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**The Australian Taxation Office's approaches to Aggressive Tax
Planning**

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Introduction

I would like to take the opportunity today to outline our current approaches including some of the key learnings from the mass marketed schemes experience. But before doing so there are some points I should make about Tina Murphy's paper and her conclusions.

Let me say at the outset that I agree that regulators like the Tax Office should be open to different strategies to influence or shape desired behaviour beyond strategies linked purely to deterrence.

Over recent years our approaches and strategies have been guided by the Taxpayers' Charter and the Compliance Model. They require us to have an understanding of taxpayer circumstances, behaviours and risk profiles so we can tailor our approaches accordingly.

The Charter is about being open and fair in our treatment of taxpayers. But our treatment must be within the framework of the law. We cannot ignore the law even though on occasions the outcome might seem unfair for a taxpayer.

The Compliance Model assists us to understand the factors that influence different compliance behaviour. This helps us to develop appropriate and proportionate responses according to the nature and level of risk identified.

Investor survey

I am not surprised by the findings from the investor survey that “scheme investors tended to be somewhat distrusting of the ATO” and that there were perceptions of unfair treatment. Those findings are consistent with the complaints and representations made by a vocal minority of investors and some representatives over the last few years.

However, I wonder how much the findings were influenced by factors such as the investors’ lack of understanding of our system of self assessment and particularly the Tax Office’s necessary power of review of initial assessments. To what extent were investors’ views influenced by perceptions of unfairness of a system that requires that the taxpayer wears all the consequences of getting it wrong even where he or she takes steps to obtain professional advice? These are genuine issues which deserve ongoing consideration and debate.

I also suggest that the findings might have been influenced to some extent by the fact that some investors continued to be misled by some promoters and representatives even after the Tax Office had made its views known.

Finally, I accept that the Tax Office's delay in getting our views out to taxpayers would have influenced the overall findings.

Whatever influenced the findings it is clear that there are a number of lessons to be learned from the mass marketed schemes experience.

What are the learnings from the mass marketed schemes experience?

In April last year in an address to the 5th International Conference on Tax Administration, the Commissioner provided some views on the Tax Office's experience in dealing with the mass marketed schemes of the 1990s. I will repeat an extract of what he said because it is a good summary of some key learnings. He stated:

“Our experience in dealing with these schemes shows that a reliance solely on audits and the four to six year review period authorised at law under the self assessment system are not sufficient to meet the objective of optimising compliance in a way that instils community confidence.

We have taken that learning on board. A key theme is the need to pro-actively deal with issues as much as possible. Another is the value in putting products in the hands of the community to better support compliance.

The introduction of the Product Ruling system has both provided potential investors with some certainty about the tax effects of arrangements and also made it more difficult for promoters to sell schemes and mislead investors.”¹

¹ Carmody, M 2002 'The Art of Tax Administration', at 5th *International Conference on Tax*

The Commissioner also discussed the establishment and role of the Tax Office's special promoter taskforce to not only look at past actions but also what is happening now.

Finally the Commissioner noted the introduction of the new Taxpayer Alert system under which we give early warnings of schemes we have concerns about.

I will come back to some of those learnings later. Some other lessons for us from the mass marketed schemes experience have been:

- the importance of communicating clearly and as early as possible with taxpayers and their agents. We made the mistake of firstly expressing our view about these mass marketed schemes to the promoter who did not always pass it on to the investors;
- communicating to taxpayers and tax advisers the features of arrangements that cause us concern so that taxpayers are put on notice that we are likely to challenge arrangements exhibiting such features;
- differentiating our treatment strategies for promoters, agents and taxpayers according to their circumstances. In other words, applying the principles of the Taxpayers' Charter and the Compliance Model;
- developing and maintaining strong networks and work practices across the Tax Office to ensure a sharing of intelligence and analysis of arrangements to identify patterns and trends. This in turn should lead to a more holistic and timely approach to addressing aggressive tax planning.

I will turn now to discuss our current approaches to managing aggressive tax planning.

What is aggressive tax planning?

I am often asked what is aggressive tax planning? In the Tax Office's view the term aggressive tax planning refers to those schemes or arrangements which undermine the integrity of the tax system and community confidence in the fairness and equity of that system. I am not too concerned about defining the term - generally arrangements which we think an anti-avoidance provision may apply to we treat as aggressive tax planning. We also focus on arrangements which we think produce an outcome which is contrary to the intended policy of the law.

