers.[93] However, the target of this allowance was most likely not the primary production industry, which already enjoyed various concessions such as income averaging and loss carry-forward rules. Rather, it was likely aimed at manufacturing businesses, as the concession was limited to acquisitions of new plant and articles and explicitly excluded structural improvements such as fences or dams. Another measure introduced simultaneously allowed primary producers to depreciate the cost of extending telephone lines to their property.[94] While arguably, the right to depreciate this expense was not a concession, allowing a depreciation period of 10 years was an important new development to broaden a depreciation asset category.

Several new concessions were introduced for primary producers in the next six years, including immediate deductions for the cost of installing fencing to combat animal pests or the adverse effects of mineral salts (introduced in 1963),[95] limiting soil erosion by excluding livestock from sensitive areas (in 1966)[96] and marking the subdivision of land (in 1967).[97] Following these, provisions allowing outright deductions for structural improvements made to conserve or convey water[98] and structural improvements used to store grain, hay or fodder were also introduced (both in 1969).[99]

Separate from the concessions aimed at the manufacturing and primary production industries, the government introduced two other measures designed to assist Australian businesses in switching from pounds to dollars and from imperial measurements to the metric system. The provisions allowed immediate deductions for the cost of replacing plant required due to the change in currency[100] and measurement systems, respectively,[101] where the former was implemented by the Holt Government of the Coalition party and the latter by the Labor Government. Undoubtedly, these measures had a concessional aspect, allowing write-offs for the cost of items such as cash registers and scales with effective life periods well beyond the year in which they were acquired.[102] The measures were passed as law without much debate in the Parliament.

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[91] *Income Tax and Social Services Contribution Assessment Act 1962* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 62AA. The investment allowance was available for depreciable assets used for seven specified purposes, a construction that was read narrowly by the Commissioner and the courts. See, eg, *Moreton Central Sugar Mill Co Ltd v Commissioner of Taxation (Cth)* (1967) 116 CLR 151 (trucks, locomotives and servicing facilities did not qualify for the allowance because they were used to transport material to manufacturing but not in the manufacturing process); *Macquarie Worsteds Pty Ltd v Commissioner of Taxation (Cth)* (1974) 23 FLR 69; 4 ATR 334 (a ceiling installed to facilitate operation of an air conditioner needed to run a factory did not qualify for the allowance because it related to the function of the ceiling, not the taxpayer's operations).

[92] Whitwell, n 35, 136–137.

[93] *Income Tax and Social Services Contribution Assessment Act (No 2) 1963* (Cth) s 15, inserting *Income Tax Assessment Act 1936* (Cth) s 62AB.

[94] *Income Tax and Social Services Contribution Assessment Act (No 2) 1963* (Cth) s 21, inserting *Income Tax Assessment Act 1936* (Cth) s 70.

[95] *Income Tax and Social Services Contribution Assessment Act (No 2) 1963* (Cth) s 24(e), inserting *Income Tax Assessment Act 1936* (Cth) s 76(2).

[96] *Income Tax Assessment Act 1966* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 75(1)(ga).

[97] *Income Tax Assessment Act (No 3) 1967* (Cth) s 8(a), inserting *Income Tax Assessment Act 1936* (Cth) s 75(1)(gb).

[98] *Income Tax Assessment Act (No 2) 1969* (Cth) s 6(a), replacing *Income Tax Assessment Act 1936* (Cth) s 75(1)(h).

[99] *Income Tax Assessment Act (No 2) 1969* (Cth) s 6(c), inserting *Income Tax Assessment Act 1936* (Cth) s 75(1)(l).

[100] *Income Tax Assessment Act 1965* (Cth) s 15, inserting *Income Tax Assessment Act 1936* (Cth) s 53F. Harold Holt succeeded Robert Menzies in 1966 to become the 17th Prime Minister of Australia. In December 1967, Holt disappeared while swimming in the sea and his body was never recovered. He was formally presumed dead on 18 December 1967, thereby ending his term.

[101] *Income Tax Assessment Act 1973* (Cth) s 5, inserting *Income Tax Assessment Act 1936* (Cth) s 53G. The Labor Government was led by Gough Whitlam at that time.

[102] In respect of the 1965 amendment, Fox noted that "[w]ithout this amendment this expenditure would have been treated as capital expenditure which could only be depreciated over a number of years". See Commonwealth, *Parliamentary Debates*, House

V. The Reduction and Later Expansion of Tax Expenditures: 1973–1992

The election of Australia's first Labor Government in 23 years, in December 1972, marked the starting point for significant changes to many aspects of Australia's social and economic systems. One set of changes began when the government formally recognised depreciation and other concessions as tax expenditures. After applying conventional budget analysis, the government decided to wind back many tax concessions that appeared poorly directed or inefficient. However, these changes were short-lived, and before it was voted out of office, the Labor Government had reverted to using depreciation concessions to achieve economic ends. That practice continued under the Coalition Government after it returned to power in late 1975 and continued again when the Labor Government was re-elected in late 1982. During its term, the Labor Government extended depreciation deductions to all buildings used to produce income or carry on a business. By this point, the depreciation rules had undergone structural reform, with standardised depreciation rates set at 120% rates for almost all categories of assets.

A. The Early Whitlam Years

The newly elected Labor Government inherited an ongoing tax inquiry from its Coalition predecessor. Headed by Justice Kenneth Asprey of the New South Wales Supreme Court, the Tax Review Committee (known as the 'Asprey Committee') conducted a sweeping study of all aspects of Australia's tax system. Separately, in March 1973, the government established a taskforce to report on the spending programs carried over from the previous government. Headed by economist Herbert Cole 'Nugget' Coombs, a former (and the first) governor of the Reserve Bank of Australia and economic adviser to the Menzies Government, the group (which had seven members) produced a comprehensive 358-page report (the "Coombs Report") fewer than two months after being appointed, in time for it to be included in the 1973–1974 Budget papers.[103]

One of the most significant aspects of the Coombs Report was that it recognised tax concessions as government expenditures that could be evaluated in the same manner as direct government spending. Interestingly, the Coombs Report was written long before the practice of identifying and costing tax expenditures was first adopted and only a few months after an important academic work was published in the United States, arguing that revenue lost through tax concessions should be treated as tax expenditures.[104] The Coombs Report identified tax expenditures across a range of taxes, including payroll tax, sales tax, excise tax and income tax. Depreciation concessions accounted for many of the income tax concessions set out in the report, which it labelled "disguised" expenditures.

The terms of reference for the Coombs taskforce did not include reviewing the tax legislation. However, because it recognised tax concessions as a legitimate form of government spending, the Coombs Report also provided the most comprehensive survey of tax concessions ever produced in Australia at the time. Soon after receiving the Coombs Report, the government moved to remove five important depreciation concessions. First, the five-year depreciation rule for primary production, which had been adopted in 1952, was removed, leaving the ordinary rates in force.[105] Second, the investment allowance for manufacturers, which had been adopted in 1962, was removed and third, a similar allowance for primary producers was adopted in 1963.[106] Fourth, the outright deductions for different types of primary

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of Representatives, 30 November 1965, 3383 (Fox). The 1973 amendment followed the suit: see Commonwealth, *Parliamentary Debates,* Senate, 5 June 1963, 2297 (Murphy) ("We are proposing the same now in this respect as was done in 1965 in relation to conversion of plant for use with the dollar currency.").

