GENERAL	JCPAA	SUBMISSION	UNCLASSIFIED
SEGMENT	AUDIENCE	FORMAT	CLASSIFICATION

Australian Government
Australian Taxation Office

Moving on

Aggressive tax planning

UNCLASSIFIED

7 JUNE 2006

OVERVIEW

The Tax Office's approach to abusive tax schemes is straightforward: early detection of emerging schemes, warnings to taxpayers, fair treatment of participants and firm action against promoters. Our response to promoters is complemented by the recent promoter penalty legislation which targets those that peddle unsustainable schemes.

The vast majority of Australia's 11 million individual taxpayers and 2.5 million businesses do not get involved in tax schemes. In fairness to those that seek to comply with tax law we take firm action against the small minority who continue to promote, market, and participate in abusive tax schemes.

We are seeing increasingly complex and sophisticated tax schemes designed to undermine the tax system and by their nature they are often difficult to detect. However, through our intelligence activities and risk analysis we can now more effectively target emerging domestic and offshore schemes.

In our 96 year history, the Tax Office has seen many schemes, and learned many lessons - from the 'bottom of the harbour' schemes of the 70s, mass marketed investment schemes and employee benefit arrangements in the 1990s, to offshore structures in the new century.

Others have also learnt lessons: "Taxpayers are a broad sample of society, and experience shows that a significant segment of society does not, or cannot, recognise a proposal which is simply not credible. Plans which are said to generate a tax saving of $5 for each $1 of cash outlay fall into this category, and almost invariably fail; and when they fail, it is no defence [to tax advisers] to a claim of negligence that the client was greedy."[1]

Tax schemes have an ever-changing face. The challenge to detect and deter new and emerging schemes is constant. The message from the community needs to be unequivocal - abusive tax schemes are not on'.

The paper schemes of the 1970's were brought under control only after the community labelled those contrivances as rorts and this was supported by legislative amendments and action by the Tax Office.

Mass marketed investment schemes (MMIS) 'spread like wildfire' in the 1990s. There were about 42,000 investors[2]. So did employee benefit arrangements (EBAs) with about 5,750 cases[3]. Notwithstanding generous settlement terms many participants of these abusive schemes at first prevaricated, often on the basis of misleading information from promoters and others. With the weight of overwhelming judicial decisions against similar arrangements, the unfortunate consequences of these schemes are largely behind us now, with over 98% of

---

[1] A.H Slater QC, *Effective Implementation of a Tax Plan*, Taxation Institute of Australia, National Conference, April 2006, p3. See also Australian Financial Review, *Action needed on tax 'virus'*, 12 February 2002, p62.

[2] See Attachment 1: *A description of a typical mass marketed investment scheme*

[3] See Attachment 2: *Description of employee benefit arrangements (EBAs)*

participants in mass marketed investment schemes and nearly 90% of employee benefit arrangement cases having finalised their income tax disputes.

Our challenge for the future is to continue to improve our risk and intelligence processes to better detect abusive tax schemes, to provide early warning to taxpayers and advisers of significant existing, new or emerging aggressive tax planning arrangements, and to take firm and early action to counter such schemes.

THE TAX OFFICE APPROACH

RISK/INTELLIGENCE BASED

Just as the Tax Office is not resourced to chase every last dollar payable under the law, we're also unable to review every last transaction or event that may have tax consequences. The Tax Office is funded to operate on a 'risk management basis'.

That means making intelligent, risk-based assessments about the allocation of resources to optimise voluntary compliance with the tax laws. We invite the community to assist us in this responsibility[4].

Honest taxpayers need confidence that there are real risks for people who do not comply with the law. Potential non-compliers need to perceive a real risk of being caught and understanding that serious consequences could follow. A failure on the part of the Tax Office to have sensible risk strategies in place could put honest taxpayers at a personal or commercial disadvantage, and reduce community confidence in the fair operation of the tax system.

We have well developed risk management processes based on information from a variety of sources which guides our strategies. For example, we rely on intelligence from a wide range of internal and external sources to identify aggressive and abusive tax planning arrangements and those who use and promote them. Sources include information we obtain by exercising our formal powers to access premises and documents, information volunteered by the public and tax professionals as well as compliance activities such as taxpayer risk reviews and audits.

We also analyse tax returns (especially high risk refunds), activity statements and applications for private rulings, along with our other sources of information. Information provided by other government agencies such as AUSTRAC and information obtained through formal exchanges with other countries plays an increasingly important role in our intelligence activities.

[4] The Tax Office's Compliance Program is published annually, with an invitation for feedback on the risks identified and the choices made.

LEARNING FROM THE PAST

Mass marketed investment schemes (MMIS)

The Tax Office is acutely aware of past criticisms that we were too slow to respond to mass marketed investment schemes, and to warn taxpayers earlier of our concerns.

We have sought to be more responsive and to improve our ability to act in a timely manner by learning from the past, particularly the 'wild-fire' proliferation of mass marketed investment schemes. These schemes flourished in the late 1990s. There were about 42,000 investors.

It is important to note that mass marketed investment schemes did not rely on any private or public rulings from the Tax Office. In respect of the 42,000 participants in over 200 MMIS arrangements, only a handful of private rulings were issued.

The Senate Economics References Committee found support for the view that "the growth of a highly competitive entrepreneurial promoter market ... has been the most significant driver of the growth in aggressive tax planning."[5]

This finding built on the Committee's previous reports. In its Interim Report it concluded:

> " it is the view of the Committee that a large number of these schemes appeared to be designed specifically to defraud the tax system and to use ordinary taxpayers in that process. Not only have they left many taxpayers with large tax bills, but many of these schemes have ceased to exist. The Committee is of the view that few schemes represented 'a good investment' in the ordinary meaning of the term, and that without the 'tax deductibility' factor, very few would have got off the ground."[6]

In its Second Report, the Committee concluded:

> "the vast majority of taxpayers involved in these mass marketed schemes may be described as 'unwitting', in that they were unaware of the alleged tax mischief of the schemes. Others have undoubtedly been victims of unscrupulous practices....
> The Committee is of the view that the majority of the schemes were principally designed in such a way as to make a profit for promoters, by using ordinary investors to defraud the tax system. The Committee criticises in the strongest terms those promoters who sought to abuse both investors and the tax system in this way."[7]

---

[5] Senate Economics References Committee, 'Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection' Final Report 2002, p5, paragraph 1.24.
[6] Senate Economics References Committee, Interim Report, 2001, p2, paragraph 1.7.
[7] Senate Economics References Committee, Second Report, 2001, para 1.5 and 1.6

The following quote from extracts of a tape that recorded on the sales pitch to be used when selling a franchise scheme says it all[8]:

> *"Now, you might want to go in with that you could say "now isn't it a great deal, how can you lose $134, keep repeating that $134 is all that you're going to pay, circle it...*
>
> *From there then you would go in and do the tax workout sheet. Make sure as accurately as you can find out what they're earning. I almost insist every time on getting a payslip...*
>
> *Work it out – I don't generally explain the tax work out sheet till I've fully written it out. Then when you've written it out, turn it so they can read, it's upside down to you, you know what you've written, then go through it. Ok, you've earned $100,000 that means you gonna pay $39, 302 in tax. We're doing this all the time, we recommend that you buy three Franchise Ltd licences. That's gonna create for you, as shown here on the back of the sheet, $40,000 the Franchise Ltd licence is worth, so that's gonna create for you this year $40,000 tax deductible expenses times three – that's $120,000 worth of tax deductions.*
>
> *From $100,000 means you're going to end up with a loss in your tax return showing of a loss of $20,000. Now if you're showing a loss of $20,000 that means you pay zero tax. That means you get the whole $39,302 back as a tax refund... $30,000 has to go to Franchise Ltd and you're left with $9302 in your hand, this year from your refund cheque at about the period July/August.*
>
> *Furthermore you've got a $20,000 loss which you can forward on to next year and because you're on 48.5 cents in the dollar means you'll get another $9,700 in your hand next year in July or you've got a choice of about $800 a month. Now here come the first close that I use.*
> *Now John, what would you prefer? $800 a month or the other $9,700 at the end of next July as a lump sum? And shut up. Let them make the choice 'cos by them making the choice they're already going to say yes to the deal...*
>
> *When you're doing the recourse loan bit and written down the words "limited recourse loan across one of the arrows", open up the information on page 6 and show them the paragraph relating to limited recourse loans, it'll be in bold print, turn it around to them so they can read it, and read it to them upside down where the limited recourse loan is a self-funding loan where the loan is repaid by – I forget the words, by the licensee - and when you say the words 'licensee' say "you, now owning a licence, are the licensee" – refer to them as the licensee. It also helps to gives them the impression that they've already bought because you're starting to call them the licensee.*
>
> *Then go down to the bottom of that section and talk through the bit about security – "as you'd know when you're buying a house you give the bank a mortgage over your house which is their security. Here the security is the people who've taken security over your*

[8] Names altered in the extract.

agreement or your licence. The worst that can happen is that you'd have to give you licence back and the $134 you paid for your licence, you forfeit that. In fact because it's tax deductible you've really only end up forfeiting $70. No real big deal, no real big risks...

Some people say, but you know, we've been in business and it's the best thing we've ever seen. And it's even concerned us because it seemed to us to be too good to be true and again I think it's worthwhile doing that – I've noticed I've done that a bit in the last few – before they bring up the objection that it's 'too good to be true', you bring it up. Yes, it looked like it was too good to be true for us, and to give you an idea how actually good it is look at this piece of paper and it says, they will even guarantee the first two years income – that's never ever been done before...