Some arrangements we come across seek to exploit perceived loopholes in the law. This is particularly so in respect of concessions in the law to encourage some type of investment. Investment in Australian films is a good example.

As a further guide to what we mean by aggressive tax planning, we have published over the last couple of years a checklist of features of transactions and arrangements which attract our attention. The features could be regarded as "red flags" or "warning lights" for taxpayers and their advisers and their publication is aimed at putting people on notice that arrangements which exhibit these features are likely to be challenged by the Tax Office. Some of these features are:

- arrangements or products that transfer or create tax benefits in circumstances not contemplated by the law;
- complex structures and intra-group transactions associated with generating tax benefits unrelated to the economic substance of a commercial activity (if any);

- tax benefits in respect of financial and other arrangements that are disproportionately high compared to the taxpayer's limited financial exposure or risk and a divergence between the real and claimed economic substance of an activity; and
- transactions that involve tax havens.

Present state of aggressive tax planning

Tax Office intelligence clearly indicates a marked reduction in the promotion and implementation of mass marketed investment schemes of the 1990s variety. Market pressures today mean that these schemes are difficult to sell without a Tax Office Product Ruling. Recent media coverage confirms this. Some examples of such coverage are:

- “Some 20,000 people in the goldfields region invested in tax driven schemes before the Tax Office crackdown in 2001, but this year.....clients with any spare cash are negative gearing property or shares.” The West Australian accountant being quoted went on to say: “I’ve never seen one tax scheme make any money, so that’s an indication of what I think about them”. – **The Australian Financial Review, 27 June 2003**
- “The Weekend AFR does not often celebrate the decline of an industry, but it makes an exception for the mass marketed tax minimisation schemes industry.Contraction in the mass-marketed tax schemes industry - and especially in the end-of-tax-year stampede into tax-effective investments - is not to be lamented”. – **The Australian Financial Review, 28 June 2003**

- “After years of scrutiny by the Tax Office and some high profile prosecutions, investors have been giving end-of-year agribusiness schemes a wide berth”. – **The Age, 30 June 2003**

The media messages over the last couple of months have been markedly different to past years. There have been numerous articles warning taxpayers to beware of end of year tax schemes and referring to our warnings about particular arrangements or features of arrangements which attract Tax Office attention.

I view these messages as a measure of the success of our actions in recent years to deal with aggressive tax planning and our increasing openness in stating our views or concerns. It indicates a rising community awareness of the risks and pitfalls of being too aggressive in their tax planning.

However, despite these messages and the reduction in mass marketed investment schemes, there is still a significant risk to the system from aggressive tax planning. We are currently examining a range of arrangements that we have identified through our compliance activities, including from our focus on promoters of aggressive arrangements. The types of arrangements are varied. Cases under examination include complex arrangements designed to avoid or minimise capital gains tax, various forms of financing arrangements and offshore arrangements including those involving the use of tax havens.

We continue to focus on capital gains tax planning, which is often associated with a business event such as a restructure, merger, an acquisition or disposal of a business or asset. We have concerns about arrangements involving complex structures and intra-group transactions which are seemingly designed to shield real capital gains from tax. Some arrangements include exploitation of the CGT rollover provisions.

Financing arrangements which exhibit one or more of the features outlined above continue to be a focus of our examinations. Arrangements which are more tailored to the circumstances of particular taxpayers are a greater concern today than the widely marketed financial products which are now often the subject of product ruling applications.

Another area of focus is partnership loss claims. Our analysis has shown that partnerships sometimes are used to pass through tax benefits that may be created through aggressive tax planning arrangements at the partnership level. We are particularly looking at losses claimed in respect of property development activities and in relation to retirement villages.

Approaches to managing aggressive tax planning

In recent years we have placed increasing importance on a whole of Tax Office approach to dealing with aggressive tax planning. Because it is a tax system “hot spot” we established a cross business line group to provide organisational leadership and ensure an integrated and strategic approach is taken to the management of aggressive tax planning.

