

Submission No. 1
(Biannual Hearing - 3/10/08)



Australian Government
Australian Taxation Office

COMMISSIONER OF TAXATION

Ms Sharon Grierson MP
Chair
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Dear Ms Grierson

I have pleasure in providing the Tax Office's report to the JCPAA prior to the public hearing on Friday, 3 October 2008.

The report describes our performance in 2007-08 and covers some additional issues which may be of interest to the Committee and the community.

Overall, we performed well in 2007-08, continuing with strong delivery on our commitments to government, including increased collections of revenue and debt as well as improving the high levels of community and tax agent confidence in us.

There have been some changes in our senior leadership arrangements within the Tax Office with the appointment of David Butler, from the OECD in Paris to take up the position of Second Commissioner, Change Program and IT. Mr Butler previously held senior positions in the Tax office and was also New Zealand's Tax Commissioner.

Yours sincerely

A handwritten signature in black ink that reads "Michael D'Ascenzo". The signature is written in a cursive style.

Michael D'Ascenzo
Commissioner of Taxation

29 September 2008



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Australian Government
Australian Taxation Office

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Issues in tax administration and Tax Office performance for 2007-08

3 October 2008



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TABLE OF CONTENTS

List of attachments	3
Chapter 1: Introduction	4
CHAPTER 2: Reporting on our performance in 2007-08	5
performance highlights against outputs.....	5
OUTPUT 1: SHAPE, DESIGN AND BUILD ADMINISTRATIVE SYSTEMS.....	5
Implementing the Government's legislation program	5
Delivering our Change Program	5
Providing quality and timely advice to Treasury and government.....	6
Delivering whole-of-government strategies	6
OUTPUT 2: MANAGEMENT OF REVENUE COLLECTIONS AND TRANSFERS	6
Reducing the rate of growth of collectable debt	7
Service Standards	7
OUTPUT 3: COMPLIANCE ASSURANCE AND SUPPORT FOR REVENUE	8
Compliance Program 2007-08	8
Working with small business.....	8
Public rulings	9
Working with large business	9
Cash economy.....	9
Misuse of tax havens.....	10
Wealthy Individuals.....	11
OUTPUT 4: COMPLIANCE ASSURANCE AND SUPPORT FOR TRANSFERS AND REGULATION OF SUPERANNUATION FUNDS.....	12
OUTPUT 5: SERVICES TO GOVERNMENT AND AGENCIES.....	13
External scrutineers.....	13
CHAPTER 3: topical issues.....	15
Compliance Program 2008-09	15
Financial Position	15
UPDATE ON MANAGED INVESTMENT SCHEMES	15
PhoEnix arrangements	16
Judicial decisions.....	16
Reliance Carpets.....	16
KAP Motors.....	17
taxation Rulings issued since April 2008.....	17
Attachment 1	19
Attachment 2	20
Attachment 3.....	21

LIST OF ATTACHMENTS

- Attachment 1: Our performance against service standards, 2006–07 to 2007–08
- Attachment 2: Our performance against service standards, 2008-09 year to date (to 31 July 2008)
- Attachment 3: Tax Office submission to US Senate Committee on Homeland Security and Governmental Affairs
- Attachment 4: Tax Office Management Arrangements – September 2008
- Attachment 5: Compliance Program 2008-09

CHAPTER 1: INTRODUCTION

This is the fourth submission relating to the Committee's biannual hearing with the Commissioner of Taxation.

As with previous September hearings, this submission contains a snapshot of Tax Office performance for the 2007-08 year. It also looks forward to the rest of the year, covers some emerging issues and some issues which may be of interest to the Committee.

Since the last hearing, we have provided the Committee with copies of our Corporate Plan 2008-09 and our 7th annual Compliance Plan.

We manage our work through six divisions referred to as sub-plans - Compliance; Easier, Cheaper and More Personalised; Information Technology; Law; Operations and People and Place.

Information about our performance last year is derived from our "Plenary Governance Forum" which brought together senior members of the Tax Office to evaluate our performance over the last year. The information is organised in terms of the outcome outputs framework for the Tax Office as is outlined in the Government's Budget Portfolio Statements.

CHAPTER 2: REPORTING ON OUR PERFORMANCE IN 2007-08

The following information is provided to highlight some particular aspects of our activities during 2007-08 to deliver on our corporate priorities.

PERFORMANCE HIGHLIGHTS AGAINST OUTPUTS

OUTPUT 1: SHAPE, DESIGN AND BUILD ADMINISTRATIVE SYSTEMS

Output 1 reflects our role in effectively shaping, designing and building administrative systems to give effect to the legislation we deliver.

Implementing the Government's legislation program

We have been progressing the design of the new First Home Saver Accounts which will be offered for the first time from 1 October this year. We have been talking to potential account providers to help them set up the systems necessary for them to provide accounts and meet their obligations. Work has commenced on changes to our IT systems and business processes to accommodate the new arrangements. On 24 September we launched the First Home Saver Accounts campaign strategy which includes a public education program, information products available on our website www.ato.gov.au and presentations at relevant forums such as home buyer shows.

We have been working with the Department of Families, Housing, Community Services and Indigenous Affairs to develop the new incentive to support the National Rental Affordability Scheme. The scheme was officially launched by the Government on 24 July 2008.

On the superannuation front, we have implemented the measure to provide tax-free superannuation benefits for those people with a terminal medical condition, as well as amendments to late payment offset rules to reduce the incidence of employers paying the same amount twice. We have worked with Treasury to further develop the Government's proposal regarding superannuation for temporary residents.

We have also provided input to tax reviews being conducted by the Board of Taxation, including the review of the anti-tax deferral regime, the review of the taxation treatment of off-market share buy backs and the review of goods and services tax administration.

Delivering our Change Program

Releases 1 and 2 of our change program have been successfully implemented, with both releases delivering their intended outcomes. We are now progressing Release 3, the final and most complex phases which will see the gradual replacement of many of our existing computer systems with a new integrated core processing system and deliver new tax agent and business portals. The new platform will provide a more robust foundation for future tax and superannuation administration.

However, there have been some challenges for us in implementing Release 3 due to issues identified during design and testing and additional new policy measures, which together have resulted in delays from the original schedule.

We have developed a replan of the Release 3 schedule. The replan takes into account learnings from other Change Program releases and ensures that we will deliver on new Government legislation. However, we will not be implementing any new system changes until we are reasonably certain that they will not have adverse impacts on the community or business.

We are currently deploying the integrated core processing platform and its implementation for fringe benefits tax, and commenced the deployment of the Lost Members Register for Superannuation. We expect further implementation for superannuation, income tax, activity statements, goods and services tax and excise to take place progressively over the next two calendar years.

Providing quality and timely advice to Treasury and government

The Tax Office/Treasury protocol on working arrangements between the two agencies was revised and published for the first time. In line with the protocol, we continued to focus on the quality, timeliness and effectiveness of our advice to Treasury.

We provided 694 formal advices to Treasury. There were 220 pieces of advice on the compliance costs, departmental impacts and revenue costings of new policy proposals. The remainder covered a range of issues, including our advice on situations where the law does not seem to be working as intended, as well as advice on the development of new tax laws. We also provided 53 responses to data requests.

We continued to identify areas we can further improve our collaboration and relationship with Treasury.

Delivering whole-of-government strategies

We continued our input into, and support of, a number of whole of government committees and processes.

For example, we contributed to the development and approval of the Standard Business Reporting (SBR) case. We also provided a whole of government/multi-agency authentication solution for business to interact with government. Work on the SBR taxonomy for software developers and accountants has been delivered. Cross agency collaboration on the tax file number declaration taxonomy has commenced.

There has been a significant improvement in voluntary compliance as a result of intervention under Project Wickenby. During 2007-08, as part of our Project Wickenby activities we raised liabilities of \$140 million, collected more than \$53 million in cash with a further \$44 million in collections as a result of improved compliance behaviour by Wickenby participants. We also completed 109 audits, raising 200 amended assessments, and the taskforce had \$60 million restrained under the Proceeds of Crime Act.

OUTPUT 2: MANAGEMENT OF REVENUE COLLECTIONS AND TRANSFERS

Output 2 reflects our role in managing client contact, revenue collections and payments we make to other taxpayers and others.

Reducing the rate of growth of collectable debt

For the third year in a row we have reduced the growth rate of collectable debt to 1%, down from 5.39% the previous year. The percentage of total collectable debt to revenue decreased to 4.06%, compared with 4.34% in last year. This is the lowest growth rate of collectable debt since the introduction of the new tax system in the 2000 – 2001 year. While the overall rate of growth slowed to 1%, there was also a reduction in income tax collectable debt of 5.4%, and in Super Guarantee Charge debt of 13.4%.