... We've taken this to lots of accountants in Perth umm there's a guy called -for instance if you look in the information memorandum – there's AB Accounting... They did the work for it in Perth, and the fella who did the work for them a guy called Fred, was so impressed with this he bought a licence for himself. Please feel free to ring Fred, he'll tell you he's bought a licence. What's more he's even recommended his father buy one. When that happens we're impressed with that sort of thing.

No we've also went to find out from a guy in BC Accounting the other day, another very big firm of accountants, a fellow was called to see what he thought about Franchise Ltd and he said, well I bought one. Same again, another guy called Bob, one of the accountants we use knows Bob he went to Bob to ask Bob's opinion on Franchise Ltd and he said, George I've already bought one. Enough said. We don't need to know how good it is because Bob's already got one.

We took it to a guy called George, he just happens to be the guy that went to university with a QC called Fred. Fred has written an opinion on this which I'll show in a moment. When George found out that Fred had written an opinion, George said you've got me. If Fred says it's ok it must be ok. We said, "why do you say that". He said, well I went to university with Fred... ... ...

Now be careful when you're talking about a QC ask your audience do they know what a QC is. Don't assume that they know. And explain to them what a QC is and if you're involved in a big legal fight and please God that you're not – but if you ever get involved in one and you know you're in the right and you've got big heaps of money – if you're smart you'd be employing a QC to look after you. By the way, QC's are expensive, they cost anything from $2,000-$30,000 a day to represent you in court. Fred's done an opinion on this because we still weren't happy and we said no, we want you to take this to a lawyer, preferably one of the better ones in Perth to tell us if this is ok.

Well they went to Fred - and he says here on the last page, that the proposal makes good sense even without the tax benefits. When we read that we're staggered because I never thought I would see a lawyer use the words that the proposal makes good sense …..inaudible……oh yes I usually open up the opinion and show them that bit..."

Many taxpayers involved in the mass marketed investment schemes might be considered unsophisticated investors who were misled by claims made about the investments[9]. Investors were not only pressured into these schemes but then also convinced (often by the same people who signed them up for schemes) that somehow they would not have to pay the tax (and penalties and interest) properly due under the law.

Taking on board the guidance provided by the Senate Economics References Committee, the Tax Office sought to deal reasonably with people who faced tax debts as a result of their involvement in these schemes. While we are certainly sympathetic to the situation many of the investors found themselves in, we have a duty to meet the community's expectations that there is a level playing field when it comes to complying with the tax law.

In February 2002, we announced a settlement offer for mass marketed investment scheme investors and a tougher strategy for tackling tax scheme promoters. The aim of the offer was to allow investors to settle on fair and reasonable terms and put the matter behind them.

The settlement offer allowed investors to claim deductions for the actual cash outlaid; most people paid no penalties or interest; and the first two years of an agreed payment period were to be interest free where the investor entered into a suitable payment arrangement. This offer was available up to 21 June 2002, and there were criticisms that it might have been too generous[10]. However, as the Senate Economic References Committee pointed out, there were 'special circumstances'.

We are now at the tail end of finalising the mass-marketed investment scheme cases. Around 98% of MMIS investors have finalised their income tax dispute with the Tax Office with more than 82% having paid the associated tax (and a further 9% have payment arrangements in place). The vast bulk of investors have moved on. The remaining disputed cases fall into three broad categories:

- franchise schemes (notwithstanding that there has been little or no underlying economic activity)
- agricultural schemes that have not settled after court decisions, and
- participants in schemes who were promoters, financial advisors or tax agents and who were not eligible for the concessional February-June 2002 settlement offer. Many of these participants are still seeking settlement terms on the same basis as 'ordinary' investors.

Six MMIS scheme cases have been considered by the Federal Court[11] and were the subject of the settlement offer made in February 2002[12] . In all of these six cases the court has upheld the Commissioner's view that deductions were not allowable. In two cases, *Puzey* and *Sleight*,

[9] Tax Office media release 01/30, 26 April 2001

[10] Barbara Smith from Taxpayers Australia commented at an Australian Law Reform Commission 2001 Conference: "Those categorised as a tax avoider are better treated than a taxpayer who makes a minor misdemeanour."

[11] See Attachment 3: *Court cases: mass marketed investment schemes*

[12] Another case, Cooke and Jamieson concerned an arrangement that predated the MMIS era. It is difficult to reconcile this decision with the MMIS cases, other than on the basis of the trial judge's findings of fact.

the taxpayers sought special leave to appeal to the High Court. The High Court refused special leave in both cases.

Case study 1 – financial planner who sold and invested in MMIS who wants to settle on highly concessional terms

The taxpayer was a financial planner who had profited from the promotion and sale of mass marketed investment schemes to investors. The taxpayer also personally invested in a number of schemes, including a franchise scheme.

Being a seller of schemes, he was not eligible for the settlement terms offered between February-June 2002 to 'ordinary' investors in mass marketed investment schemes. That settlement involved a deduction for cash outlaid where the scheme had some underlying business activity, nil penalty and nil interest.

The taxpayer was however offered in 2002 settlement terms that were the same as those offered to 'ordinary' investors but without any remission of interest. He did not accept that offer nor did he pay any of the tax in dispute as requested which would have reduced his on-going exposure to interest. Disputes were lodged against the adjustments for his participation in the schemes and multiple appeals (one for each scheme) are pending in the Administrative Appeals Tribunal.

The Tax Office is still open to settle the disputes but on terms that reflect the fact that the taxpayer sold schemes, his apparent ability to pay and the current settlement terms available to ordinary investors. The terms offered are:

- remission of penalties to 5% or 10% depending on the scheme
- a reduction of interest for the period up to 14 days after the issue of the amended assessment giving effect to the settlement but a lesser reduction than that offered to 'ordinary investors'
- a deduction for cash outlays for other than the franchise scheme, and
- a reduction of around 50% interest on an instalment payment arrangement provided direct debit facilities are used.

Employee benefit arrangements (EBAs)

While dealing with MMIS schemes, the community was confronted with another challenge – employee benefit arrangements (EBAs).

The marketing of EBAs also flourished in the late 1990s. These arrangements purported to create benefits for employees and sought to exploit concessions in the tax law intended to encourage the creation of benefits for employees (fringe benefits concessions, deductions for superannuation, etc).

There are four main types of employee benefit arrangements (involving over 80 separate schemes) that have been the subject of remedial action by the Tax Office in recent years. These are:

- Employee benefit trusts (EBT)
- Employee share plans (ESP)
- Offshore superannuation schemes (OSS), and
- Controlling interest superannuation funds (CIS).

Their peak in terms of deductions claimed was at roughly the same time as MMIS. There have been many misconceptions about the proliferation of tax avoidance schemes around this time, and the different circumstances applying to MMIS and EBAs are sometimes misunderstood by some.

Unlike mass marketed investment schemes, EBA taxpayers were often more sophisticated and were not subject to the type of aggressive marketing techniques as mass marketed investment scheme investors. Many of the MMIS investors were salary and wage employees, whereas to participate in an employee benefit arrangement you needed to be an employer and to have in place a separate structure to provide the purported benefits. The average EBA investment was significantly larger than the average investment in MMIS. Moreover, the participants in EBAs retained the effective use of the funds claimed as having been contributed for the benefit of the employees.

Unlike the situation in relation to mass marketed investment schemes there were a substantial number of private rulings issued or other advice letters on employee benefit trusts (EBTs) and controlling interest superannuation funds (CIS) – some negative and some positive, (some issued by a former tax officer who is now the subject of prosecution action). There were no private rulings or letters on offshore superannuation schemes.

There were some private binding rulings which were used as marketing tools for EBAs.

Case study 2- still to be resolved

An employee benefit trust arrangement was entered into where income tax deductions totalling $2.8 million were claimed over the three years, 1996-1998. The contributions were claimed to be made to benefit directors and arm's length employees.

$2.4 million of the contributions (87%) were made on behalf of the husband and wife shareholder/directors of the employer entity. The remaining 13% was contributed for arm's length employees subject to certain eligibility requirements and about 65% of that component was paid out in recent years to arm's length employees.

While the taxpayers have been indicating for some time a desire to settle their dispute with the Tax Office, agreeable terms have not yet been reached. This is despite the Tax Office being willing to settle on a basis consistent with court decisions and with reduced penalty, some remission of interest and adjustments to allow in later years amounts that would have been deductible for benefits actually provided to arm's length employees by the employer. The matter is on appeal to the Administrative Appeals Tribunal but dates for hearing of the matter have been vacated by the taxpayers.

The Tax Office has successfully challenged all of the EBA schemes that have been progressed to the Administrative Appeals Tribunal and the courts, starting with the Federal Court decision in *Harris* in August 2002 in relation to controlling interest superannuation fund schemes[13].

In relation to an offshore superannuation scheme, Hill J. stated in *Walstern v Federal Commissioner of Taxation* [2003] FCA 1428 at paragraph 1:

"The ability of a private company employer to obtain unlimited deductions for contributions made to a superannuation fund benefiting employees who are directors and shareholders without either the trustee of the fund being liable to pay tax on the amounts contributed or the employer being liable to pay fringe benefits tax must be the holy grail for tax planners. This is what was offered to the applicant in the present proceedings...by a well known firm of chartered accountants."

