

Chairmen's Review

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The AELA Council

AELA Chairmen and Current Year Council Membership

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ISSN-1031-6817, December 2008

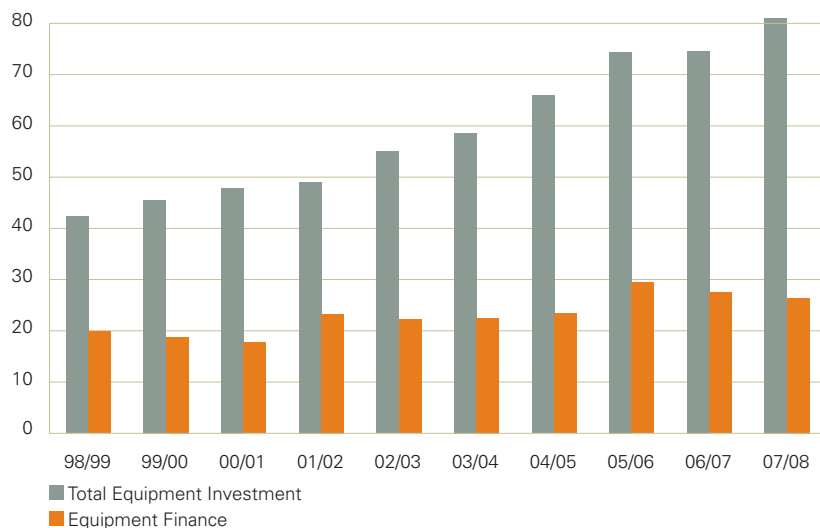
AELA is the national association for the equipment leasing and financing industry. AELA's 100 members encompass more than 90 percent of equipment financing activity in Australia.

With lease and equipment finance facilitating around 40 percent of the nation's equipment capital expenditure, the industry is vitally involved in the equipping of Australia's productive base.

This Review covers developments and issues affecting lease and equipment finance markets over the recent period.

Equipment Finance & Investment Volumes

Financial Year – \$Billion



Chairmen's Review



David Hollis
2006 / 07 Chairman



John Dennis
2007 / 08 Chairman

This Report covers the activities of the Australian Equipment Lessors Association for the two years 2007 and 2008. This period has been both particularly busy and satisfying for AELA and its members, with a number of significant long term objectives being realised during this time.

As the equipment finance association, it is AELA's role to ensure that the regulatory framework allows members to provide a dynamic range of financing products for the acquisition and utilisation of capital equipment. A wide spread of funding options provides a spectrum of choice, enabling clients to select the level of risk and service they require; at one end of the spectrum the client can assume the asset risk and operating costs associated with the equipment, whilst at the other end the risks and administration can be assumed by the equipment financier. In between, the client can select the combination of risk and service that suits their particular needs.

It is therefore very pleasing to be able to report substantial regulatory reforms in the recent period which will assist AELA members in offering innovative and dynamic funding solutions and three examples are illustrative. After a long gestation period the framework to establish a new taxation of financial arrangements regime nears finalisation; importantly, leasing has now been excluded from this regime, whereas in the original draft legislation it was included. Accordingly, leasing will continue to offer its tax benefit transfer capability. Also a new Division 250 of the Income Tax Assessment Act has been introduced, containing important exemptions for both operating and finance leases, ensuring an efficient regime for leasing to tax-preferred entities.

Another significant achievement is the now almost complete abolition of stamp duties on leasing, hire purchase and chattel mortgage, the culmination of more than a decade of AELA's efforts; this is a significant microeconomic reform initiative for the Australian economy.

Viewed in totality the range of developments during the period under review are significant, and include:

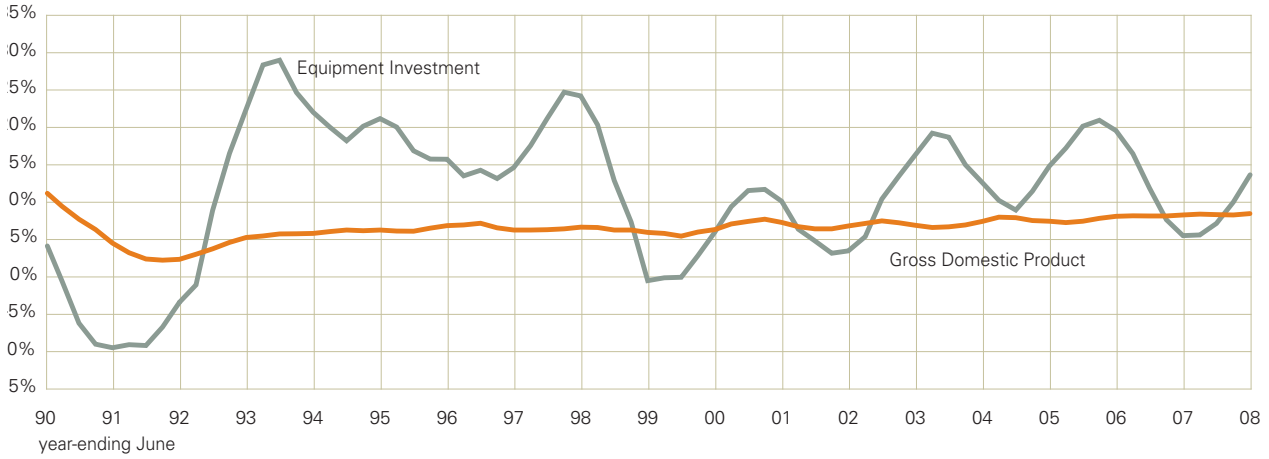
- the abolition of most state/territory stamp duties on leasing and hire purchase;
- exclusion of finance leases from the taxation of financial arrangements regime, maintaining leasing's tax benefit transfer capacity;
- new Division 250 of the ITAA for leasing to tax-preferred entities, replacing Division 16D;
- finalisation of the Tax Office practice statement on hire purchase apportionment;
- the development of the Personal Property Securities regime, ensuring priority for AELA members security interests in assets and increased efficiency;
- implementation of the new anti-money laundering regime;
- holding of the Annual AELA Leasing and Equipment Finance Conference;
- conducting the AELA/Amemba Leasing Schools in Sydney and Melbourne;
- holding of the AELA Credit Skills Workshops in Sydney and Melbourne.

The economy in the year ahead is obviously going to be most challenging. The turmoil in financial markets has become particularly marked in recent months. Since August 2008 we have seen a significant easing in monetary policy as the focus switched from containing inflation to preventing an economic contraction. Fiscal policy has also moved to expansionary and includes a short-term 10% Investment Allowance. Notwithstanding these official developments, funding markets both wholesale and retail, remain dislocated and consumer confidence and business sentiment are low. Against this uncertain economic outlook, new equipment financing volumes are down significantly on the previous record year.

The period ahead will also be a challenging one on the regulatory front, as outlined in the body of this Review, particularly if proposals to include lending to small businesses and for investment purposes within consumer credit regulation are proceeded with. AELA has a strong capacity to meet these challenges. It is a strong and cohesive association, well-supported

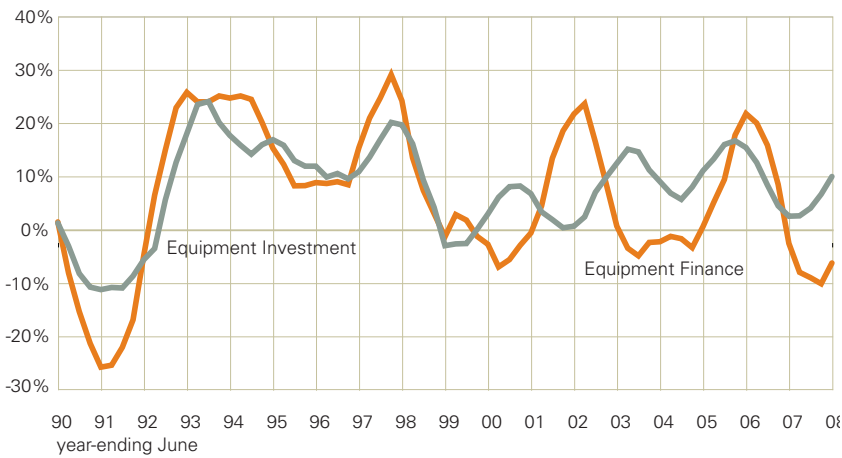
Economic Cycles: GDP & Equipment Investment

Annual % Growth Trend – Current Prices



Economic Cycles: Equipment Investment & Equipment Finance

Annual % Growth Trend – Current Prices



by its members. The AELA Directorate is skilled and experienced, with the recent achievements underlying the Directorate’s ability to greatly assist members. The AELA Council, the guiding body of the association, consists of vastly experienced and knowledgeable equipment financiers. This combination will continue to serve AELA well.

David Hollis
Chairman 2006 / 07

John Dennis
Chairman 2007 / 08

The Australian Leasing Market

Historical Development

Lease finance in Australia is a mature financial product having been offered as part of a portfolio of financing techniques for over five decades. The predominant lessor groups are finance companies and banks; lessees include all private and public industry sectors with around 20% of the economy's capital equipment being leased. Leasing and other equipment finance offered by members together account for around 40% of equipment capital expenditure.

The wider use of leasing was pioneered by finance companies in the late 1950s and early 1960s. Since that time most financial institutions have moved to include leasing in their product range.

Lease finance utilisation rose strongly as the acceptance of the philosophy of leasing broke down earlier attitudes against this non-equity form of financing. The current level of utilisation reflects this wide acceptance.

Generally speaking leasing is offered as part of a range of financing products. This allows its particular merits vis-a-vis other finance methods to be weighed and tailored to the customer's particular needs and financial position.

Applicants can usually choose between a number of sources including financiers/lessors with whom they have an existing relationship, those which may be offering leasing at the point of sale and those independently operating in the market.

Lease packagers are involved in structuring some of the more complex transactions. Lease brokers also play a role in promoting the product.

In terms of general market functioning, leases are written for most capital equipment items (provided they are used for commercial purposes) and for periods ranging between two and five years; implicit rates are competitive and are usually fixed for the period of the lease. Providing the commercial use test is met, lessees claim the full amount of the lease rentals as a tax deduction; the lessor, as owner, usually claims the depreciation and any investment incentives – the latter in the case of the Investment Allowance (when applicable) can be claimed by either the lessee or the lessor as appropriate, with leasing's tax benefit transfer capacity reflecting the incentive of the Allowance in the amount of the lease rentals. Until mid-1990 lessors may have elected to tax account and price on the finance or receivables method (on the implicit interest income stream); IT2594 however removed this election ability. Equipment acquisitions better priced through financing via the finance method (longer depreciating items of plant), are now in many instances financed via commercial hire-purchase or chattel mortgage.

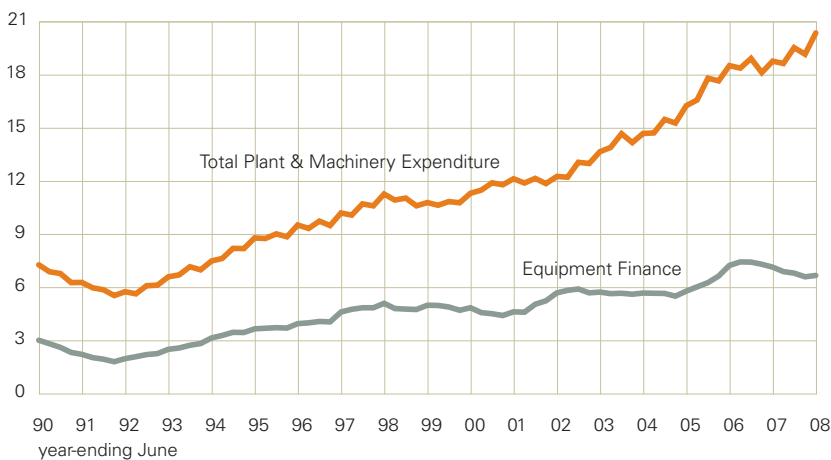
There can be no option during the lease contract to purchase the leased goods at the end of the term. The lessee may however re-lease the goods at the end or make an offer for them. In any event the finance lease will provide for the lessee to indemnify the lessor for any loss on sale for less than the residual value; this provision aims at ensuring that the lessee properly maintains and uses the equipment and, from a pricing point of view, keeps any equipment technological risk implicit in the credit risk.

In the early years most leases were motor vehicle-related and even today around one half of lease volumes is for motor cars, trucks, vans, motor buses and coaches; aircraft, ships and heavy earthmoving vehicles comprise another sizeable end-use, and in recent years EDP and office equipment have grown strongly.

For most part, the national taxation system has been relatively neutral as between the various

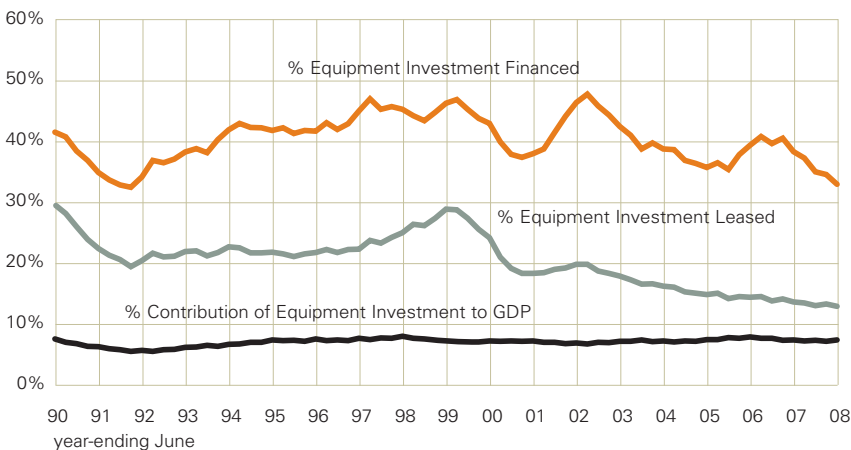
Capital Equipment

Expenditure & Finance: \$Billion per Quarter Trend



Capital Equipment

Economic Relationships: Moving Average Trend: Percentage



financing options with each alternative able to compete on the basis of its appropriateness and flexibility for the particular investment and financing need. Paradoxically the long history and high utilisation of leasing in Australia has sometimes led to a misunderstanding of its attributes; however, it is now generally accepted that leasing's tax benefit transfer capacity provides real benefits for industry, particularly small businesses and start-up operations.

In terms of taxation, leasing captures and crystallises taxation deductions and incentives available within the system and within government policy, focusing their effect on the area where it will have the most impact: reduced cash outflow for the lessee. When Government inquiries urge action to develop 'sunrise'

industries or to smooth the restructuring of other sectors or industries, it is ironic that the financing technique best suited to achieving both these objects (leasing), has sometimes been inappropriately and disparagingly described as 'tax shelter'.

A business just starting out or one in the process of restructuring is unlikely to be generating current year taxable income. In these circumstances tax deductions for depreciation or investment incentives do not achieve their desired policy effect – rather they simply add to carry-forward losses. Through leasing, the lessor can claim these deductions against its taxable income, crystallise the benefit and pass it on to the lessee in the form of the tangible incentive of reduced cash repayments.

Unfortunately, the aggregation of such deductions in the books of a relatively few lessors can be misunderstood and can result in the contemplation of restrictions. This occurred in the area of financing unit trusts for property and construction projects when the Tax Commissioner issued tax ruling IT2512 which restricted the ability of such trusts to transfer the benefit of certain deductions. The broader question of tax benefit transfer was also raised in the debate which surrounded the ruling; equipment leasing was however exempted from the Government's general policy to restrict such tax effective financing. The rationality of this exception was highlighted in the Bureau of Industry Economics' paper 'Tax Losses and Tax Benefit Transfer.'

Leasing is an essential financing tool for a dynamic and competitive economy. If from time-to-time a new application or lease product development tests the legislative or taxation framework, this should be seen as a healthy and necessary sign of an innovative financial system. An on-going role for groups such as AELA is to ensure that policy or administrative responses proceed on an informed basis with due regard to any wider consequences.

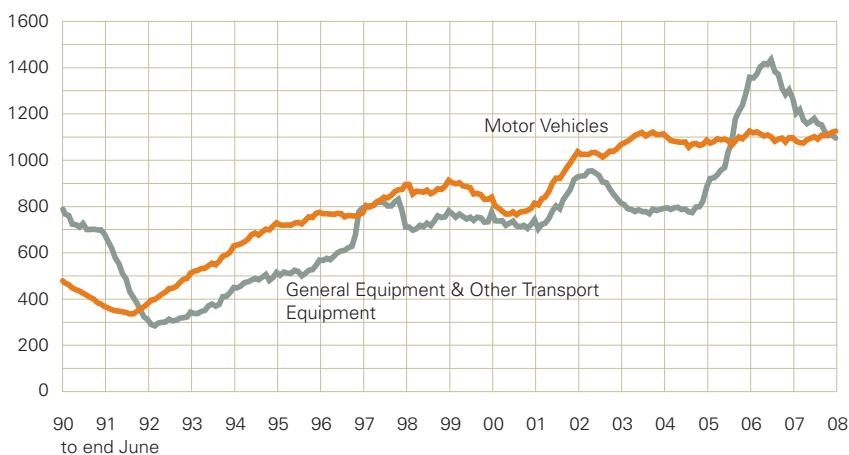
A development in the lease market over the years has been the offering of variously structured operating leases. These were in part a response to the move to Accounting Standards which require lessees, for corporate disclosure purposes, to capitalise their finance leases onto their balance sheets; operating lease commitments on the other hand, are expensed in the usual way and need only be disclosed by way of footnote to the published accounts.