We achieved these results through a community focussing on early intervention and engagement with taxpayers. The dialler technology enabled us to increase our capacity to call therefore increasing our coverage – we had over 700,000 conversations with taxpayers which is a 300% increase on last year. Other results include the referral of 196,230 debt cases to external collection agencies between November 2007 and 30 June 2008, resulting in \$110.2 million collected on our behalf.

Service Standards

We have had to reduce some of our service in standards in 2007-08, but increased some others. This adjustment in part results from managing the implementation of significant changes being made through our Change Program. Our results show that we have been managing our commitments to taxpayers in 20 of our 24 service standards and achieved an overall index of 1.34 on a benchmark of 1.0. The service standards on which we did not meet our benchmark include: paper tax returns; telephone general enquiries; paper amendments and clerical and administrative errors.

Australian Business Register

We progressed a number of projects with government and state and territory agencies to explore ways we can cut red tape for business including:

- developing a Whole of Government Registration Authority proposal
- finalising a pilot connection to ABR with the New South Wales Revenue Office;
- Standard Business Reporting project;
- progressing a number of projects to connect agencies to ABR;
- launch of ABR Update newsletter for government partners; and
- preliminary steps towards the formation of an advisory board to assist in improving services and quality of the ABR.

OUTPUT 3: COMPLIANCE ASSURANCE AND SUPPORT FOR REVENUE

Output 3 reflects our role in achieving high levels of voluntary compliance with Australia's tax and superannuation laws, and in administering access to entitlements under those laws.

Compliance Program 2007-08

As part of our 2007-08 compliance activities we:

- reviewed 25,500 returns in relation to high risk refunds resulting in revenue adjustments of \$38 million
- completed around 19,100 reviews or audits for work-related expenses resulting in revenue adjustments of \$14.7 million
- completed around 7,200 reviews or audits for rental expenses resulting in revenue adjustments of \$9.2 million
- reviewed or audited 6,690 people concerning capital gains tax resulting in revenue adjustments of \$51.5 million
- identified 175 executives and directors who had potential remuneration discrepancies in their returns. Voluntary disclosures were received in 62.5% of these cases and revenue from this project has now exceeded \$27 million
- sent 2.2 million letters to individuals informing them they may have lost track of their superannuation
- conducted a mail-out to 5,200 individuals who had not included reportable fringe benefit amounts in their tax returns, resulting in the recovery of \$2.3 million in overpaid super co-contributions
- contacted members of 430 self managed super funds that were involved in illegal early access schemes
- wrote to 377,800 individuals following up their outstanding lodgments and phoned 11,800 individuals to further ensure they met their obligations
 - these activities led to the finalisation of 48,600 income tax returns and fringe benefits tax returns and 85,400 activity statements, raising liabilities of \$111.1 million
- wrote to over 200 tax agents and visited another 300 about work-related expense claim patterns.

Working with small business

Through our Small Business Assistance Program we provide small business with the information and support they need to apply sound business practices and comply with their tax and superannuation requirements.

During 2007-08, the program has helped around 60,000 businesses through practical support, including more than 7,600 assistance visits, seminars and workshops which drew around 21,000 attendees, and more than 45,000 outbound education and assistance calls.

We also provided assistance to small business through:

- e-Record, a free record keeping tool - we distribute about 130,999 copies annually
- our Record Keeping Evaluation Tool to help businesses assess and improve their record keeping practices
- help with their business activity statements

- help with employer obligations such as withholding tax, payment summaries and superannuation obligations to employees
- computer assistance to help business connect to our Business Portal

This year we launched our Small Business Tax Calendar, an easy-to-use computer tool that helps business better plan and manage their tax obligations and provides timely reminders.

Public rulings

We improved priority technical issue processes during 2007-08 by increasing our focus on project management as well as intervention by senior Tax officers where progress had stalled. This has resulted in a 20% reduction in the number of priority technical issues on hand and a 48% reduction in those priority technical issues greater than six months old without a Tax Office view. In addition, we have implemented regular work reviews and callovers, together with rigorous quality assurance.

Working with large business

In 2007-08, we worked closely with large businesses to promote good corporate governance and greater certainty. This has been achieved through initiatives such as those outlined in the *Large business and tax compliance 2006* booklet and the Commissioner writing personally to chief executives, our priority rulings process and our new forward compliance arrangements, annual compliance arrangements and advance pricing agreements.

Under our Forward Compliance Arrangements (FCA), businesses must demonstrate high standards of self-scrutiny, governance, risk management and continuous disclosure. In return, the business receives a high level of assurance, including access to concessionary treatment of penalties and interest in the event of tax shortfalls. We have established four FCAs with three large businesses and one with a state public sector organisation.

Under our Annual Compliance Arrangements (ACA) businesses provide assurance annually that they meet the income tax risk governance requirements in *Large business and tax compliance 2006*. We provide practical certainty by confirming the outcomes of the risk assessment and identifying the higher risk issues. The ACA is initially limited to Australia's largest 50 businesses.

Cash economy

Over the past 12 months we have worked with trade associations to develop industry benchmarks to help business comply with their tax obligations. The benchmarks support our 'prevention is better than cure' approach. They help business compare their performance with the rest of the industry and check that their tax records accurately reflect their business practices. They also assist tax agents when preparing and lodging tax returns and business activity statements for their clients.

Seven industry benchmarks have been published for the concreting, floor sanding, metal roofing, painting, roof tiling and taxi industries. We are working on benchmarks for other industries.

Other preventative strategies we have been taking include providing educational material and sending out around 30,000 advisory letters to individual businesses where we identify risks associated with possible participation in the cash economy. We have also been using new strategies to identify rogue operators, including:

- extensive use of data matching to identify people whose lifestyles appears conspicuously out of step with their reported income;
- cross matching data from Centrelink, child support agencies and state fair trading agencies to assist in identifying unreported income; and
- increased use of computer-assisted risk evaluation processes to more accurately identify high risk cash economy participants for compliance follow up.

We have conducted around 2,000 audits directly as a result of our focus on the cash economy and raised around \$50 million in taxation liabilities and a number of unreported cash transaction cases have been referred for prosecution action. We have also produced improvements in amounts of tax reported and lodgment timeliness for those businesses that we have contacted over possible cash economy activity.

Misuse of tax havens

Our Compliance Program deals with abusive use of tax havens as one of its top priorities. Through Project Wickenby and a broader offshore compliance initiative, we are increasing our audit coverage. In 2007-08, to further encourage voluntary compliance, we wrote directly to more than 3,500 taxpayers asking them to review their international activities.

Our work on abusive tax havens is complemented by our Offshore Voluntary Disclosure Initiative. Under this initiative, taxpayers who come clean on their offshore arrangements may receive low or no penalties. The initiative has produced 821 disclosures amounting to \$35 million in previously undeclared income.

Australia has a program to negotiate Taxation Information Exchange Agreements with a number of countries using the model OECD agreement. Agreements have been concluded with Bermuda, Antigua and Barbuda and the Netherlands Antilles. Australia is negotiating agreements with another seven tax havens. These agreements allow us to request information if non-compliance is suspected.

In May this year we alerted taxpayers against using arrangements in Vanuatu or any other jurisdiction to claim false deductions or hide income offshore. We are conducting around 80 audits linked to Vanuatu arrangements with over \$90 million in allegedly false deductions, and will write to another 500 Australians with apparent links to Vanuatu seeking more information on their tax affairs.

In July this year, we provided a submission to the US Senate Committee on Homeland Security and Governmental Affairs for a hearing into tax haven banks and US tax compliance. Our submission is publicly available on our website at www.ato.gov.au, and a copy is provided to the Committee for information at **Attachment 3** of this report.

Wealthy Individuals

The High Wealth Individuals Taskforce (HWI) was set up twelve years ago to monitor and manage compliance by Australia's wealthiest people. This initiative is relatively unique in terms of tax administration, ensuring that the tax affairs of high wealth individuals are clearly monitored (as is the case for large companies).

The Government has provided additional funds to expand the HWI. This allows it to enhance its risk identification and treatment strategies with a particular focus on trusts, consolidations, superannuation funds, property building and construction, private equity and disposal of business interests.

The taskforce continues to collect significant amounts arising from audit adjustments. For 2007-08, we conducted 27 audits and finalised 439 reviews. Our audit activity for this period raised \$339.8 million in liabilities and collected \$305.1 million. All up an additional \$2.07 billion has been collected from highly wealthy taxpayers since the inception of the taskforce. The taskforce has also reduced losses by \$1.75 billion over the same period

This year we released the *Wealthy and wise A tax guide to Australia's wealthiest people* booklet and *Wealthy Australians and Tax Compliance* brochure. The publications are designed to facilitate a discussion between wealthy people and their tax advisors.