[103] Parliament of Australia, *Review of the Continuing Expenditure Policies of the Previous Government* (Taskforce Report, June 1973, HC Coombs, taskforce leader) (*Coombs Report*). The history of the recognition of tax expenditures in Australia was reviewed in Kerrie Sadiq, "Tax Expenditures in Australia: The Elevation from 'Disguised' Expenditures to Architectural Pillars of the 21st Century" in Lisa Philipps, Neil Brooks and Jinyan Li (eds), *Tax Expenditures: State of the Art* (Canadian Tax Foundation, 2011).

[104] Stanley S Surrey, *Pathways to Tax Reform* (Harvard University Press, 1973).

[105] *Income Tax Assessment Act (No 5) 1973* (Cth) s 11, amending *Income Tax Assessment Act 1936* (Cth) s 57AA.

[106] The investment allowance for manufacturers was removed by *Income Tax Assessment Act (No 5) 1973* (Cth) s 13, amending *Income Tax Assessment Act 1936* (Cth) s 62AA. The investment allowance had been suspended between February 1971 and February 1972: see *Income Tax Assessment Act 1971* (Cth) s 3 and *Income Tax Assessment 1972* (Cth) s 3, amending *Income Tax*

production fencing adopted in 1963, 1966 and 1967 were removed, as well as the immediate deduction for soil conservation or flood prevention structures, water conveyancing or conservation improvements and storage facilities.[107] Fifth, the outright deduction for expenditure incurred to prepare and clear land, first introduced in 1927, was replaced with a 10-year depreciation rule.[108] However, the 10-year depreciation rule for telephone connections to primary producers' properties, which was criticised in the Coombs Report for unfairly favouring primary producers over other rural businesses, remained untouched.[109]

B. The Late Whitlam Years and the Fraser Era

A year after removing various depreciation concessions for manufacturers and primary producers, the Whitlam Labor Government turned to tax expenditures as a means to achieve its policy goal of assisting female participation in the labour market.[110] The definition of depreciable plant was amended to include plumbing fixtures and fittings used principally for onsite childcare facilities for employees, while an accelerated three-year depreciation rate was extended to depreciable plant and articles used for employees or their children, principally with clothing cupboards, first aid, rest-room or recreational facilities, or meals or eating facilities.[111]

By 1974, rising inflation had reached alarming levels, at close to 20% per annum. Faced with a chorus of pleas for action from the business community, the government appointed a special committee headed by Russell Mathews to make recommendations on how to respond to the problem.[112] The Mathews Committee delivered a comprehensive report in May 1975, effectively recommending that indexation be applied to much of the tax system, including the depreciation system.[113]

The government did not wish to undertake the comprehensive reform project proposed by the Mathews Committee. Instead, it compromised on a less extensive substitute measure, adopting 'double-rate' depreciation for new plant and articles (ie, allowing depreciation at double the normal rate).[114] This provision, which became law in June 1975, only applied to items installed on or after 1 July 1974 and before 1 July 1975 and applied primarily to plant used in manufacturing and primary production, other than structural assets. Later that year, from 1 July 1975, the government extended the double deduction concession to other industries and structural assets used in primary production.[115] The amending Act received Royal Assent on 11 November 1975, the same day the Governor-General dismissed the Labor

Assessment Act 1936 (Cth) s 62AA. The investment allowance for primary producers was removed by *Income Tax Assessment Act (No 5) 1973* (Cth) s 14, amending s 62AB of the *Income Tax Assessment Act 1936* (Cth).

[107] *Income Tax Assessment Act (No 5) 1973* (Cth) ss 16, 18, amending ss 75–76, respectively, of the *Income Tax Assessment Act 1936* (Cth).

[108] *Income Tax Assessment Act (No 5) 1973* (Cth) s 16, removing the deduction. *Income Tax Assessment Act (No 5)* s 17 inserted s 75A into the *Income Tax Assessment Act 1936* (Cth).

[109] *Coombs Report*, n 103, 289.

[110] The newly elected Whitlam Government joined unions to lobby the Australian Conciliation and Arbitration Commission to review its earlier decision in *Equal Pay Case 1969* (1969) 127 CAR 1142, in which it was held that women should be paid equally for performing the same work as men. This led to the equal pay principle being extended to "equal pay for work of equal value" in *National Wage Case & Equal Pay Cases 1972* (1972) 147 CAR 172. The proportion of women in the paid workforce was around 40% in 1973, increased from 26% in 1954, and rose to 52.1% in 1983 owing to the Whitlam Government's policy: Raelene Frances, Linda Kealey and Joan Sangster, "Women and Wage Labour in Australia and Canada, 1880–1980" (1996) 71 *Labour History* 54, 56, 60. More information about women's activism can be found in Glenda Strachan, "'Changing the Unions' Agenda: Women's Activism in Australian Trade Unions in the 1970s and 1980s" (2019) (117) *Labour History* 181; Christopher A Pissarides, "Real Wages and Unemployment in Australia" (1991) 58 *Economica* 35.

[111] *Income Tax Assessment Act (No 2) 1974* (Cth) ss 11–12, amending *Income Tax Assessment Act 1936* (Cth) ss 54–55.

[112] The background to the Mathews Committee and the environment in which it operated can be found in Norman Thompson, "Taxation and the Asprey and Mathews Reports" (1976) 48(4) *The Australian Quarterly* 76.

[113] Parliament of Australia, *Inflation and Taxation: Report of Committee of Inquiry into Inflation and Taxation* (1975, RL Mathews, chair). Positive inflation causes a bias in favour of longer-lived assets: see Matt Benge, "The Ralph Report Depreciation Proposals and Investment Neutrality" (Working Paper No 371, Department of Economics, Australian National University, 1999).

[114] *Income Tax Assessment Act 1975* (Cth) s 20, inserting *Income Tax Assessment Act 1936* (Cth) s 57AC.

[115] *Income Tax Assessment Act (No 2) 1975* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 57AD.

Government and the leader of the Opposition Coalition, Malcolm Fraser, was appointed as Prime Minister.

Following an election on 13 December 1975, the Coalition Government returned to power and almost immediately set about modifying the depreciation rules again. The Coalition's first significant initiative in this regard was in 1976 when it replaced double deduction depreciation[116] with a new investment allowance that once again provided extra deductions on top of ordinary depreciation, of up to 40% of the cost of new plant or articles in the year in which the cost was incurred, which reduced to 20% after two years.[117] This provision applied to assets acquired on or after 1 January 1976. Initially, it was set to expire on 30 June 1983, but in the following year, it was extended to 30 June 1985.[118] The allowance was available for plant and articles used wholly and exclusively in Australia to produce income. It included a provision for lessors to claim deductions for depreciated assets subject to long-term leases (at least four years long)[119] and assets disposed of by way of sale and leaseback arrangements, as long as the transaction took place within six months after the lessee acquired the property.[120] A list of ineligible assets was also included in the investment allowance provisions. These included motor vehicles, artwork and assets used in the entertainment industry (eg, recreational facilities, racing animals or vehicles, gaming machines, and cinematographic film equipment).

Further expansion of depreciation concessions came in 1979 when the ordinary depreciation rule for grain, hay or fodder storage facilities was replaced with an accelerated five-year depreciation rule.[121] Even more significant concessions came in 1980, when the 20% investment allowance adopted in 1976 was extended to include almost all depreciable assets, with only a few categories excluded, such as motor vehicles and artwork.[122]

Also in 1980, the government provided accelerated depreciation deductions for plant and articles, other than motor vehicles or any other assets already subject to special depreciation rates, such as primary production assets.[123] Motor vehicles remained depreciable at the rate set by the Commissioner.[124] Accelerated depreciation took the form of 20% loading that enabled taxpayers to augment the annual depreciation rate by 120%, which would be reduced the following year to 18%.[125] This concession operated in addition to the existing upfront "investment allowance" deduction of 20% of the cost of an eligible asset. One minor restriction was also added to the depreciation rules in 1980, a measure that limited the depreciable cost of motor vehicles to $18,000 (the "luxury motor vehicle limit"), indexed for

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[116] *Income Tax Assessment Amendment Act 1976* (Cth) s 8, terminating the double deduction in *Income Tax Assessment Act 1936* (Cth) s 57AD from 1 July 1976.

