ITEM 1 - INTRODUCTORY:

101. The first Term of Reference deals with the effects of inflation on personal taxation.

102. Paras. 103 to 108 below set out some general comments, and Paras. 201 to 401 below discuss appropriate recommendations.

103. The present procedures for imposing personal income tax require the Federal Parliament to prescribe a set of tax scales at the time the various Budget measures are dealt with each year. At that time it is intended that a certain total revenue should be produced by means of those scales.

104. The Budget figures include an estimate of the taxable incomes which are expected to generate this desired total revenue. The percentage of total personal income tax to total incomes is thus readily ascertainable.

105. If taxable incomes rise because of inflation, then sliding scales of the type at present in use will mean that the percentage of total tax to total taxable incomes will increase. Experience over many years suggests that in practice the set of tax scales in use is altered only at very infrequent intervals (apart from minor adjustments).

106. It would seem preferable that this approach should be varied so that the percentage of tax to taxable incomes is the aspect which is kept constant rather than the set of tax scales, except to the extent that Parliament, by deliberate legislative action, decides on a variation. Governments seeking to increase tax collections in real terms should, for the sake of democracy, do so openly and not by stealth. Governments are, of course, fully entitled to increase the tax burden on the community in accordance with their electoral mandate, and in fact will need to do so if they are to meet the ever-increasing demands for Government spending which the community makes on them.

107. The objectionable feature of the present system is thus not that tax collections are increasing at a faster rate than taxable incomes, but rather that this is occurring as an incidental by-product of inflation - and at a rate of increase dependent on the rate of inflation - instead of as a result of actions specifically initiated by the Government of the day and justified to the people - and at a rate of increase consciously laid down.

108. Furthermore, under the present structure, inflation causes non-uniform and unintended distortions to the relative tax positions of different income groups.

ITEM 1(c)(i):

201. The problems analysed above would be solved if all amounts in the tax legislation were expressed, not in dollars, but in terms of so many units of an appropriate index. (This point is referred to in greater detail in Para. 913 below.)
The term "amounts" here refers not only to the brackets in the tax scale, but also to all other amounts in the present Act, for example, in respect to concessional deductions, exemptions, minimum and maximum amounts for various items, penalties, etc. (but not, of course, to rates expressed as so many cents in the dollar).

202. The index to be used should be prescribed by statute and an appropriate proclamation in the Australian Government Gazette should be made periodically (preferably annually) of the index values that are to apply in respect of each tax year. Responsibility for the ascertainment of these index values should, of course, be vested in an independent authority such as the Australian Bureau of Statistics.

203. To start the new system off properly, the scales, deductions, exemptions, etc., would need to be rethought and then fixed by Parliament in terms of the index as at some appropriate base date (say 30/6/75). The automatic adjustment would then have regard to the index as at each following 31st December (being the mean point of the relevant financial year). Careful consideration should, of course, be given to the design of the initial scales, etc., under the new system so as not to perpetuate the undesired inequities of the present structure.

204. It is, of course, true that the same result is obtainable by means of a series of non-automatic statutory amendments each year. But justice must not only be done, it must also be seen to be done, and there is little doubt that an automatic system would inspire greater public confidence. Such confidence as to the likelihood of receiving tax justice in relation to inflation is important if calls for price and wage restraint are to be heeded. Besides, a non-automatic system facilitates (and even encourages) action by Governments of all colours to raise taxes surreptitiously by delaying adjustments or by making them to a lesser extent than required mathematically. It also enables them to get an unfair electoral advantage for seemingly "reducing" taxes when all they may have done is to restore taxes to their former real level.

ITEM 1(c)(ii):

301. The choice of an appropriate index presents some difficulties, although any reasonable index is better than none at all.

302. For the present purposes a wage index would seem much more suitable than a price index (whether the Consumer Price Index, or the G.D.P. deflator, or any other variant). The reasons for this are as follows:

(a) Salaries and wages constitute a large part of taxable incomes.

(b) Many other forms of taxable income involve a significant labour content and thus tend to move in line with movements in wage rates.