Initially demand for the operating lease product was limited to the larger corporations and companies with overseas, especially US parents. Over the years this has changed, with a wider spectrum of private and public sector lessees now utilising the product.

From a lessor viewpoint, for the lessor to retain the advantages and disadvantages of economic ownership of the equipment (as the Standard requires of an operating lease) it is necessary to be confident that the value of the equipment when returned by the lessee will achieve a resale price which is predictable.

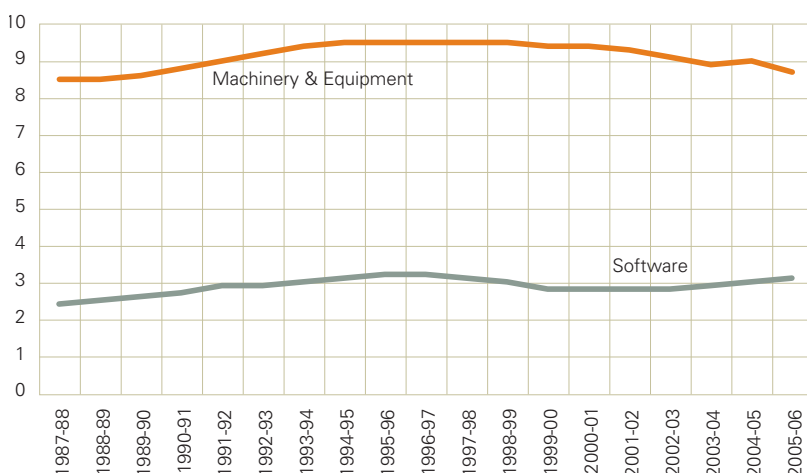
Equipment Finance by Class of Equipment

\$Million per Month Trend



End-Year Average Age of Capital Stock – All Sectors

Age in Years



This 'equipment' risk is reduced where there is a sufficiently deep second hand market for the particular equipment to allow reliance on reasonable estimates of sale values. Given the general lack of depth of Australian equipment markets (compared, say to the US or Europe), operating leases to-date have been largely limited to motor vehicles, computers and multi-purpose industrial equipment (e.g. forklifts). As the same resale market questions will affect residual value insurance premiums, such insurance can be expensive especially for specialised equipment.

When this equipment resale value risk is added to the credit/client risk (will the lessee meet the commitments) and indeed the manufacturer and goods risk (will the manufacturer/supplier continue to provide servicing, will the goods prove reliable), it is obvious that compared with a traditional finance lease, operating leases are more complex. Any legislative or other regulatory measure which results in a move to operating leases out of balance with the market's capacity to cover underlying equipment risk will have prudential consequences, as well as forcing that risk, currently implicit in a finance lease, to be explicitly priced in the operating lease. Nonetheless, these problems are being addressed and the product advanced, with some lessors specialising in this market segment.

In addition to finance and operating leases, most AELA members also provide two other products to fund the purchase of capital equipment: hire purchase and chattel mortgage. The Australian Bureau of Statistics (ABS) provides separate monthly statistical series for finance and operating leases, whereas hire purchase and chattel mortgage are included within the one

category, classified as 'non-lease equipment finance' within its wider Commercial Finance series. Unless otherwise indicated, graphs and statistics utilised in this Review are derived from ABS data. Over recent periods, a discrepancy between the ABS numbers and those derived from an internal AELA sample survey of members, has developed with the ABS series seeming to understate equipment finance activity. For example, the ABS statistics for 2007-08 show total equipment finance volumes of some \$26 billion, whereas AELA estimates that total new business for the Industry exceeds \$40 billion. AELA has been attempting to reconcile the two statistical sources and as this discrepancy appears to be increasing, is now contemplating producing our own industry-wide equipment finance statistics.

The introduction of GST on 1 July 2000 added somewhat to the complexity of leasing and equipment finance transactions, but at the same time this framework has provided a fair degree of flexibility in meeting the needs of customers. More recently, the introduction in July 2007 of Division 250 to replace the former framework governing leasing to tax preferred entities focused attention on the appropriate income tax treatment for leases to tax exempts. In a similar vein, the proposals for a new regime for the Taxation of Financial Arrangements (TOFA) have focused this attention on leasing to taxables. The detail of these developments is covered elsewhere in this Review, but it is important to note that for leasing to continue to provide a dynamic and creative solution to the equipment finance needs of businesses, it cannot be placed within the conventional homogeneous 'sale and loan' approach. The proposal to introduce the Tax Value Method for determining taxable

income could have had important implications for the equipment finance industry, and AELA was one of the many groups that welcomed the Government's decision not to proceed.

Current Activity and Prospects

The Australian equipment finance market continued to experience robust conditions in 2007-2008. Strong business levels have been a feature of the Industry since the early 1990s, apart from a temporary hiatus during the period of the introduction of GST in 2000.

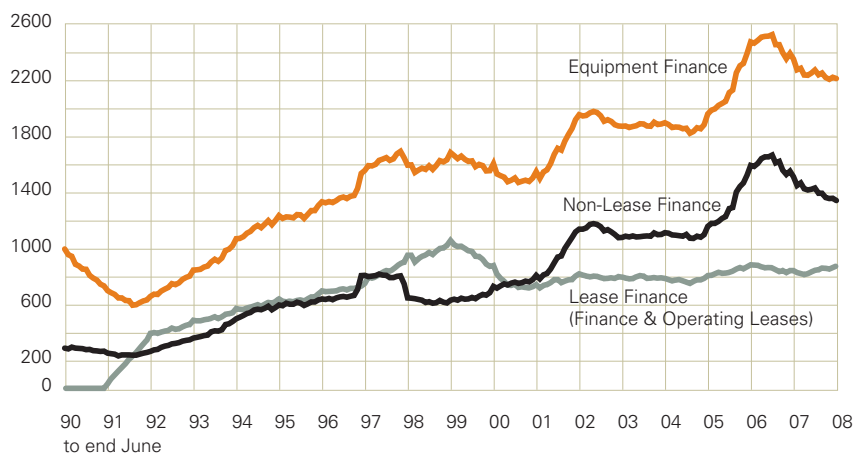
The trends in this broad mix are not only affected by economic conditions but also by Government policy, with the latter particularly evident in recent times. The introduction of GST produced a significant shift away from finance leases and initially to hire purchase, as the transitional GST arrangements did not apply to hire purchase. This trend has been followed by a move away from hire purchase to chattel mortgage and leasing, caused by an inappropriate GST outcome in relation to hire purchase contracts entered into by cash basis taxpayers. As from 1 January 2005, the Commissioner of Taxation's revised effective life determinations for trucks and like assets has translated into unrealistically high 'safeharbour' residual values in leases for these assets, resulting in a shift away from leasing to the provision of hire purchase and chattel mortgage products for these transactions. As detailed in this Review, these tax issues are the subject of ongoing discussions with Treasury and the Tax Office, and have been raised in AELA's submissions to the Board of Taxation GST Review and the Henry AFTS Review; we are hopeful of a sensible resolution. Besides GST and income tax, differences between the States in the scope and rate of stamp duty have caused distortions in the product mix. However, as also outlined elsewhere in this Review all jurisdictions have now largely abolished these duties, and accordingly it is pleasing to report that in the not too distant future, stamp duty distortions will no longer exist in the equipment finance market.

The impact of these influences on the composition of equipment finance business has been quite dramatic. Since 2000 total lease business has declined from 60% to around 40%, hire purchase has declined from 40% to 20%, and from very little chattel mortgage business only five year ago it now makes up 40% of the total.

The ABS provides a break-down of the broad asset classes only for leasing; of the total, motor related business accounts for 51%, general equipment for 41% and other transport

Lease and Non-Lease Finance

\$Million per Month Trend

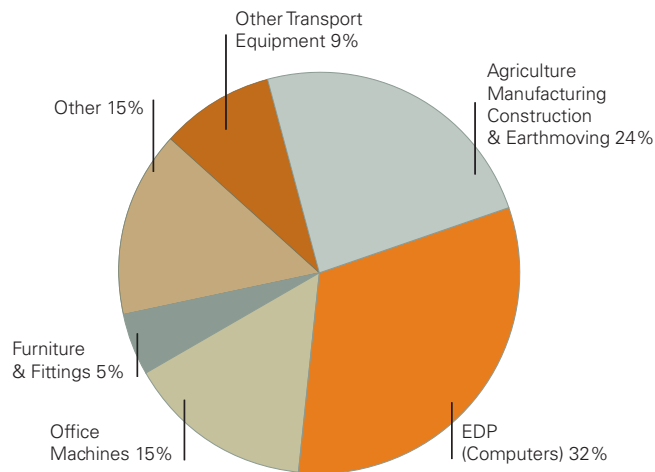


equipment for the remainder. Within the leasing for motor category, 66% is new cars, 15% new trucks, 13% used cars and 4% used trucks. The trend over recent years has been for new vehicle leasing to expand at the expense of used vehicles. For non-motor leasing, EDP equipment makes up 32%, agricultural and other heavy equipment 24%, and office machines 15%.

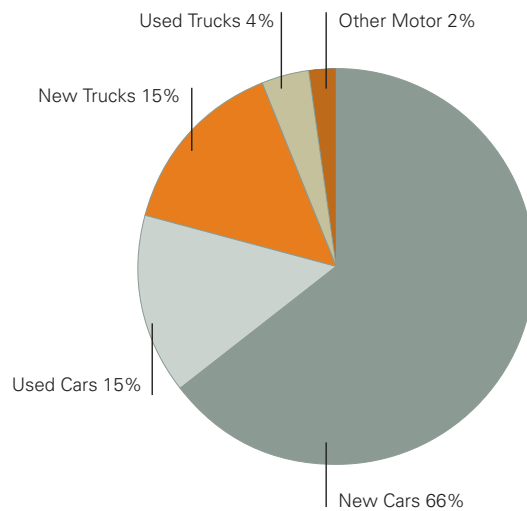
Equipment finance is provided to the broad range of Australian industry sectors. No one industry sector particularly dominates; the single largest are the Property and Business Services sector together with Finance and Insurance, accounting for 14% and 18% respectively. On a State/Territory basis, NSW accounts for 43%, Victoria for 23% and Queensland for 17%, so that the three eastern states and ACT made up 83% of total business. The WA economy has been very strong over the recent period, and this State accounts for a further 9% of business.

Until the September Quarter 2008, the Australian economy had experienced an extended period of expansion from the early 1990s. Since 2002, the rise in commodity prices increased Australia's terms of trade by some 70%. However, as substantial domestic supply constraints emerged and the inflation rate rose above the Reserve Bank's target of 2-3%, from late 2001 official interest rates increased 13 times over the 7 years from a low of 4.25% to 7.25% in August 2008. With negligible GDP growth in the September Quarter coinciding with a series of global financial crises and dislocated funding markets, monetary policy has been rapidly eased such that the official rate has been reduced 4 times in 4 months to 4.25% in late December. Fiscal policy has also been significantly eased with a \$10.4 billion consumption stimulus announced mid-October to commence 8 December and a 10% Investment Allowance for expenditure on plant and equipment over \$10,000 contracted for between 13 December and 30 June 2009. These major positive domestic policy responses have however to be weighed against the local impacts of unprecedented disruptions to global financial markets and international economic slowdowns. At the time of the Review, the outlook for the Australian economy, capital investment and equipment financing remained uncertain, although the starting points of Budget surplus and firm interest rates, give some optimism that fiscal and monetary policies can continue to be applied to minimise any economic slowdown.

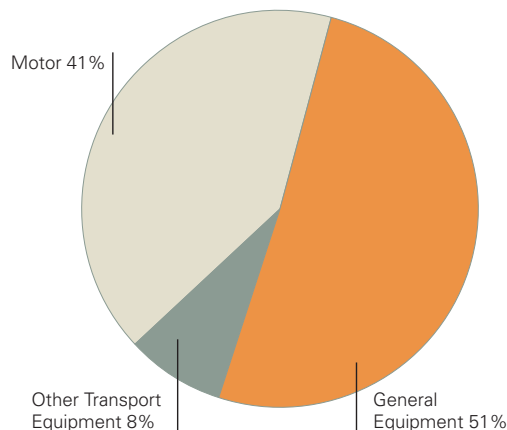
New Leasing: Non-Motor Related
12 Months to June 2008: \$5.1 Billion



New Leasing: Motor Related
12 Months to March 2008: \$5.3 billion



Equipment Finance by Class of Equipment
12 Months to June 2008: \$26.4 Billion



The Taxation Framework

Like all financial products leasing and other equipment finance operate within the framework provided by the Commonwealth, State and Territory Governments' taxation statutes.

Over the past 40 years there has been a series of reports on and inquiries into various aspects of the Australian Taxation System. Some have set down principles which should underpin a better system (e.g. simplicity, efficiency, equity); some have dealt with changes necessary to address external factors (e.g. inflation), while others have attempted to set an agenda for overall change; similar reviews have taken place at the State level. In addition, other wider-ranging inquiries (e.g. the Campbell Financial System Report and the Wallis Financial System Inquiry)

have made observations and recommendations concerning tax. In 2008 the incoming Rudd Government announced a comprehensive review of Australia's tax system; the Board of Taxation was also requested to conduct a review of the legal framework for the administration of the Goods and Services Tax.

Contemporaneously the various statutes have been continuously amended or added to, as governments have responded to social, fiscal and commercial developments.

Many changes have been made, and while AELA does not necessarily agree with all of them, it is fair to say that the general direction has consistently been towards improvement. The

framework itself however has become overburdened by continuous amendment, resulting in excessive complexity, increased scope for 'unintended consequences' and major distortions caused by the narrowness, overlap and economic shift in the various tax bases. Given the complexity of modern commercial transactions, this outcome while regrettable, is nonetheless understandable.

Commonwealth Taxation

The Review of Australia's Future Tax System (AFTS) is scheduled to report to the Treasurer by the end of 2009. Prior to this review the 1997 Task Force on Taxation culminated in the 1 July 2000 commencement of the Goods and Services Tax (GST), which replaced the previous Wholesale Sales Tax (WST) regime and Financial Institutions Duty (from 1 July 2001) with a 10% GST coincident with a reduction in personal income tax. At the same time the 1999 Review of Business Taxation (RBT) process was an attempt to deliver enduring tax simplification and a lower rate of company tax. The various issues for the industry arising from these are dealt with in the following sections.

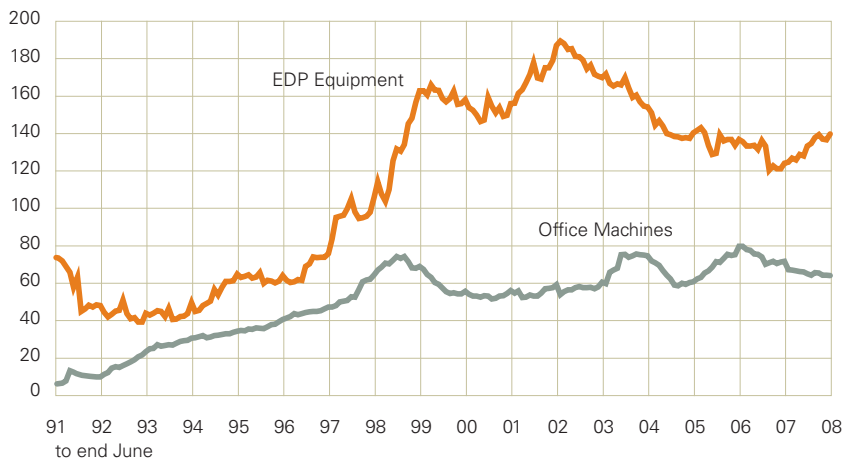
A role of bodies like AELA, has always been to assist members and other market participants with the interpretation of statute amendments, as well as to offer informed advice to governments on their drafting and revision. In the context of the major GST, RBT and AFTS reforms, this role has been even more necessary and encompassing, with the following several key issues the subject of on-going focus.

Leasing and Tax Benefit Transfer

At the Commonwealth level the tax framework generally applies to leasing such that, provided the equipment is used for business purposes, the lessee claims the lease rental as a business running expense tax deduction. The lessor is generally tax-assessed on the basis that the capital item is being used to produce assessable income: taxable income therefore is lease rentals received less depreciation and any investment (dis)incentives operating through the tax system and taking into account any balancing amounts (profit or loss on sale) at the end of the respective lease agreement.