OUTPUT 4: COMPLIANCE ASSURANCE AND SUPPORT FOR TRANSFERS AND REGULATION OF SUPERANNUATION FUNDS

Output 4 reflects the Tax Office processes required to assure and support compliance and the information and assist the community in relation to the transfers and superannuation obligations we administer.

Superannuation guarantee

We provide extensive education and advice to employers and employees to promote voluntary compliance. For employers, we have released a new calculator to help them complete a quarterly super guarantee charge statement. This is in addition to the calculators released last year to help determine employee eligibility for super. We are also working on the capability for employers to lodge their quarterly super guarantee statements online direct from the calculator.

During 2007-08, complaints increased by 55% due to employees' increased awareness of their entitlements and our proactive validation of incomplete complaints. We expect this trend to continue. We acted on 3,200 employee complaints, raising \$131 million in super guarantee liabilities.

Self managed super funds

There are around 380,000 self managed super funds (SMSFs) holding more than \$285 billion in assets – about 25% of all assets in Australia's superannuation system. This means over 700,000 Australians have all or part of their superannuation under self management.

To help new trustees meet their responsibilities in the management of their fund, we send them a start-up kit which sets out their role and responsibilities. We also introduced a new declaration for trustees requiring them to acknowledge that they understand their obligations and responsibilities. We also have a quarterly online newsletter, SMSF News that alerts trustees and advisers to changes in the rules and clarifies areas of uncertainty. There are approximately 12,000 subscribers to the newsletter.

Under an early intervention strategy, we also contact by phone or letter at least 10% of all new trustees, including all those where the auditor has reported a contravention of the rules. Where our enquiries reveal compliance failures or risks, we provide advice and help to get them back on track.

To improve the quality of audits and reporting, we are currently piloting eSAT, an electronic tool for SMSF auditors to identify and report contraventions. eSAT is expected to be released by the end of this year.

During 2007/08, we completed 655 auditor cases resulting in two referrals to professional bodies, with a further 15 to come. In addition, we are further investigating 56 cases, either because of poor audit performance or failure to respond to our questionnaire.

OUTPUT 5: SERVICES TO GOVERNMENT AND AGENCIES

Output 5 covers the range of services we provide to the Treasurer, Assistant Treasurer, Minister for Superannuation and Corporate Law, Treasury, Parliament, Australian Government agencies, external scrutineers and state and territory governments.

External scrutineers

In 2007-08, there were 12 external reviews completed involving the Tax Office and a further ten were in progress by our three external scrutineers across a broad range of areas.

Australian National Audit Office

During 2007-08, the Australian National Audit Office tabled eight performance audit reports specific to the Tax Office. We agreed to all 39 recommendations. In addition, we were involved in one cross-agency audit and had limited involvement in a performance audit involving the Department of Treasury. The audit reports included:

- *Audit Report No. 12: 'Performance audit: Administration of high-risk income tax refunds in the individuals and micro enterprises market segments' (tabled 1 November 2007)*
- *Audit Report No. 13: 'Performance audit: The Australian Taxation Office's approach to managing self-managed superannuation funds compliance risk' (tabled 1 November 2007)*
- *Audit Report No. 15: 'Performance audit: Administration of Australian Business Number Registrations follow-up audit' (tabled 29 November 2007)*
- *Audit Report No. 30: 'Performance audit: The Australian Taxation Office's use of data matching and analytics in tax administration' (tabled 24 April 2008)*
- *Audit Report No. 31: 'Performance audit: Management of recruitment in the Australian Public Service – cross agency' (tabled 29 April 2008)*
- *Audit Report No. 32: 'Performance audit: The preparation of tax expenditures statement – Department of Treasury, with limited Tax Office involvement' (tabled 8 May 2008)*
- *Audit Report No. 36: 'Performance audit: The Australian Taxation Office's strategies to address tax haven compliance risks' (tabled 29 May 2008)*
- *Audit Report No. 40: 'Performance audit: The Australian Taxation Office's Taxpayers' Charter follow-up audit' (tabled 11 June 2008).*

The following two ANAO audits were in progress:

- Business continuity management in the ATO
- ATO's assessment of benefits realisation relating to the change program.

Commonwealth Ombudsman

We continue to work with the Ombudsman in relation to own motion reviews on possible systemic issues and on complaints. In 2007-08, three projects were underway:

- Administration of superannuation guarantee.
- Investigation into ATO practices and procedures for re-raising written-off tax debts.
- Cross-agency investigation into administration of the Compensation for Detriment from Defective Administration Scheme.

In 2007-08, the Ombudsman referred 146 investigations to us, compared with 154 investigations last year.

Inspector General of Taxation

In 2007-08, the Inspector General of Taxation completed four reviews. We agreed wholly or in part with 23 of the 25 recommendations from these reviews.

- *A case study on research and development syndicates (released by Minister, 16 August 2007)*
- *Potential revenue bias in private binding rulings involving large complex matters (released by Minister, 25 February 2008)*
- *Implementation of agreed recommendations included in previous Inspector-General reports (released by Minister, 5 March 2008)*
- *Review of the ATO's administration of GST audits for large taxpayers (released by Minister, 11 June 2008).*

The following five reviews were in progress:

- *Fourth report on the ATO's ability to identify and deal with major complex issues within reasonable timeframes*
- *Review of the underlying causes and management of objections to our decisions*
- *Review into the ATO's administration of public binding advice*
- *Review of aspects of our settlement of active compliance activities*
- *Review of non-lodgment of income tax returns.*

We note the recent appointment of Mr Ali Noroozi as the Inspector-General of Taxation. We will continue to provide high level assistance to this position.

CHAPTER 3: TOPICAL ISSUES

COMPLIANCE PROGRAM 2008-09

Key areas of focus are summarised in the Highlights section of the program CP 3-4 and for each chapter in the headlines section.

In the coming year, our focus areas include:

- across all aspects of business and the community we have a strong investment in strategies that help them comply. This ranges from prefilling for individuals to annual compliance agreements for large businesses.
- improving our assistance program to support small businesses, particularly helping them get started and stay on track.
- promoting good corporate governance for large business and looking at global corporate restructures that shift assets offshore
- detecting and discouraging the abusive use of tax havens and dodgy tax schemes, and encouraging people who may have done the wrong thing to contact us and take advantage of reduced penalties for coming clean
- expanding our review of executives and directors to include senior executives of private and foreign companies
- tackling the unfair cash economy practices that adversely impact many small businesses
- expanding our scrutiny of highly wealthy people
- greater use of data matching to more effectively identify and target people who under-report income or over-claim expenses, and

FINANCIAL POSITION

In April this year, we reported to the Committee on the difficulties we face in the next few years as we seek further improvements to productivity and to meet the Government's policy agenda. We said that we are reviewing a range of risks and priorities to identify where efficiencies might be made, whilst at the same time, being committed to implementing the substantial program of new measures announced since the last Federal Election as well as our transformational change program. In relation to the latter we are on the right journey, but the challenges in the short term are impacting on our financial position.

In allocating our budget within the Tax Office for the coming year, we have prioritised delivery of the Government's program of new measures and our internal Change Program. We will continue to focus on identifying opportunities to manage and mitigate risks. While the tight budget environment will have an impact, on balance we are positioned to substantially deliver on most of our commitments. We will regularly review our approach to assess the sustainability of our business strategies and the impact on our financial performance throughout the year.

UPDATE ON MANAGED INVESTMENT SCHEMES

In our April 2008 submission we provided an update on what we are doing to manage our change in view on the income tax treatment of registered agricultural managed investment schemes as contained in Taxation Ruling TR 2007/8. We

noted that a test case has been progressed with industry by way of a private ruling application for an investment in a project that would be offered in the 2008-09 financial year. We also advised that due to delays in developing and progressing industry's test case it was unlikely that a court decision would be handed down before the end of the transitional period set out in TR 2007/8, being 30 June 2008.

The test case was heard by the Full Federal Court on 14 August 2008. While we have not extended the transitional arrangements, we have agreed to process and stockpile any requests for Product Rulings for 2008-09 arrangements. We have done this to minimise further implications for the industry pending the decision from the Full Federal Court.

We are unable to anticipate when the court will hand down its decision, although we are hopeful of an early decision. In the meantime, we will continue to closely monitor industry implications as to the timing of the decision. We consider that industry should have sufficient time to market their 2008-09 products if the decision is handed down prior to the end of the calendar year. We will, of course, review the matter as we get closer to the end of the calendar year if no decision is handed down by then.