[117] *Income Tax Assessment Amendment Act 1976* (Cth) s 10, inserting *Income Tax Assessment Act 1936* (Cth) Pt III Div 3 Subdiv B. The full allowance applied to assets costing at least $975 with a shade-in rate formula applicable to spending from $500 to $975. The allowance encouraged creative characterisation by some taxpayers seeking to circumvent restrictions on the allowance, including an unsuccessful attempt to portray an energy efficient display house, which was also used by the architect, as eligible plant (*Cases Nos AT 86/454* (1987) 18 ATR 3955; *Cases Nos TT 87/44* (1987) 19 ATR 3019); an unsuccessful attempt by a caravan park to demonstrate that a caravan rented to park residents was not "leased" (*Tourapark Pty Ltd v Commissioner of Taxation (Cth)* (1982) 149 CLR 176; 12 ATR 842); and an unsuccessful attempt by an airplane owner to demonstrate that providing the plane to a third party did not give that third party a right to use (*Kirby v Commissioner of Taxation (Cth)* (1987) 14 FCR 563; 18 ATR 839).

[118] *Income Tax Assessment Amendment Act (No 2) 1977* (Cth) s 5 amended the last day by which plant had to be ordered or construction of plant had to commence in *Income Tax Assessment Act 1936* (Cth) s 82AB. The plant had to be used or installed and ready to use before 1 July 1986.

[119] *Income Tax Assessment Act 1936* (Cth) s 82AA(b).

[120] *Income Tax Assessment Act 1936* (Cth) s 82AB(7).

[121] *Income Tax Laws Amendment Act 1979* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 57AE.

[122] *Income Tax Assessment Amendment Act (No 6) 1980* (Cth) s 12, amending *Income Tax Assessment Act 1936* (Cth) s 82AF(2)(f).

[123] *Income Tax Assessment Amendment Act (No 4) 1980* (Cth) s 6, inserting *Income Tax Assessment Act 1936* (Cth) s 57AG.

[124] For example, cars (other than taxis, hire and travellers' cars) were depreciable at 25% per annum using the prime cost method or 22.5% using the diminishing value method.

[125] *Income Tax (Assessment and Rates) Amendment Act 1981* (Cth) s 8, amending *Income Tax Assessment Act 1936* (Cth) s 57AG.

inflation from 1980 onwards.[126] The restriction achieved the dual objectives of assisting the Australian automobile industry, which generally did not produce luxury cars, and capping tax deductions for vehicle-related fringe benefits provided to high-income employees, who could otherwise avoid taxation entirely at the time, both at the personal and employer level.

As noted earlier, the 20% loading did not apply to assets already subject to special depreciation regimes. Several other new special depreciation (or immediate deduction) regimes were added to the legislation in 1980. Many of these aimed to unwind the primary production depreciation reforms implemented by the Whitlam Government and restoring or even enhancing concessions for the sector. A five-year depreciation rule was adopted for new primary production plant, including structural improvements, neither of which had been included in the rules for storage facilities adopted in 1980.[127] The same year, outright deductions were provided for the cost of designated primary production assets that had been depreciable over 10 years under the Whitlam reforms. These included expenditure for structural assets used to conserve or convey water or combat animal or vegetable pests,[128] boundary fences to prevent the spread of animal disease[129] and outlays to combat soil erosion[130] (which was replaced by the broader term "land degradation" five years later).[131] From 1981, to further subsidise rural business, an immediate deduction was provided for the cost of installing mains electricity connections on rural properties, if used within 12 months, in a business carried on to generate assessable income.[132]

In 1981, outright deductions were provided for the cost of facilities used wholly and exclusively for storing liquid or gaseous petroleum fuel before sale.[133] Two concessions were provided to taxpayers who converted from oil-fired plant to alternative energy sources. The first was an investment allowance (upfront deduction) equal to 40% of the conversion costs[134] (in addition to the existing depreciation deduction available for the replacement plant). The second provided an outright deduction for conversion costs in lieu of a depreciation deduction for the replacement plant, for conversions undertaken between August 1979 and April 1981, or a deduction over two years for costs incurred between May 1981 and May 1983.[135]

Another significant and long-awaited development that occurred around this time was extending depreciation deductions to hotels and motels. Prior to the World War II, the Ferguson Royal Commission had recommended that buildings be recognised as depreciable assets. Similarly, after the war, the Hulme Committee had called for general depreciation deductions for buildings used to generate assessable income. However, apart from a few exceptions, the government had consistently resisted recognition of the wasting nature of buildings attached to non-wasting land. The exceptions to this position were very narrowly constructed, such as the special regime that applied to buildings used in the war effort, the post-war cost recognition rules for buildings used for scientific research activities, or the special depreciation rules targeting specific kinds of buildings used in primary production and mining.

[126] *Income Tax Assessment Act (No 2) 1980* (Cth) s 9, inserting *Income Tax Assessment Act 1936* (Cth) s 57AF.

[127] *Income Tax Assessment Amendment Act (No 6) 1980* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 57AH.

[128] *Income Tax Assessment Amendment Act (No 3) 1980* (Cth) s 5, inserting *Income Tax Assessment Act 1936* (Cth) s 75B.

[129] *Income Tax Assessment Amendment Act (No 4) 1980* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 75C.

[130] Eligible expenses include expenses incurred to eradicate animal and vegetable pests, to remove unwanted plant growth, to install fencing, to exclude livestock, limit salinity and to construct levee banks or drainage works (not draining a swamp or low-lying land): see *Income Tax Assessment Amendment Act (No 6) 1980* (Cth) s 9, inserting s 75D into the *Income Tax Assessment Act 1936* (Cth).

[131] The provision was extended to include expenditure incurred to prevent land degradation: *Taxation Laws Amendment Act (No 4) 1985* (Cth) s 12, amending *Income Tax Assessment Act 1936* (Cth) s 75D.

[132] *Income Tax Laws Amendment Act 1981* (Cth) s 9, inserting *Income Tax Assessment Act 1936* (Cth) s 70A.

[133] *Income Tax Laws Amendment Act 1981* (Cth) s 8, inserting *Income Tax Assessment Act 1936* (Cth) s 57AJ.

[134] *Income Tax Assessment Amendment Act (No 2) 1980* (Cth) s 19, inserting investment allowance into Pt III Div 3 Subdiv BB into the *Income Tax Assessment Act 1936* (Cth).

[135] *Income Tax (Assessment and Rates) Amendment Act 1981* (Cth) s 7, amending *Income Tax Assessment Act 1936* (Cth) s 53H.