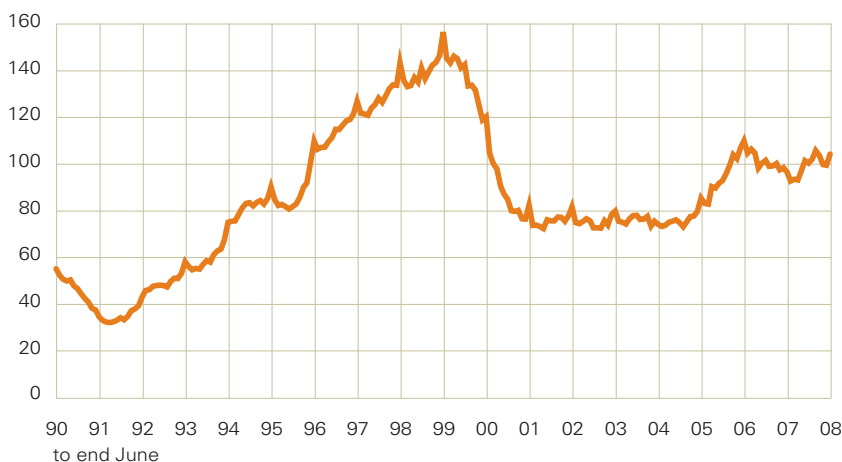
Computer Equipment & Office Machines

Finance Leases: \$Million per Month Trend



Agricultural, Construction & Manufacturing Equipment

Total Lease Finance: \$Million per Month Trend



For non-lease equipment finance on the other hand, the business borrower claims tax deductions for interest and depreciation and the financier is taxed on its interest income.

Around 20% of national private equipment capital expenditure is leased, with lease finance being widely used by all sectors of the economy. Another 20% or so is financed via chattel mortgage and hire purchase. Compared with such other financing techniques, leasing has a number of competitive features: the lack of equity outlay conserving the lessee's cash resources; the ability to tailor lease rental schedules to seasonal or irregular income streams; a lesser effect of the equipment utilisation decision on balance sheet ratios; the removal of the lessee's need to maintain an asset register for tax purposes; the regular review of the equipment's technological appropriateness to the task; and the greater flexibility for unbundling equipment, supplier and maintenance risk and service delivery.

A particular feature in relation to the Commonwealth tax system is the ability of the lessor (as equipment owner) to concentrate the various taxation attributes of that ownership into the amount of the lease rental. This tax benefit transfer (TBT) enables the lessor to price depreciation and investment incentives (when applying) on an after-tax basis and offer a

rental stream that is lower than other products' repayment schedules. This is especially important for lessees with minimal current year taxable income (firms just starting-up, those restructuring or those otherwise in a bona fide tax loss situation) for whom interest, depreciation and incentives deductions only add to carry forward losses.

Without leasing, the otherwise available benefits of the tax system would be lost or significantly diminished. In AELA's view Australia's production and employment, as well as the economy's essential infrastructure, have been well-served by this tax benefit transfer capacity, as well as by leasing's other product features. The leasing industry's commitment to further improving the lease product has, over the years, led to an increasing sophistication which has put other financing techniques on their mettle. Occasionally policy or administrative responses have been introduced to curb the impact of some of these product refinements.

An important role of AELA is to liaise with governments and officials regarding such measures to ensure that their objective is achieved without prejudicing the other economic benefits and features of the lease product.

For example, this role was much in evidence during 1988 when, in the context of a Tax

Commissioner's Ruling (IT2512) on Financing Unit Trusts, the Government considered its policy response to this issue of 'tax effective financing'. AELA along with other affected parties made representations and on 20 December 1988 the Government announced the result of its review as follows:

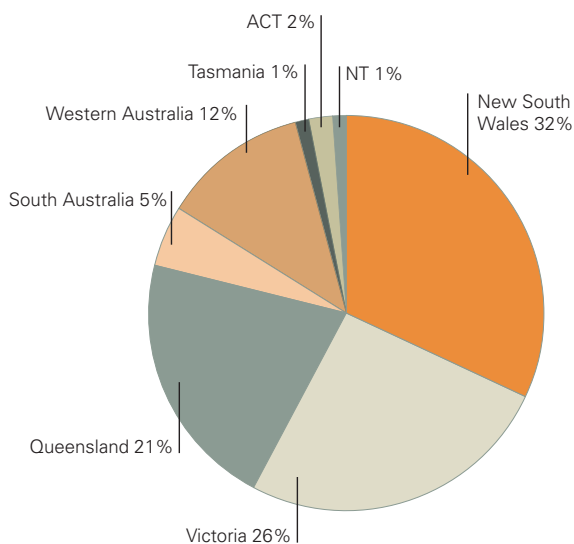
'This review has confirmed the need to act against tax effective financing. Tax effective financing relies upon the ability to transfer or share tax benefits. The Government considers that the broad scheme of the tax law requires that tax losses be carried forward by the taxpayer who in substance incurs them and that in general, such losses should not be available for transfer to other parties, including financiers. An exception, long accepted by revenue authorities, has been in respect of genuine leasing transactions for plant and equipment but the Government believes that other forms of tax benefit transfer should not be accepted.'

AELA welcomed the decision in relation to leasing. At the same time the Government announced that a consultative paper on the 'economic issues and taxation law relating to tax benefit transfer arrangements' would be prepared. To assist this process AELA commissioned the Bureau of Industry Economics to research the issues involved; their report 'Tax Losses and Tax Benefit Transfer' was finalised in October 1990 and remains relevant in today's environment.

The research focused on the extent of tax losses in the system, the distortion to resource allocation and investment caused by the carry-forward of such losses, the potential gains that might result from reducing those distortions via tax benefit transfer and the options available for remedying the problems identified without opening-up too great a drain on Commonwealth Revenue. In identifying the discrimination against riskier projects and newer investors caused by the carry-forward of losses, the report found that 'if the businesses which were deterred from making particular investments would have been more efficient at undertaking them, or if potentially valuable but riskier projects are abandoned because those who

Equipment Finance by State

12 Months to June 2008: \$26.4 Billion



do not face the tax-related disincentive are not well-placed to invest in them, the economic costs associated with this discrimination are likely to be significant’.

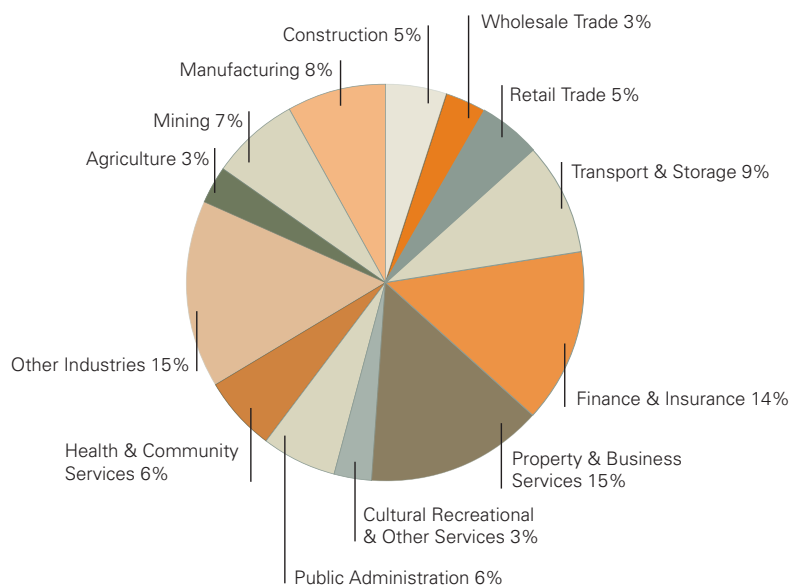
A number of options were considered to overcome the distortions; these included – refunds for tax losses, loss carry-forward with interest, the sale of tax losses and the availability of tax benefit transfer arrangements. As a significant source of tax losses in the system was depreciation and investment incentives for plant and machinery, the report found that the overall level of tax losses would have undoubtedly been higher but for the use of leasing’s tax benefit transfer capacity.

The research noted the long-standing exception of equipment leasing from restrictions on tax benefit transfer and, in relation to the current taxation regime, found that ‘leasing has the desirable effect of making the investment feasible for entities either in tax loss or anticipating some tax losses, without encouraging them to any greater extent than for fully taxed entities.’

While the theoretical preferred means of ameliorating the tax loss carry-forward distortions were loss refund, loss sale or loss carry-forward with interest, they involved other problems; the report concluded that in such cases the continued allowance of current tax benefit transfer mechanisms (i.e. leasing) was ‘useful in alleviating these distortions’. The Bureau of Industry Economics report represented a constructive input into the broader consideration of the future structure and features of the taxation system.

In November 1994, the Government commissioned its then Economic Planning Advisory Commission (EPAC) to investigate how the private sector might best participate in the provision of public infrastructure. In its May 1995, EPAC’s Private Infrastructure Task Force Interim Report noted that the issue of tax arbitrage through leasing by tax exempt bodies should be dealt with by developing appropriate rules for leasing rather than placing restrictions (legislated initially as section 51AD and Division 16D and replaced from 1 July 2007 by Division 250) on particular types of infrastructure investments. In response to this and to the need to define leasing for the purposes of its exclusion from the proposed accruals legislative regime for the taxation of financial arrangements, in June 1995 a joint Treasury/Tax Office review of leasing arrangements was announced. Its objective was to replace the current leasing framework (based on Tax

Total Leasing by Sector
12 Months to June 2008: \$10.4 Billion



Office public and private rulings and advices and on passing regulatory references) with a comprehensive legislative framework which did not ‘place unwarranted roadblocks in front of legitimate separations of economic from legal ownership (including in relation to private sector participation in infrastructure provision) while also preventing unwarranted tax benefit transfers’. AELA made preliminary input to this forum, which was then overtaken by the broader Review of Business Taxation (RBT).

In its initial February 1999 discussion paper, the RBT proposed that a lease be treated as a sale-and-loan for tax purposes. This approach was in line with its high level design principles of simplicity and certainty, on the basis that ‘transactions with similar economic substance should be treated in a similar manner’ so that the ‘allocation of resources reflects market realities’. AELA disagreed with the presumption of this device and argued for the benefits of leasing’s tax benefit transfer capacity, which its adoption would negate. In subsequent discussions with officials, the exclusion of so-called ‘routine’ leases from the proposed regime was canvassed, with the criteria for such leases being those tests which had been developed over the years to identify genuine leases. AELA supported this policy direction. However, when the RBT’s final report was released in September 1999, the criteria for such ‘routine’ leases bore little resemblance to market practice. In the event, the Government did not include them in the first or subsequent tranches of implementation.

During 2006 AELA made a number of submissions to Treasury on the proposed new regime

for the Taxation of Financial Arrangements (TOFA), and met with the Assistant Treasurer and Minister for Revenue in this regard. AELA accepts that leases are but one of several arrangements (including hire purchase and chattel mortgages) widely used to finance the acquisition of plant and equipment, and at one level a case could be made for the inclusion of leasing in a TOFA regime. However to do this, i.e. to treat leases as ‘sales-and-loans’ and tax their implied interest income stream rather than to maintain the established approach of taxing their periodic ‘rentals less depreciation’, would destroy leasing’s TBT capacity to the detriment of the business sector.

AELA maintained that there was no intrinsic reason for the TOFA regime to include leases. The over-riding policy issue is whether leases should continue to facilitate TBT; that is, should firms just starting-up, those restructuring or those otherwise in a bona fide tax loss situation be given the benefit of the same depreciation and similar allowances that are available generally. Accordingly AELA submitted that the TOFA proposals should reflect existing policy, by way of the specific exclusion of leasing from the proposed regime.

The TOFA Stages 3 and 4 Exposure Bill was released for comment in October 2008, as the 2007 TOFA Bill lapsed due to the Federal election. Division 230 applies to ‘financial arrangements’, and sets out the methods for bringing gains and losses to account for tax purposes. In broad terms, a Division 230 financial arrangement is one where the rights and obligations under that arrangement are

'cash settleable'. It is pleasing to report that the Explanatory Memorandum notes that most leasing arrangements will not be cash settleable financial arrangements under Division 230, and to that extent leasing will continue to retain its TBT capacity. Division 230 is to apply to income years commencing on or after 1 July 2010, with a taxpayer election to apply to income years commencing on or after 1 July 2009.

As indicated previously, leasing is a mix of debt and equity in financing equipment utilisation, which will test any regime preferring the simplicity of rules, which avoid this duality. AELA's role continues to be to advance the long-term economic benefits of the lease product's tax benefit transfer capacity.

Leasing Tax Guidelines

Because of the significance of its tax benefit transfer capacity, a regular issue over the years has been the definition of what constitutes 'genuine leasing transactions for plant and equipment'. Unfortunately a starting point in this regard has often been what is referred to as IT28 – a 1985 Tax Office Ruling which reproduces a July 1960 Circular from the Commissioner of Taxation which aimed at distinguishing 'an ordinary commercial lease entered into in the normal course of trade' from an arrangement where the repayments were 'in substance consideration for the sale of the goods purported to be leased.'

Several criteria were set down in this Circular to be included in a 'genuine' lease to evidence its 'current' (i.e. full amount of rentals tax deductible by the lessee) rather than 'capital' (i.e. lessee deducts only notional interest and depreciation) nature.

In certain respects however, these criteria differ from what is ordinarily included in a lease and these differences have on occasion confused policy and administrative discussion. This confusion first arose in November 1989 when a Taxation official cited the IT28 criteria as the benchmark for a 'genuine' lease. Subsequently a degree of uncertainty as to Tax Office approach arose when some commentators interpreted this citation as a major departure from the then existing tax treatment; that this was not the case was later confirmed by the Tax Office – however the differences and potential for confusion remained.

In October 1990, the Tax Office convened a working group comprising Treasury, legal, accounting and taxation professional groups, as well as Tax Office and Industry representa-

tives to discuss the broader policy framework for leasing. At the conclusion of the meeting, AELA was asked to prepare an 'omnibus' draft ruling, bringing together the series of rulings on particular lease-related matters made in public and private rulings by the Tax Office over the previous thirty years. This was completed and was made available to provide a comprehensive basis for any further consideration of the lease product's legal, taxation, accounting and commercial context as it has developed in Australia.

In this 'omnibus' draft ruling, AELA amongst other things reconciles IT28 with the commercial reality of the current lease product. In essence what occurred was that during 1961 the Tax Office issued further statements which qualified the earlier criteria. Had these changes been incorporated in IT28 when it was released in 1985, much of the confusion would have been avoided.

This has particularly affected two areas: residual value indemnities and the acceptable term of the lease. Contrary to IT28, most existing finance leases provide that the lessee cover any loss on sale of the equipment by way of a residual value indemnity. This has been an important commercial feature of the Australian market. Because of Australia's geographic expanse and remoteness, second-hand equipment markets are generally more shallow. When added to high transport and other frictional costs, there is a much higher equipment risk domestically than would be the case in a lease of similar goods in major overseas markets. The costs and risks associated with retrieving and selling a particular item of specialised plant at the end of the lease, when the plant is located at a remote site in Central Queensland, is much greater than if it were occurring in Europe or North America.

But for the residual value indemnity, the cost of leasing such equipment would need to be significantly increased for the explicit pricing of this aspect of equipment risk which is not already bundled with the transaction's credit risk. Whereas at present the lessee indemnity renders this risk implicit (and largely unpriced) any change would not only force up the cost of equipment financing to Australian business but to the extent that financiers could not accommodate the priced risk within their prudential objectives, it would also add to tax loss carry-forward distortions currently ameliorated by leasing's tax benefit transfer capacity.

The reconciliation of this feature with IT28 as published, dates from November 1961 when the

Tax Office advised that such indemnities were permitted subject to a number of conditions dealing with commerciality.

Similarly, also in 1961, the Tax Office revised its earlier position indicating that 'no objection would be taken to the leasing of plant and machinery for the period of its estimated life' provided always that the transaction was arms-length and commercial. This position was made less certain in March 1994 however when Tax Determination TD94/20 (now withdrawn) put the view that an acceptable lease should not be written for the whole or a substantial part of the asset's useful life. As this is a common feature of the lease product, AELA requested the review of this matter; given the range of views taken on how effective or useful life is assessed, the Determination did not however present much practical difficulty. In this context, Income Tax Ruling TR2006:5, 'Income Tax: effective life of depreciated assets', notes the following at paragraph 62 under the heading of 'Lease periods': 'Because effective life is, among other things, the period a depreciating asset can be used for the relevant purposes, it is unlikely that an asset could be leased for a period greater than its effective life. Consideration of this factor will, in many instances, suggest that the effective life of an asset is no shorter than the period it is leased'.

A further area of tax guidelines for the Australian lease product relates to residual values. The July 1960 Circular (later published as IT28) set a range of residual values which the Tax Commissioner considered to be reasonable and realistic. The schedule derived from historical depreciation rates for particular types of equipment and had its RVs set at 75% of the relevant prime cost written down value, in recognition that lessees are likely to inflict more wear and tear on the equipment than owners. The schedule was subsequently confirmed in January 1981 through IT174, and in July 1993, via TD93/142, it was recast in terms of underlying effective life rather than prime cost depreciation rate.

For the record the guideline is shown in the accompanying panel.

The Determination notes that residual values lower than those outlined in the guideline may be used where a well-considered and fair estimate of the likely market value of the item at the end of the lease warrants this. AELA supports this commercially realistic approach. Following the Government's adoption of the RBT recommendation to fund most of the Revenue

Effective Life In Years:	5	6.7	10	13.3	20
Term of lease	Minimum Residual Value – % of Cost				
1 Year	60%	63.75%	67.5%	68.5%	70%
2 Years	45%	52.5%	60%	62.5%	65%
3 Years	30%	41.25%	52.5%	55%	60%
4 Years	15%	30%	45%	50%	55%
5 Years	nil	18.75%	37.5%	45%	50%

foregone in dropping the company tax rate from 36% to 30% by removing the acceleration in the broad-banded safe-harbour depreciation regime, the Commissioner of Taxation was charged with revising his determinations of safe-harbour effective lives of a wide range of assets. Taxpayers continue to have the option to self-assess the effective life of an asset as an alternative to adopting the Commissioner's schedule, or where they are in existence to apply statutory caps.