(c) Even forms of taxable income which are not so related (for example, investment income from ordinary shares or property) ought to move in this way, as the suppliers of capital are morally as entitled to protection from inflation, and to increases resulting from improvements in productivity, as are the suppliers of labour. (To the extent that some incomes tend to increase at a slower rate than wages the use of a wage index will result in (i) a proportionate reduction in the tax burden on such incomes, thus supplying a partial correction working in the right direction (ii) a slight reduction in total tax collections in real terms - but this should be roughly balanced by a corresponding reduction on the total expenditure side (see also sub-paragraph (d) below).)
Much Government expenditure increases in line with increases in wage rates (public service salaries; the labour content of building and construction and other contracts; and also, in practice, most social service benefit payments and many grants to State Governments), thus making tax collections indexed to wages very practical having regard to the needs of Governments that current tax revenue should meet current Government expenditures.

Increases in wage rates contain an element representing productivity increases as well as an element representing price increases. It is preferable that both elements should be taxed at a taxpayer's "average" rate, as otherwise he would not get a fair share of the gains resulting from improved productivity; adjustments based on a price index would tax wage increases from this source at the taxpayer's "marginal" rate.

Thus the A.B.S. index of average weekly earnings or the A.B.S. index of minimum weekly award wage rates would both be suitable indices for the purpose under discussion. (Alternatively, a new index could possibly be devised specifically for use in relation to taxation legislation.)

The above remarks apply specifically to personal income tax. The principles are, however, quite general and apply equally in the case of other taxes in respect of which sliding scales are used, e.g. estate duty, gift duty, etc.

The second Term of Reference deals with the effects of inflation on the treatment of trading stock and depreciation in company accounts. This subject is of great importance to investors large and small as well as indirectly to all employees of tax-paying enterprises.

Paras. 503 to 507 below set out some general comments; Paras. 601-619 and 701 to 804 make recommendations dealing with stock and depreciation respectively; Paras. 901 to 916 make some additional comments applicable to both subjects.

The "profit" of an enterprise may be defined as "the maximum amount which its owner may consume in a given period in the expectation that at the end of the period he will still be as well off as he was at the beginning of the period". Naturally, this concept of profit involves placing a meaning on the phrase "as well off".

In this context it is submitted that an owner is not as well off at the end of a cycle of trading transactions (see Para. 601 below) as at its beginning unless either the physical volume of trading stock has not diminished (other things being equal) or he is put in an equivalent monetary position.
505. Similarly, an owner is not as well off at the beginning and end of a cycle of manufacturing operations (being a cycle commencing with the purchase of new plant and equipment and ending with the purchase of a further lot of plant and equipment by way of replacement after the original lot has worn out) unless the plant and equipment on hand at both times correspond in physical terms.

506. The present tax law can well turn true profits into losses and increase true losses by levying a tax intended to be imposed on profits only. In addition, serious inequities can arise between different enterprises, e.g.,

(a) between those which are heavily labour-intensive and those which are heavily capital-intensive

(b) between those with depreciating assets having a relatively long life and those with such assets having a relatively short life

(c) between those using equipment going up in price rapidly and those using equipment having relative price stability.

507. Apart from that, onerous or unreasonable company taxation must in itself be a factor causing or adding to inflation, as companies will endeavour to correct their net profitability and liquidity positions, both by increasing prices wherever possible and by concentrating their activities on those product lines carrying the largest margins.

508. The analysis which follows should be read as a whole, as in the interests of clarity some deliberately oversimplified arguments are introduced in the first instance and expanded later on (see also illustrative Examples at back).

ITEM 2(a):

601. Trading transactions can be represented by stages as follows:

<table>
<thead>
<tr>
<th>Cash ($A) used to purchase Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash ($B) used to purchase replacement Stock with Surplus Cash ($X)</td>
</tr>
<tr>
<td>Stock sold for Cash ($C) remaining</td>
</tr>
<tr>
<td>etc.</td>
</tr>
</tbody>
</table>

602. Traditionally, gross profit (before deductions for expenses, interest, depreciation and tax) is obtained by comparing "cash" with "cash" (i.e., profit = $B - $A). But in terms of the definition in Para. 503 above, profit is also obtainable by comparing "stock" with "replacement stock plus surplus cash" (i.e., profit = $X).