The absence of a general depreciation rule for industrial buildings gave rise to three noticeable dynamics within the income tax system. The first was the unintended incentive for taxpayers to characterise parts of buildings as severable depreciable assets rather than components of building structures.[136] In the often-cited case *Wangaratta Woollen Mills Ltd v Commissioner of Taxation (Cth)*, the taxpayer (audaciously and unsuccessfully) argued that virtually an entire building had been constructed from depreciable plant.[137] Other taxpayers who adopted less aggressive stances achieved mixed success in their quest to label smaller items incorporated into buildings as plant. Some claims were accepted by the courts,[138] while others were rejected.[139]

The second dynamic at play was the unintended incentive for taxpayers to purchase run-down buildings instead of asking vendors to spend money on bringing the buildings up to a useable state before sale. Rather than paying a higher price for a renovated building, a purchaser could then attempt to characterise their initial renovation costs as tax-deductible repairs. These attempts often failed, with the courts endorsing an "initial repairs" doctrine that characterised the cost of initial repairs after acquiring a used building as capital expenditure.[140] Similarly, the third dynamic was the unintended incentive for taxpayers to characterise structural improvements as deductible repairs.[141]

While the government was reluctant to permit capital allowances for all buildings used in generating assessable income, it was responsive to lobbying by various industry groups. As a result, as explained above, the definition of "plant" was extended to include structural assets used in primary production, and separate depreciation regimes were adopted for different industry-specific deductions. However, in 1980, following a sustained lobbying effort by the tourism industry, the government agreed to allow

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[136] The line between plant and articles versus a constituent of a building was not always clear: see, eg, *Case 108* (1964) 11 CTBR(NS) 652 (a building treated as plant to the extent of 35%); *Woodward v Commissioner of Taxation (Cth)* (2003) 51 ATR 1115 (kitchen counters, bathroom mirror shower screen, wardrobe shelving and mirrored doors in a rental property were plant, whereas the electrical switchbox, telephone installation, etc, were constituents of a building); *Port of Portland Pty Ltd v Federal Commissioner of Taxation* (2008) 73 ATR 990 (in the case of port facilities, breakwaters were plant but retaining walls were not plant and, presumably, were infrastructural assets).

[137] *Wangaratta Woollen Mills Ltd v Commissioner of Taxation (Cth)* (1969) 119 CLR 1; 1 ATR 329.

[138] See, eg, *Case C27* (1952) 3 TBRD 170 (hot water system for a hotel), *Case 65* (1960) 9 CTBR(NS) 413 (effluent disposal system specific to a sugar mill), *Case 37* (1943) 11 CTBR 131 (chimney stack used in tile-making operations), *Case 11/97* 97 ATC 173 (built-in wardrobe and kitchen cupboards of rental property). Note *Case 37* (1943) 11 CTBR 131 was one of the earliest cases, in which the Board of Review concluded that "plant" had a broad meaning and referred to *Australian Gas Light Co v The Valuer-General* (1940) 40 SRNSW 126.

[139] See, eg, *Case D81* (1953) 4 TBRD 418 (roof, staircase, foundations, walls, floor and ceiling); *Case F51* (1955) 6 TBRD 522 (septic tanks); *Case 25* (1961) 10 CTBR(NS) 151(plate glass shopfront); *Case 107* (1962) 10 CTBR(NS) 594 (stoves, sinks, baths, toilets and hot water systems); *Case 101* (1964) 11 CTBR(NS) 587 (steel floor tiles, sheet metal on posts and doors, electrical light and power installations, etc); *Case 102* (1964) 11 CTBR(NS) 606 (hand wash basins, toilet suites, laundry tubs, hot water piping and bathroom cupboards); *Imperial Chemical Industries of Australia and New Zealand Ltd v Commissioner of Taxation (Cth)* (1970) 120 CLR 396; 1 ATR 450 (ceiling panels and electric fittings); *ICI Australia Ltd v Commissioner of Taxation (Cth)* (1972) 127 CLR 529; 2 ATR 672 (acoustic ceilings and electrical equipment in city buildings); *Case No M 246/1967* (1967) 15 CTBR (NS) (acid resistant subfloor and its support structures and acid drains); *Case B70* 70 ATC 335 (sun louvres, parquetry flooring and roller shutters); *Case D42* 72 ATC 239 (buildings, although designed for reception and storage of mineral sands); *Case D42* 72 ATC 239 (buildings, although designed for reception and storage of mineral sands); *Case No B 69/1972* (1972) 19 CTBR (NS) 713 (floor, although designed for drainage and hygiene in factory); *Case No NT 86/12511* (1989) 20 ATR 3708 (roller shutter doors); *Cases Nos VT 91/87* (1991) 22 ATR 3446 (roller shutter doors, water tapping, electrical wiring and toilet fittings in storage facilities).

[140] The doctrine that initial repairs were capital expenditures on the building rather than deductible repairs, as set out in *Law Shippings Ltd v Inland Revenue Commissioner* [1924] SC 74; 12 Tax Case 621, was endorsed by the High Court of Australia in *W Thomas & Co Pty Ltd v Commissioner of Taxation (Cth)* (1965) 115 CLR 58.

[141] For example, in *Case No NT 87/1030* (1988) 19 ATR 3647, the taxpayer characterised the cost of updating a fire control system as repair costs or, alternatively, as plant acquisition costs, which allowed depreciation to be claimed on the pump installed to boost the water supply to fire hoses of the building. Deductions for repair costs were denied in *Lindsay v Commissioner of Taxation (Cth)* (1961) 106 CLR 377 (reconstruction cost of the shipway of a ship repairer) and *Commissioner of Taxation (Cth) v Western Suburbs Cinemas Ltd* (1952) 86 CLR 102 (reconstruction cost of cinema ceilings). A comprehensive list of "improvement" cases can be found in Christina Allen, "From Uncertainty to Objectivity: Reforming Tax Deductions for Repair Costs in Australia" (2020) 35(4) *Australian Tax Forum* 496.

depreciation over a 40-year period for the cost of "traveller accommodation".[142] This measure proved to be an important departure from the government's traditional refusal to recognise the cost of wasting buildings separately from the cost of non-wasting land. Arguably, it represented a far more rational approach to recognising the cost of wasting buildings and paved the way for broader reform within a few years.

In the final years of the Coalition Government, its depreciation policy, like that of many countries, was significantly influenced by developments in the United States. In the late 1970s, the US Treasury published its "blueprints" for tax reform, which set the tone for tax reform debates globally for almost a decade. The document advocated for a "cash flow tax" or "expenditure tax" to be adopted to more towards neutrality – that is, a tax system has minimal impact on economic decisions, under which businesses would be able to deduct the full cost of capital assets immediately.[143] While the short-term transitional costs (ie, lost tax revenue) involved in shifting from an income tax to an expenditure tax made adopting a full expenditure tax unlikely, the goal of introducing an across-the-board accelerated depreciation mechanism remained popular in the US Treasury Department. The resulting "accelerated cost recovery system" adopted by US Congress in 1981 introduced '5/3 depreciation' to the world, a new system in which assets with a life span of five years or less were depreciable over three years and most other plant and equipment were depreciable over five years.[144]

With this US precedent clearly in mind,[145] in early 1982, the Australian Government took a tentative step towards a 5/3 depreciation system by introducing a 5/3 depreciation rule limited to plant used by iron and steel producers.[146] A few months later, in July 1982, the Prime Minister indicated that the government planned to extend the 5/3 depreciation rule to plant in general.[147] Treasurer John Howard included the proposal in the annual Budget in August.[148] However, the measure had not been legislated by the time Parliament prorogued for the March 1983 election, which the incumbent government lost.

C. The Hawke–Keating Tax Expenditure Programs

The new Prime Minister of the Labor Government, Bob Hawke, and Treasurer, Paul Keating, had campaigned on the promise to deliver "a program to produce growth and expansion in the economy", although tax relief and reform policy was modest.[149] However, the new government's first significant tax measure was a wholesale adoption of its predecessor's radical proposal to adopt a 5/3 depreciation regime. The new Parliament commenced sitting on 21 April 1983, a month after Labor came to power and less than a month later, a Bill establishing a broad 5/3 depreciation system was presented. Within a week, the Bill had passed through all three readings and received Royal Assent. It was enacted as

[142] *Income Tax Assessment Amendment Act (No 2) 1980* (Cth) s 20, inserting *Income Tax Assessment Act 1936* (Cth) Pt III Div 10C (ss 124ZA–ZE). Traveller accommodation was defined as a hotel, motel, guesthouse or building containing at least 10 apartments, units or flats used wholly and principally for travellers.