In the first round of revisions, from 1 July 2002 the Commissioner increased the effective life of aircraft from 8 to 20 years, of offshore oil/gas platforms from 20 to 30 years and of motor vehicles from 6.67 to 8 years. In the case of aircraft and offshore platforms, the Government legislated statutory caps of 10 and 20 years respectively, considerably ameliorating or removing the impact of the Commissioner's change. Recourse to statutory caps of course, does not mean that the revised effective lives are incorrect, rather they are to address competitive factors in particular markets.

For motor vehicles, the variation did not present a significant concern at the time, but in the recent period the second-hand market for cars has demonstrated considerable fragility. The Commissioner proposed, as from 1 January 2004, to increase the effective life determinations from generally 6.67 to 12 years for light commercial vehicles and 15 years for trucks. As these increases were considerably greater than that for motor cars, the determination potentially had a much more dire consequence for the resulting safe-harbour residual value and hence equipment and credit risk.

In response, AELA developed a co-ordinated approach to assist members in addressing these impacts, which incorporated the following elements: a request to the Tax Office to delay implementation of the revised determinations; a request to the Government to introduce statutory life caps for these assets; the development of a methodology consistent with

the Tax Office framework to enable lessors to confidently self-assess an effective life shorter than the Commissioner's determinations; and the assembly of independent data on the market value of light commercials and trucks for common end-lease periods, as a basis for members to adopt more realistic minimum residual values, and also to support the introduction of statutory caps and effective life self-assessment.

In the event the Tax Office twice deferred the revised determinations, initially to 1 July 2004 and then to 1 January 2005. In the meantime the Government announced (in August 2004) that statutory effective life caps would be introduced for light commercial vehicles, trucks, buses (7.5 years) and truck trailers (10 years) effective as from 1 January 2005. This issue is covered in more detail later in this Review in the section dealing with 'Trucking and Transport Issues', but in brief the statutory caps have resulted in depreciation allowances for these assets more in line with the fall in their value.

AELA has subsequently again written to the Commissioner of Taxation in relation to the impact of the substantial increase in his determinations of effective lives of assets on 'safe-harbour' minimum residual values in leases. These are resulting in very high 'safe-harbour' residual values, presenting an unacceptable credit risk for financiers, in that the asset at the end of the lease is likely to be worth considerably less than the safe-harbour residual value pursuant to the revised effective lives.

AELA is not suggesting that the Commissioner's revised determination is not an accurate reflection of the 'effective life' of an asset, but rather that an asset's value does not depreciate in a 'straight-line' over the effective life and in the early years the depreciation is disproportionately high. That such straight-line depreciation does not provide an accurate reflection of an asset's loss of value in its early years has been recognised by the Government in recent times in two ways. Firstly, the introduction of statutory

effective life caps (first introduced in January 2002), and the 2006 Commonwealth Budget announcement that the diminishing value (DV) rate of depreciation would increase from 150% to 200%. In announcing this measure, the Treasurer stated that it would ensure that depreciation deductions for income tax purposes more closely reflected an asset's decline in actual value. AELA accordingly requested that lessors should be given similar ability to use effective life caps (when in place) and DV depreciation in utilising the safe-harbour residual value methodology, but at the time of writing the Commissioner has not acceded to this request.

Guidance is also provided for practices on trade-ins and in relation to balloon payments. This is via TR98/15 which states that where a previously leased asset is traded-in on a replacement asset, the trade-in credit is taken into account in determining the lessee's taxable income, notwithstanding that the proceeds are not paid to the lessee but are used to reduce the cost of the replacement asset or the lease payments that would otherwise be payable. The Ruling also specifies when balloon payments are deductible.

In the equipment finance area of hire purchase, the Government in February 1998 announced that it would formalise the long-standing (October 1951- IT 196) administrative practice whereby taxpayers acquiring assets by hire purchase are treated as owners for eligibility to depreciation and other capital allowances. Coincidentally a Federal Court decision in *Bellinz v Commissioner of Tax*, found that a lessee (in this instance, a leveraged lease partnership) with an unexercised purchase option, held insufficient ownership rights to be regarded as the owner for the purposes of claiming depreciation. Given the legislative amendments by way of Division 240 of the Income Tax Assessment Act 1997, this decision has not had major consequences for regular hire-purchase transactions, however AELA has continued to monitor developments to ensure no unforeseen outcomes.

A number of other areas of the Commonwealth taxation framework affect leasing.

In May 1994 the Tax Office issued Draft Taxation Ruling TR94/D26 on depreciation of fixtures. The legal principles discussed in this ruling would, in some instances, preclude the availability of depreciation, not because of limits on tax benefit transfer, but because of the general law of property. Representations were made by AELA and on 11 June 1996 the Federal Treasurer announced that legislative amendments would

be introduced to ensure that lessors retain entitlements to depreciation where leased equipment is a fixture on someone else's land, and where the lessor has an effective right to remove the equipment. In April 1997 legislation was introduced to ensure that lessors retain this right to claim depreciation.

In August 1995 the Tax Office issued Taxation Ruling TR95/30 on Sale and Leasebacks. The Ruling addressed many of the concerns raised in AELA's submission on the draft, and states that where an arrangement is legally characterised as a sale and leaseback then generally the lessor is entitled to claim depreciation and other deductions, and the lease payments are deductible to the lessee. A draft ruling TR2006/D5 was issued in April 2006, which revised and updated TR95/30, and was issued in November in final form as Tax Ruling TR2006/13. This Ruling confirms the general tax treatment for sale and leaseback described in TR95/30.

In relation to the tax treatment of software, the 1998 Budget provided for software to be depreciated over 2.5 years. An immediate deduction is available for software spending of \$300 or less and for undeducted spending where software development projects are abandoned. An immediate deduction was also available on software expenditure for Y2K compliance. The amendments generally apply to software spending incurred after 11 May 1998.

In February 1999 the Tax Office issued Tax Ruling TR1999/3: Depreciation of Second-hand Luxury Cars. The ruling states that the cost of a second-hand car for depreciation purposes is the purchase price, and will be subject to the luxury car Depreciation Limit where this exceeds the Limit. Section 42-90 of the Income Tax Assessment Act 1997 provides a discretion to the Commissioner to limit the cost of previously depreciated property; the ruling notes that the fact a car has previously been subject to the luxury car Depreciation Limit would not, of itself,

cause the Commissioner to exercise this discretion. A further area in which Tax Office rulings have been relevant is that of novated leases. These leases involve an employee leasing a vehicle (often as part of a salary package) from a leasing company, with the obligation to make the repayments novated (i.e. taken over) by the employer for the term of employment.

Following the August 1996 changes to the Luxury Vehicle Depreciation Limit (i.e. lessee becomes owner for tax purposes), some confusion arose as to the tax consequences for lessees under 'partial novations'; subsequently TR 1999/15 was released which ensured no tax implications for lessees, provided that the conditions in the Rulings are met and AELA welcomed this outcome.

In May 2001 the Government introduced legislation for the recommendations of the Ralph Review of Business Taxation to unify the various Capital Allowance regimes. The 'second hand plant rules' are part of the Uniform Capital Allowance (UCA) regime, and apply from 9 May 2001. Generally, when calculating tax deductions for depreciable assets the taxpayer can choose either the diminishing value or the prime cost method, and choose either the Commissioner's safe-harbour determination of effective life or self-assess the effective life of the asset. However, under the 'second-hand plant rules' these choices are restricted.

The new holder of the asset (being the person entitled to depreciation deductions under the UCA regime) is required to use the same method and same effective life used by the former holder. Where the new holder does not know and cannot readily find out which method and/or effective life the former holder was using or the former holder did not use a method and/or effective life, the second hand plant rules provide a default rule, being the use of the diminishing value method and/or the Commissioner's determination of effective life. This seems to be the general outcome in practice.

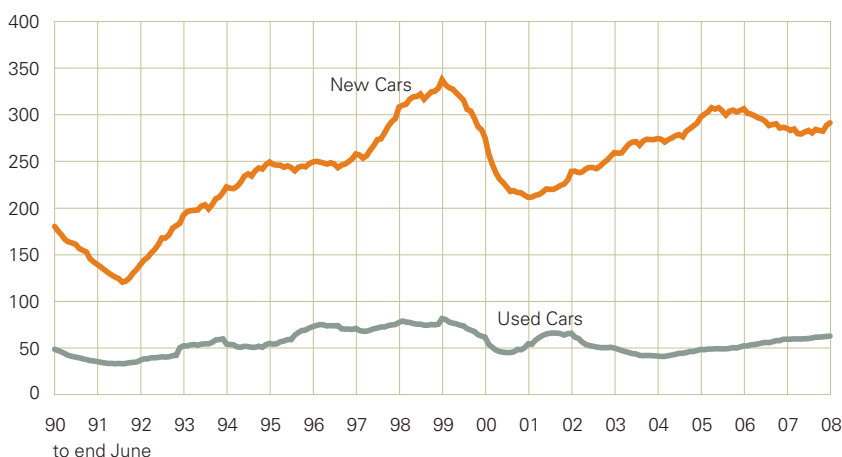
Leveraged Leasing and Leasing to Government and other Tax Preferred Entities

The general structure of leveraged leasing in Australia is also determined within the Commonwealth taxation framework.

The July 1983 Tax Ruling IT2051 set down the guidelines for 'acceptable' leveraged leases. Where the transaction is structured according to this Ruling and does not have any other unusual feature, it is not necessary to seek Tax Office

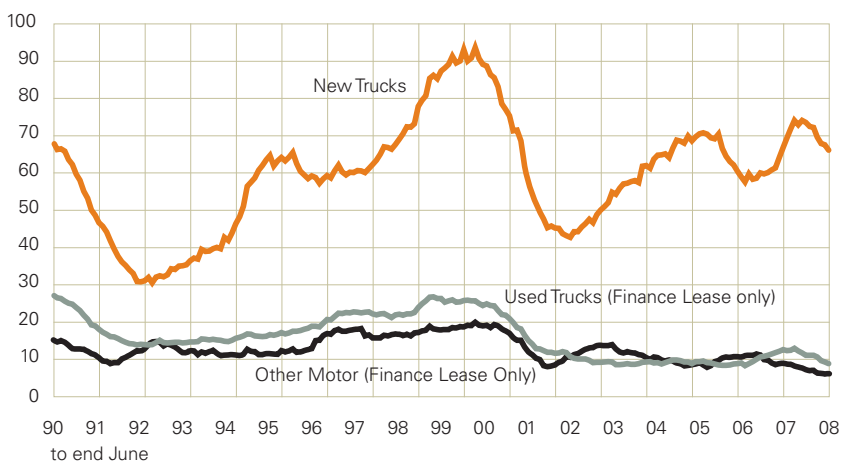
Car Finance

Total Lease Finance: \$Million per Month Trend



Other Motor Finance

Total Lease Finance: \$Million per Month Trend



approval. The Ruling covers debt/equity ratio (20 percent), capitalisation of charges (not allowed) and residual values (fair estimate of market value at lease end). Subsequently in June 1985 a further Ruling (IT2169) extended a number of these requirements to equity or partnership leases.

Another area where leasing structures have been affected by tax laws is leasing to tax exempt public and semi-government authorities. Following the announcement of restrictions in December 1981 (denying the Investment Allowance in leveraged arrangements where a tax exempt was the real end-user), and June 1982 (denying all ownership deductions (depreciation, interest and Investment Allowance) in leveraged or similar arrangements where overseas plant or sale-and-leasebacks to tax exempts was involved), in May 1984 Division 16D of Part III of the Act was added (Sns 159GE-GO) which effectively required that traditional finance leases to these bodies be tax accounted by lessors only using the 'finance' method (i.e. the interest earned from the transaction). The rationale behind this was to deny the depreciation claim (among other deductions) for (especially State and Territory) public sector and overseas ('cross border') equipment investment against Commonwealth Revenue caused by the lessor using the 'asset' method (i.e. rentals less depreciation).

Unfortunately aspects of the Division 16D definitions as to what constituted a finance (as distinct from operating) lease differed from the accounting standard with the result that many operating leases could not be offered to government authorities. Of particular concern was the requirement that where the total repayments under the arrangement exceeded 90 percent of the cost price of the property, the arrangement was a finance lease – in the accounting standard this 90 percent test relates to the present value of the repayments. Over the years AELA made several submissions seeking that present value be taken into account.

Following from the RBT recommendations, the Government proposed a new legislative framework to replace Division 16D (and section 51AD), which govern the tax treatment of leasing and similar arrangements with tax preferred entities.

In August 2007 the government introduced the long-awaited tax-exempt asset financing reforms, Division 250, which replaced Division 16D and Section 51AD. Division 250 applies to leasing and similar arrangements between

taxpayers (e.g. lessors) and the tax preferred sector. Arrangements coming within Division 250 are denied capital allowances, and taxed as a financial arrangement on a compounding accrual basis.

The Division broadly applies where the taxpayer does not have the 'predominant economic interest' in the asset. Short-term and relatively lower value arrangements are excluded, ie where the arrangement does not exceed 12 months or where the 'financial benefits' are less than \$5 million. The Division does not apply to hire purchase arrangements with a tax preferred entity, and these are treated as 'notional loans' under Division 240 of the ITAA.

Finance leases to tax-exempt bodies prima facie come within Division 250 because they contain a guaranteed residual value, and operating leases are prima facie within this Division if they are 'effectively non-cancellable' or the present value of the expected financial benefits under the lease exceed 70% of the market value of the asset. However, both finance and operating leases are excluded if any of the following applies: the lease does not exceed 12 months; or the taxpayer (ie lessor) is a small business entity; or the financial benefits under the lease do not exceed \$5 million. There is a further exclusion for leases of non-real property, where certain criteria are met.

In relation to public sector leasing, from the 1993-94 year, the previous Loan Council Global Limits for borrowing were replaced by Loan Council Allocations which include operating leases as a memo item where payments under such leases have a net present value of more than \$5 million. In March 1994, Guidelines for Loan Council Coverage of Infrastructure Projects with Private Sector Involvement were issued. The risk-weighting approach involves estimating the degree of public sector risk exposure in an infrastructure project and including that exposure in the particular State or Territory's Loan Council Allocation.

With a range of privatisations involving assets of previously exempt entities entering the private sector, in 1998 the Government introduced a number of technical amendments (effective from 4 August 1997) to limit the depreciation deductions that can be claimed by purchasers of tax exempt entities, to the higher of the asset's notional written down value or its undeducted pre-existing audited book value.

Tax Incentives and Disincentives

Historically Australian Governments have

provided a range of capital allowances via the taxation system to encourage or discourage various equipment investments. Over the years AELA has put forward the following principles to the series of business tax reviews; these focus specifically on international tax relativity:

- the rate of Australian company tax should be at a rate which is in line with that of our major trading partners and competitors;
- the Australian depreciation regime should not be any longer than that of our major trading partners and competitors; and
- the level of investment incentives in Australia should be kept similar to and not less than those applicable in our major trading partners and competitors.

AELA firmly believes that the above principles of business tax relativity should be kept under review, also taking into account the changing mix of other socio-economic variables (e.g. inflation, interest rates, wage growth, 'regulatory burden'). To the extent that these get out of balance with those economies with which Australian business is expected to compete, investment incentive and capacity can be adversely affected, and the business taxation system should be ready to foster investment over consumption without disturbing the overall policy mix.

The 1999 Review of Business Taxation (RBT) recommendations and the Government's response, came at a most positive point in the cycle of domestic economic and fiscal outcomes, with the consequence that the level of investment incentive was reduced. This trend was most obvious in the RBT recommendations on depreciation as well as in the Commissioner of Taxation's changes to effective life determinations for a range of assets, which has resulted in a lengthening of safe-harbour effective lives and an associated reduction in annual depreciation allowances for those assets. In response, the Government has introduced statutory effective life caps (shorter than those re-assessed) for some asset classes and in the latest period increased the diminishing value depreciation rate to better reflect an asset's actual decline in value.

It is noteworthy however that such outcomes, especially their international relativity to major trading partners and competitors, can and do change.

By way of background it is worth recording the series of incentives which have been operating in the market. In 1975/76 a 'double' depreciation acceleration (relative to the Tax Commissioner's

long standing safe-harbour rates) measure was introduced. From January 1976 this was replaced by a 40% General Investment Allowance and from August 1980 a 20% depreciation acceleration. In 1978 the Allowance dropped to 20% and in April 1981 both the Allowance and the depreciation acceleration dropped to 18%; the Allowance as scheduled phased-out on 30 June 1985.

In 1982 a simplified depreciation acceleration regime was introduced which wrote-off equipment over 3 or 5 years. In May 1988 the pre-existing Commissioner's depreciation rates were restored with the prior acceleration increased from 18 to 20%. In March 1991 an 'effective life' self-assessed regime with a default 7-tier broad-banded safe-harbour schedule was introduced. In February 1992 the tiers were reduced to 6. In February 1993 a 10% Investment Allowance was introduced for items over \$3,000 (phasing-out June 1994). As with the previous year's 10% Development Allowance (for large scale projects of more than \$50 million) the long-standing rules whereby the lessor or lessee could apportion the claim were applied.