In an attempt to assist those participants who wish to move on and finalise their disputes we have developed terms of settlement for each type of EBA scheme. The terms reflect the varying characteristics of each type of arrangement and take into account the individual circumstances of the participants. All the terms of settlement incorporate the long standing position of the Tax Office that we will settle on one taxing point and, in addition, include some remission of penalty and interest plus options for repayment over time. The terms vary depending on the particular circumstances of the taxpayer's involvement in the EBA, however they generally provide:

- payment of tax on one taxing point

[13] See Attachment 4: *Court cases: Employee benefit arrangement schemes (EBAs)*

- remission of penalty to 0, 5% or 10% depending on the scheme and adjustment circumstances, and
- remission of interest in certain circumstances where the taxpayer relied upon advice provided by the Tax Office, unreasonable Tax Office delays and/or the financial position of the taxpayer.

We have written to all participants and their advisors informing them of settlement terms that are available and we have also had discussions directly with many of them to ensure that they understand what the terms mean for them. As an example, a copy of one of the letters, sent to taxpayers who participated in a particular EBA is attached[14]. We also provide an opportunity to them to raise any additional factors that may be relevant.

Around 90% of EBA participants have finalised their income tax dispute with the Tax Office. More than 88% have paid the associated tax and a further 2% have payment arrangements in place. The vast bulk of participants have now moved on with their life.

We expect the remaining disputed cases to reduce significantly in the near future as virtually all of the participants in two arrangements (one an employee share plan and the other an offshore superannuation scheme) have indicated their desire to accept the settlement offered.

This will mean that the few remaining participants fall into two broad categories:

- employee benefit trust participants who argue that their facts differ from those in the precedential court decisions of *Essenbourne* and *Spotlight/Pridecraft P/L; and*
- offshore superannuation participants in the same scheme as that considered by the Federal Court in the *Cameron Brae* case which is currently awaiting decision.

Now that the courts in *Essenbourne, Kajewski* and *Spotlight/Pridecraft P/L* have clearly found the arrangements not to be effective for income tax purposes there is minimal risk to the revenue in amending to nil the FBT assessments for cases with similar facts. We expect about 400 cases will be affected with 200 already having been amended to nil.

In line with advice provided by the Solicitor-General that we should fund test cases where we consider that the outcome is not consistent with the policy intent of the relevant provision, we have funded a case, *Indooroopilly Childrens Services (Qld) Pty Ltd v FCT* (presently reserved before the Federal Court in Queensland), to test our view on the application of FBT to employee benefit arrangements (as has been our publicly stated response to the Essenbourne decision).

---

[14] See Attachment 5: A copy of a letter sent to taxpayers in a particular EBA.

Case study 3 – Poor Advice

A meeting between the Tax Office and some EBA participants, facilitated by the Minister for Revenue and Assistant Treasurer was held in November 2005. The meeting was attended by the participants, their tax agent, another representative, the promoter of the arrangement and Tax Office staff. The purpose of the meeting was to inform the taxpayers about settlement options to enable them to make a decision about what to do. The information provided to them was readily available on the Tax Office website.

At the meeting the Tax Office staff explained why and what amendments were raised, including why multiple assessments had been raised. They also explained that the Tax Office was only collecting the tax on one assessment.

At this point one of the taxpayers, a joint director of a company that implemented an Employee Share Plan, broke down in tears asking why she had not been told this before as having all 3 assessments on the kitchen bench for so long had caused her much unnecessary worry.

It became clear that the taxpayers were also not aware of the interest and penalty concessions announced by the Tax Office in November 2004 and the settlement options available to them. This was despite a letter being sent to them and their tax agent.

The meeting allowed us to discuss with the taxpayers the options available to them. The meeting highlighted to all attendees that the taxpayers had not been kept fully informed. This had prevented them from making informed decisions on whether they wanted to finalise their case by settling or to continue to dispute and litigate.

The meeting prompted a change in the way the Tax Office communicates with taxpayers. Now all communication is sent directly to the taxpayer as well as their tax agent and in some cases the letters are followed up by phone.

The taxpayer has since settled and she has entered into a 12 month payment arrangement.

In our 2004-05 Annual Report the Tax Office reported that we have again identified new employee benefit arrangements being marketed, highlighting the ongoing nature of these arrangements and the challenges the community continues to face from abusive schemes.

Case study 4 – settled and moving on

The taxpayer is a director and principal owner of a group involving a number of member entities and some associated entities. The group was involved in employee benefit trust arrangements and claimed total deductions of $2.5 million over 3 years, 1996-1998.

The contributions were made on behalf of the employees/directors/owners of the employer entities and no amounts of the contribution had been paid out as benefits to the beneficiaries. The funds were used in the taxpayer's business. The taxpayer after seeking a better deal settled the matter on the terms applied to other taxpayers in similar circumstances and paid the debt in full.

Ten similar matters had been listed for hearings by the Administrative Appeals Tribunal but were settled by the taxpayers on the same basis as our published terms.

GREATER FOCUS ON PROMOTERS

Our experience with past schemes has highlighted the need to focus on scheme promoters and their associates to detect and deter the on-going promotion of abusive tax schemes.

The *Taxation Laws Amendment (2006 Measures No 1) Act 2006* now introduces a civil penalty regime to deter the promotion of tax exploitation schemes. It applies to conduct on or after 6 April 2006.

The new regime ensures that promoters of unsustainable schemes are at risk of penalty when they expose their clients to scheme penalties.

There are indications that the regime is already starting to achieve its aim with one firm advising the Tax Office that it ceased "…*offering facilities of the type currently under review*…" by the Tax Office prior to the date the regime came into effect.

The provisions are intended to apply in two circumstances:

- where a promoter engages in conduct that results in them or another entity being a promoter of a tax exploitation scheme (i.e. an arrangement that is not reasonably arguable in law), or
- where an individual or entity implements a scheme promoted on the basis of conformity with a product ruling in a way that is materially different to that described in the product ruling.

The Commissioner can apply to the Federal Court in both circumstances for a civil monetary penalty to be imposed. There are two further aspects of the legislation that will also assist the Commissioner to stop the promotion of schemes before taxpayers are put at undue risk. These

aspects are the ability to seek a voluntary undertaking from the promoter and the ability to seek an injunction from the Court.

The introduction of the new promoter penalty regime will go some way to restore confidence that the Tax Office goes after the promoters and not just the participants.

However, in achieving this objective we need to ensure that the application of the new regime does not unduly impact in an unintended way.

Accordingly, we are committed to working with the National Tax Liaison Group (NTLG), to co-design some important aspects of the administration of the regime, including decision making processes within the Tax Office and guidelines on the circumstances when a voluntary undertaking, injunction or the imposition of a penalty would be sought, to ensure that the new legislation is applied in a fair and proper manner in accordance with the law. These additional checks and balances should give tax agents (and in-house advisors) comfort that the new regime will be applied in accordance with its legislative intent.

The work we have already conducted in relation to promoters places us in a good position to implement the new regime. For example, learning from the past, we established a special promoter taskforce some years ago to not only look at existing matters but also to be vigilant about the promotion of new schemes. The primary role of the taskforce is to implement active compliance strategies targeted specifically at the promoters of aggressive tax planning arrangements and their associates.

Our promoter strategies include:

- using our formal access powers, including unannounced visits when necessary
- requiring high-risk promoters to lodge tax returns early and expand on the information in their returns
- escalation of lodgement and debt collection action
- monitoring the marketing of any new aggressive tax planning arrangements and publishing taxpayer alerts where appropriate to inform the community of our concerns, and
- working with other government agencies to ensure a whole-of-government approach to high risk promoters, including the referral of matters, as appropriate to the Director of Public Prosecutions.

We have taken action against a number of promoters, including:

- 8 have been sentenced to jail for offences relating to their promotion of schemes
- referring 15 to our Serious Non Compliance branch for investigations of possible criminal prosecutions
- referring 4 to the Tax Agents Board
- conducting access visits on 68 promoters, and
- auditing over 35 promoters.

We are particularly concerned that some promoters are involved in the tax profession as tax agents, lawyers and accountants. We want the tax professional bodies to work with us to identify those who seek to undermine the system and tell us about new schemes that they're seeing. While we can refer agents to the Tax Agents' Board, we need more support from the professional bodies who must also take some level of responsibility, including through their disciplinary approaches, for members who promote abusive tax avoidance schemes[15].

Case study 5 – promoter adjustments and reduction in schemes promoted

The promoter was a firm of solicitors specialising in promoting tax avoidance arrangements through seminars, referrals from tax practitioners and direct marketing. Incomes of their clients and of the principals of the firm are washed through the promoted schemes. The partners of the firm had not paid any tax for many years despite earning significant amounts from their legal practice and from the promotion of tax avoidance schemes.

Audits of the partners have been undertaken and tax and penalties totalling more than $20 million have been raised. Disputes are pending against these liabilities. Tax and penalties raised in relation to the implementation of the schemes exceeds $250 million.

Tax Office activity was resource intensive due to the need to exercise formal access powers to obtain the necessary information and to deal with a number of administrative issues including numerous requests under the Freedom of Information laws, requests for statements of reasons for decisions made, administrative law legal challenges and threats of personal action against individual Tax Office staff.

The Tax Office approach involved continuous real time monitoring of the products the firm was promoting and taking prompt action to obtain details of the arrangements and, from a range of sources, identifying the participants in these schemes. We also sought to alert relevant taxpayers at an early stage of the tax risks involved.