[143] US Department of the Treasury, *Blueprints for Basic Tax Reform* (1977).

[144] For a history of US depreciation rules, see David Brazell, Lowell Dworin and Michael Walsh, "A History of Federal Tax Depreciation Policy" (OTA Paper 64, Office of Tax Analysis, US Department of the Treasury, 1989).

[145] The Industries Assistance Commission reported that the 5/3 (or 10-5-3) depreciation system in the US would sacrifice some neutrality but offer significant administrative simplicity: see Industries Assistance Commission, *Certain Budgetary Assistance to Industry: Industries Assistance Commission Report* (Parliamentary Paper No 172/1982, 26 March 1982) 173–174. The government took this on board to introduce 5/3 depreciation. See Commonwealth, *Industry Assistance* (Industry and Commerce Press Release, 19 July 1982).

[146] *Income Tax Assessment Amendment Act 1982* (Cth) s 8, inserting *Income Tax Assessment Act 1936* (Cth) s 57AK.

[147] Prime Minister Malcom Fraser, "Incentives for Manufacturers and Farmers: PM's Statement on Taxation and Industry Assistance", *Canberra Times*, 20 July 1982, 6.

[148] Commonwealth, *Parliamentary Debates*, House of Representatives, Second Reading Speech, Appropriation Bill (No 1) 1982–83, 17 August 1982 (John Howard, Treasurer).

[149] Australian Federal Election Speeches, *Bob Hawke* <https://electionspeeches.moadoph.gov.au/speeches/1983-bob-hawke>. The Labor Party proposed to "prevent the erosion of after-tax income by inflation, and so support the prices and incomes policy" and not to introduce new capital gains tax.

law less than a month after being introduced into Parliament.[150] Surprisingly, the new provision was backdated to apply retrospectively, from 19 July 1982, the day the previous Prime Minister, Malcolm Fraser, first announced the plan to introduce the concession.[151]

The new 5/3 depreciation rule applied to assets eligible for the 18% loading on depreciation rates, which had been in effect since 1981. After applying the 18% loading, all depreciation rates of 20% or less were increased to a five-year write-off, while other depreciation rates between 20 and 33⅓%, exclusive, were increased to a three-year depreciation. Other legislative amendments made soon afterwards reconciled the 5/3 depreciation rule with earlier concessions. The five-year depreciation rules for grain, hay or fodder storage facilities and newly acquired primary production plant came under 5/3 depreciation.[152] Duplication of the existing 5/3 depreciation rule for basic iron or steel production assets was removed.[153] The rules confirmed that 5/3 depreciation replaced the immediate deductions previously available for petroleum storage facilities[154] and the cost of converting oil-fired plant to alternative energy sources.[155] Meanwhile, the extra investment allowance deduction for taxpayers who incurred oil-fired plant conversion costs was eliminated.[156]

The Labor Government's second significant tax expenditure was also inherited from its Coalition predecessor. The scope of this second initiative was much narrower than the general depreciation rules. It focused on one particular type of plant, Australian trading ships.[157] Since 1976, ships had been eligible for the 20% investment allowance that applied in addition to depreciation if they were used wholly and exclusively in Australia. Concerned about the state of the shipping industry, the government had commissioned a series of reports in 1980. They were consolidated into a summary by JG Crawford, a former Secretary of several government departments and the Chancellor of Australian National University. In his report, submitted in 1981 and published in 1982, Crawford criticised the eligibility restrictions for investment allowance deductions that excluded ships trading overseas. He suggested the rule be extended to all Australian trading ships while recommending a five-year accelerated depreciation for ships, commencing the year before the ship entered into service, provided the owner had paid one-fifth of the cost by that point.[158]

Although Crawford's report and recommendations had been commissioned by the previous Coalition Government, the Hawke Labor Government accepted both recommendations and, in 1984, legislated them in two forms. The first, effective from 29 July 1982 (the day the previous government first announced the proposal),[159] provided depreciation deductions of either 20% of the total costs or the actual costs incurred during the tax year, whichever was less.[160] The second initiative was an 18% investment allowance rule for Australian trading ships that were ineligible for: the general 20% investment allowance deduction

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[150] *Income Tax Assessment Amendment Act 1983* (Cth) s 15, inserting *Income Tax Assessment Act 1936* (Cth) s 57AL.

[151] *Income Tax Assessment Act 1936* (Cth) s 57AL(1)(b).

[152] *Income Tax Assessment Amendment Act 1983* (Cth) ss 10, 13, amending *Income Tax Assessment Act 1936* (Cth) ss 57AE–57AH.

[153] *Income Tax Assessment Amendment Act 1983* (Cth) s 14, amending *Income Tax Assessment Act 1936* (Cth) s 57AK.

[154] *Income Tax Assessment Amendment Act (No 2) 1983* (Cth) s 6, amending *Income Tax Assessment Act 1936* (Cth) s 57AJ.

[155] *Income Tax Assessment Amendment Act (No 2) 1983* (Cth) s 3, amending *Income Tax Assessment Act 1936* (Cth) s 53H.

[156] *Income Tax Assessment Amendment Act (No 2) 1983* (Cth) s 7, amending *Income Tax Assessment Act 1936* (Cth) s 82EB.

[157] Australian trading ships referred to those registered under the *Shipping Registration Act 1981* (Cth), staffed by Australian residents or non-residents authorised by the Secretary of the Department of Transport and used wholly and exclusively to produce assessable income in Australia. The staffing requirement was later replaced by the eligibility to receive a grant under the *Ships (Capital Grants) Act 1987* (Cth), giving effect to narrowed eligibility for taxpayers.

[158] Commonwealth Department of Transport, *Revitalisation of Australian Shipping: An Overview* (Parliamentary Paper No 159/1982, 25 February 1982, JG Crawford, chair).

[159] Minister for Transport and Construction, "New Direction for Australian Shipping Policy" (News Release DTC 36/82, Parliament House, 29 July 1982).

[160] *Income Tax Assessment Amendment Act 1984* (Cth) ss 8–9, amending the 5/3 depreciation rule in s 57AG and inserting s 57AM into the *Income Tax Assessment Act 1936* (Cth). Prior to this amendment, the Commissioner's rate for ships was 5% in ordinary conditions: see Federal Commissioner of Taxation, *Depreciation. Income Tax Order No. 1217: General Rulings on the Deductions Allowed for Depreciation under Section 54 to 62 of the Income Tax Assessment Act 1936 and Schedule of Rates of Depreciation* (12 June 1936) 30.

adopted in 1976.[161] When the 20% investment allowance expired on 30 June 1985,[162] the additional 18% deduction rule was extended to all Australian trading ships.[163]

Apart from its apparent enthusiasm for introducing new depreciation tax concessions, one of the most striking initiatives of the previous Coalition Government was extending the depreciation rule for buildings to hotels and motels. As previously noted, this move refuted the long-held view that for depreciation purposes, capital expenditure for constructing or modifying buildings was not separately deductible as was for plant and articles. Taking that change a step further, in mid-1983, at the same time it introduced 5/3 depreciation for plant and equipment, the Hawke Government extended the building depreciation rules to all remaining categories of buildings used to generate assessable income, other than residential rental accommodation.[164] It did not attempt to reconcile or consolidate the new depreciation regime with the existing building depreciation measures. Instead, yet another depreciation regime was added to the legislation to accommodate the new rules, which provided for a 40-year effective life for buildings. The following year, faced with a slowing economy, the government changed the depreciation period for hotels, motels[165] and general income-producing buildings to 25 years.[166]