In March 1995, a 10% Drought Investment Allowance was introduced, to run for 5 years with a cap of \$5,000 per lessee taxpayer per year. Reflecting the Government's recognition of the benefits of leasing's tax benefit transfer capacity, the cap for lessors was \$5,000 per item per year. Following adoption of the RBT recommendation, from September 1999 the acceleration implicit in the 6 tiers was abolished and the Commissioner's pre-existing effective life schedule re-instated, and an on-going review of that schedule was commenced. Over the period from 1975 to the present, the company tax rate has been reduced from 49% to 30%.

In the 2006 Budget, the Treasurer announced the increase in the diminishing value (DV) rate of depreciation from 150% to 200% of the prime cost (PC) method. This measure applies to assets used for a taxable purpose acquired on or after 10 May 2006. It includes assets subject to leasing arrangements, and to that extent is tax-neutral as between leasing, hire purchase and chattel mortgage.

In December 2008, the Government announced a 10% Investment Allowance to apply to equipment acquisitions of over \$10,000 contracted for before 30 June 2009. AELA is working with officials on the detailed operation of the measure.

As for tax incentives, so too for disincentives. In 1979 the Sn57AF Motor Vehicle Depreciation Limit was introduced as a disincentive to 'luxury' motor vehicle purchases. Initially set at \$18,000 it has been annually indexed in line with the motor component of the Consumer Price Index to now (2007-08) stand at \$57,180. In recent years AELA has sought review of the Limit both generally, given the range of other tax imposts on luxury vehicles (FBT, GST, Luxury Car Tax) and specifically for anomalies; in 1993 the provisions were amended to clarify that for lessors with substituted accounting periods the Limit applied to vehicles first used from July each year, and in 1997 changes were made to ensure that where the indexation factor was negative in a given year, the Limit does not change. AELA has also submitted that where the vehicle is used to produce assessable income (such as hire cars and limousines) it should be excluded from the Limit.

By limiting the depreciation claimed by the lessor, the disincentive measure worked to increase the rental paid by the lessee. This only operated however where the lessor was in a taxable position to claim the depreciation within the Commonwealth tax system and in a number of circumstances lease arrangements were such as to negate the price impact of the Limit. After several attempts to stabilise the market disruption which resulted, the Government in August 1996 introduced legislation to treat the lessees of such vehicles as if they were the owner for tax purposes, effectively treating the lease as a sale-and-loan for tax purposes. The measure has been implemented without major disruption to achieve the Government's objective.

In the May 2008 Budget the Government announced an increase in the luxury car tax from 25% to 33%. Senate amendments to these proposals have resulted in two thresholds for the purpose of determining luxury car tax, a 'general' threshold and one for 'fuel efficient' vehicles.

Review of Business Taxation

The then Government's August 1998 Tax Reform announcement, which foreshadowed the GST and a range of changes to personal income tax, also set in train a review of the business tax system. That Review (comprising three prominent businessmen, Messrs John Ralph (Chairman), Rick Allert and Bob Joss) was set a clear goal: to reduce the rate of company tax to 30% (from 36% then current) on a Revenue neutral basis. With the cost to Revenue of such a company tax rate cut estimated in the order of \$3 billion per annum, the achievement of neutrality was a considerable challenge.

In February 1999, a discussion paper ('A Platform for Consultation') was released by the Review. This highlighted the acceleration (over effective life) of depreciation inherent in the Tax Commissioner's broad-banded safe-harbour depreciation schedule (IT2051) as an annual cost to Revenue of some \$2.5 billion. Other integrity, reform and high level design issues were also identified.

In the event, at the end of July 1999, the RBT final report and recommendations were handed to the Government and on 21 September, the first tranche of policy responses was announced. Key amongst these was the immediate abolition of accelerated depreciation to in large part compensate for the phased reduction in the company tax rate to 30% for the year-commencing 1 July 2001 (34% for 2000/2001). A range of other decisions were also taken, including the immediate removal of the 13 month rule for advance expenditure and of the balancing charge offset on equipment disposal. Further decisions were deferred to a second tranche to be the subject of further study.

In AELA's main representations to the RBT, it was accepted that it was a matter for Government policy to set the level of equipment investment incentive (implicit in the particular mix of company tax and depreciation rates) for a given state of economic activity. AELA's concern however, is that within such tax mix as determined, leasing's tax benefit transfer capacity should not be inhibited. That the changed tax mix represents a disincentive to equipment investment needs to be borne in mind when financing decisions are being made, as the lease rental (where the lessor has priced the lower depreciation) will reflect it whereas the loan repayment will not; after tax however, the disincentive effect is the same.

The Government's response to the Review also introduced a new Simplified Tax System (STS) for 'small businesses', defined as those with average annual turnover of less than \$1 million. This measure incorporates an immediate write-off for capital purchases up to \$1,000 and a simplified depreciation regime (including access to the pre-existing accelerated write-off rates until 30 June 2001), after which all eligible assets (ie with an effective life under 25 years) will be pooled and the pool depreciated at the declining balance rate of 30% per annum. This can represent a significant incentive for such businesses and AELA has raised with the Government the need for lessors to be able to price its benefit into relevant lease rentals.

Another RBT policy area which subsequently required AELA's attention was the changed approach to Thin Capitalisation. While previously this measure had centred on the prevention of Australian Revenue being adversely impacted by the payment by foreign controlled companies of tax deductible interest to overseas parents or associates rather than the return of non-tax deductible dividends to the same parties, the RBT approach taken up by the Government was to restrict such deductible payments to all parties, overseas or domestic, related or non-related. From AELA's perspective, it was necessary to ensure that the leasing portfolios of our overseas-owned members were not disadvantaged by the operation of the prescribed financial intermediary gearing. Also important was to ensure that the Debt/Equity Rules which accompanied the restrictions, did not adversely impact on affected lessees. In the event, these objectives were achieved.

A range of other higher level tax system change proposals affecting equipment investment and finance were also under consideration. Of these the proposal to introduce the Tax Value Method was potentially the most significant, but in August 2002 the Government announced that it had accepted the recommendation from the Board of Taxation not to proceed with the Tax Value Method; this decision was welcomed by AELA members.

Australia's Future Tax System

In early 2008 the Government established the review of Australia's Future Tax System (AFTS) to comprehensively review Federal and State taxes, with the final report to be provided to the Treasurer by the end of 2009. An initial discussion paper was released by Treasury in August 2008, setting out the framework of Australia's tax and welfare systems. In areas relevant to AELA, the paper noted that Australia's corporate tax rate of 30% is above the OECD average of 26.6%, whereas in 2001 when our rate went from 36% to 30% the OECD average was 32.5%. In relation to effective life depreciation, it suggests that corporate tax reductions in other OECD countries have been partly financed by less generous tax depreciation allowances, and that effective life depreciation coupled with the 2006 introduction of the 200% rate for the diminishing value method have resulted in a greater alignment of tax depreciation with economic depreciation.

AELA's submission to the review suggested that Australia introduce GST zero-rating of financial services. The most undesirable feature of our present input taxation is the over-taxation of

business consumption of financial services; without the entitlement to the input tax credit, the GST is no longer in fact a value added tax. Other countries have introduced zero-rating or equivalent mechanisms to rectify this distortion, and Australia's GST regime needs to regain its international competitiveness.

We also suggested the abolition of luxury car tax. Even with this abolition, 'luxury' cars would remain subject to limits on depreciation and input tax credits, tax imposts not borne by any other goods. For these purposes a common threshold of \$75000 should apply, indexed to the general Consumer Price Index.

Our submission proposed an alternative to the current Fringe Benefits Tax statutory formula, increasing the present four bands so as to remove the incentive for more car use. This would also provide consistency with the operating costs method, reduce compliance burdens, ameliorate greenhouse gas emissions and address tax expenditure concerns. A significant micro-reform move would be the further abolition of state taxes. The legislative framework covering remaining state taxes should be made uniform. We await the Review's recommendations.

Goods and Services Tax

In September 1997 the Government announced the establishment of a Task Force on Taxation, commencing a process which has delivered one of the most pervasive tax reform initiatives in Australia's history. The GST legislation was introduced into the Parliament on 2 December 1998 and commenced operation on 1 July 2000. AELA was closely involved with its members in preparing for GST. In the early stages this activity focused on representations to the Government concerning the transitional provisions; AELA suggested that special transitional arrangements should apply so that goods acquired in the wholesale sales tax regime should not be subject to GST in addition to wholesale sales tax already borne. AELA was very appreciative of the final rules to apply to hire purchase agreements in this regard, that is, there were no GST consequences for hire purchase contracts entered into prior to 1 July 2000. Following extensive AELA representations, partial relief was also provided for operating leases entered into prior to 2 December 1998. However, the outcome in relation to those remaining leases of equipment, which had already borne sales tax and subsequently attract GST on rentals and on sales at lease end, resulted in significant lessee concern. In many of these cases the recipients of the supply were

entitled to input tax credits, but nevertheless they were concerned about the perception of double tax. The major hardship occurred where the recipient was not entitled to full input tax credits. AELA again raised this issue with the Government as this negative lessee sentiment extended beyond the transitional GST period, as leasing contracts have a typical life of 3-4 years. AELA requested that the Government give further consideration to ameliorating this impact, particularly where the recipient was not entitled to input tax credits, however this relief was not forthcoming.

Following the release of the legislation in December 1998, AELA worked in conjunction with a major accounting firm to prepare a comprehensive GST Guide for members, which was subsequently updated in to reflect all interim changes, and to take account of the ATO public rulings relevant to our members, and also the specific private rulings provided to AELA.

AELA worked closely with the Tax Office in preparing for the introduction of GST. This process clarified a significant number of issues for members, as AELA obtained private rulings, which cover the GST consequences of the crucial operational issues dealt with by financiers on a day-to-day basis. AELA and members were particularly appreciative of the assistance provided by the Tax Office in this regard.

The GST treatment of the leasing and equipment finance facilities provided by AELA members traverses the full GST spectrum. At one end, chattel mortgages are treated as a financial supply; such transactions are accordingly input-taxed, no GST is payable on the provision of the loan or the repayment of the interest and principal, but the financier is unable to claim input tax credits for GST incurred on costs related to the provision of the loan (subject to the operation of the Reduced Input Tax Credit (RITC) rules). When the customer uses the loan funds to purchase the item of property, GST may well be payable by the customer on the acquisition of the property. Input tax credits may be claimable by the customer, provided they are entitled to a credit.

At the other end of the GST spectrum, both finance and operating leases are taxable supplies; lease rentals incorporate a GST component, but in most cases the business lessee will be entitled to an input tax credit for this component. When the lessor purchases the equipment, the purchase price will be GST-inclusive. However, the lessor should be entitled to a full input tax credit for both the GST

cost incurred in acquiring the equipment and other operating expenses (subject to any specific input tax credit rules, such as the phasing-in of input tax credits which applied for motor vehicles).

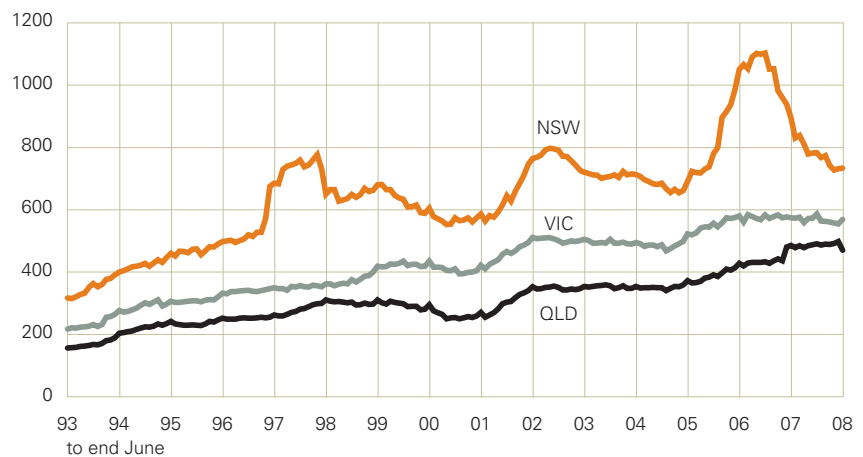
In between these two ends of the spectrum, a hire purchase transaction may have both a taxable and a financial supply component. To the extent that the consideration is referable to the sale of the asset, this component of a hire purchase is a taxable supply. The financier is liable for GST on this component, and is entitled to input tax credits for GST costs referable to the supply of the asset. The provision of credit under a hire purchase agreement is a financial supply, and therefore input-taxed, where the credit is provided for by way of a separate charge and the separate charge is disclosed to the customer.

Accordingly there are two types of hire purchase agreements for GST purposes. Under agreements where no separate credit charge is disclosed to the customer, the hire purchase will be treated as a taxable supply. That is, the financier is liable for GST on all charges under the agreement, and will be entitled to input tax credits in relation to all acquisitions required to make that supply. By contrast, under agreements where a separate credit charge is disclosed there will be two types of supplies: a financial supply and a taxable supply. The liability for GST on the taxable supply arises at the commencement of the agreement and not continually throughout the period of the agreement. There is no liability for GST on the financial supply component of that hire purchase; the GST cost incurred by the financier in acquiring the equipment is recoverable as being referable to the onward supply of the equipment by way of the hire purchase. However, GST costs incurred by the financier in respect of other operating costs are unlikely to be fully recoverable, as they will be partly referable to the provision of credit, which is an input-taxed supply.

AELA continues to work with the Tax Office in relation to issues that arise. Whilst such issues have generally been resolved in a satisfactory manner, one which is causing concern is the treatment of cash basis taxpayers under hire purchase arrangements. AELA has put the view that hirers who account for GST on a cash basis should be entitled to claim input tax credits in the tax period in which the GST liability arises under the hire purchase agreement. Where the financier is an accrual basis taxpayer, as in virtually all cases, a cash basis hirer should be entitled to an input tax credit at the commencement of the hire purchase agreement.

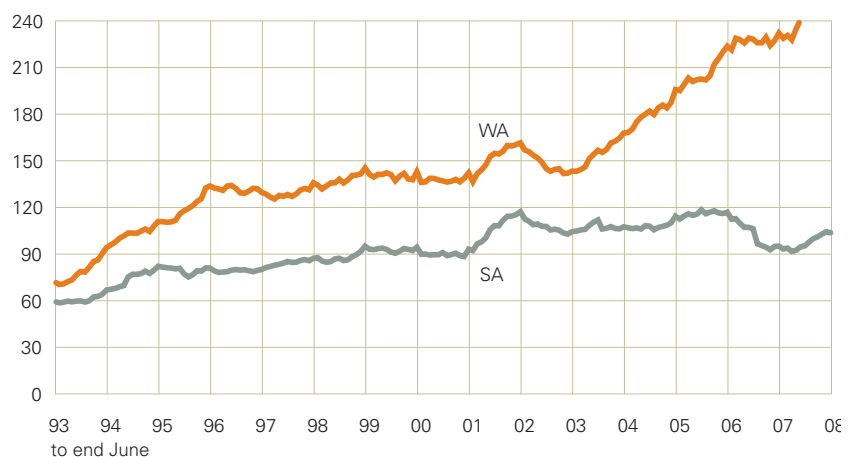
Equipment Finance by State

\$Million per Month Trend



Equipment Finance by State

\$Million per Month Trend



In August 2004 AELA made further submissions to Treasury on this issue, providing analysis which concluded that the present treatment did not provide a neutral and efficient taxation outcome, and an international comparison which highlighted that comparable GST/VAT jurisdictions have introduced special rules to ensure that a cash basis taxpayer under a hire purchase agreement can claim input tax credits upfront. This issue was a major feature of AELA's submission to the 2008 Board of Taxation's GST Review.

Also in the GST area, the Tax Office released a Ruling (GSTR 2003/11) on early termination of leases, which addressed the main issues raised by AELA. Any payment received to compensate the lessor for genuine damages flowing from early termination as a result of default by the lessee is not consideration for a supply, and no GST liability attaches to this payment. Similarly, no GST liability attaches to a payment relating to a casualty event. The Ruling also confirmed that an amount payable on late payment of lease instalments is a financial supply, hence input-taxed and no GST applies.

In early 2006, the Tax Office issued three Interpretative Decisions (IDs) in relation to the GST consequences when a hirer defaults under a hire purchase and the financier exercises its right to terminate the agreement. Importantly, these IDs confirm that the financier is entitled to a GST decreasing adjustment when it exercises its right to terminate the agreement, and that the termination amount is a payment in respect of damages and does not attract a GST liability.

The issue of GST hire purchase apportionment has been the subject of ongoing consultation between the Tax Office and AELA since early 2000; it relates to the appropriate methodology to apply to a financier's overheads such as brokerage, rent, electricity, etc, as a basis for determining the financier's entitlements to input tax credits. In January 2008 the Tax Office issued Law Practice Statement (PS LA 2008/1), outlining acceptable methods for calculating input tax credits for acquisitions related to supplies made under a disclosed hire purchase agreement. For a tax period up to 1 April 2008, an 'acceptable' revenue based formula can be applied, but after that period the Tax Office will accept as fair and reasonable a method that provides a recovery of less than or equal to 15%. Taxpayers were encouraged to seek a GST private ruling if they wish to apply a higher percentage.