The strategy resulted in an 80% reduction over two years of fees earned by the firm from the promotion of tax avoidance schemes. We are continuing to monitor their activities.

[15] Senate Economics References Committee, Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection, Final Report, 2002, paragraph 2.64.

STRIKING THE RIGHT BALANCE BETWEEN HELP AND ENFORCEMENT

Our objective is not primarily to punish the participants in tax avoidance schemes, rather it is to ensure that they do the right thing in the first place or next time. We aim to support those taxpayers who want to do the right thing (and maintain their confidence in the fair operation of the tax system), and deter those that don't. We also want to be firm with promoters of abusive schemes.

To improve compliance, we have recognised the need to put information and resources in the hands of the taxpayers to clearly communicate our concerns, and any tax risks we have identified, as quickly as possible.

We have various resources available to help us achieve that goal, and we are constantly looking for ways to improve.

COMPLIANCE PROGRAM

We have engaged with the community through our published *Compliance program* by making public our analysis of risks to the tax system and encouraging feedback on the choices we have made.

By detailing the compliance risks as we see them, and what we are doing to address them, we send a clear message to the community on how to avoid the risks associated with non-compliance.

PRODUCT RULINGS

Introduced in 1998, product rulings provide certainty to potential participants in managed investment schemes.

A product ruling is not an endorsement of the commercial viability of the investment. It does not mean, for example, that the investment will make money. It merely means that investors can legally claim tax deductions for their investment as long as the arrangement is carried out as described in the ruling.

The ruling presents an unbiased view of the application of the tax laws to the facts and is not aimed at assisting the promoter to sell the product. We rule in accordance with what we believe to be the correct application of the law. Taxpayers are not bound by our rulings and are free to take their own advice (or that of their advisors). If challenged by the Tax Office, their liability to tax rests with the AAT or the courts.

We also review some of the arrangements entered into following the issue of a product ruling. We look to ensure the arrangement was entered into as described to us and watch to ensure

that arrangements that didn't get a ruling or for which a request was withdrawn aren't suddenly implemented.

TAXPAYER ALERTS

Another initiative we introduced is the Taxpayer Alert system, which has been in operation since 2001. The alerts are intended to be an early warning of our concerns about significant and emerging potential aggressive tax planning issues or arrangements that the Tax Office has under risk assessment. Since their introduction we have alerted the community to 31 arrangements. However, it needs to be stressed that Taxpayer Alerts do not cover all schemes that may be in the market place.

Case study 6 – Taxpayer Alert and follow up

A Taxpayer Alert issued in May 2005 (TA 2005/1) for an arrangement to avoid tax being paid on business profits by washing those profits through a trust so that they would be offset against losses of an unrelated entity.

After the Tax Office view was formed and published in August 2005 by Taxation Determination TD 2005/34, about 750 taxpayers who had been identified as connected with the arrangements were contacted. They were given the opportunity to self amend their tax returns to remove the distributions that were made to the trust.

Over 75% of the identified taxpayers who were contacted have responded so far. 55% of these (309 taxpayers) had decided not to utilise the structure created to wash their business profits. 24% (140 taxpayers) had used the structure and about 50 of these have self amended their tax returns to remove the distribution, resulting in a $5.8 million increase in combined taxable income. We are following up the rest.

WORKABLE CERTAINTY

Another aspect of our approach is to be more transparent about when a scheme might attract the operation of the general anti-avoidance provisions (Part IVA). The Tax Office has published a practical guide to Part IVA and also released an updated detailed practice statement for staff on the operation of Part IVA.

This practical guide includes tips on understanding the risk of Part IVA, and how it applies to particular arrangements.

We also provide private rulings on the application of the general anti-avoidance provision to proposed or implemented arrangements.

TAKING PROACTIVE STEPS

We are aware that the current resources boom and skills shortages have led to high incomes in regional areas. We are proactively warning taxpayers, particularly at Taxtime, of the dangers of investing in arrangements at year end to reduce their tax bill.

On 7 May 2006 we started a media campaign in regional Queensland, the Northern Territory and Western Australia to warn taxpayers about investing in risky investments. We have commenced visits to regional areas to reinforce this message. Our website also contains this warning about 'dodgy investments'[16].

The current environment is very different to the 1990s. The help and support available to potential investors is more prominent, and the community's awareness of the pitfalls is significantly greater.

Our immediate priorities, as outlined in the *Compliance program 2005-06,* include:

- detecting aggressive tax planning schemes early and implementing a mix of compliance activities, law clarification, advice and strategic litigation, and
- continuing to identify high-risk cases and issues through our tax haven risk identification program, which includes AUSTRAC data analysis and fieldwork.

Over recent years we have focussed on arrangements involving tax havens and countries with bank secrecy laws. When it comes to detection and enforcement, we work closely with other government agencies such as the Australian Securities and Investments Commission (ASIC), the Australian Federal Police (AFP), Australian Crime Commission (ACC) and Commonwealth Director of Public Prosecutions (DPP).

Our collaborative efforts through for example Operation Wickenby have been significant. This whole-of-government initiative recognises that by working collaboratively we can send a clear message that the Commonwealth will take firm action against abuses of the tax system.

Last year, as part of the operation, access visits were undertaken and warrants executed. The additional information gained has helped us understand future actions required.

The Government has given additional funding of $305 million to combat tax scams[17]. The $160 million, allocated to the Tax Office will be used to fund around 230 extra auditor, investigator, and debt positions, as well as additional legal and information technology directed at promoters and participants of off-shore tax schemes and fraud.

---

[16] See Attachment 6: Tax Office brochure *"Don't get caught up in dodgy schemes"*

[17] See Attachment 7: Treasurer's media release 2006 No. 4, "*Government provides extra funds to combat tax scams"*, 8 February 2006.

OUR COMMITMENT TO ACCOUNTABILITY

We are committed to an open and transparent tax administration which works with the community in the care and management of Australian's tax system. We welcome feedback, collaboration and co-design where it is constructive and assists in the implementation of practical improvements to the law and to our administration.

We are subject to accountability at many levels including parliamentary inquiries, Senate Estimates and the Commissioner's Annual Report to Parliament, at Ministerial level through the Statement of Expectations[18] and the Outputs/Outcomes framework; at the legal level through the Financial Management Accountability Act and other legal requirements; and at the community level through our consultative forums and the media. We are also subject to scrutiny by the Australian National Audit Office, the Commonwealth Ombudsman and the Inspector-General of Taxation. This scrutiny is supported by our own governance arrangements including internal reviews and reporting processes.

The area of aggressive tax planning has been considered in 11 formal external reviews, starting with the Commonwealth Ombudsman's report on the review of ATO activities related to the Budplan scheme, released in June 1999.

Six of these have been specific to aggressive tax planning such as the 2001 reviews of the ANAO and Commonwealth Ombudsman, and the inquiry conducted by the Senate Economics References Committee.

Other external reviews used aggressive tax planning examples to focus on general administrative areas such as the application of penalties and interest, or the Tax Office's handling of complaints.

The Tax Office has answered questions in relation to MMIS and EBAs at numerous Senate Estimates hearings and provided answers to 15 questions on notice arising from those processes. Government Ministers have been provided with information to assist in responding to over 50 questions asked in Parliament since January 2000.

The self-assessment system as a whole was subject to review by the Joint Committee of Public Accounts in 1993 and has recently been the subject of a further review by the Treasury, leading to legislative and administrative changes in areas such as periods of review and application and remission of interest charges.

We worked constructively on those reviews and have adopted the thrust of the recommendations that were made. We continue to be very responsive to the guidance provided by Parliament, scrutineers and other stakeholders.

For example in order to ensure consistency in our decision-making we set up a new internal panel of senior officers to consider situations where widely based settlement offers are

---

[18] The Government has accepted recommendation 1 of the *Review of the Corporate Governance of Statutory Authorities and Office Holders* provided June 2003 by John Uhrig.

appropriate. A widely-based settlement is one where the terms of the offer or proposal under consideration will affect at least 20 taxpayers, either directly or indirectly[19].
The widely based settlement panel was established to look at situations where these types of offers might be appropriate for tax disputes. The advice provided by the panel ensures:

- transparency about the decision-making process
- consistency in the factors taken into consideration when a decision maker is contemplating whether to propose, accept or reject a settlement offer
- consistency in similar situations about the way factors are applied, and the elements, terms and conditions of widely based settlement offers, and
- appropriate differentiation and weighting of factors according to differences in widely based arrangements, including the circumstances of the participants where appropriate.

Terms of settlement have now been endorsed or recommended by the widely based settlement panel for participants in the MMIS, EBA and some boutique scheme arrangements[20]. As each of the schemes has been considered, participants have been advised by letter of the terms for the schemes in which they participated. We are in the course of progressively publishing these terms of settlement on our website. This work has led to the settlement of over 2300 arrangements over the last year, with around a further 700 currently being processed.

THE WAY FORWARD

In large measure the participants in the old MMIS and EBA schemes have moved on with their lives. They should be allowed to do so.

Into the future, the Tax Office must remain vigilant so as to protect the community from emerging tax schemes. One of our methods is what we call 'one day visits' – where we hear of a new entrant promoter we visit them and outline our areas of concern and what our views and actions are likely to be. Many modify their activities as a result.