PHOENIX ARRANGEMENTS

We are involved in a number of strategies to address the Phoenix issue. Our broad objective is to focus on prevention. Our new strategies include identifying and contacting likely Phoenix operators much sooner than before via a targeted letter/phone campaign and working closely with the Australian Securities and Investments Commission, the Insolvency Practitioners Association of Australia and building and construction industry representatives.

Since the beginning of our Phoenix Project in 2000, there have been 10 prosecutions. We have also finalised 1,343 Phoenix audits on entities from July 1998 to June 2008, raising \$606 million in tax and penalties.

JUDICIAL DECISIONS

The following two cases resulted in judicial decisions with potential goods and services tax revenue impacts for the states and territories:

Reliance Carpets

On 22 May 2008, the High Court handed down its decision in the Reliance Carpets case. It upheld the Commissioner's appeal and found that a forfeited deposit in relation to a sale of land was subject to goods and services tax (GST).

The court concluded that there was a supply on entry into the contract of sale. This statutory definition of supply was satisfied because there was an entry into obligations by the vendor, and also there was a supply of real property, taking into account the expansive definition of that term in the GST law. The deposit was consideration for that supply.

We responded promptly to the High Court decision by releasing a Decision Impact Statement on 4 June 2008 which explained our view of the decision and administrative implications.

We are undertaking a review of our GST public rulings to ensure that they are consistent with the High Court decision.

KAP Motors

The Federal Court's decision in the KAP Motors case held that refunds were allowable on any goods and services tax paid in respect of 'holdback payments' made before 2005.

To co-ordinate the refunds we have established a dedicated compliance team to manage and review the holdback refund claims. In addition to processing the refund claims the team has fielded significant numbers of telephone enquiries from motor vehicle dealers and their representatives and conducted meetings with industry and their taxation representatives to encourage correct claims.

As at 8 August 2008 the compliance team has, on hand or processed, a total of 694 refund claims. The value of refunds claimed on business activity statements is \$218.2 million¹ and the amount refunded is \$35 million.

TAXATION RULINGS ISSUED SINCE APRIL 2008

A summary of draft and final taxation rulings issued since April 2008 which may be of interest to the Committee are outlined below:

Taxation Ruling

TR 2008/6 Petroleum resource rent tax and income tax: treatment of geosequestration expenditure and receipts

Issued: 27 August 2008

Geological sequestration refers to the long-term storage of material in underground geological formations such as oil and gas fields, unworkable coal beds and deep saline formations.

This Taxation Ruling provides the Tax Office view in relation to the circumstances when expenditure and receipts related to geological sequestration are deductible expenditure and assessable receipts respectively for the purposes of ascertaining taxable profit under the *Petroleum Resource Rent Tax Assessment Act 1987* (the PRRTAA) and so ascertaining liability for petroleum resource rent tax (PRRT).

The Ruling also describes income tax consequences of expenditure on geological sequestration generally (that is, not just in relation to PRRT projects) under sections 8-1, 40-735 (mining site rehabilitation) and 40-755 (environmental protection activities) and also more generally under Division 40 of the *Income Tax Assessment Act 1997*.

Market segments affected: Small and Medium Enterprises, Large Business

Draft Taxation Ruling

SGR 2008/D1 Superannuation guarantee: payments made to sportspersons

Issued: 27 August 2008

¹ The actual amount of GST related to holdback payments is greater as claims on the Business Activity Statement are the net amount for the statement after deducting other taxes including Pay as you go withholding, Pay as you go instalments, Fringe benefits tax and Deferred company instalments.

This draft Taxation Ruling explains the Commissioner's view of how the definition of 'employee' and 'employer' contained in subsection 12(8) of the *Superannuation Guarantee (Administration) Act 1992* (SGAA) applies to sportspersons and persons providing services in connection with sporting activities. It further discusses whether prize monies and other payments made to sportspersons are 'salary or wages' under paragraph 11(1)(d) of the SGAA and are 'ordinary time earnings' under subsection 6(1) of the SGAA.

The Ruling also considers whether the definition of 'employee' and 'employer' in subsection 12(1) of the SGAA or the extended definition of 'employee' and 'employer' in subsection 12(3) of the SGAA may apply to sportspersons and persons providing services in connection with sporting activities.

The Tax Office view is that a sportsperson who is not in a common law employment relationship with the entity that pays the sportspersons prize money will not be an employee for superannuation guarantee purposes. As such prize money paid in this circumstance is not considered to be salary or wages or ordinary time earnings.

Market segments affected: Individual, Micro Enterprises, Small and Medium Enterprises

ATTACHMENT 1

Our performance against service standards, 2006-07 to 2007-08

Service standard	Standard ^(a)	2006-07		2007-08			
		Benchmark	Achieved YTD ^(b)	Volume YTD ^(c)	Volume Met YTD ^(d)	Benchmark	Achieved YTD ^(b)
		%	%			%	%
Registrations							
Registrations	28 days	93	97.2	2,119,660	2,070,499	85	97.7
Lodgments							
Electronic tax returns	14 days	96	95.7	13,287,203	12,770,163	82	96.1
Paper tax returns	42 days	92	91.7	1,615,705	1,447,257	90	89.6
Refund activity statements – paper	14 days	90	92.5	1,190,253	1,096,326	85	92.1
Refund activity statements – electronic	14 days	92	95	1,181,192	1,125,517	90	95.3
Electronic debit activity statements	14 days	95	99.3	5,487,919	5,473,678	90	99.7
Paper debit activity statements	42 days	92	98.3	10,538,384	10,354,301	90	98.3
Refunds and payments							
Refund of overpaid tax	28 days	92	85.6	231,876	214,435	90	92.5
Superannuation holding accounts (SHA) special account payment requests	21 days	85	93.9	923	814	80	88.2
Excise fuel schemes – claims	14 days	92	88.3	29,540	28,012	92	94.8
Enquiries							
Automated email response	3 days	90	99.5	26,815	25,398	90	94.7
Inbound correspondence ^(f)	28 days	85	79.7	3,517,470	3,123,361	80	88.8
Private written binding advice	28 days	83	93.3	12,106	10,383	80	85.8
Telephone general enquiries	5 min	83	80	8,649,818	6,670,262	83	77.1
Tax practitioners premium telephone service	2 min	90	87	1,501,351	1,376,801	90	91.7
Visit general enquiry service	10 min/ 15 min ^(e)	90	92.3	242,869	228,123	90	93.9
Amendments and objections							
Paper amendments	56 days	92	55.2	257,793	214,913	85	83.4
Electronic amendments	28 days	92	91.1	216,237	194,540	85	90
Objections against private written binding advice	28 days	88	90.3	184	157	85	85.3
Objections other than to private written binding advice	56 days	70	82	16,826	12,582	70	74.8
Audits							
Audits finalised advice	7 days	99	99.6	4,691	4,660	99	99.3
Errors							
Clerical and administrative errors	14 days	70	63.8	7,740	4,407	70	56.9
Complaints							
Complaints ^(g)	3 days	88	94.4	15,539	14,352	88	92.4
Resolution of complaints	21 days	85	94.4	15,539	13,633	85	87.7

(a) The Tax Office and a taxpayer may negotiate an extended timeframe.

(b) The figures show the performance in finalising cases within the set timeframe or negotiated timeframe.

(c) The number of cases finalised.

(d) The number of cases finalised within the relevant service standard.

(e) These represent performance standards for peak and off-peak periods. At peak times we may not be able to achieve our standard of 10 minutes. We aim to answer most enquiries within 15 minutes during these periods.

(f) This standard was reported as 'General correspondence requiring a response' in 2006-07. The change in title reflects the broader scope of cases included in the service standard from 1 July 2007.

(g) This standard was revised in 2007-08. Increase benchmark from 85% to 88% in 2007-08 to reflect productivity improvements.