While conceptually similar to the general depreciation regime, the capital allowance rules for buildings contained three unique features. Unlike depreciation deductions for plant and articles, which could be calculated on a straight-line or declining balance basis, capital allowances for buildings were calculated only on a straight-line basis. Significantly, each regime only applied to buildings constructed after the commencement of the depreciation or capital allowance rules. Purchasers of particular classes of buildings erected earlier were only entitled to capital allowance deductions in respect of structural modifications made after the commencement of the allowance. Finally, unlike the ordinary depreciation rules, the building allowance did not include balancing charges (which the ordinary depreciation regime had included since 1927, as well as the 10-year depreciation rules for access roads and timber mill buildings). Instead, all building sales were presumed to take place at the written-down value, with the buyer entitled to deduct capital allowances from that value. There was one exception; a balancing charge deduction was available when a building was involuntarily destroyed (eg, fire) or voluntarily demolished. That way, the owner was allowed to deduct the loss incurred in the course of producing assessable income.[167]

Later in the Hawke Government's first year in office, several more changes were made to the depreciation rules. One significant change was the removal of the 10-year depreciation rule recognising the cost of clearing land, including timber removal and swamp drainage, which had been adopted by the Whitlam Government 10 years earlier to replace an outright deduction that had been in effect since 1927.[168] The deduction rule concerning the cost of clearing land was never replaced, reflecting increasing environmental concerns,[169] which are still at play today.[170] A year later, in 1984, the government extended

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[161] *Income Tax Assessment Amendment Act 1984* (Cth) ss 10–11, amending *Income Tax Assessment Act 1936* (Cth) ss 82AA–82AB.

[162] *Income Tax Assessment Act 1936* (Cth) s 82AB, as amended (see *Income Tax Assessment Act* s 82AA(b)).

[163] *Income Tax Assessment Amendment Act (No 4) 1984* (Cth) s 15 and *Taxation Laws Amendment Act (No 4) 1987* (Cth) s 20 extended the expiry of the 18% investment allowance by amending *Income Tax Assessment Act 1936* (Cth) s 82AB.

[164] *Income Tax Assessment Amendment Act 1983* (Cth) s 54, inserting *Income Tax Assessment Act 1936* (Cth) Pt III Div 10D (ss 124ZF–124ZK).

[165] *Income Tax Assessment Amendment Act (No 4) 1984* (Cth) s 18, amending *Income Tax Assessment Act 1936* (Cth) s 124ZC.

[166] *Income Tax Assessment Amendment Act (No 4) 1984* (Cth) s 19, amending *Income Tax Assessment Act 1936* (Cth) s 124ZH.

[167] This can be inferred by the condition that the building must have been used for income-producing purposes immediately before the destruction or demolition: see *Income Tax Assessment Act Bill* (Cth) s 124ZK. See also Explanatory Memorandum, *Income Tax Assessment Amendment Bill (No 2) 1980* (Cth) "Section 124ZE: Deduction in respect of destruction of building".

[168] *Income Tax Assessment Amendment Act (No 4) 1983* (Cth) s 7, amending *Income Tax Assessment Act 1936* (Cth) s 75A.

[169] See Explanatory Memorandum, *Taxation Laws Amendment Bill (No 3) 1993* (Cth) [9.15]. S Davenport argued the accelerated depreciation of primary production assets did not address the agricultural environmental policy: S Davenport, "The Role of Income Taxation in Natural Resources Management" (1995) 63(1) *Review of Marketing and Agricultural Economics* 200.

[170] Currently, these expenses are still excluded from the depreciation rules in the *Income Tax Assessment Act 1997* (Cth) s 40–555(3) (depreciation of water facility, horticultural plant, food storage asset and fencing asset), s 40–635(2) (landcare operation) and s 40–840(2)(d)(ii) (project depreciation).

the outright deduction for fencing, adopted in 1980 and due to expire that year, by a further two years.[171] The following year, immediate deductions for assets used for soil conservation were expanded to include assets used for preventing land degradation. At the same time, the deductions were tightened so they only applied when soil conservation or land degradation prevention was the primary and principal purpose.[172] This excluded assets used in conserving or conveying water, which were depreciable for five years.[173]

One issue attracting ongoing attention at this time (and remains controversial even today) was negative gearing on rental properties because some investors were using the deductions for excess interest to shelter other income from tax. In some quarters, it was argued that the general deduction provision required deductions for excess interest to be apportioned where the interest was incurred to derive assessable rental income and non-assessable capital gains. In 1983, the Victorian branch of the Australian Taxation Office accepted this argument until it was overruled by the national office.[174] In mid-1985, the government announced it would quarantine deductions for excess interest expenses incurred on loans to acquire negatively geared rental properties (ie, properties where the interest expense exceeded rental income), allowing unused interest deductions to be carried forward indefinitely to reduce rental income.[175] However, because many investors were strongly opposed to these proposals, the government moved to soften the blow by offering an extension of the building depreciation rules to include residential rental properties,[176] making rentals eligible for the 25-year effective life that applied to other buildings.[177] However, the negative gearing restrictions proved to be short-lived, as the rules prompted an unprecedented lobbying effort by the real estate industry.[178] During election time, the government reversed course and removed the negative gearing rules from the legislation in 1987.[179] At the same time, it reverted to a 40-year depreciation period for all income-producing buildings, including rental accommodation.[180]

In early 1986, with the stated object of encouraging research and development in Australia,[181] the government adopted a new subsidy program, offering income tax concessions to companies registered with the Industry Research and Development Board.[182] The eligibility criteria for these concessions

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[171] *Income Tax Assessment Amendment Act (No 4) 1984* (Cth) s 8, amending *Income Tax Assessment Act 1936* (Cth) s 75C (repealed by *Taxation Laws Amendment Act (No 3) 1989* (Cth) s 35).

[172] *Income Tax Assessment Amendment Act (No 4) 1985* (Cth) s 12, amending *Income Tax Assessment Act 1936* (Cth) s 75D.

[173] *Income Tax Assessment Amendment Act (No 4) 1985* (Cth) s 11, amending *Income Tax Assessment Act 1936* (Cth) s 75B.

[174] See Jeffrey Waincymer, "Highly Geared Property Investments – A Case-Study in the Operation of Section 51" (1984) 1(3) *Australian Tax Forum* 135, 175. Debate over the issue continued to increase throughout 1984. See, eg, Mark Leibler, "Taxation Deductions for Losses from Highly Geared Rental Investments: Issues of Law and Policy" (1984) 1(1) *Australian Tax Forum* 39; Richard Krever, "Apportioning Interest Expenses" (1984) 1(4) *Australian Tax Forum* 413.

[175] This included a petition to parliament opposing the proposal; see Commonwealth, *Parliamentary Debates*, House of Representative, 17 October 1985, 2337–2338 (Blunt).

[176] *Taxation Laws Amendment Act 1986* (Cth) s 11 (*1986 Act*) inserted Pt III Div 3 Subdiv G into the *Income Tax Assessment Act 1936* (Cth) to deny interest expense deductions and under ss 16–18 of the *1986 Act*, the building depreciation rules included rental properties in *Income Tax Assessment Act 1936* (Cth) Pt III Div 10D.

[177] *Income Tax Assessment Act 1936* (Cth) s 124ZH.