603. Either approach is valid provided the units for measuring the two items compared are of consistent value. In times of inflation it is incorrect to assume that "all dollars are equal", and therefore the traditional approach ($B - $A) gives misleading results unless appropriate adjustments are made.
Shareholders' Funds in a company (or their equivalent in the case of unincorporated enterprises) may, broadly speaking, be used to acquire two different types of asset:

(a) Assets which keep their dollar value but lose some real value in times of inflation, e.g., cash, loans granted (less borrowings), debtors, creditors, etc. ("monetary items").

(b) Assets which keep their real value but show increases in dollar value in times of inflation, e.g., property, stock, plant and equipment, etc. ("non-monetary items").

Notes: (i) For this purpose, preference capital should be regarded as borrowings rather than as part of the Shareholders' Funds.

(ii) The assets of type (a) above may be negative in total (i.e., they may be liabilities) (e.g., if borrowings exceed cash plus loans granted), but this does not affect the analysis below.

If an asset of type (b) above is purchased on Date 1 at a price $P_1$ and sold on Date 2 at a price $P_2$, the apparent (or traditional) profit is clearly $P_2 - P_1$. If inflation at rate $f$ has taken place in the interim, this apparent profit should, however, be regarded as being made up of the following:

(i) A true profit of $P_2 - P_1 (1 + f)$

(ii) A correction to Shareholders' Funds of $+ P_1 f$

Total: $P_2 - P_1$

Only (i) should be subject to tax. A tax imposed on (ii) would be a tax on capital and not a tax on profits. (The term "inflation at rate $f$" used in the above analysis is discussed on Para. 901 below. The expression "Indexed Accounting" is used below to describe accounting allowing for inflation on these lines.)

In other words, the historical cost price $P_1$ needs to be replaced by an adjusted price $P_1 (1 + f)$ which allows for inflation and which (if the correct value of $f$ has been applied) has regard to the concepts developed in Paras. 503 and 504 above.

It follows that an asset of type (a) above should be given a consistent treatment in the books. However, an adjusted price of $P_1 (1 + f)$ is obviously unsuitable for a "monetary" asset, the value of which in dollars remains (other things being equal) at $P_1$. The appropriate book treatment is as follows:

(i) A true profit of $- P_1 f$

(ii) A correction to Shareholders' Funds (as before) of $+ P_1 f$

Total: Nil
609. Again, (i) should be subject to tax. For an asset, the true profit (as shown above) is, of course, negative; this is in line with the earlier statement (Para. 604) that assets of type (a) involve their owners in a real loss; a reduction in their tax burden is thus morally justified. For a liability, the true profit is positive; a tax burden is justified here, as a borrower able to repay in depreciated dollars has had a benefit. (Furthermore, the combined position of a borrower and his lender should obviously be zero.)

610. There is reason to believe that current interest rates on loans and other fixed interest investments consist of a "true interest" element and an "inflation compensation" element (although the latter is probably far lower than justified by reasonable expectations). The approach of the previous paragraph is consistent with taxing as income only the "true interest" component.

611. Thus, if (for example) stock has been purchased entirely with borrowed money (as distinct from with Shareholders' Funds), the position would be as follows:

(a) Traditional Accounting:

At purchase: Cost = P₁; Borrowings = P₁; Net effect on Shareholders' Funds = Nil.

At sale: Price received = P₂; Borrowings repaid = P₁; Emerging profit (taxable) = P₂ - P₁.