ATTACHMENT 2

Our performance against service standards, 2008-09 year to date (to 31 July 2008)

Service Standard	Standard	Benchmark %	Performance YTD % (as at 31 July 2008)
Registrations			
Registrations – Commissioner of Taxation	28 days	85.0	97.6
Registrations – Australian Business Register	28 days	85.0	99.2
Lodgments			
Electronic tax returns – individuals	14 days	90.0	92.9
Electronic tax returns – non-individuals	14 days	90.0	80.5
Paper tax returns – individuals	42 days	80.0	93.2
Paper tax returns – non-individuals	56 days	80.0	90.6
Electronic refund activity statements	14 days	90.0	98.4
Paper refund activity statements	14 days	85.0	98.3
Electronic debit activity statements	14 days	90.0	99.8
Paper debit activity statements	42 days	90.0	96.8
Refunds and payments			
Refund of overpaid tax	28 days	90.0	89.4
Superannuation holding accounts special account payment requests	21 days	80.0	96.9
Excise fuel schemes – claims	14 days	92.0	97.5
Enquiries			
Automated email response	3 days	90.0	99.6
Inbound correspondence	28 days	80.0	79.5
Private written binding advice	28 days	80.0	92.2
Telephone general enquiries	5 min	80.0	88.0
Tax practitioners premium telephone service	2 min	90.0	92.9
Visit general enquiry service	10/15 min	90.0	93.5
Amendments and Objections			
Electronic amendments	28 days	85.0	80.6
Paper amendments	56 days	75.0	86.1
Objections against private written binding advice	28 days	85.0	91.7
Objections other than to private written binding advice	56 days	70.0	88.0
Audits			
Audits finalised advice	7 days	99.0	N/A (refer note)
Errors			
Clerical and administrative errors	21 days	70.0	79.3
Complaints			
Complaints – initial contact ²	3 days	88.0	93.7
Complaints – resolution	21 days	85.0	90.4

We have lowered some of our service standards to acknowledge temporary productivity dips caused by implementing significant changes to our computer system. However, as our new systems come on-line we have raised some of our service standards to recognise improved efficiency.

Some minor data issues may be experienced throughout the 2008-09 year with any variance in performance to be reported in the Commissioner of Taxation Annual Report. There are plans in place to carefully manage any anticipated impacts on taxpayers. We will continue to monitor our progress and review how our service standards might be affected.

Note: We are unable to report for the month of July as there are data collection issues with our systems for this service standard.

² This standard reflects our aim to make initial contact within three working days of receipt of a complaint.

ATTACHMENT 3

AUSTRALIAN TAXATION OFFICE SUBMISSION TO US SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

The Australian Taxation Office provided this submission to the US Senate Committee on Homeland Security and Governmental Affairs for a hearing into tax haven banks and US tax compliance conducted by their Permanent Subcommittee on Investigations on 17 July 2008.

INTRODUCTION

The Australian Taxation Office (ATO) believes that persistent and sustained compliance action is required to contain abusive use of tax havens. We believe this is important not only to contain revenue leakage but also to sustain the community's confidence in the fairness of the system and the effectiveness of tax administration.

While we are not aware of an effective way to measure the "compliance gap" in respect of the abusive use of tax havens, we note that the flow of funds through tax havens is increasing. For example, we are aware of OECD estimates that between \$US 5-7 trillion are held in tax havens or banking secrecy jurisdictions.

In addition, the Australian Transaction Reports and Analysis Centre (AUSTRAC), Australia's Financial Intelligence Unit (FIU), has sophisticated capabilities to track international fund flows. In the fiscal year ending 30 June 2007, about \$16 billion was sent directly to tax havens from Australia, and approximately \$18 billion was sent directly from tax havens to Australia.

These figures show a material increase in fund flows over the 2006 fiscal year. Some of this increase is attributable to better capability i.e. our systems are providing better measurement of the flow of funds.

We also know from our risk assessment activities that a significant part of the flow of funds to and from tax havens is not abusive. These amounts may relate to tourism or travel, or legitimate business in goods or services. Another aspect of these funds relates to havens as "hubs" for certain financial transactions like insurance, private equity or hedge funding. These financial transactions may not give rise to tax risk other than in terms of tax competition.

Putting aside the use of havens for legitimate tax benefits and other purposes, we believe that Australia needs to be vigilant in relation to tax haven risk. This is because modern technologies make it easier to use tax havens, and the abusive use of tax havens adversely affects trust and confidence in our tax system. Our Compliance Program that publishes our compliance strategies for business and the community, has made cross border dealings a top priority over the past 6 years and highlights our strong focus on dealing with abusive use of tax havens.

What has changed during this period is that international dealings with tax havens are beginning to spread beyond large corporates and high wealth individuals to all parts of the community. We are seeing examples of the "migration" of tax haven use to small businesses and individuals. We believe this is partly driven by globalisation, ease of travel, advances in communications (including the availability of International Business Companies over the internet), and relatively low establishment costs. However there are also risks associated with this activity.

The ATO has increased its efforts to educate the community on the dangers of abusive use of tax havens and strengthened its ability to deter, detect, disrupt tax haven schemes typically linked to tax avoidance or evasion, and in some cases concerned with serious criminality like money laundering. These risks are outlined in our *Tax Haven Booklet*.

An essential ingredient has been strengthening our ability to work with other Australian agencies and international cooperation with other revenue authorities, such as the Joint International Tax Shelter Information Centre (JITSIC)¹. For example, one strategy in Australia Project Wickenby links various federal agencies (regulators, law enforcement, intelligence and prosecutors) in a taskforce under the leadership of the ATO.

We have made improvements in all stages of our compliance strategy associated with tax havens:

- Detecting the risk
- Educating and communicating
- Encouraging voluntary disclosure and correction
- Dealing firmly with the worst behaviours including promoters of abusive tax havens
- Recommending law reform, and
- Strengthening international cooperation.

Detecting the risk

A range of structures or typologies have been identified as abusive tax haven schemes. These range from the use of false invoices to inflate deductions to the establishment of legal entities to hold securities or other assets. The common element in all of these typologies is the secrecy or lack of transparency by which beneficial ownership can be hidden.

We make use of strategic intelligence analysis to understand the tax haven landscape, identify key leverage points and refine our strategies to combat the abusive use of tax havens.

These include:

- taxpayer profiles to draw trends across a broader population and understand behavioural drivers such as hiding assets from creditors (including family members after divorce), disguising "black funds" or concealing ownership to manipulate markets e.g. securities trading
- scheme typologies to expedite evidence gathering, achieve consistency in the application of the law and result in more targeted litigation and debt recovery

- mapping promoter and intermediary networks to understand the risks (taxpayer numbers, types of schemes, fund flows, whether historical or real time, commissions etc)
- engage with tax havens and have dialogue about concerns arising from aggregated case data and seek options for reform.

Together with partner agencies, we have sought to profile higher risk regions for Australian tax (and other regulatory) systems e.g. Vanuatu.

Educating and communicating

We have strengthened our communications with the community and the tax profession. The messages are simple: "don't get mixed up in dodgy tax haven arrangements and, if you have, come clean!" We use every vehicle for relaying the message including taxpayer alerts to warn people what arrangements to avoid and booklets that gives tips on what to watch out for and what to do if you think you are at risk.

Encouraging voluntary disclosure and correction

We emphasise the benefits of coming clean, including peace of mind and low or no penalties for those who voluntarily tell us about their offshore arrangements. Our marketing efforts are supported by letters and calls to those we have detected as having tax haven transactions, prompting them if necessary to lodge a voluntary disclosure.

In some cases reduced risk of prosecution is also possible. Importantly this requires cooperation and full disclosure of the arrangements and the promoters involved.

Dealing firmly with the worst behaviours including promoters of abusive tax havens

Our top priority is to deal very firmly with the worst abuses and in particular promoters and their onshore associates who encourage use of abusive tax haven schemes. For this purpose, promoters are those who design, market or implement abusive haven schemes, and include some banks and financiers, accountants and lawyers, agents, trustees and brokers. Often based in tax havens or banking secrecy jurisdictions, promoters specialise in hiding assets or income so as to divide legal and beneficial ownership.

In these cases we will use the full weight of the law, including referral for prosecution and action to confiscate proceeds of crime to send a strong deterrent message. Our aim is to make Australia a "no go zone". To support this it is essential we have integration and cooperation among partner agencies. In 2006 this was significantly strengthened with the funding of the multi-agency taskforce - Project Wickenby. The Australian Government supported the Wickenby taskforce by providing special funding and amending taxation laws to allow the sharing of tax information. Integration is also supported at the agency level by the secondment to, and rotation of, officers between agencies to share experiences, expertise and skilling.

The taskforce is focused on the most abusive cases and on those who promote these activities. Currently over 370 civil audits and 20 criminal investigations are underway. To date, Wickenby has raised \$157 million in liabilities, collected over \$70 million and restrained about \$72 million from the proceeds of criminal activity.

Criminal prosecution activity is underway. Several people have been charged with taxation offences, including one alleged promoter and one conviction resulting in a custodial sentence.

Recommending Law Reform

Changes have been made to our tax secrecy disclosure provisions to allow partner agencies involved in Project Wickenby to be able to "talk together" rather than deal with each other bilaterally. New anti-money laundering laws and our new promoter penalty regime also provide significant new tools to deter and deal with this behaviour.

