Date Introduced: 19 October 1978
House: House of Representatives

Short Digest of Bill

Purpose

To clarify the position regarding the entitlement of employers' to deductions for the cost of their employees' long service, annual and other leave entitlements.

Background

On 27 September 1978 the Treasurer, Mr. Howard, announced that the Government had decided to amend the Income Tax Assessment Act 1936 because of the Victorian Supreme Court decision in Nilsen Development Laboratories Pty. Ltd. v. F.C. of T. (78 A.T.C. 4335). The Court held that the liability to make a payment in respect of long service or annual leave could be incurred, and thus be deductible, in a year of income prior to that in which actual payment for the leave is made.

Mr. Justice Murphy said that the deduction must be claimed in the year in which the liability was incurred. A previously accrued liability could not be claimed, though the taxpayer could deduct so much of the liability as accrued in the claim year e.g. accretions to long service leave entitlement resulting from a pay rise. His Honour did however seem to be prepared to allow a deduction in the year in which the claim was actually paid. The proposed amendment removes doubts as to the validity of this latter statement. Both the taxpayer and the Commissioner have appealed against the decision.

The Commissioner of Taxation's long standing practice has been to disallow deductions for fully accrued holiday and long service leave except for the year in which payment was actually made based on the decision in the James Flood case in which the High Court disallowed a claim for a deduction in respect of the entitlement to holiday pay of employees who had not yet qualified for annual leave by completing 12 months service. The current practice of the Commissioner in not allowing deductions for long service and other leave as it accrues has been criticized by the business community and also the Jackson Committee. The
objection is based on the belief that it does not comply with the accounting concept of matching a firm's income with its expenditure and the practice of making provision for accrued leave after a certain period of time, say 10 years. It is accordingly against the spirit of s.51(1) of the Income Tax Assessment Act 1936. In this regard the Asprey Committee Report (1975) recommended that "a deduction be allowable for the total amount of employees entitlements at each year end, calculated according to each employees entitlement should his services have been terminated by his employer at that date but only to the extent that a deduction in respect thereof has not been allowed against a taxpayer's income of a prior year" (para 8.57).

Despite the fact that appeals are still pending the Government has decided to introduce amendments. According to the Second Reading Speech the revenue implications (a cost of $600m. in the current year) and the considerable uncertainty created are the major reasons for the Government's decision. The Government has also foreshadowed that further amendments may follow depending on the result of the Nilsen appeal.

Provisions

Sub-clause 3(1) inserts a new sub-section 51(3) which specifies that a deduction is not allowable in respect of long service leave, annual leave, sick leave or other leave except for an amount actually paid to the person to whom the leave relates, or if he is deceased, to a dependant or personal representative. It also specifies that an amount is not to be treated as a loss or outgoing incurred other than at the time the payment is made.

Sub-clause 3(2) provides that the amendment is to apply to assessments in the income year commencing 1 July 1977 other than assessments made before 28 September 1978.

Sub-clause 3(3) declares that the amendment is made in order to remove doubt and cannot be taken to imply that certain deductions are presently allowable under s.51.