(b) Indexed Accounting:

<table>
<thead>
<tr>
<th></th>
<th>In respect of stock</th>
<th>In respect of borrowings</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) True Profit (taxable)</td>
<td>P₂ - P₁ (1 + f)</td>
<td>+ P₁ f</td>
<td>P₂ - P₁</td>
</tr>
<tr>
<td>(ii) Correction to Shareholders' Funds (non-taxable)</td>
<td>+ P₁ f</td>
<td>- P₁ f</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Total = Apparent Profit P₂ - P₁ Nil P₂ - P₁

612. The preceding argument has taken the sale price at Date 2 as being a matter of record. It may, however, be worthwhile to have some regard to pricing policy. A trader in setting his selling prices would have regard to (inter alia)

(i) cost price
(ii) operating expenses
(iii) profit desired.
613. It follows from what has been said above that ideally (i) here should be the replacement cost price and not the historical cost price, as otherwise the Shareholders' Funds will be eroded as compared with a zero inflation position. This is important both in regard to "return on funds employed" considerations and in regard to liquidity. (Thus, public opinion and the views of the Prices Justification Tribunal notwithstanding, a trader who alters the selling price on his existing stock in line with inflation is behaving quite reasonably.) In practice this ideal price will, of course, not always be obtainable, in which case the profit desired (iii) above will not be achieved. It is quite inequitable that this reduced profit and a strained working capital situation should then be further weakened by excessive taxation.

614. The discussion so far has dealt with the ascertainment of the total profit over a complete cycle from purchase to sale. For accounting and tax purposes it is, however, necessary to apportion this total profit over the financial years concerned. This is done by in effect postulating a sale of each item of stock at some suitable figure (see Para. 615 below) as at the last day of each year (Income Tax Assessment Act, Section 31) and a repurchase at the same figure as at the first day of the succeeding year (Section 29).

615. Section 31 gives the taxpayer four options as to the stock values which he uses for these hypothetical transactions:

(1) cost price
(2) market selling value (sub-section 1)
(3) replacement price
(4) with the Commissioner's approval, a lower "fair and reasonable value" (e.g. scrap value) (sub-sections 2 and 3).

(Note: Uniform treatment over the taxpayer's whole stock is not required, nor is consistency of treatment required at successive balance dates; "stock" includes raw materials as well as finished goods.)

616. In line with the reasoning applied earlier, bases (2), (3) and (4) need no alteration, but the historical cost price (1) should be replaced by a price which allows for inflation (see Para. 607 above). (A corresponding correction is, of course, required to adjust the Shareholders' Funds.)

617. It is accordingly recommended

(i) that the taxable profit calculated in respect of trading stock disposed of during any financial year should have regard to its cost price adjusted for inflation

(ii) that the taxable profit calculated in respect of trading stock on hand at the close of any financial year should likewise have regard to a cost price adjusted for inflation if the taxpayer elects to use a "cost price" approach, and
(iii) that (although the Terms of Reference make no specific mention of this subject) total taxable profit should allow for losses and profits in real terms in respect of "monetary" assets and liabilities.

The mechanics for this are discussed in Para. 914 below.

618. Most businesses prefer to sell older stock before disposing of newer stock, and under the present law this results in "First In, First Out" (FIFO) book-keeping if the "cost price" option is utilised. It has been suggested that "Last In, First Out" (LIFO) should be permitted. (This method cannot be used for taxation purposes in Australia at the present time, as the transactions would not then be recorded "in accordance with the physical facts".) Such a method produces a profit closer to reality in times of inflation (because a more recent cost price is closer to the likely cost price of a replacement item - see the argument in Para. 602 above). This method therefore produces less apparent profit and thus less overstatement of true profit and correspondingly less tax (although it distorts the balance sheet position by understating the value of assets, as the unsold stock is then brought in at the older and lower cost price).

619. However, the LIFO method is not recommended as

(i) It has no regard to the concept of "true profit" developed above.

(ii) The cost price of the newer stock, while closer to a current price than cost price of the older stock, may still be considerably out of date.

(iii) Distortions would occur from year to year according to the old-new product mix actually sold. (In extreme cases, where no stock remains at the balance date, FIFO and LIFO would in any case produce the same cumulative profit, proving that the two methods are both unsound in times of inflation.)

(iv) It encourages the undervaluation of assets in published balance sheets.