Strengthening international cooperation

On an international level, the ATO participates in the processes of the OECD encouraging transparency and effective exchange of information. We are also strengthening our international framework via the negotiation of Tax Information Exchange Agreements.

More importantly, we are working with tax administrations through our double tax agreements with unprecedented levels of cooperation. This includes sharing data pursuant to tax treaties and the conduct of simultaneous examinations across jurisdictions and sharing intelligence and strategy so that common issues can be developed and actioned. These issues include tax haven regions, promoters and intermediaries, and some particular higher risk taxpayers.

An important development was the establishment of JITSIC in 2004 to supplement the ongoing work of tax administrations in identifying and curbing abusive tax avoidance transactions, arrangements and schemes. The ATO is working with our JITSIC partners in Washington DC and London to enhance bilateral and multilateral efforts to attack cross border schemes, including those promoted by firms and individuals who operate without regard to national borders.

In particular, the ATO enjoys excellent working relations with the Internal Revenue Service (IRS). The interaction between our officers may include weekly teleconferences, opportunities to jointly workshop matters, sharing intelligence and training tools, enhanced evidence gathering to support civil or criminal investigations. The strength of these personal and professional relationships allows us to make joint representations to tax havens in order to explore reform options. For example, the ATO is working with other tax agencies including Her Majesty's Revenue and Customs (HMRC) and IRS in respect of Liechtenstein in making joint representations for greater transparency.

We now address the 7 focus questions.

1. THE SCOPE AND IMPACT OF TAX EVASION THROUGH THE USE OF TAX HAVEN ENTITIES AND ACCOUNTS AND ITS IMPACT ON THE INTERNATIONAL COMMUNITY

The OECD estimates globally, \$US5-7 trillion is held off-shore².

Abusive use of tax havens is a problem for many countries. Our analysis of Australia's situation suggests that the risk of abusive transactions with tax havens

may have increased, particularly among individuals and small businesses. However the size of the issue in Australia is small relative to some other countries.

While the flow of Australian dollars to and from tax havens is significant, it needs to be seen in the context that not all tax haven transactions are abusive under Australian tax law.

Intelligence also suggests that increases in flows to particular regions can be based on economic and commercial factors. An example of this is the concentration of hedge funds in the Cayman Islands.

Intelligence also indicates that fund flows to countries other than tax havens may also represent a tax risk where that country is being used as a conduit to channel funds to a tax haven.

Bank secrecy is often a feature of tax havens. However, some countries that are not low-tax jurisdictions have bank secrecy arrangements that may be exploited to conceal income and evade tax because they do not have effective tax information exchange with other countries.

While revenue is at risk because of abusive tax haven schemes, those who participate in these schemes also run risks. Some participants lack financial awareness and – through poor or unethical advice, lack of knowledge or wishful thinking – may believe that an abusive arrangement is legitimate. Some funds in tax havens have disappeared or been lost to the investor by the misdeeds of the promoter.

Offshore evasion is a concern internationally. However, we are not aware of an effective way to estimate precisely the amount of tax at risk. Factors that mitigate this risk in Australia include:

- geographical factors
- the existence of AUSTRAC
- our own vigilance in this area
- the lack of an inheritance tax or gift duty
- the relative size of the flow of funds from Australia to tax havens (compared to some other countries)
- the law-abiding ethics of most Australians
- the message we are sending from Project Wickenby and other activities.

Arrangements we are concerned about

Concealment is our main concern – in particular, those schemes and arrangements that use secrecy laws to conceal assets and income that are subject to tax in Australia.

In the simplest case of concealment, a taxpayer may seek to conceal assets and income by setting up a bank account in a tax haven. As the tax haven does not have an agreement to exchange information with Australia, or the country has a strict bank secrecy regime, we cannot obtain detailed information about the offshore bank account directly.

In more complex cases, taxpayers may use an 'international promoter' to set up and manage offshore trusts or companies that seek to conceal the taxpayer's beneficial ownership of assets. The most common form of tax haven structure used to conceal ownership is the 'international business company'.

In these cases, the international promoter may interpose trusts or companies as the shareholders, using their own companies as trustees or nominees. The directors of the offshore company may also be companies associated with the international promoter. Arrangements are put in place to ensure that the Australian taxpayer is still able to influence or control the offshore trust or company eg letter of wishes.

These complex arrangements aim to conceal the true ownership of assets and result in the failure to declare any offshore income or gains in relevant tax returns. Australians who use these arrangements leave other Australians to bear a greater tax burden. These arrangements erode community confidence in Australia's tax system.

Intelligence indicates that a few Australians are using more complex offshore structures which involve the creation of layers of entities offshore and the opening of bank accounts under the names of these entities in jurisdictions not recognised as tax havens.

An example of the typologies is the intelligence obtained as a result of our compliance activities regarding Liechtenstein entities. A structure peculiar to Liechtenstein law, the "Foundation" has been identified as a vehicle that is used to conceal the ownership of assets and/ or income.

2. ROLE OF FINANCIAL INSTITUTIONS, TRUST AND MANAGEMENT COMPANIES AND PROFESSIONAL FIRMS IN THE STRUCTURING AND SERVICING OF OFFSHORE ENTITIES AND ACCOUNTS FOR EVASION OF TAXES

The ATO is currently reviewing the taxation affairs of Australian taxpayers who appear to have concealed income in offshore entities located in banking secrecy jurisdictions and tax havens.

International promoters provide specialised accounting, banking and professional trustee services. The services commonly include tax planning, administration of offshore assets and advising on the establishment of trust and corporate structures.

In many cases the international promoter provides its services to Australian residents and associated entities through intermediaries, commonly Australian attorneys and accountants.

Marketing material indicates that the essential service provided by the international promoter is tax and financial planning, which includes administering companies and trusts domiciled in tax haven or banking secrecy countries. Our intelligence shows that a component of the services provided by the international promoter is to establish entities or structures which are not able to be connected to the ultimate or beneficial owner. These arrangements rely on local bank secrecy and confidentiality laws in the jurisdictions where the entities are established.

The international promoter may act on verbal instructions from a client to settle a trust, which in turn owns shares in a company incorporated in a low tax jurisdiction, for example, the British Virgin Islands.

In-house entities associated with the international promoter are used as office bearers when incorporating entities for particular clients. The use of these entities makes it difficult to identify any natural person who controls, is associated with or receives a benefit from an entity established by the promoter.

The promoter may also arrange a bank account for the company it has incorporated for its client in, for example, London, Jersey or Switzerland and provide signatories for the account.

Other techniques used by the promoters include:

- the provision of foreign cell phones to prevent the tracing of calls in Australia
- meetings held in person, either in Australia or overseas
- the use of "e-faxes" which requires the client to have a subscription to access the e-faxes
- the use of London post office box addresses and London bank accounts for entities created, to give the appearance of UK domicile for those entities, when they are in reality domiciled in a low tax country
- the use of encryption on computer records
- the identification of clients by reference to initials or cryptic identifiers
- the use of couriers to deliver documents.

3. HOW PRIVACY AND SECRECY LAWS IN TAX HAVENS FACILITATE TAX EVASION AND IMPEDE TAX EVASION INVESTIGATIONS AND ENFORCEMENT EFFORTS

Banking secrecy poses a significant risk to the public revenue.

Essentially, the main impediment to the ATO posed by tax haven secrecy laws arises from the difficulty of obtaining basic information that may be indicative of fraud and evasion. This is a "Catch 22" situation – without knowing that a person has funds in a tax haven, it can be difficult to identify or prove fraud or evasion. Without having identified fraud or evasion, access to relevant information is precluded by the secrecy laws of the tax havens.

Tax havens which operate on the basis of privacy or secrecy laws provide the opportunity for trust and asset management institutions, such as LGT, to establish tailored, confidential structures for taxpayers looking to take advantage of these laws to conceal their income from their tax administrations.

Experience has shown that many taxpayers who use these tailored financial structures in tax havens are engaging in tax evasion. The hallmarks of these structures are:

- Deception about ultimate beneficial ownership
- Structures may be used to hide assets and/or income offshore and/or create deductions by deception
- Secrecy surrounding access to funds and repatriation
 - funds accessed offshore or to fund lifestyle
 - back to back loans for purchase of assets
 - accounting records and bank accounts may be held offshore.

For example in the Liechtenstein context, the true beneficial owner of a foundation and its assets does not appear on the public records of the official public registry. The statutes and by-laws of an unregistered foundation are not available publicly.

The establishment of structures that use layering via multiple entities, such as nominee companies incorporated in various tax havens, makes it difficult for the ATO to gather offshore information which may reveal participation by Australian taxpayers in tax evasion. Secrecy laws in these tax havens mean that investigations into the interposed companies may not reveal the links to Australian taxpayers.