We have put in place an end to end process for identifying and addressing aggressive tax planning issues. This process is premised on the basis that to deal effectively with this risk area the Tax Office needs to embrace systemic approaches which address **Promoters**, their **Associates**, the **Schemes**, **Taxpayers** involved, and **Other** issues (such as criminal law breaches). We call that the “PASTO” model. This integrated approach reflects the natural linkages in the tax planning landscape and helps us to understand and deal with the risk in a systemic way.

Our approach involves the creation of an integrated intelligence system which assists us to identify, analyse, address and communicate our views about aggressive tax planning.

Identification of aggressive planning arrangements

The gathering of early intelligence is obviously a key to being able to address aggressive tax planning in real time. We have been criticised in being slow to respond to what has been happening in the past and particularly in relation to the mass marketed and employee benefit schemes.

As indicated earlier, we have taken that criticism on board and our goal is to identify and deal with aggressive arrangements as currently as possible. To do this requires assistance from the community.

As stated earlier aggressive tax planning or tax avoidance undermines the integrity of the tax system and community confidence in the fairness of the system. It therefore is an issue for the whole community, not just the Tax Office.

Tax agents and other advisers in the tax profession have an especially important role in working with us to identify aggressive planning arrangements. Tax agents and the Tax Office rely on each other in many ways and, in the area of aggressive tax planning, it is in the interests of tax agents and their clients that they are aware of the Tax Office's views about arrangements which may not comply with the law.

From time to time we do get some positive feedback from tax agents. For example, an agent wrote to us recently commending us on our stance on aggressive tax planning. He commented that "the job of a tax agent is difficult enough without having to compete against organisations that promote unlawful tax schemes".

We encourage the tax profession to let us know about arrangements and schemes being promoted. A couple of years ago we established a tax practitioners' hotline to provide an avenue for letting us know about currently marketed schemes.

While we have received some information I think it is fair to say that there is a general reluctance within the tax profession to help us to identify aggressive arrangements currently being marketed. This is a pity and it's an area where we need to work on establishing ways of improving relationships and trust. We need to engender a greater sense of ownership of the integrity of the tax system within the community.

Focus on promoters

As mentioned earlier, a key learning from our mass marketed schemes experience is the need to focus more on those who promote and design aggressive arrangements or schemes. The integrated approach mentioned above involves looking at the promoter and their associates with a view to finding out what arrangements are currently being promoted and also to deter ongoing promotion of schemes. Addressing the supply side of aggressive arrangements is a key leverage point for us.

Where a particular tax adviser or promoter of a tax avoidance arrangement is taking a lead role in aggressive tax planning we will investigate their clients to determine whether they have participated in the same and/or other aggressive arrangements. We will also investigate the adviser or promoter to ensure the person or entity is complying with their own tax obligations. Our experience is that the more aggressive advisers and promoters are high-risk taxpayers.

A number of promoters continue to be jointly investigated by the Tax Office and other agencies including the Australian Federal Police and the Commonwealth Director of Public Prosecutions.

Some promoters will not be deterred by ATO action. For example, one promoter we examined last year amended his prepayment scheme after we paid him a visit, amended it again after we issued a Taxpayer Alert and he continued to market the scheme even after we issued a Tax Determination.

Making sense of intelligence

Once having received and analysed information about arrangements, we aim to respond quickly by focusing on the patterns, trends and drivers of arrangements. The Tax Office's objective is to understand and deal with the highest risks in a way which identifies leverage points so we can address issues quickly and holistically.

It is not easy to make sense of information and intelligence from a variety of sources so that patterns and trends of aggressive tax planning can be identified. We need to continue to develop our skills in this area. Part of this development involves leveraging the knowledge and experience of people both within and outside the Tax Office.

Consistent with the principles of the Compliance Model it is important that we also try to understand the drivers of aggressive arrangements. Some drivers are within the law and there are also behavioural drivers. To improve our understanding of behavioural drivers we have been working with the Centre for Tax System Integrity here at the ANU. Tina Murphy's investor survey is one of the projects undertaken.