ITEM 2(b)(i):

701. As explained in Paras. 503 and 505 above, the rationale behind making depreciation provisions is to ensure that an owner of plant and equipment remains equally well off financially as the plant and equipment wears out (or becomes obsolete) and that he does not treat as "profit" any income arising from the use of the plant and equipment until the appropriate provisions in this regard have been made. Two methods of depreciation ("Prime Cost" (i.e., "straight line") and "Diminishing Value") are in common use in Australia and have statutory sanction for tax purposes (Section 56(1)). While these two methods can be criticised on theoretical grounds, they both achieve the above objective and do so in a way which in the absence of inflation spreads the charges to profit in a broadly reasonable way over the lifetime of the asset.
In times of inflation allowance should be made for the fact that a replacement article will require the expenditure of a larger number of dollars than the original article required (other things being equal).

The problem can thus be solved by adjusting historical cost prices in the same manner as described above in relation to stock, and applying the appropriate depreciation rate to the adjusted cost prices (or, in the case of the Diminishing Value method, to the written-down values derived from these).

Thus, if the cost price at Time 0 of an article with an assumed life of n years (depreciated linearly) was $P$, then the position in the financial year commencing at Time $t$ may be summarised as set out in the Appendix. (Similar principles apply if the Diminishing Value method is used.)

ITEM 2(b)(ii):

The Terms of Reference mention the possibility of allowing "deductions for depreciation calculated at flexible or accelerated annual rates". These words imply the retention of the concept that total depreciation should remain at 100 per cent. of the historical cost price, but that the total might be apportioned over time in some other manner than at present. If this interpretation is correct, then the concept should be rejected as in no way making adequate allowance for inflation.

An argument for "flexible" depreciation rates can, of course, be made. For example, lower amounts of depreciation in earlier years than in later years can be justified on the grounds that more physical deterioration and greater obsolescence occurs towards the end of an asset's life. On the other hand, lower amounts of depreciation in later years than in earlier years can also be justified both on the grounds that previous provisions can be deemed to be invested at compound interest and on the grounds that in normal circumstances market values of second-hand plant and equipment move in that way. Again, a case can be made out for allowing depreciation in a pattern consistent with the income, outgo and yield assumptions made for purposes of the discounted cash flow calculations prior to the installation of the plant and equipment. But adjustments for inflation should be superimposed on refinements such as these, rather than be thought unnecessary because of them.

Depreciation at "accelerated" rates should also be thought of as a separate matter requiring adjustments for inflation rather than replacing the need for them. To the extent that a dollar of tax saving received at an earlier point of time is more valuable than a dollar received at a later point of time, accelerated depreciation represents a disguised subsidy from the Government. It would seem preferable that any subsidies which the Government desires to grant should be made outright rather than in this indirect way as -

(a) the total amount of subsidies would then be under the direct control of the Government instead of being variable according to the actions of individual taxpayers as to when and to what extent they incur capital expenditures
(b) limited funds could then be rationed according to a properly-established system of priorities

(c) suitable rules could be imposed as a condition of each grant

(d) proper accountability could be imposed to prevent wastage

(e) the time for the payment of the subsidy could be better fitted in with the time at which the corresponding expenditure is incurred.

804. Similar arguments also apply in respect to the so-called Investment Allowances and other devices permitting "depreciation" at rates in excess of 100 per cent. of cost.

ITEM 2 - GENERAL:

901. The above analysis used expressions such as "rate of inflation" and "current price" without qualifying their meaning. However, two main schools of thought exist. One, known as the "Current Purchasing Power" approach (CPP) or the "Adjusted Historical Cost Concept", favours the use of an index reflecting the general level of inflation, and its application uniformly to all items. The other, known as "Replacement Cost Accounting" (RCA) or the "Current Cost Concept", has regard to the current replacement cost of each item separately.

902. In terms of the definition of "profit" in Para. 503 above an owner of an enterprise is not "as well off" as he was unless when striking his profit he had regard to the replacement cost of stock and of plant and equipment. Thus, prima facie, RCA would seem the more logical method to use - see Para. 905(i) below.