The lack of transparency inherent in these structures means that the ATO is largely reliant on the co-operation of the taxpayer (where the taxpayer is known) to proffer further information in the course of its investigations. The exercise of the ATO's information gathering powers would otherwise prove ineffective given the jurisdictional limits of these powers.

The ATO is also aware that the level of secrecy afforded to a taxpayer may be linked to their political status. In the LGT context we are aware that different provisions may be put in place for politically exposed persons to maintain their confidentiality.

Whilst the legislative framework of banking and privacy laws governs the operation of financial institutions, trusts and nominee companies, it is useful to recognise the importance of separating the powers between the financial sector, the executive and the judiciary to ensure transparency and effective operation of the regulatory system. As a general comment, tax haven jurisdictions may have closely connected administrative arms with the Government in power, in contrast to the modern and transparent approach to separation of powers.

Where they exist, these close connections between financial institutions, regulators, administrators and the judiciary may undermine any outwardly transparent statutory framework.

4. OTHER IMPEDIMENTS TO ATO ARISING FROM USE OF TAX HAVEN INSTITUTIONS, ENTITIES AND ACCOUNTS

The ATO has encountered difficulties in applying Australian taxation laws to non-common law entities, such as Liechtenstein foundations. These hybrid entities possess characteristics of both a common law trust and a corporation and they may not fall squarely within the anti-deferral of tax provisions³.

Until legislative or judicial clarification is provided on this issue, the ATO will continue to characterise these hybrid entities on a case by case basis.

The ATO also faces impediments to gathering offshore information from banking institutions. For example, where a subsidiary or branch entity of an Australian bank is operating offshore, the question arises whether we are able to access offshore banking information in these circumstances. The question also arises where a foreign bank operates in Australia and has tax haven links.

5. INITIATIVES TAKEN BY THE AUSTRALIAN GOVERNMENT TO COMBAT OFFSHORE TAX EVASION, INCLUDING THE ROLE AND EFFECTIVENESS OF LEGAL ASSISTANCE TREATIES, TAX INFORMATION EXCHANGE AGREEMENTS, AND MULTILATERAL TAX ORGANIZATIONS AND GROUPS

Project Wickenby Taskforce

Project Wickenby is a multi-agency taskforce. It was formally funded in 2006 to investigate internationally promoted tax arrangements that allegedly involve tax avoidance or evasion and, in some cases, large-scale money laundering. The project has \$305 million in funding over seven years. Its focus is to take decisive action against identified promoters and their Australian associates and clients.

The agencies involved in Project Wickenby, are the ATO, law enforcement agencies and the corporate regulator. The ATO is the lead agency. This is the first time these agencies, supported by our FIU, AUSTRAC, have brought their expertise and powers together to deal with tax avoidance and evasion.

Project Wickenby has led to a number of arrests and charges.

Legislative Reform

After the establishment of the Project Wickenby taskforce and the whole of government approach to tackling its challenges, it was considered that secrecy provisions contained in the tax legislation impeded the efficient and effective operations of the taskforce, necessitating some changes.

New provisions were enacted, sections 3G and 3H of the Taxation Administration Act, 1953, to allow greater interaction with all arms of the taskforce and to provide a mechanism to share tax information between taskforce members.

We will also use other approaches such as our new promoter penalty regime which provides substantial increased penalties – for a body corporate, up to \$2.75 million or twice the profits from the scheme. This legislation is aimed at eliminating

unscrupulous operators who promote unsustainable arrangements to the detriment of both taxpayers and ethical advisers.

In 2006 a new Anti-Money Laundering and Counter-Terrorist Financing Act 2006 was introduced which covers the finance sector, gambling sector, bullion dealers and some professions that provide financial services, such as lawyers and accountants. These groups will be required to monitor and report to our FIU on a wide range of services such as opening accounts, accepting deposits, issuing travellers cheques and some gambling activities.

Multi Jurisdiction Collaboration

The ATO in conjunction with its partner agencies including the IRS, HMRC, Canada Revenue Agency (CRA), and New Zealand Inland Revenue Department (NZIRD) are collaborating to develop strategies to combat the abusive use of tax havens. The ATO is also engaged with JITSIC to combat cross border tax non-compliance.

International Promoter Strategy (IPS)

The aim of this strategy is to engage tax havens about common issues with a view to reforms like enhanced transparency. Our approach is to identify off-shore promoters who are operating in Australia, and identify their on-shore associates (intermediaries) who are marketing and selling to Australian taxpayers.

By addressing high risk promoters, intermediaries and taxpayers we gather intelligence on the activity/ mischief and collate the information to produce a greater understanding of the tax haven and related tax risk. We share our intelligence with tax treaty nations as a step towards representations seeking reform. International cooperation is critical to the success of this strategy.

Mutual Assistance Requests

Mutual assistance protocols enhance our ability to tackle tax haven schemes involving criminality. However, material provided to police and prosecutors under mutual assistance is often restricted in that it cannot be shared with the ATO. This can impede our efforts towards collaboration.

Mutual assistance requests and assistance are predicated upon Australia reasonably making out a criminal matter. However, in havens and countries with banking secrecy laws, it may be very difficult to gather information in the first place. In other words, this "Catch 22" situation inhibits Australia's ability to seek support under mutual assistance provisions.

AUSTRAC

An important source of information is AUSTRAC, which identifies Australian taxpayers who may be engaged in tax evasion using tax havens. AUSTRAC routinely monitors domestic transactions over \$10,000 as well as international fund transfers.

AUSTRAC records the details of the ordering customer, beneficiary customer, the account to which the funds are to be credited, the amount transferred and the sending and receiving institutions. We use the information in these reports to identify participants and promoters of abusive tax schemes and tax evasion, as well as

taxpayers who are hiding outside the tax system. In addition, we use AUSTRAC information to:

- monitor money movements into and out of Australia
- profile individuals and other taxpayers
- identify high-risk or suspicious transactions
- identify and quantify compliance risks and develop compliance strategies, and
- select cases for further investigation.

We also have access to information from financial institutions, as well as transaction data for credit and debit cards that have been issued offshore and used in Australia.

Information gathering powers of the ATO

The ATO has compulsory information gathering powers under the *Income Tax Assessment Act, 1936 (ITAA)*.

Under *section 263 of the ITAA* the ATO can seek access without notice to places, buildings, and documents. The decision to use this power is made by a senior ATO officer.

Under *section 264 of the ITAA* the ATO can issue a formal notice requiring production of documents or information including the attendance at a formal interview. In these formal interviews the privilege against self incrimination is not available. However, attorney/ client privilege still applies in respect of the powers. In some cases, ambit claims of attorney/ client privilege have been used to hinder investigations.

There are penalties for non-compliance with these provisions.

Under *section 264A of the ITAA* the ATO can issue an "offshore information request". There is an evidentiary sanction for non-compliance with this provision.

Encouraging Voluntary Compliance

Our Compliance Program that publishes our compliance strategies right across the community has dealing with abusive use of tax havens as one of its top priorities. Through Project Wickenby and a broader offshore compliance initiative, we are increasing our audit coverage including our coverage of high wealth individuals. We are also sending several thousand letters asking taxpayers to review their international issues.

The other element of our compliance strategy relates to enhanced communications with the community and the tax professions. Our tax haven concerns have been relayed via publications, in speeches to business and professional forums, and via the media. The messages have been simple – don't get mixed up in this and if you do come clean!

The benefits of coming clean have been articulated as reduced penalties and interest, less audit stress and inconvenience and in some cases reduced risk of prosecution. The Australian prosecutor, the Commonwealth Director of Public Prosecutions, has stated publicly that he will, subject to certain conditions, look favourably on voluntary haven disclosures, thus reducing the prosecution risk.

Penalty concessions have been provided under our Offshore Voluntary Disclosure Initiative (OVDI). Under this initiative, taxpayers who volunteer their offshore arrangements may receive low or no penalties. To date 733 people have made disclosures involving over \$31 million in income.

Intelligence and feedback from the tax profession has been favourable about our efforts to encourage voluntary disclosures. Some firms are establishing particular expertise in unwinding haven structures and settling up with the ATO.

Analysis of data trends and community perception testing confirm that our tax haven strategies are having a positive impact on compliance. Data analysis suggests that those people subject to review under Project Wickenby have ongoing improved compliance up to 57% higher than the "control" population. Community perception surveys also suggest broad support for ATO strategies in dealing with haven participants firmly and fairly.