Given the serious risk posed by international tax schemes, we are expanding our working arrangements with other tax authorities to combat aggressive tax planning. We are continuing our work with Canada, the United Kingdom and the United States on the Joint International Tax Shelter Information Centre aimed at detecting complex aggressive tax planning by:

- improving our systems to capture information about promoters or advisers who devise abusive tax schemes, and
- focusing on international arrangements to ensure they are consistent with the intent of the law.

[19] Draft PS LA 2005/x, *"Draft guidelines for settlement of widely based tax disputes",* 28 June 2005.
[20] These schemes are tailored for individuals, are professionally presented and promise extremely attractive outcomes without outlining the risks.

New and expanded priorities this year include:

- increasing our focus on promoters to deter where possible the marketing to taxpayers of tax exploitation schemes, including offshore arrangements. Where schemes are promoted, to take remedial action under the new promoter regime to seek voluntary undertakings, injunctions or civil penalties. We will continue to refer appropriate cases to be considered for potential criminal prosecution.
- to finalise the few remaining MMIS and EBA cases. This involves the continuing commitment of resources to determine the remaining objections, settle disputes where appropriate, expedite litigation of appeal cases and take appropriate action to deal with debt that is properly owed to the community.
- in dealing with outstanding debt, taxpayers are liable to pay the tax they owe. If they face financial or other difficulties, we will allow them a reasonable time to pay their debts by instalments. Where the payment of the tax will cause serious financial hardship, we will encourage them to apply for a release from all or part of the tax debt. However, in fairness to other taxpayers, the Tax Office has a responsibility to collect the tax that is owing in respect of these schemes.

Through lessons learned from the past, and our current risk and intelligence approaches, we aim to deter the promotion and participation in abusive tax schemes, and seek to provide taxpayers with information to assist them to make better, informed decisions about the tax risks they may be taking. However, this important work must be supported by professional and community standards that do not tolerate abusive tax schemes.

ATTACHMENT 1

DESCRIPTION OF A TYPICAL MASS MARKETED INVESTMENT SCHEME (MMIS)

WHAT IS A MASS MARKETED INVESTMENT SCHEME?

They generally had the following characteristics:

- based on a public offer document (prospectus);
- were often supported by a legal opinion;
- promoted to a mass audience;
- were often aggressively marketed to participants who had no control over, and very little knowledge of, the internal workings of the arrangements; and
- may rely on common structuring features including:
  - round robin financing;
  - limited or non-recourse loans; and
  - participant obligations limited to investment profits.

THE TAX OFFICE VIEW

Our concerns centre mainly on the financial arrangements surrounding the schemes. These arrangements included round-robin arrangements, limited or non-recourse loans and guaranteed return arrangements.

- Round robin arrangements are broadly circular transactions involving the passing of documents between participating parties, usually arranged to take place on the same day, with no change in the overall level of cash.
- Non-recourse loans are where the loan provider has no recourse as to the investor's other assets if the investor defaults on the loan. A limited recourse loan is where the loan provider has recourse as to a defaulting payment; however in these cases it was usually limited to any profits derived from the scheme.

Guaranteed return arrangements involved contributions by investors to a promoter and a guaranteed return to the investor a few years later. The guaranteed return amount was usually slightly in excess of the amount contributed.

ATTACHMENT 2

DESCRIPTION OF EMPLOYEE BENEFIT ARRANGEMENTS (EBAS)

There are four types of employment benefit arrangements:

- Employee Benefit Trust Arrangements
- Employee Share or Incentive Plans
- Controlling Interest Superannuation Scheme
- Offshore Superannuation Scheme

EMPLOYEE BENEFIT TRUST ARRANGEMENTS

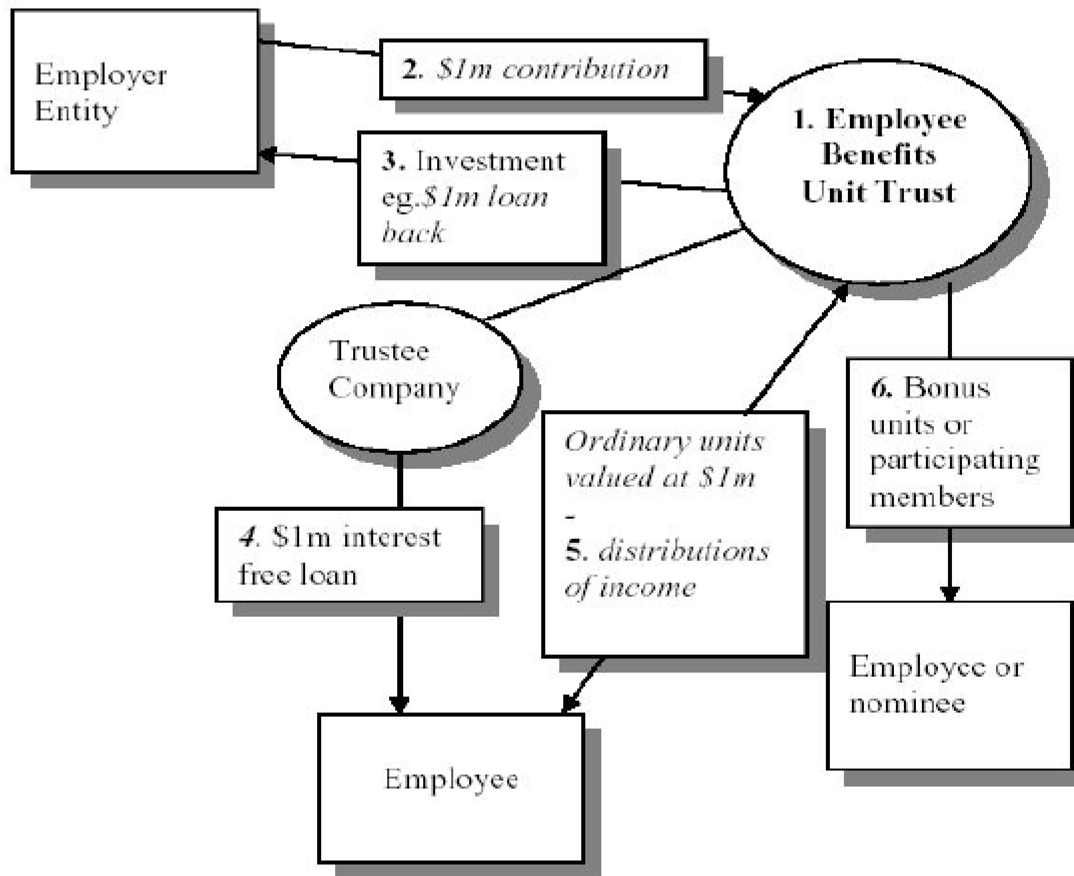
The scheme

A typical employee benefits trust arrangement has the following features:

- An employer entity sets up an Employee Benefits Trust.
- The entity contributes to the trust for employees or other people nominated by the employees. Often this contribution is financed through a loan or overdraft.
- The trust invests these contributions on behalf of the employees or their nominees, often by loaning an amount equal to the contributions back to the employer entity or an associate of the employer entity.
- A selected employee or person may be invited to acquire an interest (for example, by taking up ordinary units) in the trust. This is generally financed by money borrowed from the trust. Where the trust is not a unit trust, selected employees or persons may be nominated as beneficiaries. The selected employees are predominantly directors or shareholders of both the employer and trustee companies.
- The holders of ordinary units are entitled to distributions of income in proportion to their holding.
- Bonus units may be issued to selected employees or selected employees may become participating members. Corpus may be distributed, at the trustee’s discretion, among the holders of bonus units in proportion to their holding and then to participating members. There is no consideration provided by employees to become bonus unit holders or participating members.

ATTACHMENT 2

The flow of funds



The tax mischief

The taxpayer's legal perspective

The arrangements are designed to defer or avoid tax on the employer company's profits but are structured to purportedly provide a large tax deduction to the employer and avoid a fringe benefits tax liability.

Our legal perspective

The Tax Office has a number of concerns relating to employee benefits trust arrangements including:

- the application of the *Fringe Benefits Tax Assessment Act 1986* to the employer's contribution to the employee benefits trust, and
- the employer's contribution not being included in the aggregate fringe benefit amount resulting in the provision of a tax benefit for the purposes of section 67 of the Fringe Benefits Tax Assessment Act 1986.