In response, AELA advised the Tax Office that while the Practice Statement had enabled

members to proceed with certainty, our long-standing concerns remained. Our view remains that the '15% approach' should be regarded only as one which the Commissioner regards as complying with the law, and AELA does not consider a 15% recovery rate to be at the top end of the range of what is likely to be a fair reflection of the apportionment required by the law. AELA has suggested that the percentage of total to taxable supplies under a disclosed hire purchase is an alternative methodology which is fair and reasonable.

In response to the release of the GST Ruling on securitisation (GSTR 2004/4), AELA made further representations to the Tax Office on the issue of 'servicer services'. AELA submitted that allowing a reduced input tax credit for only some components of servicer services would not be consistent with the policy intent of the reduced credit acquisitions policy regime, or the legislative provisions of the GST Act. AELA requested that the Tax Office not issue assessments based on the ruling until the review of this issue has been completed. This matter is still under consideration by the Tax Office.

With the release of the three Interpretative Decisions on hire purchase default terminations noted above, AELA provided members with an operational overview of: making decreasing adjustments for GST and luxury car tax that arise on default terminations; GST on the recovery of 'shortfall' amounts in respect of default lease terminations; and also reduced input tax credits in respect of service fees charged to securitisation vehicles. This guidance outlined the methods acceptable to the Tax Office for determining GST liability and for calculating adjustments. With the finalisation of the Tax Office Practice Statements on hire purchase apportionments, in July 2008 AELA provided guidance on the adjustments available to members.

Following GST reforms in New Zealand, AELA has been giving consideration to similar initiatives in the Australian context. The basic design of GST is that it is a tax on private consumption. To ensure GST is effectively borne by consumers, and to prevent cascading, suppliers are generally entitled to an input tax credit (ITC) for the GST component of their acquisitions. However, financial supplies are input-taxed, and there is no entitlement to ITCs (apart from reduced ITCs, where available). When Australia introduced GST, the Government noted that this treatment of financial services was consistent with the international model. But from 1 January 2005 New Zealand introduced 'zero rating' of business-to-business (B2B) financial

services. This approach integrates the supply of financial services more fully into the GST system by taxing (at 0%) such supplies and allowing financial service providers to claim ITCs. AELA members believe these developments merit consideration of such reform in Australia.

In June 2008 the Government requested the Board of Taxation to review the legal framework for the administration of GST. The review does not extend to the rate of GST or the scope and extent of what goods and services are subject to GST. The principal issue raised in AELA's submission was the need to rectify the distortion to the equipment finance market resulting from the GST treatment of cash basis taxpayers under hire purchase arrangements. Recommendations were also made on a wide range of other issues to enhance the efficiencies and equity of GST administration. AELA also suggested an annual report on overseas GST initiatives, and the need for a follow-up review in three years. Although outside scope, AELA suggested that the Board may see merit in recommending consideration be given to zero-rating of financial services.

States' Taxation Stamp Duty Rewrite

A major AELA long-term objective has been the abolition or rationalisation of the array of state taxes that impacted on equipment financing with little commonality of rate, definition, incidence and nexus, making compliance for nationally-operating financiers and for transactions involving cross-border elements, tortuous and costly. Various referred to as hire of goods, rental business or mortgage duty, they were also most distorting to the equipment financing decision. At the more obvious level, most State governments had imposed a stamp duty on equipment leasing in the range of 1.5% to 2% compared to minimal duty on hire purchase and lower and quite differently based taxes on chattel mortgages. Whilst governments acknowledged the distortion, progress in adopting AELA representations had been slow because of the perceived financial implications for State budgets. While other factors were also at work, this stamp duty distortion was a major cause of the shift over the period from leasing to the non-lease means of equipment finance, and accordingly there was a detriment to the lease product, to State government revenue and to customers better suited to leasing.

Nonetheless, from the mid-1990s onwards all the jurisdictions moved to ameliorate the rate distortion and pursued consistency of tax nexus and approach as part of the Multi-jurisdictional Rewrite project. In terms of rate distortion,

NSW was the first State to implement reform, announcing in its 1996 Budget that Hiring Arrangement Duty would be levied on a broader base from 1 October 1996 and the rate of tax halved to 0.75% and from the same date, the ACT introduced a broadened duty along the NSW lines. Victoria introduced a similar restructuring effective from 1 January 1997. In practice there was minimal disruption to markets and to administrative arrangements, the distortion was eliminated in these jurisdictions and despite a substantial lowering of the rate of duty, a more durable revenue base resulted. This encouraged the other states, in the context of their Rewrite implementation to remove the distortion, Tasmania from 1 July 2001 (then abolished altogether from 1 July 2002), SA from 1.8% to 0.75%, effective 1 October 2003 and WA from 1.8% to 0.75% effective 1 July 2004.

IGA 2005 Review of State Taxation

Coincident with these improvements at the individual state level, AELA was encouraged that under the initial GST proposals State taxes on most financial transactions were to be abolished shortly after the 1 July 2000 GST commencement date. However with the revised GST framework announced in May 1999, the abolition of financial institutions duty was deferred by six months to 1 July 2001, the removal of debits tax put off to 1 July 2005 and the abolition of the range of other State taxes on financial transactions was indefinitely deferred but within the context of the 2005 Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA).

As stand-alone initiatives, NSW abolished debits tax from 1 January 2002, Tasmania abolished duty on equipment leases and hire purchase as from 1 July 2002 and Victoria abolished mortgage duty as from 1 July 2004, the latter reintroducing major distortion into that market, favouring the non-taxed chattel mortgage product over leasing and hire purchase.

In March 2005 AELA made submissions to Commonwealth and State Treasurers in the context of the IGA Review, stressing that the Review presented the opportunity to achieve the significant micro-economic reform that abolition of these duties would represent. Our submissions noted that the case for abolition had in fact been well made by both the Commonwealth and the States. The original GST blueprint listed their drawbacks as being: narrowly based; selectively levied; having inconsistent tax bases and rates; with compliance costs significant, particularly for businesses

that operated in more than one jurisdiction; and creating opportunities to avoid taxes and encourage taxpayers to conduct activities in States with lower stamp duties.

AELA urged Governments to recognise that there was a compelling economic case for the abolition of stamp duties on equipment finance, and that the IGA Review was the opportunity to achieve this outcome. Accordingly it is most pleasing to be able to report that all jurisdictions are now well advanced on a program for the abolition of stamp duties on equipment finance; this commenced on 1 January 2007 and was expected to be finalised by June 2009, however the mid-2008 abolition of NSW chattel mortgage duty was recently deferred until 1 July 2012. Abolition of these duties represents a major micro-economic reform, and the States and Commonwealth are to be congratulated on this outcome. AELA will continue to assist members in the transitional stages of these reforms and to assist members' compliance and systems development processes, has prepared a matrix which summarises on a national basis the timetable and relevant implementation legislation.

Abolition of these duties completes a major undertaking commenced by AELA more than a decade ago, and the results are most gratifying.

Lease Training and Education

One of the broader AELA objectives is to improve lease education through a greater knowledge of lease product technicalities and developments, both in Australia and overseas. This process began in 1988 when AELA introduced a detailed lease training course, coincident with the hosting of the World Leasing Convention in Sydney. In 1990 a program focusing on credit assessment in the equipment finance market was commenced and in 1992 the first Annual Lease and Equipment Finance Conference was held.

AELA/Amembal Australian Leasing School

The AELA Leasing School conducted by Mr Sudhir Amembal, the leading North American lease educator, commenced in 1988 as a 3-day detailed lease training program. The course content was rigorously adapted to Australian taxation and market conditions, and the overwhelming endorsement of the 80 participants at the first course indicated a continuing need for this program. It has now evolved to a two-day comprehensive workshop encompassing the financial, tax, accounting, marketing and various other aspects of finance and operating leases. In 2007 it was augmented by a half-day workshop on the financial computations of leasing.

In August 2008 two of the half-day workshops were held in Sydney, and two 'Winning with Leasing' courses were held in Sydney and one in Melbourne. To-date, over 2,500 people involved in equipment finance have participated in the Schools.

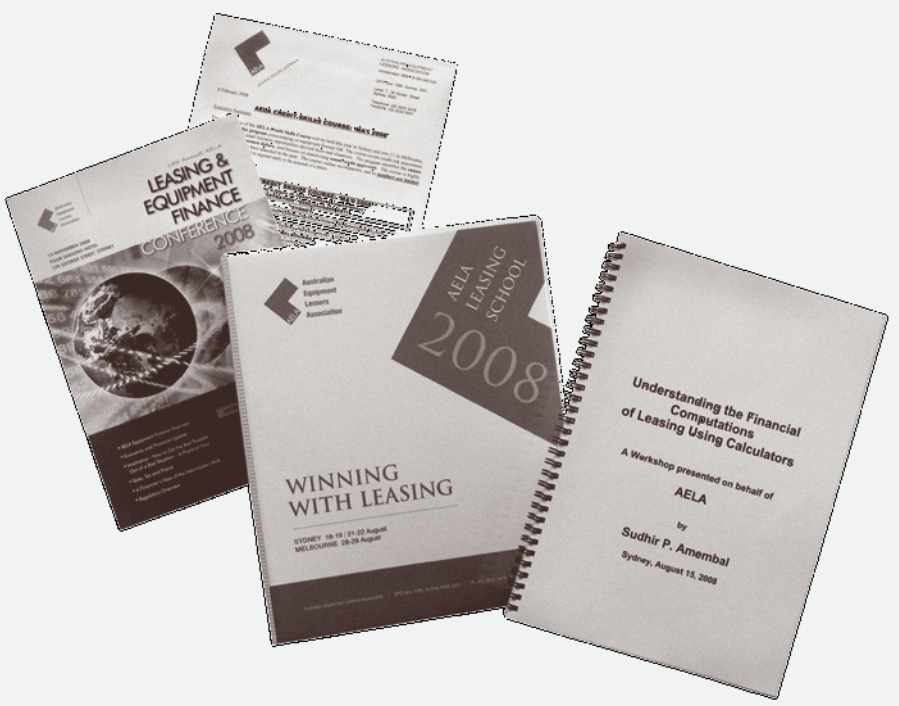
Credit Skills Workshops

The AELA Credit Skills course was introduced in 1990, in conjunction with Mr Shane Stewart of Bay Consulting, as a one-day program concentrating on credit risk assessment of commercial and small business equipment finance applications. The case studies are derived from actual situations, with the aim of identifying the causes and symptoms of business failure and fraud and the encouragement of sound credit approvals. It is an annual event on the AELA calendar, usually conducted in May, with the Workshops being held in Sydney and Melbourne. To-date some 1,300 members have attended the Workshops.

Annual AELA Leasing and Equipment Finance Conference

In 1992 AELA introduced the Annual AELA Leasing and Equipment Finance Conference to address key market and regulatory issues impacting the equipment finance industry. Over the years AELA has been fortunate in obtaining high calibre international speakers to provide an insight into developments in the major overseas leasing markets. Usually held in November, the 14th Annual Conference (2007) included international presentations from Ms Valerie Jester, Chairman of the U.S. Equipment Leasing and Finance Association and Mr Richard Priestman, Managing Director of Lombard Finance, U.K. Our international presenters at the 15th Annual Conference were Mr Bill Verhelle, CEO of First American Equipment Finance and out-going ELFA Chairman and Mr Alun Richards, Principal of the ALTA Group (Europe, Middle East and Africa).

Attracting around 150 industry participants, the Annual Conference also provides a display and demonstration facility for AELA Associate Members offering software systems and like operational services.



Other Association Activities and Issues

Accounting for Leases

For financial years commencing on or after 1 January 2005, compliance with the International Financial Reporting Standards (IFRS) is required for Australian lessors and lessees. At first glance, the impacts appear minimal with the revised Australian Accounting Standard for Leases AASB 117 reading much like its predecessor. However there are some subtle and potentially significant differences – some of which are a result of other standards.

For finance lessors the impacts of IFRS primarily reside in AASB 139 - the Financial Instruments standard. Finance leases are a class of financial asset which result in income recognition on an effective yield basis, with any upfront fees received and incremental direct costs incurred in originating the business forming part of that yield. In addition, general bad debt provisions are no longer permitted with provisions only permitted for known or incurred losses.

The definition of an operating lease also changed, with the Australian definition moving into line with the current UK and US definition whereby any lease that is not a finance lease is defined as an operating lease. This is important for structured financiers who previously may have had to demonstrate that the lessor had retained substantially all the risks and rewards of ownership to qualify for operating lease treatment. There are some changes to the concept of 'cancellability'. Under the old AAS 17, if a lease was cancellable, then prima facie this would present a strong case for operating lease treatment. Under AASB 117 however, lease cancellation needs to be 'reasonably certain' at inception. As a result, it will be more difficult to demonstrate operating lease classification based on cancellability alone.

For the medium term, the International Accounting Standard Board (IASB) continues to have on its agenda, a fundamental review of lease accounting moving from the long-standing 'risk/reward' basis to that of the more technically challenging 'right-to-use' concept. In July 2006, the IASB announced a joint project with the US Financial Accounting Standards Board (FASB) to rewrite the current International Lease Accounting Standard (IAS 17). Deliberations are

on-going with more recently consideration being given to truncating and deferring the conceptual debate until after IASB/FASB standard convergence and applying current finance lease rules to all lessees, leaving lessor/lessee accounting asymmetrical.

Anti-Money Laundering Reform

Australia is a founding member of the international Financial Action Taskforce (FATF) on money laundering which has issued global anti-money laundering (AML) and counter-terrorism financing (CTF) standards, known as the FATF Forty Recommendations on Money Laundering and Nine Special Recommendations on Terrorist Financing. In order to ensure that Australia's anti-money laundering laws meet the FATF standards and are consistent with equivalent laws in other countries, Australia introduced new anti-money laundering and counter-terrorism financing laws in December 2006. The first tranche of the new laws covers the financial services and gambling industries and bullion dealers.

The AML/CTF regime covers the financing and borrowing activities of banks, building societies, general financiers and leasing companies (referred to as "reporting entities"). Reporting entities must identify, mitigate and manage the risk they may reasonably face that the provision of their services might involve or facilitate money laundering or terrorism financing. Some of the obligations may be met by putting in place risk-based systems and controls, having regard to the nature, size and complexity of the business and the type of money laundering or terrorism financing risk that the reporting entity might reasonably face. Factors to be considered include customer types, the services/products offered, the methods by which services are delivered and any foreign jurisdictions dealt with. Financiers must verify the identity of their customers across a broad range of financial services, including lending, leasing, hire-purchase and factoring products. They must also implement an AML/CTF program providing for AML/CTF risk awareness training, employee due diligence and appointment of an AML/CTF compliance officer. The program must be applied to all areas of the business, including functions carried out by third parties, such as collection

and verification of customer information and record keeping.

AUSTRAC is Australia's anti-money laundering and counter-terrorism financing regulator and specialist financial intelligence unit. The new regime consists of the AML/CTF Act and Rules and various non-legislative material issued by AUSTRAC, including Policy Statements, Guidance Notes, a Self Assessment Questionnaire, a Regulatory Guide, a Typologies and Case Studies Report, a Public Legal Interpretation Series and an AML/CTF e-learning program. The new laws were introduced in a staged approach over two years. Commencing on 12 December 2006 were provisions covering identification of customers and their agents, cross-border movements of currency and negotiable instruments, electronic funds transfers, record-keeping and compliance reporting. Obligations regarding ongoing customer due diligence, transaction monitoring and reporting of suspicious matters commenced on 12 December 2008.

In response to industry concerns about the level of change required to systems and procedures in order to achieve full compliance, the Government allowed a fifteen month educative phase/assisted compliance period during which action would not be taken against a reporting entity that is taking reasonable steps to comply with the new laws. Matters to be taken into account to determine whether reasonable steps have been taken include: whether the entity has previously failed to take such steps; any steps it has taken to comply with its obligations; whether the entity complied with any obligations under the Financial Transaction Reports Act 1988; and any discussions and agreements it has had with AUSTRAC.

During the consultation phase, AELA made representations to ensure that changes to Members' existing practices were kept to a minimum, particularly in relation to the customer identification requirements for individuals, companies, trusts and partnerships; and to avoid the requirement for re-identification of existing customers (in the absence of specific risk triggers). AELA also sought recognition of electronic verification and continues to seek greater access to

government databases to assist with streamlining of verification of customer information.

AELA participates in various AML/CTF industry/government working groups, including the AML/CTF Council headed by the Minister for Home Affairs. Proposals have been put to the Minister and to AUSTRAC for amendments to the AML/CTF Act and Rules in order to ameliorate some of the operational difficulties being experienced by Members in implementing the new requirements. AELA has worked with AUSTRAC in relation to delivery of AML/CTF awareness training to the financial services industry and has published a Financier's Guide to the AML/CTF Regime. The Guide provides an overview of the new regime with detailed guidance on customer identification requirements, AML/CTF Programs and third party/agency provisions. It includes examples of customer identification procedures for facilities commonly provided to individuals, domestic companies, trusts and partnerships. A Briefing Note about the AML/CTF requirements has been circulated to various intermediary associations, including motor traders, lease and finance brokers and insurance brokers for the information of their members. AUSTRAC continues to release Rules and various materials to assist industry to interpret and comply with its AML/CTF obligations.