Education and Communication

Taxpayer Alerts

The ATO issues "taxpayer alerts" to help people avoid becoming entangled in the abusive use of tax havens. The ATO issues alerts on our website about emerging schemes we are concerned about and risky arrangements.

The ATO issued a specific taxpayer alert (TA 2008/2) on 13 March 2008 to address the risks identified in relation to the abusive use of Liechtenstein foundations and/or bank accounts. We also issued a taxpayer alert (TA 2008/08) on 7 May 2008 warning against using tax evasion arrangements in Vanuatu.

Publications

To assist taxpayers in their understanding of tax havens and their Australian tax obligations, in October 2007 the ATO published a revised version of its original 2004 publication Tax havens and tax administrations. This publication illustrates the ATO's approach to dealing with tax avoidance and evasion where tax havens are used, including the information sources that are available, such as AUSTRAC.

Taxation Information Exchange Agreement (TIEA)

In March 2002, the OECD's global forum on taxation developed a model agreement for information exchange on tax matters. Australia has begun a program to negotiate TIEAs with a number of countries using the model agreement. We concluded agreements with Bermuda in November 2005, Antigua and Barbuda in January 2007, and the Netherlands Antilles in March 2007. We are negotiating agreements with another seven countries. In addition, the Isle of Man has agreed to sign an agreement with Australia. Whilst we are pleased that TIEA negotiations progress, their broader use and effectiveness is yet to be determined.

6. THE SCOPE AND IMPACT OF THE LGT TAX INVESTIGATION AND ANY LESSONS LEARNED

Tax Office Strategy

The ATO is investigating the use of Liechtenstein entities and bank accounts in collaboration with other revenue agencies. In Australia, we are conducting 20 tax audits which are likely to raise tax liabilities in excess of \$100 million. Anecdotal information suggests that relatively few Australians are involved in Liechtenstein arrangements relative to citizens from other countries.

Liechtenstein

The ATO is currently reviewing the taxation affairs of Australian taxpayers who appear to have concealed income in offshore entities located in banking secrecy jurisdictions and tax havens. We have a particular focus on taxpayers who have used the services of the LGT Group and its trustee entity, LGT Treuhand Aktiengesellschaft in Vaduz, Liechtenstein (LGT).

- LGT Treuhand A.G. operates a fiduciary or trustee service and establishes and administers legal entities such as anstalts, stiftungs (foundations) and trusts for its clients.
- LGT Bank in Liechtenstein A.G. is the banking division of the LGT Group. It has responsibility for banking services related to the investment functions of the LGT Group.

The services provided by LGT include administration and investment of offshore assets which appear to be beneficially owned by the client. LGT acts on instructions from a client to establish or create a Liechtenstein entity and subsidiary entities in other tax haven jurisdictions. In the Australian examples, the parent entity is usually a foundation or trust. In some instances, LGT appears to have been retained as an agent of the client, and has established and administered a Liechtenstein entity acting in that capacity.

The beneficial owners of the Liechtenstein entity are commonly a natural person and their family members, however their identity and control appear to be concealed on public and bank records by the interposition of a foundation board comprising LGT officials, who exercise control of that entity on behalf of the beneficial owners. Documents relating to a private family foundation are not recorded on the Liechtenstein public registry. The foundation is a separate legal entity and the board members have discretion to nominate beneficiaries, so that secrecy is maintained.

The ATO understands that in practice the foundation board members act on the wishes or instructions of the settlor or beneficial owners of the entity. In other cases the client has used a foreign attorney to give instructions to the foundation board members or has replaced the by-laws or regulations of the foundation to appoint new beneficiaries.

LGT allegedly designs client structures so that the client or beneficial owner is unable to be connected to the Liechtenstein entity, whether that entity is a foundation, trust or anstalt. The services provided by LGT rely on the banking and secrecy laws operating in Liechtenstein to prevent disclosure of the client's identity or information.

LGT will also arrange to open and operate a bank account for the foundation or trust it has established for its client. The bank accounts are typically held in the name of the entity, to avoid any connection with the instructing client, and to meet the bank's anti-money laundering obligations.

Assets administered by LGT may be invested in a diverse range of managed funds and currencies. Further, safety deposit facilities can be arranged for clients to secure other valuable items such as art and jewellery which may also form part of the investment portfolio.

Funds owned by entities that are established by LGT for its clients are commonly invested with its own bank or funds management entities:

- LGT Bank in Liechtenstein;
- LGT Capital Invest Limited Grand Cayman; and
- LGT Portfolio Management (Cayman) Limited.

At the client's direction, funds may be invested with a third party bank, usually operated in a banking secrecy jurisdiction.

The ATO understands that for a trust or foundation to be established by LGT, substantial funds must be settled in the trust or foundation for it to be economically viable for LGT. LGT clients are wealthy investors who typically invest a small portion of their total wealth in a LGT structure and who do not need access to these funds to support their domestic lifestyle.

LGT plays an active role in servicing and administering the client's Liechtenstein entity. For example the board members of a foundation will be LGT employees. They are responsible for administration of the entity and are the approved signatories.

The use of LGT employees as board members or trustees and in-house or 'omnibus' entities as nominee directors of interposed entities is considered to be another means by which the beneficial owner is distanced from being connected to their Liechtenstein entity. This may facilitate the avoidance or evasion of tax on any offshore income derived by the Liechtenstein entity by an Australian taxpayer, who is the beneficial owner.

LGT also arranges for shell entities incorporated in other tax haven jurisdictions (such as BVI or Panama) to be set up as interposed entities of the Liechtenstein entity for its clients. The ATO considers that these special purpose vehicles are used to layer the transactions and the flow of funds, and may be designed to prevent regulators and tax administrators from determining the underlying ownership and control of the entity established by LGT and its assets and income.

LGT allegedly recommends to clients that fund transfers be conducted through interposed entities in countries outside the client's domestic jurisdiction. The Australian experience is that clients have adopted this recommendation and that few international fund transfers are remitted directly between Australian residents and Liechtenstein or Switzerland as detected by our FIU.

Communication between the ultimate beneficial owner of the foundation and LGT appears to be limited to either face to face or telephone contact. LGT instructs the ultimate beneficial owner of the foundation to avoid written correspondence with it

and clients are provided with codes and passwords to maintain confidentiality and secrecy.

Intelligence held by the ATO indicates that at July 2006 there were 14 banks operating in Liechtenstein with funds under control of approximately 255 billion Swiss francs. Also operating in Liechtenstein was numerous Treuhand (Trust Service Companies). Further intelligence indicates that as at November 2006 approximately 127,000 entities were registered with the public company registry (the population of Liechtenstein is approximately 35,000).

The ATO has employed several compliance strategies – audits, issuing information production notices (both domestically and off-shore), conducting formal and informal interviews, accessing premises (with or without notice) to copy documents, and exchanging information with our Tax Treaty partners.

More importantly, the sharing of intelligence between international tax agencies has provided a unique understanding of Liechtenstein financial services and entities and will provide an opportunity to engage with Liechtenstein to achieve greater transparency and exchange of information.

The ATO welcomes news that new laws in Liechtenstein will enhance regulation and transparency in relation to some legal entities. However, we are concerned to see the detailed law and its proposed implementation in 2009 to determine whether there are practical changes to trustee/ banking practices.

Lessons learned

- Project management strategies are essential to successful audit outcomes.
- Sharing of information with other revenue agencies expedites the progress of cases.
- Our compliance activities have resulted in disclosures or settlements.

7. WHAT INITIATIVES AND REFORMS WOULD STRENGTHEN INTERNATIONAL EFFORTS TO COMBAT TAX EVASION

- Information sharing amongst revenue authorities – multi jurisdictional as opposed to bilateral (treaty based)
- Where appropriate undertake simultaneous audits
- Regular and timely exchange of information under the treaty
- Compliance with OECD guidelines on exchange of information and transparency
- Defensive legislative measures to protect revenue bases from the abusive use of tax haven arrangements
- Looking at broader options for sustainable economic and social development for those tax havens which are developing economies
- Develop close working relationships and regular communications, including participating in successful workshops with other revenue agencies
- Policy makers and country leaders that drive cultural and behavioural changes resulting in the belief that tax haven abuse is inconsistent with being a good citizen.

Footnotes

¹ JITSIC member countries include Australia, Canada, Japan, United Kingdom and the United States of America.

² Testimony of Mr Jeffrey Owens, Director of the Centre for tax Policy and Administration at the OECD before the USA's Senate Finance Committee on Off-shore tax Evasion.

³ For example, Australia's Controlled Foreign Companies provisions apply where a tax haven company is controlled from Australia and the company is primarily in receipt of passive income. Different provisions apply to trusts