ATTACHMENT 2

EMPLOYEE SHARE OR INCENTIVE PLANS

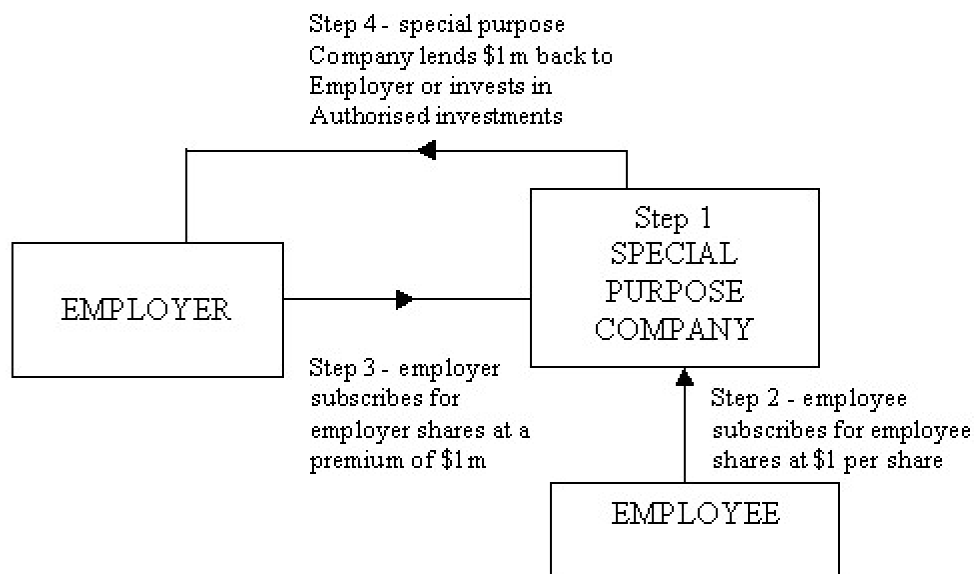
The scheme

An employee share or incentive plan scheme has the following characteristics:

- The employer entity establishes a special purpose company.
- Shares or membership interests are allocated to selected employees for a nominal amount in the special purpose company.
- The employer contributes a sum of money to the special purpose company, greatly increasing the value of the employees' shares or membership interests.
- The special purpose company invests the contribution amounts on behalf of the employees, often lending the contribution back to the employer entity or their associate.

The flow of funds

An example where employees are issued with shares in the special purpose company.



The tax mischief

Employee share or incentive arrangements are designed to provide the employer with an effective incentive plan for employees. However, the only employees who generally participate in such plans are the controllers of the employer business.

The taxpayer's legal perspective:

The advantages to the employer are:

- a deduction is allowable under section 51(1) or section 8-1 to the value of the employer contribution into the special purpose company
- the contribution will not be subject to fringe benefits tax
- the contribution will not be subject to the superannuation guarantee charge, and
- the contribution will not be subject to payroll tax or workcover.

The advantages to the employee are:

- no tax payable on the amount of the contribution credited into the employees' account at the date of deposit
- the contribution is not taken into account in determining the income of an employee for the purpose of the superannuation contributions surcharge
- contributions to the special purpose company are not subject to 15% tax as are super contributions
- there are no retention restrictions with the special purpose company contributions as there are with superannuation contributions
- subject to certain limitations, an employee can withdraw funds from an ESP at any time, and
- contributions to the special purpose company are not subject to the age based Reasonable Benefits Limits.

What we think the legal effect is:

The Tax Office has a number of concerns including (where applicable):

- calculating the discount for the purposes of Division 13A of the *Income Tax Assessment Act 1936*
- applying the *Fringe Benefits Tax Assessment Act 1986* to the contributions made by the employer to the special purpose company, and
- providing a tax benefit, being the deduction claimed for the employer's contribution to the special purpose company, for the purposes of the potential application of Part IVA of the *Income Tax Assessment Act 1936*.

In our view contributions for employees made by way of premium or otherwise, may be assessable income of the employee under Division 13A, and/or paragraph 26(e), and/or subsection 25(1) of the *Income Tax Assessment Act 1936*. Also:

- part IVA may apply to include the amount of the contribution in the assessable income of the employee
- as a property fringe benefit or a residual fringe benefit taxable to the employer
- section 67 of the *Fringe Benefits Tax Assessment Act 1986* may apply to increase or adjust the aggregate fringe benefit to include the premium contribution amount
- the deduction claimed under section 51(1) of the *Income Tax Assessment Act* 1936 or 8-1 of the *Income Tax Assessment Act* 1997 in respect of the value of the employer entity's contribution to the special purpose company may be disallowed, and
- part IVA may apply to cancel the deduction that has, or may be claimed by the employer in respect of each contribution.

Furthermore, deductions under section 69 or subsection 51(1) of *Income Tax Assessment Act 1936,* or section 8-1 of *Income Tax Assessment Act 1997* for advisers' fees may not be allowable.

ATTACHMENT 2

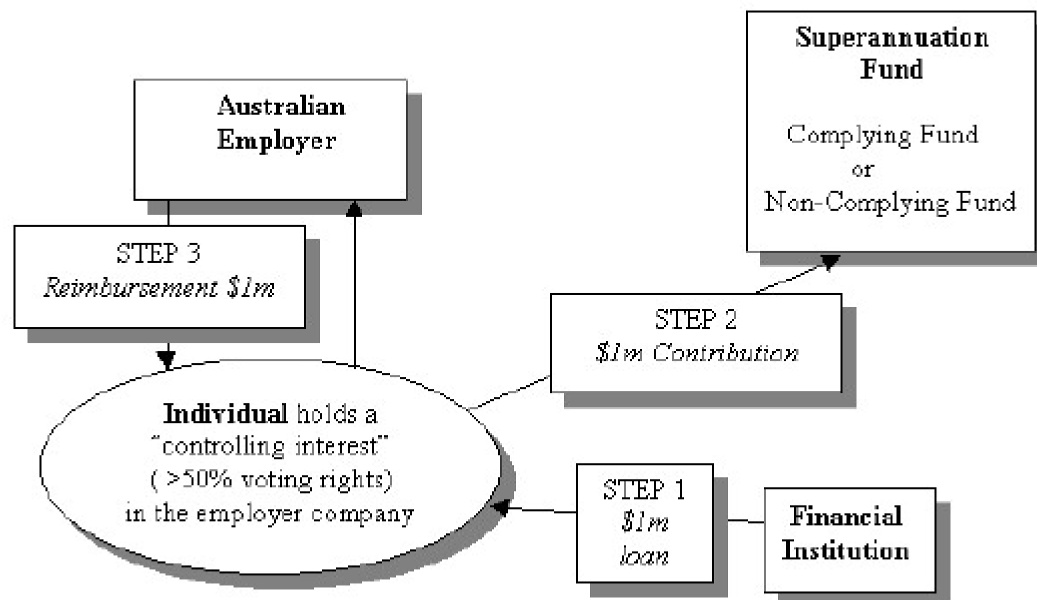
CONTROLLING INTEREST SUPERANNUATION SCHEME

The scheme

A controlling interest superannuation scheme has the following characteristics:

- A taxpayer is a director or employee at common law engaged in producing assessable income of a company in which they have a greater that 50% voting interest. As a result the individual is regarded as both an eligible employee and a taxpayer who has a controlling interest in that company. The taxpayer may take out a loan to finance a superannuation contribution.
- The taxpayer makes the contribution for themselves to a complying or non-complying superannuation fund.
- The taxpayer's contribution may be reimbursed by the employer company.
- Often the complying or non-complying fund invests the contribution in an entity associated with the controlled entity or in term deposits with the company that lent the funds to the taxpayer to make the contribution.

The flow of funds



The tax mischief

No tax obligations are purported to arise from the scheme, so a tax mischief stems from a legislative weakness in section 82AAA.

The taxpayer's legal perspective:

- The taxpayer claims deductions under sections 82AAC or 82AAE for the contributions made to the fund (unless they are reimbursed by the employer) as they are an eligible employee.
- They claim deductions under subsection 51(1) of the *Income Tax Assessment Act 1936* or section 8-1 of the *Income Tax Assessment Act 1997* for any interest expense incurred on any loan to finance the contribution.

- They claim that the contribution does not constitute a fringe benefit for the purposes of the *Fringe Benefits Tax Assessment Act 1986 (Cth)* where it is made to a complying superannuation fund or non-complying superannuation fund. Where the contribution is reimbursed by the employer any such fringe benefit has no (or minimal) fringe benefits taxable value.
- It is asserted that the contribution to the superannuation fund is not a taxable contribution as defined in section 274 of the *Income Tax Assessment Act 1936 (Cth)*. This is because the contribution is not made for the purpose of making provision for superannuation benefits for another person. The contribution is made for the purpose of making superannuation benefits for the individuals themselves.
- It is asserted that the contribution does not constitute a surchargeable contribution under section 8 of the *Superannuation Contributions Tax (Assessment and Collection) Act 1997*.

Our legal perspective:

The Commissioner's view is that, depending on the facts, one or more of the following applies:

- deductions under sections 82AAC or 82AAE for a contribution are not allowable, either because the contributions were not made for the purpose of providing superannuation benefits or because the controlling individual is not an eligible employee deductions under subsection 51(1) of the *Income Tax Assessment Act 1936 (Cth)* or section 8-1 of the *Income Tax Assessment Act 1997 (Cth)* for the interest expense (if any) incurred by the taxpayer in relation to a loan to finance a contribution are not allowable.

OFFSHORE SUPERANNUATION SCHEMES

The scheme

Offshore superannuation schemes had the following characteristics:

- The fund is a non-resident and non-complying fund with central management and control maintained overseas. It has no branches or permanent establishments in Australia and has no intention of establishing any.
- Participating employer maintains portfolios. Contributions are made by an employer (or an associate) to the fund in respect of employees who are nominated by the employer for membership.
- Membership is typically obtained only after a series of transactions. For example, the trustee invites the employee to make an application for membership, the employee applies and the trustee accepts the application.
- Employee member entitlements under the terms of the fund may either be fixed or discretionary. Where the employee's entitlement is fixed, employer contributions are not allocated to an individual employee's account until the employee becomes a member of the fund. Where the employee's entitlement is discretionary, the contribution remains unallocated until the employee is entitled to receive it. Where employee membership is contingent upon the employee making a contribution to the fund, that contribution is usually financed by a limited recourse loan from the fund and both the contribution and the loan is offset against each other when they become repayable. Any interest on the contribution and loan (which is typically charged at the fringe benefits tax rate) is also offset against each other.