[178] The negative gearing restrictions were blamed as the cause of residential rent increases in Sydney and, to a lesser extent, Perth. The fact that rental prices had not climbed as quickly elsewhere (and rental price growth rate had actually fallen in Melbourne), combined with a significant increase in lending for housing investment following the reform, indicated that local issues, not the income tax changes, were responsible for the upsurge in rental prices in certain markets. See Saul Eslake, "Australian Housing Policy: 50 Years of Failure" (Speech delivered at the 122nd Annual Henry George Commemorative Dinner, 2013); Reserve Bank of Australia, *F5 Indicator Lending Rates* (Spreadsheet) <https://www.rba.gov.au/statistics/tables/xls/f05hist.xls>.

[179] *Taxation Laws Amendment Act (No 4) 1987* (Cth) s 21, inserting *Income Tax Assessment Act 1936* (Cth) s 82KZD(1A).

[180] *Taxation Laws Amendment Act (No 4) 1987* (Cth) s 36, amending *Income Tax Assessment Act 1936* (Cth) s 124ZH. Daryl Dixon and John Toms supported the removal of restricted interest deductions on negative geared properties and reduction of the building depreciation rate to 2.5%: Daryl Dixon and John Toms, "Housing Finance in Australia: The Impact of Taxation" (Occasional Paper No 3, Australian Tax Research Foundation, 1987).

[181] Commonwealth, *Parliamentary Debates*, House of Representatives, Second Reading Speech, Income Tax Assessment Amendment (Research and Development) Bill 1986, No 149, 4 June 1986 (Hurford).

[182] The authority for the grant program was set out in the *Industry Research and Development Act 1986* (Cth).

significantly broadened the scope of the previous rules. Whereas eligible scientific research had previously been limited to the "extension of knowledge", the new program would now include activities involving innovation as well as technical risk. Three new rules were introduced. First, the three-year depreciation period for buildings used for scientific research purposes, which had been in effect since 1949, was extended to include building extensions, alterations or improvements used exclusively for research and development activities. Second, the three-year depreciation deduction increased to 150% of the cost of plant and equipment used solely for research and development, when total annual research and development expenditure was more than $20,000.[183] The third was a three-year limit on depreciation for the cost of "pilot plant" up to $10 million – that is, experimental versions of commercial plant used exclusively for research and development activities.[184] From the fourth year onwards, expenses greater than $10 million incurred on pilot plant were depreciable under the general depreciation regime.

Between 1985 and 1987, apart from its depreciation reform initiatives, the Hawke Government also engineered a more comprehensive overhaul of the Australian tax system in response to years-long neglect of structural problems that caused serious problems of tax avoidance and evasion.[185] It released a draft white paper on tax reform in 1985, intending to achieve a more equitable and efficient income tax system.[186] Subsequently, the changes made during this period included: a regime to include capital gains in the tax base, a separate tax on employee fringe benefits, replacing the foreign income tax exemptions with a foreign tax credit regime, a new shareholdercompany imputation system and increasing the company tax rate from 39% to 49% to offset a decrease in the highest personal income tax rate. Although those changes were far short of comprehensive income featured in the US Treasury's "blueprints",[187] they were the most far-reaching shift in the Australian tax policy.[188] However, the distortionary effects of 5/3 depreciation were clearly recognised in the draft white paper.[189]

On 25 May 1988, the government released an economic statement that set out its vision for a further wave of far-reaching reforms, including abandoning most tariffs and returning the company tax rate to 39%.[190] Several more changes to the depreciation system followed. The most important was the end of 5/3 depreciation system adopted in 1983, a measure that had provided its largest concession to long-lived assets.[191] In its place, 20% depreciation loading was reinstated.[192] Assets subject to their own special

[183] *Income Tax Assessment Amendment (Research and Development) Act 1986* (Cth) s 7, inserting *Income Tax Assessment Act 1936* (Cth) s 73B. The additional deduction percentage increased from 100% to 150% as annual aggregate research and development expenditure increased from $20,000 to $50,000.

[184] *Income Tax Assessment Act 1936* (Cth) s 73B.

[185] See John G Head, "Reforming the Australian Tax System: The Issue of Comprehensiveness in the Draft White Paper and the Tax Reform Package" (1986) 16(2) *Economic Analysis and Policy* 145. Eccleston said it was Treasurer Keating who made a case for tax reform by stressing the importance of economic liberation: see Richard Eccleston, "The Tax Reform Agenda in Australia" (2013) 72(2) *Australian Journal of Public Administration* 103.

[186] Commonwealth Department of the Treasury, *Reform of the Australian Tax System* (Draft White Paper, June 1985) (*Reforming the Australian Tax System*').

[187] Similarly, the Royal Commission on Taxation in Canada featured in its 1966 report (Carter Report) comprehensive income that stemmed from Henry C Simons, *Personal Income Taxation* (University of Chicago Press, 1938).

[188] *Reforming the Australian Tax System*, n 186, 148; Russell Mathews, "Some Reflections on the 1985 Tax Reforms (with Special Reference to Business Taxation)" (1985) 2(4) *Australian Tax Forum* 415.

[189] *Reforming the Australian Tax System*, n 186, Ch 19. See the developments of the US cost recovery system compared with the suggestions in the draft white paper in Michael J Graetz, "Reform of Australian Business Taxation" (1985) 2(4) *Australian Tax Forum* 385.

[190] Treasurer Paul Keating, Parliament of Australia, *Economic Statement, May 1988* (Parliamentary Paper No 98, 25 May 1988) (*Economic Statement*).

[191] By this time, the concession was recognised as a compensation for inflation: see *Reforming the Australian Tax System*, n 186, 151; "Scrapping of the 5/3 system 'regrettable'", *Canberra Times*, 30 May 1988, 17.

[192] *Taxation Laws Amendment Act (No 4) 1988* (Cth) ss 33, 34 (*1988 Act*), repealing s 57AE and amending s 57AG, respectively, of the *Income Tax Assessment Act 1936* (Cth). As a note, plant and articles used in mining or petroleum operations were subject to the resource sector regime and, in 1988, were brought within the scope of the general depreciation system by *1988 Act* ss 48–49, amending *Income Tax Assessment Act 1936* (Cth) ss 122A, 124AA.

depreciation rules, notably, the accelerated five-year depreciation rule for grain, hay or fodder storage facilities adopted in 1979, the new primary production plant rules adopted in 1980 and the rules for Australian trading ships adopted in 1984, had been excluded from the 5/3 depreciation regime. All three sets of special depreciation rules were repealed as part of the 1988 reforms,[193] coinciding with the expiry of the 18% loading on the investment allowance for Australian trading ships.[194] At the time, immediate deductions for mains electricity connections, introduced in 1981 as part of the Fraser Government's expansion of primary production and rural sector tax expenditures, were also replaced with a 10-year depreciation rule, similar to the one that applied to telephone lines.[195]

An important integrity measure was added to the system in 1988. It removed a loophole that allowed taxpayers to whipsaw the tax system by changing depreciation methods at will. Since the diminishing value percentage was raised to 150% of the prime cost rate in 1957, taxpayers had been able to switch from the diminishing value method to prime cost depreciation in years when diminishing value deductions dipped below straight-line deductions. The new integrity measure required taxpayers to choose a depreciation method for each asset irrevocably.[196]

Another integrity measure introduced with the reforms was the tightening of the three-year depreciation period available for buildings used exclusively for scientific research purposes or for research and development activities approved by the Industry Research and Development Board.[197] This depreciation period was consolidated with the depreciation period of income-producing buildings (ie, 40 years). Buildings partially used for these purposes were eligible for reduced deductions in respect of expenditure related to the income-producing part, like other income-producing buildings, which helped to simplify tax administration.[198] The following year, in 1989, a review of the government's innovation policy led it to terminate income tax concessions for scientific research, which had largely been superseded by the research and development incentive program adopted in 1986.[199] The termination came into effect five and a half years later, for expenditure incurred from 1 July 1995 onwards.