Asset Forfeiture Provisions

Asset forfeiture legislation is used as a tool in criminal law enforcement. Asset forfeiture forms part of proceeds of crime legislation, but also of such diverse legislation covering customs, fisheries management and environment protection. The operation of such laws can adversely impact on third party interests, such as those held by financiers. AELA is concerned to ensure that the interests of financiers are both easily identifiable and adequately protected when an asset, which has been used in connection with the commission of a crime, is seized and forfeited. AELA supports an approach which strikes an appropriate balance between the interests of financiers and law enforcement agencies, and continues to lobby the State, Territory and Federal governments in this regard.

Broker Regulation

A large proportion of the business of AELA members is introduced through brokers. However, the regulation of finance brokers varies markedly across the jurisdictions and by type of finance. In March 2003 the Australian Securities and Investments Commission (ASIC) released a report on the finance broking industry including options for reform, mainly in relation to mortgage brokers where instances of market

failure and consumer detriment were identified. In December 2004 the Ministerial Council on Consumer Affairs (MCCA) released a discussion paper detailing options for a regulatory scheme for finance and mortgage brokers. This was followed by an outline of a package announced in December 2006 and a Consultation Package (draft Bill and notes) released by MCCA in November 2007. The draft legislation proposed licensing of businesses that provide advice or intermediation to 'consumers' (including "small businesses") to secure credit. Numerous licensing, conduct and disclosure requirements were included. "Small business" credit as well as exclusive or first choice arrangements would have exemptions from some provisions including disclosure requirements and a written agreement.

Throughout the various consultation stages AELA had discussions and lodged submissions with officials seeking to minimise adverse impacts on financiers. These included: confining coverage to mortgage broking; the full exemption of commercial finance brokering from the regime; the full exemption of vendors (including dealers, retailers) arranging finance at point-of-sale from rules based primarily on the mortgage broking model. In addition AELA supported national template legislation.

In May 2008, the Productivity Commission's final report, Review of Australia's Consumer Policy Framework, recommended transferring regulation of credit providers to the Commonwealth Government and implementing the national licensing for finance brokers – at least initially based on the then current MCCA proposal. In June, the Minister for Superannuation and Corporate Law, released a Green Paper on the reform of financial services and credit regulation. The paper supported the Commonwealth regulation of mortgage brokers. Then in July the Council of Australian Governments (COAG) agreed that the Commonwealth would regulate mortgage brokers as part of a package which passes regulatory responsibility for credit from the States and Territories to the Commonwealth. AELA is involved in the policy deliberations underpinning this transfer and is concerned to ensure additional costs and liabilities and operational disruption are minimised.

'Business Protection'

Over the years there has been a tendency for consumer credit type legislation to extend its protections into business finance areas. Although properly subject to Common Law protections as well as the fair trading sections of the Trade Practices Act, lease and other forms

of equipment finance have to-date only been marginally affected by this extension.

Earlier developments in NSW (the Credit (Rural Contracts) Act (1987) and the General Credit Bill (1989)) could have applied these regulations to most of the commercial finance portfolio. AELA, along with other finance sector groups, does not believe that the financial and procedural details of a \$400,000 harvesting machine financing contract should be subject to protections aimed at \$5,000 personal loans. Enterprises in business for a profit should, we believe, be treated as such and not protected as if they are disadvantaged consumers. Business transactions are of necessity often complex.

AELA supports proper disclosure but is opposed to its legislative prescription as the rigidity, potential for technical breach and frustration of remedies which arise, ultimately lead to a reduced availability of finance and/or a higher finance cost to the sectors so 'protected' as lenders respond to the addition of legal risks to the already considerable uncertainties of providing finance to especially small-to-medium sized business. Representations were made urging the abandonment of this regulatory direction; in the event the governments involved at that time decided not to proceed.

In 1992 the Trade Practices Act was amended to insert s51AA which provides: 'A corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time-to-time, of the States and Territories.' AELA supported this approach as against the alternative of detailed statutory prescriptions, so that a body of law could evolve based on court decisions on specific facts. It has been our view that there is already sufficient uncertainty in commercial transactions without adding the questions of unconscionability, harshness and oppression. Disparity in bargaining powers and positions is in our view the normal situation in commercial dealings, and of itself could not, nor should not, ever be regarded as unconscionable, harsh or oppressive.

The key is the abuse of power and position. Enhancing competition is the preferred long-term industry and economic strategy. However, in 1998 several years of vigorous debate and inquiries about allegations of unfair trading against small business culminated in the Commonwealth Parliament enacting the Trade Practices Amendment (Fair Trading) Act 1998 which, effective 1 July 1998, prohibits unconscionable conduct in a significant range

of commercial transactions and gives statutory support to voluntary and mandatory industry codes of practice. In essence the unconscionability remedy is available for transactions where the price does not exceed \$1M and is not available to listed public companies. As a further part of its small business initiative, the Commonwealth Government also announced its intention: to further resource and empower the Australian Competition and Consumer Commission in relation to small business; to foster alternative dispute resolution schemes for small business disputes; and to encourage better methods of assessing small business lending risk. AELA remains to be convinced that this type of legislation in a commercial context will achieve desired policy outcomes without unintended consequences. To-date however, there has been minimal action under these new laws in relation to equipment finance.

More recently, regulation could however have become far more intrusive. The development of the Commonwealth's Financial Services Reform legislation, initially drafted to cover the retail side of compulsory superannuation, derivatives and like wealth-creation products, was misguidedly expanded to capture most lending, including equipment finance, on the semantic grounds that loans were 'financial services'. Fortunately, the anomaly of including retail and commercial finance accommodation in a licensing and regulatory regime aimed at financial products wherein the regulated business takes money from the retail investor (rather than the opposite under leasing) was accepted and the legislation, which commenced on 1 March 2002, was duly restricted more in line with its original intention.

Consumer Credit Regulation

The Consumer Credit Code commenced operation on 1 November 1996, and for equipment financiers it represented a major improvement on the various State and Territory Credit Acts which it replaced. Leasing and equipment finance transactions made with incorporated customers are not subject to the Code nor are transactions which are wholly or predominantly for business/investment purposes and are made with sole traders and partnerships. The Code also provides for a form of consumer lease. AELA's principal concern in relation to the Code is that commercial finance continues to be excluded from its ambit, and has been a participant which has successfully countered attempts during 2007-2008 to dilute the Code's borrower/lessor declaration process which would have left members unclear of their compliance position when dealing with non-corporate customers.

More recently, the COAG process which agreed that the responsibility for consumer credit be transferred from the States and Territories to the Commonwealth during 2009, also raised the issue of including small business and investment finance in the same consumer protection regime. Current constrained market conditions aside, such a policy decision would be most concerning in terms of both cost and availability of finance. As previously indicated, AELA is involved in the policy development and is arguing strongly against the extension.

Hire Purchase Acts

Hire Purchase Acts were first introduced from the late 1950s to regulate the then predominant form of consumer finance. With the passage of time and the introduction of broad-based consumer credit legislation, where this legislation remained in place its coverage by default became confined to commercial transactions.

AELA formed the view that this type of legislation was an anachronism and an inappropriate form of regulation of what had essentially become a commercial finance product. This view was confirmed by successive official inquiries, and the legislation has now been largely repealed in all jurisdictions. SA repealed its Act in the early 1970s, with NSW and ACT following in the mid-1980s, and Tasmania and the NT in late 1996 to coincide with the introduction of the Consumer Credit Code. The Victorian legislation was largely repealed in 1998, and those provisions, which were retained, lapsed on 30 June 2003.

In Queensland the Hire Purchase Act was effectively repealed from 1 January 2003. Hire purchase contracts entered into after 1 January 2003 are no longer regulated. Contracts entered into before 1 January 2003 remain regulated by the Act until it expires on 30 June 2010.

In WA, Part 9 of the WA Acts Amendment and Repeal (Competition Policy) Act 2003 commenced on 1 May 2004, substantially repealing the Hire Purchase Act. Contracts entered into before 1 May 2004 remain subject to and regulated by the full range of provisions of the Hire Purchase Act 1959. For contracts made subsequent to that date, some rights continue to apply according to whether the hirer is a farmer or not. Non-farmers have rights to receive the benefit of any surplus on repossession or voluntary surrender and to ask a court to review the contract if it is unconscionable. For farmers, in addition to those rights, they must receive prior written notification of enforcement action and can ask a court to postpone repossession of the farmer machinery.

In addition, there remains other legislation affecting hire-purchase contracts in Victoria (where the hirer must receive the benefit of any surplus on repossession) and NSW and Queensland (where there are procedures to follow when enforcing a hire-purchase agreement against a farmer).

AELA will make an assessment in light of the impact of Personal Property Security Reform about the continued application of specific state statutory rights and obligations to hire-purchase agreements, and if necessary make representations for further change or full repeal.

International Contact

AELA involvements with the various national and regional lease industry associations enable a greater appreciation of emerging lease market and regulatory trends. During the year in support of this objective, contact was maintained with the Equipment Leasing and Finance Association of America, the Finance and Leasing Association of the United Kingdom, the Canadian Finance and Leasing Association, Leaseurope, Felalease (for South America) and Asian Leasing and Finance Association, as well as with other banking and finance sector bodies. During the year a continued focus for regular discussions has been the proposals by various accounting standard bodies to develop a new approach to accounting for leases (see earlier discussion on this item).

Lease and Equipment Finance Statistics

The statistics and graphs used in this Review are taken from a range of Reserve Bank of Australia and Australian Bureau of Statistics publications. Regular up-dates can be found in the AELA General Equipment and Motor Finance Reports.

While in general the then existing statistical sources provided a useful and accurate description of lease and equipment finance market developments there were a number of areas (involving industry sector of lessee, type of equipment leased and detail of financing product), which were deficient. In 1989 therefore AELA proposed appropriate amendments to the collections to overcome these shortcomings.

Discussions with the Bureau of Statistics on these formats resulted in the commencement from July 1991 of a more detailed analysis particularly on Operating Leases, and this data continues to be utilised in this Review. More recently the fee-for-service philosophy inherent in the expanded series was applied to the previous statistics, with AELA agreeing to contribute towards the maintenance of the

continued monthly series so as to preserve the economic and market utility of the data that that frequency provides.

AELA also provides Early Indicator statistics for members. Participating companies provide a breakdown of their lease and equipment finance business within five working days after the close of the month; these are then aggregated, with the objective of providing the information to members on the sixth working day. This compares with an elapsed time of some two months for other statistics.

In recent times there has been some discrepancy between the ABS statistics and the Early Indicator series. AELA has been attempting to clarify this discrepancy, as we believe the ABS statistics have been understating equipment finance activity. Although a greater correlation appeared to be emerging, AELA is still not confident that the ABS statistics are capturing all equipment finance activity. This issue is discussed in further detail in the earlier section on Current Activity and Prospects.

Lender Liability - Environmental Penalties and Remediation

The implementation of appropriate legislation for the protection of the environment across Australia continues. The work of government has been at two levels: the development of legislation with respect to remediation of contaminated sites and the development of modern pollution control laws. All governments have now consulted on the development of new laws for contaminated land. Representations made by AELA have focused on the lender liability issue. Of particular concern is the potential for financiers to be made liable for the remediation of contaminated sites and for the clean-up and abatement of polluting activities not caused by them. AELA has been most active over the years in the development of appropriate lender liability provisions and Queensland, NSW, ACT, Victoria and, most recently, SA. All now have legislation dealing with land contamination that includes significant protections for 'passive financiers' and lenders which enforce their security over the land for the purposes of debt recovery but are not involved in its day-to-day management. These developments are most welcome. The relevant legislation in WA and Tasmania exempts mortgagees-in-possession from liability in relation to contamination but does not provide the same degree of protection for passive lenders as does the law in the other jurisdictions. NT continues to develop its law. Overall, these effectively national developments are generally in the right direction. AELA

continues to monitor government activity in this and related areas, with the objective of ensuring coincident enactment and maintenance of the passive lender exemption.

Lender Surrogacy - Product Liability and Occupational Health and Safety Laws

While the topic of 'Product Liability' is ordinarily more a matter of interest to manufacturers of goods, AELA is concerned that the concept of lender surrogacy could significantly increase finance risks and costs. The surrogacy concept seeks to make financiers, including lessors, liable for faults or claims arising out of the goods being financed. An earlier version of the concept is the 'linked credit provider' principle present in many consumer credit statutes.

AELA is strongly opposed to the imposition of liabilities on financiers where, in the general course of financial activity, equipment is chosen by the lessee or borrower without reliance on the skill or judgment of the financier. The product liability regime under the Trade Practices Act has adopted a form of financier surrogacy by imposing obligations on suppliers, but the regime has had little or no adverse impact on finance providers.

Similar concerns apply in other legislative areas (including environmental protection law) where the liability net via 'ownership and control' and supply tests can be cast widely to cover lessors and other financiers with the risk of high penalties without reasonable or adequate defences. Law reform measures such as these should always be analysed for their economic costs and benefit. AELA, along with other financier groups, continues to press for control tests and appropriate defences in this type of legislation.

A major concern in this regard was the strict and unlimited liability placed on owners and operators by the 1999 Commonwealth Damage by Aircraft Act. A minor insurance matter in the pre-11 September 2001 world, the exposure to lessors and other financiers in the absence of war/terrorism cover was a major liability for aircraft lenders. AELA made ongoing representations to Transport and Attorney-General's Departments in relation to the problems that the strict and unlimited liability provisions of this legislation posed for aircraft owners/lessors in their capacity as passive financiers. In response to AELA's detailed submissions, the Government agreed in September 2002 to a full passive financier exemption from the legislation.

Occupational Health and Safety (OH&S) legislation may make financiers under lease and hire-purchase facilities responsible for the safe use and maintenance of financed plant, equipment, materials or substances; and for health and safety incidents arising from use of a financed asset. This may result from the financier being the "owner" or "supplier" of the financed asset under the particular wording of the OH&S laws, standards and codes of practice, which differ slightly in each Australian jurisdiction. In most cases, the asset financed does not come into the possession or control of the financier, with the result that there is little opportunity for the financier to influence plant safety, work practices or OH&S outcomes in general.

The laws of some states (including Victoria, the ACT and NSW) include 'passive financier' exemptions which give some relief to financiers from the application of health and safety laws. The position is not as clear in other states. AELA aims to ensure that OH&S laws include "passive financier" provisions so that the mere provision of finance does not attract OH&S obligations where the financier does not have day-to-day control over the asset or any responsibility for its selection or maintenance during the term of the financing arrangement.

In April 2008, the Federal Government began a national review of OH&S laws, with the support of the Workplace Relations Ministers' Council. Stage 1 will consider the harmonisation of these laws and make recommendations on the optimal structure and content of a model OH&S Act, including duties of care, identification of duty holders, the scope and limits of duties and the nature and structure of offences and defences. Stage 2 will address the scope of the model laws and other matters identified as important to be addressed in a model Act. Recommendations from Stage 2 are due by 30 January 2009. AELA made a submission to the review to ensure that the review panel is aware of concerns about the unsatisfactory application of the National Standard for Plant and other OH&S laws to financiers. The submission supported the harmonisation of OH&S laws and the inclusion of passive financier provisions and a "control" test incorporating the concept of an ability to manage and influence OH&S outcomes as a crucial element in allocating duties/responsibilities under these laws.

Privacy and Credit Reporting

Privacy continues to be an important issue for credit providers as policy makers attempt to find a balance between the community's (including credit providers) need to know and its desire

to remain private. At the national level for over a decade the credit reporting provisions of the Privacy Act have developed, under the oversight of the Privacy Commissioner, towards a reasonable (if paper heavy) balance.

From December 2001, the Act was expanded to regulate information-handling within the private sector more broadly through the enactment of a set of principles. AELA participated in their development as non-credit information of individuals was caught within these principles. To assist members comply with the new law, AELA developed a compliance strategy consisting of four phases: audit; review; changes to documents, operations and systems; and a training program. In implementing their compliance programs members identified a range of operational issues, and in response AELA prepared compliance assistance notes for members, and also prepared notes for distribution by members to their introducers to assist increased compliance awareness.

Recently, AELA has helped shape a range of recommendations for reform of the privacy laws, including the credit reporting provisions, advanced on completion of a review by the Australian Law Reform Commission. AELA's objective in this regard has been to maintain the integrity and current access by equipment financiers to the credit reporting system while modernising the law to achieve operational efficiencies. In brief, if adopted by the Government, the reforms would result in a standard set of information handling principles (termed UPPs) to regulate information of individuals in both the private and public sectors. Relevant recommendations relating to credit reporting included a proposal to repeal and replace the current provisions with a simplified and modernised framework that retains the current level of consumer privacy protection while recognising business imperatives and technological developments. Importantly, more positive information (eg type of account, date opened / closed and limit and repayment history) was recommended for inclusion on the credit file. Proposals of a more general nature relevant to AELA members included "bundled" consent, removal of small business and employee record exemptions and access to public register information for identity validation purposes. The Government has announced a staged approach to consideration of the reforms with legislation being developed to implement the UPP and credit reforms over the next 12 to 18 months. AELA will continue to work with the Commonwealth Government through this process.