ATTACHMENT 2

Example: offshore superannuation arrangement with fixed class members

1. The fund is a non-resident non-complying superannuation fund.

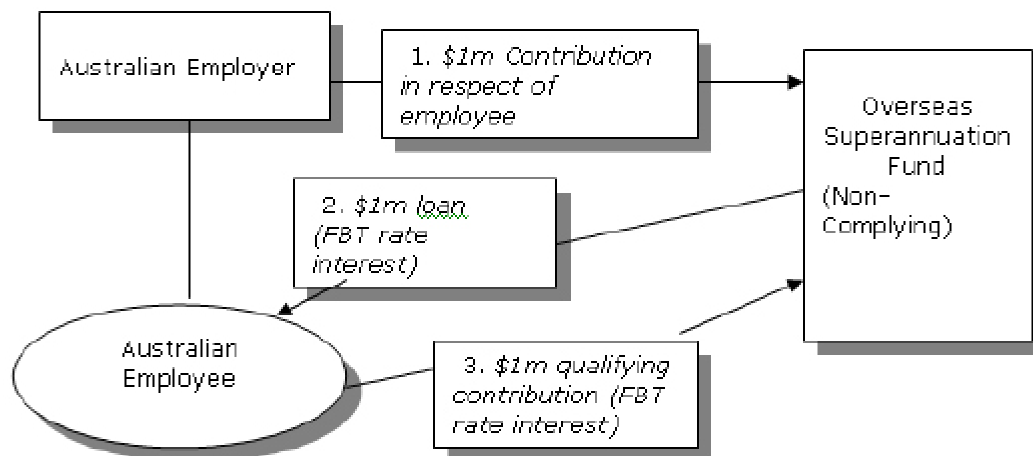
2. The employer (or associate) makes contributions to the fund, and a deduction is claimed for that contribution under section 82AAE.

3. Employer contributions are not allocated to individual employees is admitted as a member of the fund.

4. Employees become members only after the trustee invites them to apply for membership, the employee applies, the trustee accepts the application and the employee makes a contribution to the fund.

5. The employee's contribution is financed by a limited recourse loan from the fund, and both the contribution and the loan will be offset against each other at the time of repayment. Any interest on the contribution (charged at the FBT rate) and the loan will also be offset against each other.

The flow of funds



The tax mischief

Non-complying funds that generate tax concessions even greater than those provided to complying funds by Parliament create a tax mischief as these funds avoid contributions tax and surcharge even though there is a clear policy intent on what must be paid.

The taxpayer's legal perspective:

The concessions claimed include deductibility of the contributions, no tax or surcharge in the hands of the fund, no age-based limits, no impact from reasonable benefits limits and no FBT liability. The end benefit is said to be tax free on withdrawal at any time. In extreme examples, any amount of income can be completely washed of tax.

ATTACHMENT 2

Our legal perspective:

The Commissioner's view is that, depending on the facts, one or more of the following applies:

- deductions under section 82AAE for an employer's contribution is not allowed
- deductions under subsection 51(1) of the *Income Tax Assessment Act 1936 (Cth)* or section 8-1 of the *Income Tax Assessment Act 1997 (Cth)* for the interest expense (if any) incurred by the employer in relation to a loan to finance a contribution is not allowed
- deductions under section 69 or subsection 51(1) of the *Income Tax Assessment Act 1936 (Cth)*, or section 25-5 or section 8-1 of the *Income Tax Assessment Act 1997 (Cth)* for advisors' fees in relation to the offshore superannuation scheme are not allowable
- fringe benefits tax applies to a contribution with the taxable value of the fringe benefit to the trustee equal to the amount of the contribution
- the trustee will not be exempt from Australian tax on a contribution, and the contribution to the superannuation fund will constitute a taxable contribution, as defined in section 274 of the *Income Tax Assessment Act 1936 (Cth)*
- Section 108, section 109 and/or Division 7A applies to deem a contribution or loan a dividend from the employer if the employee is a shareholder (or an associate of a shareholder)
- part X of the controlled foreign companies provisions applies to fund members
- the foreign investment fund provisions of Part XI will apply to fund members
- the foreign investment fund provisions of Part XI will apply to fund members
- the non-resident trust provisions of Subdivision D of Division 6AAA of Part III will apply to participating employers and/or fund members to include the attributable income of the fund in their assessable income
- there will be application of the trust accrual provisions
- Part IVA may be applied to the arrangement, and
- section 67 of the *Fringe Benefits Tax Assessment Act 1986 (Cth)* may be applied to the arrangement.

The legislation was amended in 2000 so that there is no doubt that offshore superannuation schemes are no longer effective.

ATTACHMENT 3

COURT CASES: MASS MARKETED INVESTMENT SCHEMES (MMIS)

Seven investment scheme cases have been considered by the Federal Court.

Six of these cases concerned mass marketed investment schemes which were part of the Commissioner's 14 February 2002 settlement offer. In all six cases the Courts have now confirmed the Commissioner's view that the deductions are not allowable.

The seventh case Cooke and Jamieson concerned an investment scheme which was not part of the Commissioner's settlement offer. In this case the Court upheld the original decision that the deductions were allowable.

The following is a summary of each of the six decisions.

CALDER

On 1 July 2005, the Federal court held that a taxpayer who invested in Main Camp Tea Tree Oil Project No 3 was not entitled to a deduction for his investment as the dominant purpose for entering into the scheme was to obtain a tax benefit. The Court reached this decision after considering the objective rather than subjective purpose of the taxpayer.

On the 7 December 2005 this decision was upheld by the Full Federal Court on appeal.

SLEIGHT

On 4 May 2004, the Full Federal Court held that the taxpayer was not entitled to a deduction for his half share of the deductions claimed by a partnership of himself and his wife investing in the Northern Rivers Tea Tree Oil project in the 1995 income year.

The Court found that although the taxpayer was carrying on a business the dominant purpose for entering into the scheme was to obtain a tax benefit and therefore Part IVA of the income tax law operated to deny the deduction claimed. In overturning the original finding that the overall commercial objective of the scheme saved it from the application of Part IVA, the Court considered the objective rather than the subjective purpose of the taxpayer in entering into the scheme.

On 4 February 2005 special leave to appeal to the High Court was not granted.

PUZEY

On 26 August 2003, the Full Federal Court upheld an earlier decision of 19 September 2002. The court maintained that expenses claimed for the purchase of seedlings relating to the taxpayer's investment in the Kununurra Tropical Forestry project were not allowable in the first year of the project. This was because the sole or dominant purpose of entering into the scheme was to obtain a tax benefit and therefore Part IVA of the income tax law operated to deny the deduction claimed.

The court found that the seedling purchase costs in the second year of the project were not allowable as expenses of a capital nature because the pooling arrangement that happened

under the trust structure provided that the taxpayer became a passive investor in someone else's business.

The seedling purchase agreement was a scheme entered into by the taxpayer for the dominant purpose of obtaining the deduction of $40,000 in each year. The scheme was promoted with the tax consequences to the fore and with the taxpayer signing pre-prepared documents, while the success of the project was highly speculative. However, the tax consequences were certain. The amount paid for the seedlings was grossly excessive ($80,000 compared to a likely market price of $3,000), such that the tax refund from the deduction claimed was sufficient in each year to fund the cash outlays (repayments of the $80,000 borrowed) in each year of $14,000.

On 13 February 2004, the Full Federal Court handed down a supplementary decision that the $800 plantation management fees were deductible and that the $2,000 plantation establishment fees were of a capital nature and not deductible.
On 28 October 2004 special leave to appeal to the High Court was not granted.

KRAMPEL NEWMAN PARTNERS PTY LTD (KNOWN AS MEPHISTO'S WEB)

On 28 February 2003, the Federal Court handed down its judgment in which it considered the deductibility of amounts purportedly paid for the copyright and other costs associated with the production of an animated feature film.

The Court held that these amounts were not allowable under the general income tax deduction provisions nor under the specific regime in Division 10B for capital expenditure on Australian films. The Court also found that the specific anti-avoidance provisions in section 82KL of the income tax law and the general anti-avoidance provisions in Part IVA operated to disallow the deductions. The Court concluded that penalty tax of 50% was payable as the investor's position on the deductions they claimed in connection with the scheme was not 'reasonably arguable'.

VINCENT

On 16 September 2002, the Full Federal Court decided that the expenses claimed by the taxpayer were not deductible under the general deduction provisions because the expenses were of a capital nature. Despite this finding, the court allowed the appeal in the 1995 year as the amendment, relying only on Part IVA, was outside the four-year period allowed under the general amendment provisions. In the 1996 year the deduction was not allowed by the court.

No application for special leave to appeal was filed by the Commissioner or the taxpayer.

HOWLAND ROSE AND ORS (KNOWN AS BUDPLAN)

On 18 March 2002, the Federal Court held that amounts paid to participate in the Budplan Personal Syndicate were not deductible under the general deduction provisions of the income tax law. The court also held that the general anti-avoidance provisions in Part IVA of the income tax law operated to deny deductions for the amounts subscribed because the investment made no commercial sense without the tax benefits.

No appeal was filed by the taxpayers.

ATTACHMENT 3

COOKE AND JAMIESON

On 26 March 2004, the Full Federal Court upheld the original decision that expenses claimed by the taxpayers in relation to their investment in the Australian Horticultural Project (No 1) were deductible under the general deduction provisions of the income tax law. Further the court held that the anti-avoidance provisions did not apply to disallow the deductions.