Also in 1989, the last remaining proposal to remove the 150% deduction for research and development expenditure was legislated,[200] but it was achieved differently from the one proposed. It temporarily reduced the additional deduction rate to 125%, taking effect from 1 July 1993.[201] The 125% deduction program was made permanent in 1991.[202] In 1991, the immediate deduction for assets used by primary producers to prevent land degradation was extended to include other rural businesses.[203]

[193] *Taxation Laws Amendment Act (No 4) 1988* (Cth) ss 33, 35 (*1988 Act*), repealing s 57AE (storage facilities for grain, hay or fodder) and s 57AH (new primary production plant) of the *Income Tax Assessment Act 1936* (Cth), respectively. *1988 Act* ss 39, 54(7) removed the special depreciation rule for ships in *Income Tax Assessment Act 1936* (Cth) s 57AM. The ship depreciation rule was largely replaced by grants for investment in ships under the *Ship (Capital Grants) Act 1987* (Cth) (see Commonwealth Department of Transport, n 158). See also Industries Assistance Commission, *Costal Shipping* (Report No 415, 20 July 1988).

[194] *Taxation Laws Amendment Act (No 4) 1988* (Cth) s 38 (*1988 Act*) repealed the 5/3 depreciation in *Income Tax Assessment Act 1936* (Cth) s 57AL. *1988 Act* ss 43, 54(7) terminated the operation of *Income Tax Assessment Act 1936* (Cth) s 82AB.

[195] *Taxation Laws Amendment Act (No 4) 1988* (Cth) s 41, amending *Income Tax Assessment Act 1936* (Cth) s 70A.

[196] *Taxation Laws Amendment Act (No 4) 1988* (Cth) ss 26, 27, amending s 56 and repealing *Income Tax Assessment Act 1936* (Cth) s 56A.

[197] *Taxation Laws Amendment Act 1988* (Cth) ss 12, 13, amending ss 73(2A), 73B(5A), respectively, of the *Income Tax Assessment Act 1936* (Cth).

[198] *Taxation Laws Amendment Act (No 4) 1989* (Cth) s 20, amending *Income Tax Assessment Act 1936* (Cth) s 124ZJ.

[199] *Taxation Laws Amendment Act (No 4) 1989* (Cth) s 7, amending *Income Tax Assessment Act 1936* (Cth) s 73A.

[200] *Economic Statement*, n 190, 80–81. See also the May 1989 Australian Science and Technology Council, *The Core Capacity of Australian Science and Technology: A Report to the Prime Minister* (Report, April 1989), which suggested the 150% deduction for research and development expenditure should operate for two more years.

[201] *Taxation Laws Amendment Act (No 4) 1989* (Cth) s 7, amending *Income Tax Assessment Act 1936* (Cth) s 73B.

[202] *Taxation Laws Amendment Act (No 3) 1991* (Cth) s 35, amending *Income Tax Assessment Act 1936* (Cth) s 73B.

[203] *Taxation Laws Amendment Act (No 2) 1991* (Cth) s 30, amending *Income Tax Assessment Act 1936* (Cth) s 75D.

The early 1980s recession was overcome by the government's free trade policy, market deregulation and flexible labour markets, influenced by the neoliberal wave.[204] While the tax system underwent major changes, including lower tax rates and the attack on free economic rent-seekers, the work to refine the depreciation system was still in progress. Many years of continual changes in the system to support the nation's economy led to a number of similar and sometimes conflicting rules scattered across the tax legislation. It laid a path to complex and challenging tax administration and compliance, calling for major structural tax reform. The consolidation era that followed in the early 1990s incorporated the neoliberal agenda in depreciation policy.

VI. Conclusion

The original federal income legislation provided depreciation rules for limited categories of assets, with a wide range of wasting tangible assets left out of the depreciation regime. Buildings, most structural assets connected to land and assets used in the forestry and fishery industries were outside the system. The rules were designed to accurately measure the depreciating value of assets, with few accelerated depreciation or immediate write-off measures included to distort the calculations. Over time, through an entirely ad hoc process that produced dozens of separate depreciation rules, operating independently of each one another, other assets were brought into the regime.

During and after the World War II period in particular, the existing patchwork of depreciation rules was expanded into dozens of inconsistent regimes. The government began to regard depreciation deductions less as an important element for accurately measuring business income and more as a tool for government intervention in the economy. The increase in accelerated depreciation concessions and instant write-off options benefited manufacturing and primary production industries in particular during a period of expanding export markets and later, in response to industry lobbying, forestry and fishing.

In 1973, Australia's first comprehensive tax expenditure analysis was undertaken. The government accepted the view presented in the report that the existing tax concessions were distortionary and inefficient and removed many of them from the tax legislation. However, this policy was short-lived. For the next two decades, more comprehensive tax expenditure programs were added to the already-fragmented depreciation regimes. Both Labor and Coalition Governments tinkered with the depreciation rules in many different ways to adjust for inflation in an administratively simple manner, such as adjusting asset value thresholds and changing depreciation rates. Additional deductions were allowed on top of accelerated depreciation for certain assets, designed to encourage innovation and new business investment in Australia. With significant changes in economic structuring in the 1980s, industry lobbying also had a significant influence on tax concessions and special deductions – for Australian trading ships and hotel accommodation, for example. The recognition of hotels and motels in particular was an important step towards creating a general depreciation regime for buildings.

By the early 1990s, most tangible assets became subject to deductions. However, the fragmented approaches to increasing the pool of assets in favour of particular industries over time had fractured the depreciation system. Inconsistent and incoherent treatments had become a cause of distortions as the tax law grew increasingly complex and large in volume. Despite several concessions remaining in the tax law, the policy rationale of continuing these concessions was unclear, and the ex-post effects remained largely questionable.

[204] Christopher Higgins, "Australian Economic Policy Conference Opening Address"; E Sieper and GM Wells, "Macroeconomics on the Left: Australia and New Zealand in the Eighties" in FH Gruen (ed), *Australian Economic Policy: Conference Proceedings* (Australian National University Centre for Economic Policy Research, 1991). Beeson and Firth described the 1980s economic policy with neoliberalism: see Mark Beeson and Ann Firth, "Neoliberalism as a Political Rationality: Australian Public Policy since the 1980s" (1998) 34(3) *Journal of Sociology* 215. Some critiques about the economic success may be useful to note: see, eg, John Quiggin, "Looking Back on Microeconomic Reform: A Sceptical Viewpoint" (2004) 15(1) *Economic and Labour Relations Review* 1; John Quiggin, "The Australian Productivity Miracle: A Sceptical View" (2001) 8(4) *Journal of Policy Analysis and Reform* 333. More discussion about Australia's trade and industry policy can be found in Richard Pomfret, "Australian Trade Policy in the Twenty-First Century" (2019) 52(4) *Australian Economic Review* 462; Tom Conley and Elizabeth van Acker, "Whatever Happened to Industry Policy in Australia" (2011) 46(3) *Australian Journal of Political Science* 503.

The move by the Keating Government in 1992 to use depreciation as a platform for sweeping neoliberal changes to the income tax system that have endured to this day rested on the tax expenditure foundation established in the first seven and a half decades of depreciation policy in Australia. More significantly, perhaps, is the impact that policy has had in cementing into the psyche of Australian politicians of all colours the notion of taxation as a tool of economic policy, not a neutral impost to raise revenues for direct expenditure programs.