903. However, the present legislation has regard to the "purpose" (or "intention") of a taxpayer, and this suggests that CPP may be more appropriate, on the grounds that changes in the replacement cost of any particular article at a faster or slower rate than inflation generally are in the nature of windfalls and thus do not affect tax liability. This is best seen when considering a situation of zero inflation: balance sheet revaluations would then still be appropriate for individual assets, but these would not alter the tax position in any way.

904. All that CPP endeavours to do is to express historical dollars in terms of current dollars, in the same way that Section 20 of the Income Tax Assessment Act requires items expressed in a foreign currency to be expressed in Australian dollars for tax purposes.

905. The gross profit obtained by comparing "cash" with "cash" (see Para. 602 above) can thus be considered as made up of three components rather than the two mentioned in Para. 605. These are:-

(i) A true profit margin equal to the difference between the replacement cost price and the sale price (both of these already being expressed in current dollars). Theoretically only this item should be subject to tax.

(ii) A correction to the Shareholders' Funds obtained by applying the general inflation rate to the historical cost price.
(iii) A further correction to the Shareholders' Funds equal to the difference between the cost price as thus adjusted and the actual replacement cost price. (This is the windfall gain or loss referred to in Para. 903 above.)

906. From a taxation point of view, CPP seems preferable on balance. Broad justice is done, and the calculations are made on an objective basis. This is not to say that balance sheets would not be more meaningful if assets were shown at a realistic current value such as the market value or replacement cost or present value; however, revaluations of this type should be made for their own sake, and without affecting the tax liability.

907. From a theoretical point of view, historical costs should be adjusted to values equal to the cost of acquiring identical objects at the point of time desired. However, this concept is not a very practical one, as there will frequently not be a "one for one" relationship between the articles originally purchased and corresponding articles purchased later. These latter might well be completely different, if customers' requirements have changed, or if the vendor has chosen to modify the lines of stock he carries; or they might be similar, but not identical, having regard to the development of later models and the possible use of alternative sources of supply. Even if the articles are identical, price differences may have come into force for reasons quite unconnected with inflation (for example, increases or decreases in the level of competition applying in the industry concerned, or the application of different levels of discounts according to the volume of goods purchased from time to time).

908. It thus seems preferable both that a general inflation index should be used throughout and that a specific index should be prescribed officially (see also Para. 202 above). This approach would ensure broad equity, even if there are instances where the prescribed index might understate or overstate the theoretical rate of price movement which would otherwise be appropriate. The use of a prescribed index would also save both the taxpayer and the taxing authorities the need to make a case by case investigation and would eliminate the need for the Commissioner of Taxation to exercise any discretionary powers as to the appropriateness or otherwise of varying any taxpayer's claims in that regard. Its use would also ensure that all companies were treated in a similar manner.

909. It is perhaps fortunate that CPP has both practical and theoretical attractions. Its use fits in with five important criteria for judging taxation structures, viz:

(i) That a taxation system should be as simple as possible.

(ii) That taxation should be equitable as between taxpayers in similar positions.

(iii) That discretionary powers conferred on tax-levying authorities should be kept to an absolute minimum.
(iv) That the legislation should minimise the ability of taxpayers to reduce their taxation by rearranging their affairs.

(v) That the costs of collection should be kept as low as possible for taxpayers and their auditors, as well as for the taxation authorities.

910. The choice of an index to reflect a general inflation rate on the lines discussed above presents similar difficulties to those discussed in Paras. 301 to 303 in relation to personal incomes.

911. Although the arguments for using a wage index here is not quite so strong as in the case of personal incomes, a wage index still seems more suitable than a price index, having regard to the high labour content in the cost of goods, the moral entitlement of investors, and the needs of the Government. Furthermore, there would appear to be some advantages in having uniformity throughout the Act rather than in using different indices in different contexts.

912. The term "inflation at rate \( r \)" has been used in analyses above, when it was convenient to adjust a price \( P \) at the Beginning of a period (time \( B \)) to a price \( P (1 + r) \) at the End of the period (time \( E \)). In terms of index numbers

\[
P (1 + f) = P \frac{I_E}{I_B},
\]

where \( I_B \) and \( I_E \) represent the index numbers at times \( B \) and \( E \) respectively.