As a separate issue, at the State level, privacy affects members' operations with several jurisdictions indecisive as to how credit providers can locate their secured chattels (e.g. vehicles) which have disappeared but which are readily traceable through Motor Registry files. The availability of name and address details from the electoral roll and telephone customers' IPND information can also be a difficulty which impacts on financier's risk management in a range of areas. AELA continues to work with governments to find an appropriate means of balancing the individual's right to privacy against social responsibilities, including fraud, credit and regulatory risk management.

Registers of Security Interests

In the 1980s all States enacted legislation which extinguished financial interests (e.g. mortgage, hire-purchase and lease contracts) in various goods in favour of purchasers who bought without knowledge of those interests. To prevent large scale frauds governments established public registers of such securities which give notice to intending purchasers. Most of the securities covered were over motor vehicles, and as indicated earlier, in excess of 50 percent of leasing and equipment finance volumes are motor-related.

Given that these registers of vehicle encumbrances are State-based and motor vehicles have a capacity to cross State borders, AELA members had a major interest in their practical operation. Much lobbying effort over the years therefore was invested in linking them and ensuring commonality of processes such that by 2008 they were almost virtually national.

The issue of security interests in equipment is further complicated by the variety of registration requirements as between Bills of Sale and ASIC Company Charges registers as well as by the Commonwealth registration system for inter-state trucks, changes to some States' registration/proof of identity requirements and the national VIN system for new vehicles. For a number of years therefore, AELA has supported the reform and rationalisation of this complex legal area. Pleasingly this process is well advanced.

A number of overseas jurisdictions have introduced or are evaluating comprehensive regimes for the recording of financial interests in all non-real estate assets, covering for example debts, insurance, licenses and intellectual property. These are known at law as personal property securities (PPS). More particularly, in May 2002, New Zealand introduced a PPS

regime leading to the Australian Standing Committee of Attorneys-General also undertaking such a review, following which the Council of Australian Governments committed to the introduction of the reform by May 2010. When introduced, the reforms would apply to all arrangements which are regarded in substance or which are deemed to be 'security interests' in personal property, and would include equipment leases, hire purchase and chattel mortgages.

As such, this development is relevant to equipment financiers across the full spectrum of their activities. A key element of PPS reform is that title (eg. under a lease or hire purchase) would have no bearing on priorities, rather what matters is whether there is an actual or deemed interest or whether and when that interest is registered. When implemented, these reforms will abolish many laws and merge registers dealing with company charges, bills of sale, vehicle, stock, etc into one register which determines priority between secured creditors, supported by one electronic registration procedure, ie. one law, one register and one process. AELA has been closely involved in this significant microeconomic reform.

Regulatory Burden

Although often characterised as a period of deregulation the last decade has witnessed a continuous addition to the regulatory burden of Australia. Corporations and taxation laws have been regularly changed and seem always to have new proposed amendments imminent. Other statutes are subject to periodic 'initiatives': from trade practices, anti-money laundering, privacy, and grouped proceedings to product liability, environmental penalties, suspect transactions, equal opportunity and 'simplification', to name but a few. The Financial Services Reform Act (FSRA) came into effect in March 2004 and while not impacting on equipment finance itself, placed far-reaching and onerous requirements on many of the institutions that offer it. Although the Government through its Corporate and Financial Services Regulation Review, has moved to ameliorate the FSRA's impact for the future, this will not recover the extensive sunk costs. In a similar vein Australia's anti-money laundering (AML) framework is currently undergoing major change, within the context of international obligations agreed by Australia, and despite adopting a risk-based approach to customer identification and account monitoring, the proposed framework has imposed further major compliance cost.

While it is appreciated that a complex modern society requires an up-to-date regulatory

framework, the impact of this constant change on business certainty and incentive is often ignored and the equation of good government with more legislation rather than with better management has a sapping effect on confidence.

On the positive side, the National Competition Policy adopted by the Council of Australian Governments (COAG) has over recent years played an important role. Its February 2006 in-principle decision to adopt a common framework for benchmarking, measuring and reporting on the regulatory burden on business is welcome and hopefully will lead to an effective means of over-sighting this accumulating burden or forcing each new proposal to rigorous cost/benefit analysis. Building on this, COAG's Business Regulation Competition Working Group has identified a range of reforms to move Australia to a seamless national economy. A heightened role for the Office of Best Practice Regulation is also welcome.

Trucking and Transport Issues

In recent times a number of States have reformed their public transport regulations leading to changes to the traditional financing and security arrangements for taxi, bus and coach operators licensed under the new regulations and to the level of vehicle registration fees. AELA has continued to work with the respective industries and governments to smooth the operation of the new rules as they affect financing. In relation to road freight trucking operators vehicle registration fees AELA, while appreciating the governments' approach to cost recovery on a 'user pays' basis, notes the wider benefit and externalities of this infrastructure investment for the entire economy. Moreover as the impact of the changes on the economics of individual operator's activities, existing contracts and commitments can be considerable, we would urge that the implementation of these policies take into account such financial consequences.

A particular issue impacting on the trucking industry is the Commissioner of Taxation's review of effective life determinations, which had the potential to substantially reduce capital allowances in this sector. AELA has worked successfully with trucking associations to ameliorate the impact of these changes.

As noted earlier in this Review, the Government announced in September 2004 that it would introduce legislation to provide statutory effective life caps for the depreciation of transport assets, to be 7.5 years for light commercials, trucks and buses, and 10 years

for truck trailers. The statutory caps will apply to purchases made on or after 1 January 2005, and will provide significantly shorter effective lives than those decided by the Commissioner. Diminishing value depreciation for assets with a statutory cap of 7.5 years will be 26.7 percent per annum compared to 13.3 percent under the Commissioner's proposed determination. Unfortunately the Tax Office did not accept that the statutory cap effective lives could not be used for determining safe harbour residual values in leases, and this has caused significant disruption in this market segment.

Used Vehicle Imports

In 1992 the Federal Government introduced a special tariff of \$12,000 per vehicle for imports under the so-called 'Low Volume Scheme'. However, used vehicle imports grew from around 1,000 pa in early 1990s to around 15,000 pa in late 1990s. In 2000 AFC made a submission to a Review of the Motor Vehicle Standards Act and to the Minister for Industry, and we advocated that these numbers be restricted to their original intent.

On 8 May 2000 the Government announced a new scheme for these imports, and the previous bulk compliance approval was replaced with a system of vehicle-by-vehicle inspection and approval through registered workshops, together with other measures. The Government indicated that the overall effect of these measures would likely result in second hand vehicle imports remaining at around the 15,000 per annum level.

The Productivity Commission was subsequently requested by the Government to report on options for Post 2005 Assistance Arrangements for the Automotive Manufacturing Sector. Their Interim Position Paper made reference to the \$12,000 tariff for used vehicles and concluded that the potential benefits of its removal appeared not to warrant the additional uncertainty at that stage. Accordingly, AELA wrote to the Review, noting the concerns of Members in relation to the impact of 'grey' imports on used vehicle prices, and in turn the potential to jeopardize underlying security values under operating leases. We again noted that the \$12,000 tariff on used imports is an appropriate response to the particularly stringent periodic inspection regimes for used vehicles in exporting countries.

AELA members believe that the arrangements now in place will continue to result in used vehicle import levels which more appropriately reflect the original policy intention, and AELA maintains a keen interest in the trend in these import levels.

AELA Formation and Structure

After a series of formative meetings during 1986, the Australian Equipment Lessors Association was formalised on 4 December 1986.

AELA was born out of a perceived need by lessors for an association which could address their specific finance product problems separate from broader financial institutional concerns. Its principal objective is to provide a forum and focus for all matters affecting the lease and equipment finance industry, its regulatory framework and market structure.

AELA is incorporated under the NSW Associations Incorporation Act and membership is open to lease market participants having a minimum of \$20 million net lease receivables in their own name or having a minimum of \$200 million net lease receivables under their professional management; provision is also made for associate membership in a range of instances.

Membership is corporate rather than personal.

In general AELA members comprise banks, finance companies, merchant banks, general financiers, equipment vendor lessors and lease packagers; associate members include other industry associations and legal, accounting, actuarial firms and support system suppliers with an interest in lease and equipment finance products. Although utilising the nation-wide resources of the Australian Finance Conference, AELA is structured and functions as an independent body and voice for leasing.

AELA Objectives

AELA's principal objective is to represent the views and interests of its members in relation to all matters affecting leasing and equipment financing in Australia. Other objectives include:

- The formulation of a cohesive Lease and Equipment Finance Industry response to specific issues;
- The development of Lease and Equipment Finance Industry proposals for change to the existing (or likely future) regulatory or market environment;
- The undertaking of an educative role promoting the benefits of leasing and equipment finance to specific legislative and business audiences as well as to the general community;
- The provision of a forum for the discussion of Lease and Equipment Finance Industry issues;
- The representation of Lease and Equipment Finance Industry views in local and overseas forums;
- The promotion of ethical standards in the conduct of business among Association members and with the general community; and
- The liaison with other associations and participants having a significant interest in the Lease and Equipment Finance Industry.

AELA Code of Practice

A major AELA objective is: 'the promotion of ethical standards in the conduct of business among Association members and with the general community.'

In pursuit of this objective, AELA members undertake to:

- transact their business in such a manner as will reflect credit on that member and on the Leasing and Equipment Finance Industry;
- transact their business fairly, reasonably and honestly and encourage such conduct by suppliers, brokers, packagers and others in the Leasing and Equipment Finance Industry;
- transact their business with competence, care and prudence, ensuring their due compliance with relevant established legal, legislative, accounting and commercial requirements;

In transacting their business in the above manner, AELA members will endeavour to:

- ensure that all relevant facts concerning the contract and transaction are properly disclosed;
- ensure that the documentation clearly sets out all the terms and conditions of the transaction;
- ensure that facts concerning the transaction are not misrepresented; and
- ensure that all queries, complaints or disputes from a lessee or borrower regarding the transaction and its administration are answered and/or resolved promptly, efficiently and economically.

In recognition that AELA membership is corporate rather than personal, AELA members shall take all reasonable steps to bring this Code of Practice to the attention of their officers and employees and shall use their best endeavours to ensure that such persons observe this Code.

The AELA Council

The AELA Council is the association's committee of management, meeting as frequently as necessary to put into effect the specific objectives and to respond to market or other developments.

Members' representatives are elected to the Council in their personal capacities. The composition of the Council takes into account representation of the various categories of lessor and equipment financier participants.

Council Meetings

2007

20 March
17 May
26 July
20 September
11 December

2008

12 February
13 March
20 May
22 July
30 September
9 December

AELA Chairmen and Current Year Council Membership

Eric Reichert (Chairman 1986/87)	Beneficial Finance	December 1986 – April 1987
David Braidwood (Chairman 1987/88)	Partnership Pacific	December 1986 – November 1992
Rex Elvish (Chairman 1988/89)	Commonwealth Bank	December 1986 – March 1990
Chris Harvey (Chairman 1989/90)	Lease Underwriting	May 1987 – February 2004
Tim Quilty (Chairman 1990/91)	Metway Finance	July 1988 – July 1992
Ramsay Moodie (Chairman 1991/92)	Fuji Xerox Finance	December 1986 – July 1996
Ken Small (Chairman 1992/93)	AGC	March 1991 – June 1994
Peter Harvey (Chairman 1993/94)	Hunter MMI	April 1987 – February 1998
John Deane (Chairman 1994/95)	Asset Capital	July 1992 – February 2003
John Ivkovic (Chairman 1995/96)	Advance Bank	July 1991 – May 1997
John McPhail (Chairman 1996/97)	Esanda Finance	July 1994 – February 1998
John Malouf (Chairman 1997/98)	AGC	June 1994 – September 1998
Sean Littlebury (Chairman 1998/99)	National Australia Bank	June 1994 – October 1999
Glenn Stone (Chairman 1999/00)	SG Equipment Finance	July 1995 – January 2002
David Berkman (Chairman 2000/01)	Flexirent	July 1999 – June 2003
Mike Anderson (Chairman 2001/02)	CBFC	July 1997 – Current Member
Lloyd Thomas (Chairman 2002/03)	Macquarie Leasing	December 2000 – September 2006
Keith Rodwell (Chairman 2003/04)	GE Commercial Finance	April 2000 – July 2004
Paul Russell (Chairman 2004/05)	Westpac Institutional Bank	July 2002 – Current Member
Steve Riddle (Chairman 2005/06)	BOQ Equipment Finance	July 2002 – Current Member
David Hollis (Chairman 2006/07)	De Lage Landen	July 2002 – Current Member
John Dennis (Chairman 2007/08)	Australian Structured Finance	February 2003 – Current Member
David Taylor (Chairman 2008/09)	National Australia Bank	September 2005 – Current Member
Ron Hardaker (Director)	AELA	December 1986 – Current Member
Murray Hamilton	Alleasing Group	July 2002 – Current Member
Tom Muir	Meridian International	July 2004 – Current Member
Andrew Egan	GE Commercial Finance	September 2006 – Current Member
Campbell Paterson	Esanda Finance	February 2007 – Current Member
Andrew Sidery	Macquarie Leasing	July 2007 – Current Member
John Rees	SG Equipment Finance	November 2007 – Current Member
Craig Edwards	Capital Finance	May 2008 – Current Member

Member	Representative	Member	Representative
ABN Amro Australia	Jeremy Yates	Mercedes-Benz Financial Services	Lorraine Parrott
Allleasing Group	Murray Hamilton	Mercer Australia*	Oleg Palashevsky
Allens Arthur Robinson*	Ian Wallace	Meridian International Capital	Tom Muir
Alliance e-finance	Peter MacMillan	MinterEllison*	Ralph Ayling
ANZ Investment Bank	Jeremy Sneddon	Musgrave Peach*	Greg Peach
Australasian Asset Residual Management*	Steve Wilson	National Australia Bank	David Taylor
Australian Structured Finance	John Dennis	NLC*	Matt Reinehr
Baker & McKenzie*	Stephen Watts	Paccar Financial	Greg White
Bendigo and Adelaide Bank	Alan Mackay	Pitney Bowes Credit Australia	Lorna McGhee
BFL Capital	Paul Crutchley	Protecsure*	Mark Osborn
Blake Dawson*	Timothy Lipscombe	Queensland Treasury	Don Licastro
BMW Australia Finance	Clive Prevost	Realtime Computing*	Bryan Miller
BOQ Equipment Finance	Steve Riddle	RentSmart	Ned Montarello
Bynx Australia*	Greig Swebeck	Rhodium Asset Solutions	Steven Holovka
Canon Finance Australia	George Lagos	Ricoh Finance	David Berriman
Capital Finance Australia	Craig Edwards	RR Australia	John Hughes
Caterpillar Finance Australia	Robert Bennes	Service Finance	Terry Power
Commonwealth Bank	Mike Anderson	SG Equipment Finance	John Rees
CHP Consulting*	Kathryn Cussell	Sharp Finance	Carmel Smith
Cisco Systems Capital Australia	Karl Hardman	Sofico Services Australia*	Koenraad Van Grimbergen
CIT Group Australia	Keith Rodwell	Solutions Asset Management	Paul Hammond
Clayton Utz*	Jason Huinink	Southern Financial Group	Hugh Macdonald
CNH Capital Australia	Danny McTaggart	Spectra Financial Services*	John Southwood
Colin Biggers & Paisley*	David Kennedy	St. George Bank	Sam Turri
Commercial Asset Finance Brokers Association*	David Gandolfo	Suncorp-Metway	Daniel Mckenna
Corrs Chambers Westgarth*	Edward Cowpe	SunGard Asia Pacific*	Campbell Clout
Deacons*	Bill Farrow	Technology Leasing	Alistair Jamieson
De Lage Landen	David Hollis	The Leasing Centre (Australia)	Michael Moses
Dibbs Abbott Stillman*	Peter Ryan	Toyota Finance Australia	Ian Ritchens
EDX*	Kim Powell	Traction Group*	Simon Bird
equigroup*	Matthew Ingram	United Financial Services Capital	Brad Dale
Esanda Finance	Campbell Paterson	Upstream Print Solutions*	Andrew Barbour
Experien	Robert Westgarth	Volvo Finance	Dominic Arcamone
Flexirent Capital	John De Lano	Westlawn Finance	Mark Dougherty
Freehills*	John Angus	Westpac Institutional Banking	Paul Russell
Fuji Xerox Finance	Stephen Doherty	White Clarke Asia Pacific*	Chris Pearson
GE Commercial Finance	Andrew Egan	Yamaha Motor Finance	Warren McDonald
Henry Davis York*	Simon McSweeney		
HP Financial Services	Ross West	* Associate	
IBM Global Financing	David Evans		
Innovation Fleet*	Tony Robinson		
Insyston*	Stephen MacMillan		
Integrated Asset Management	Robert Spano		
International Decision Systems*	Scott Masterton		
ISIS Capital	Murray Jorgensen		
John Deere Credit	Mark Saunders		
Kemp Strang*	Peter Harrison		
Key Equipment Finance Australia	James Eck		
Komatsu Corporate Finance	Simon Rawther		
KPMG*	John Bardsley		
Komatsu Corporate Finance	Craig Gee		
Lanier (Australia)	Greg Cameron		
Macquarie Leasing	Andrew Sidery		
Mallesons Stephen Jaques*	John Canning		
Medfin Australia	John Coupe		
Members Equity Bank	Lou Viola		