Communicating the ATO View

I mentioned earlier that another key learning we have taken on board from our mass marketed schemes experience has been the importance of being more pro-active in letting the community know as quickly as possible about arrangements and issues we have concerns about and getting our view out of how the law operates. Our strategies to improve community awareness of the issues and risks associated with aggressive tax planning and the actions we are taking to address these risks include:

- publication of the Tax Office's compliance program. We will be publishing the 2003/04 program shortly;
- issuing Taxpayer Alerts which provide an early warning to taxpayers and their advisers of some significant new and emerging aggressive tax planning issues under examination by the Tax Office;
- sending early warning letters to taxpayers and advisers about arrangements we have concerns about;
- the development of an aggressive tax planning website to provide information about alerts, media releases, cases and rulings; and
- speeches, interviews and articles.

Of course implementation of the above strategies will only make a difference if the messages get through to taxpayers and their advisers. As most taxpayers use tax agents we are increasing our communication focus on tax agents. We try to ensure they are aware of the issues and risks associated with aggressive tax planning as well as the ATO views about particular arrangements.

We are also conscious of the need to express our views or explain our position to taxpayers and agents in ways which they can clearly understand. I think it is fair to say that the way we communicated with mass marketed schemes' investors was often too legalistic. We did not always "stand in the shoes of the investor" when we were explaining why they owed the Tax Office money.

Product Rulings

The introduction of Product Rulings has had a significant impact on the ability of promoters to market investment projects of the type which gave rise to the mass marketed schemes of the 1990s. While an ATO Product Ruling aims to give taxpayers certainty about the tax consequences of an arrangement it will only do so if the arrangement is actually implemented in accordance with the terms of the ruling. We have seen some instances where there have been differences in the implementation of arrangements.

During 2002/2003 we also saw a marked increase in the number of product ruling applications in respect of which we were unable to give a favourable ruling. This indicates some promoters of investment projects are seeking to push the boundaries of what is acceptable. It's an area we need to carefully watch.

We will be increasing the number of reviews of product ruling arrangements during 2003/2004 to ensure compliance. This includes reviewing arrangements where we refused to provide a ruling.

In the area of marketed finance products we have sought over recent years to develop a more cooperative relationship with the financial institutions which market these products. Our aim has been to encourage the institutions to let us know what products they intend to market so we can express our view about the taxation implications as early as possible. This helps inform potential investors.

Apart from Product Rulings we also issue private rulings and other Public Rulings and Determinations to set out our view of particular arrangements.

Clarifying the law through the courts

Our strategies for managing aggressive tax planning include a preparedness to test our view of how the law applies to aggressive arrangements through the courts. In relation to mass marketed investment schemes it is clear that the court decisions confirming the Tax Office's view of these schemes were a major turning point in the great majority of investors agreeing to accept our previously announced settlement offer.

There are still around 1900 objections from investors who have not settled which we will be determining and we are prepared to pursue these cases through the Administrative Appeals Tribunal and courts as necessary. In addition, there are around 380 individual appeals already at the Tribunal or Federal Court.

In order to deal effectively with aggressive tax planning it is important that the Tax Office does not create a perception within the community that we will shy away from litigation and be prepared to nearly always settle disputes. Such a community perception would have a negative impact on compliance behaviour.

We are not always successful in the courts and clearly there are tax planning arrangements where the issues are contentious and the outcomes far from certain. This uncertainty is more likely in respect of arrangements or transactions entered into by larger corporates and wealthy individuals. At present there is some uncertainty about the application of the general anti-avoidance provisions in the income tax law to transactions which have a broad purpose of achieving some

commercial end but which are at least partly tax driven. Hopefully, the High Court in the *Hart* case, which involves a split-loan arrangement, will provide some answers.

Conclusion

The Ralph Review of Business Taxation said “tax avoidance is an ongoing issue, reflecting in part the structure and compromises inherent in constructing a politically sustainable tax system”.² While there are significant profits to be made and little downside from the promotion of aggressive tax planning, it will continue to be a feature of our tax system.

The Tax Office recognises the importance of being alert to what is happening and responding quickly and firmly in a way that instils community confidence in the administration of the system. We need to continually look for improvements in the way we operate and heed the lessons of the past. As George Santayana in the publication *Life of Reason* (1905) said “those who cannot remember the past are condemned to repeat it”.

I believe we have learned from the experience of the past. As Tina Murphy’s paper argues, part of the learning is not to rely solely on strategies linked purely to deterrence. We are moving beyond that as we attempt to improve voluntary compliance and reduce the incidence of aggressive tax planning.

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