913. The easiest way to record data is probably to store values of \( \frac{P}{I_B} \) for each item (corresponding to historical cost \( P \) at time \( B \)). Adjusted values at time \( E \) are then obtained by multiplying the said \( \frac{P}{I_B} \) by the appropriate index number, i.e. by \( I_E \). (Thus everything can be expressed very simply in terms of an appropriate number of units of the prescribed index. Subsequent calculations can then be made very easily.)

914. Each month's transactions (say) can be re-expressed in year-end dollars for accounting and taxation purposes, using the index for the month concerned. Two categories need to be considered:

(a) Purchases and sales of property, stock, plant and equipment, etc., as well as income and expenditure of all kinds, would require a correction to Shareholders' Funds, in non-taxable form.

(b) Cash transactions (including loans and borrowings), whether the contra to the transactions just mentioned or the contra to transactions directly affecting Shareholders' Funds (i.e., dividends and capital subscriptions and repayments), would require

(i) a correction to Shareholders' Funds, in non-taxable form, together with

(ii) a contribution to profit and loss (in the reverse direction), in taxable form.
915. One final point, not directly related to the above. The calculation of taxable income on the lines just discussed, or on some similar lines, should become compulsory. If taxpayers were given the option to retain traditional approaches, they would, naturally enough, tend to use them in those instances when this would result in a lower tax burden. Furthermore, they would be encouraged to restructure their affairs so as to avoid as much tax as possible - for example, by setting up two companies with one lending money to the other; the 'borrower' company, which would benefit from inflation (see Para. 609 above), would tend to opt for taxation on the traditional basis, while the 'lender' company would tend to opt for taxation using indexed accounting; the total tax would thus be less than if both companies were made to use the same approach.

916. It should, of course become mandatory for all companies taxed on an indexed basis to present their published accounts in that form. If (in the absence of compulsion as recommended in Para. 915) companies wished to avail themselves of such tax treatment on an optional basis, they should as a condition therefor be required to publish their accounts in indexed form.

ILLUSTRATIVE EXAMPLES

(1) (See Paras. 601-602 and 905.)

Cash $1000

\[
\begin{align*}
\text{Apparent Profit} & : \$600 \\
\text{Stock (Cost $1000)} & \downarrow \\
\text{Cash $1600} & \downarrow \\
\text{Replacement Stock (Cost $1200) + Cash $400} & \\
\end{align*}
\]

General Inflation Rate (for the period concerned) = 16% (i.e. $1000 increases to $1160).

Gross Profit (before Deductions):

True Profit (see Para. 905 (i)) = $1600 - $1200 = $400

Windfall Correction (see Para. 905 (iii)) = $1200 - $1160 = $40

General Inflation Correction (see Para. 905 (ii)) = $1160 - $1000 = $160

Total = Apparent Profit = $1600 - $1000 = $600
BOOK REVIEW

LEGAL PROBLEMS IN DEVELOPMENT FINANCING

The University of Queensland Press has recently published a work entitled "Credit and Security: The Legal Problems of Development Financing." It is written by three Australian academic lawyers: David E. Allan, Mary E. Hiscock and Derek Roebuck.

It is the last volume in a series of ten which survey legal aspects of financing private sector development by lending in Asia. The purpose of this series is to examine and evaluate the legal framework for credit and security in the light of current industrial development.

This tenth volume is said by the publisher to be "the key to the entire series." On the basis of data found in the previous nine volumes, the editors expound a thesis on the nature of security in development financing; they examine some of the problems which arise in development lending transactions; and they proffer and comment on a series of types of solutions to these problems. The discussion moves through the law of securities and the nature of development spanning all nine jurisdictions under review, Indonesia, Singapore, Japan, Korea, the Republic of China (Taiwan), the Philippines, Thailand, Australia and Sri Lanka.

This volume and the rest of the series could be(204,746),(762,758) of interest to lawyers mainly and to a lesser extent to certain businessmen.

("Credit and Security: The Legal Problems of Development Financing", University of Queensland Press, St. Lucia, Queensland, 1974, pp.262, $11.00)