No application for special leave to appeal was filed by the Commissioner.

7 February 2005

ATTACHMENT 4

COURT CASES: EMPLOYEE BENEFIT ARRANGEMENT SCHEMES (EBAS)

SPOTLIGHT/PRIDECRAFT PTY LTD

On 25 May 2004, the Federal Court handed down its judgment in a case involving an employee benefit trust arrangement in which deductions were claimed for contributions to an employee incentive trust that would benefit arm's length employees in future years.

While the Court held that the contributions were deductible under the general deduction provisions, it also held that the general anti-avoidance provisions in Part IVA of the income tax law applied to strike out the deductions otherwise allowable. The Court concluded that the case "*is one in which 'a flurry of activity around the end of the tax year' in establishing and carrying out the Pt IVA Scheme is clearly aimed at obtaining a substantial deduction in that year*".

In the related Spotlight Stores decision, the Court held that the contribution to the incentive trust did not amount to the provision of a taxable fringe benefit. The Court concluded that it should follow its earlier decisions in Essenbourne and Walstern because they were not clearly wrong.

The Full Court upheld the earlier decisions when it dismissed appeals in both cases on 23 December 2004.

WALSTERN

On 8 December 2003, the Federal Court handed down its judgment in which it considered the deductibility of 'contributions' made to an off-shore non-complying superannuation fund.

The Court denied deductions for contributions made by a company to a New Zealand based superannuation fund on behalf of its owners who were also its sole employees.

The Court agreed with the Tax Office that the sole purpose of the contribution was not to provide superannuation benefits to persons who were employees.

It also held that the fringe benefits tax (FBT) applied in respect of the contributions at the time the amounts contributed were allocated by the fund to the employee owners.

PREBBLE

On 22 August 2003, the Full Federal Court dismissed the taxpayer's appeal in relation to whether the controller of a company, of which the controller was also an employee, could claim deductibility for contributions he or she made to a superannuation fund. As the Court concluded that an earlier favourable decision of the Full Court on the same issue in the Harris case was not plainly wrong, they decided not to overturn that decision.

On 8 October 2004 special leave to appeal to the High Court was not granted.

ATTACHMENT 4

KAJEWSKI & ORS

On 26 March 2003, the Federal Court handed down its judgment in which it considered the deductibility of 'contributions' purported to have been paid under an employee retention plan.

The Court held that the scheme was entered into only to provide the taxpayer's employer with a large tax deduction to claim against an increased business income. The 'contribution' was not a business expense made for the purpose of establishing a genuine employee retention plan. The Court confirmed the Commissioner's powers to amend assessments going as far back as the 1990 income year where an avoidance of tax was the result of fraud or evasion of the taxpayer's tax agent.

It was also held that the taxpayers involved in the scheme were not entitled to any reduction of the significant tax penalty imposed.

ESSENBOURNE

On 17 December 2002, the Federal Court handed down its judgment, in which it considered the deductibility of 'contributions' purported to have been paid under an employee incentive trust. The Court held that an income tax deduction was not allowable for an amount contributed by a company to an employee incentive trust because the payment was simply a distribution of the company’s profits to the three principals of the company.

However, the Court disagreed with the Tax Office’s view that fringe benefits tax (FBT) should apply.

In relation to FBT, we are of the view that the Court’s decision is not correct and inconsistent with our understanding of the intent of the FBT law. However, we consider that the Essenbourne case is inappropriate for clarifying the FBT law on an appeal to the Full Federal Court given her Honour’s finding that the contribution to the employee incentive trust was a profit sharing exercise of the three principals of the company.

ELIAS

On the 13 September 2002, the Federal Court handed down its judgment on the Commissioner’s decision not to further remit the general interest charge. The charge was imposed for late payment of a liability incurred by the taxpayer. The liability arose after an assessment issued disallowing their deduction for contributions to a controlling interest superannuation fund.

The Court held that the decision was reasonable and was made within the Commissioner’s discretion.

The Court also held that there were good reasons put forward for discriminating between taxpayers involved in mass marketed schemes and those involved in employee benefit arrangements.

ATTACHMENT 4

HARRIS

On 8 August 2002, the Full Federal Court handed down its judgment in which it considered the deductibility of superannuation contributions made under a controlling interest superannuation scheme. The Court held deductions were not available where employer contributions were made to a superannuation fund by the controller of a company for the controller's own benefit, and that in fact there must be a contribution by an employer for an employee (who must be a different person). Further, the Court held the legislative history supported the Commissioner's view and supported the view put by the primary judge that any other outcome would be extraordinary or at least anomalous.

ATTACHMENT 5

6 Gladstone Street Moonee Ponds VIC 3039
PO Box 3000 Moonee Ponds VIC 3039

Name of taxpayer
Agent
Address

Our reference: EBA Settlements
Telephone: 1800 001 111
Facsimile: (03)9275 4470
Email: ebasettlements@ato.gov.au

Date: 23 November 2005

DEAR SIR/MADAM,

XXXX EMPLOYEE SHARE ACQUISITION PLAN (ESAP) SETTLEMENT OFFER

Our records show that you participated in XXXX Employee Share Acquisition Plan (the arrangement). I understand that you are interested in finalising this matter. I would like to offer you a settlement based on the following terms.

Settlement Terms

The terms of settlement include:

- full primary tax on one taxing point (this means you will only have to pay tax on either your fringe benefits tax assessment or one of your income tax assessments);
- a reduction in the shortfall penalty to 5%, currently it is 40% or 50%; and
- a remission in the general interest charge to 4.72% for the period 19 May 1999 to the 29 July 2002.

To access these terms you will be required to:

- pay all outstanding debt or enter into a payment arrangement;
- if you enter into a direct debit payment arrangement the interest will be remitted to 6.28% for the period of the arrangement; and
- not object or appeal against amended assessments and withdraw any existing objections or appeals with respect to the arrangement.

This settlement offer was endorsed by a panel of senior tax officers who considered the circumstances surrounding this matter and determined that the above terms are fair and reasonable in these circumstances.

Individual Circumstances

We believe that you may have circumstances that may not have been taken into account when developing this settlement offer. If this is the case you should contact us either by phone or in writing, our contact details are on page two. Examples of these circumstances could include having suffered financial difficulties because of the existence of both income tax and fringe benefits tax assessments, or that there was an unreasonable delay by the Tax Office in issuing amended assessments after you provided all the necessary information. These circumstances could entitle you to further concessions, for example a further remission of interest. We have enclosed a fact sheet (NAT 11998) which gives you more information.

Next Steps

If you wish to settle on the basis outlined in this letter you should review and complete the attached draft settlement deed. There are several options on which you may settle however we have attached a draft settlement deed based on the income tax assessment raised to your

ATTACHMENT 5

employer entity. We have also attached all the documents required for a direct debit request and a payment arrangement. Please send your settlement deed and if required the other documents by the **16 December 2005** to the address below.

Australian Taxation Office
Employee Benefit Taskforce
Attention: EBA Settlements
PO Box 3000
MOONEE PONDS VIC 3039

Furthermore if after considering your individual circumstances, we decide that you are entitled to more concessions we will prepare another deed for you.

If you are in another employee benefit arrangement you may also wish to discuss settlement of that arrangement.

If you require any assistance please phone XXXXXXX on **XXXXXXX** or XXXXXXX on **XXXXXXX**.

Yours faithfully

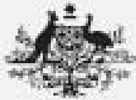
Marina Dolevski
Assistant Commissioner of Taxation

.

ATTACHMENT 6

Don't get caught up in dodgy schemes

The end of financial year is approaching – investigate before you invest.



Australian Government
Australian Taxation Office

BEWARE

At the end of the financial year people often try to reduce their tax bill through investments that promise large refunds.

But, it can be hard to tell a good investment from a bad one. They can all come with convincing sales pitches.

Promoters of dodgy investments often target people who earn a lot of money like miners and pilots.

Here are some tips for spotting a dodgy investment. If you hear any of these sales pitches, beware…

'There's no risk – we guarantee the returns.'
Be careful if you are offered a guaranteed return on your investment.

Real investments come with real risks.

The Australian Securities and Investment Commission's (ASIC) website **www.fido.gov.au** has tips on avoiding dodgy investments.

'You don't need credit or asset checks, we'll lend you the money.'
Dodgy investment schemes often require you to take a loan from a scheme related company that is only repaid from future profits or tax deductions.

Remember, real loans have real repayments and realistic repayment plans.

'The investment is legal but the tax man doesn't like it – that's why it's all done offshore.'
Many tax avoidance schemes involve off-shore dealings.

The Tax Office has issued warnings, and is currently cracking down on offshore schemes.

'Even if the investment doesn't go ahead you will still make a profit from your tax refund.'
Steer clear of investments that concentrate on tax deductions but make little business sense.

If the Tax Office finds that the main purpose of the investment is to avoid tax, you may lose your initial investment, have to pay back the tax and face penalties.

'Sign this secrecy agreement – we don't want our competitors stealing our ideas.'
Beware if you are told to keep the investment a secret. Often the real reason for secrecy is that they don't want the Tax Office or ASIC to find out about it.

'There's no need to ask the Tax Office if it's okay – we already have a ruling.'
Don't take anyone's word for it. Call the Tax Office or an independent tax adviser to find out if the scheme really does have a Tax Office product ruling.

Genuine 'tax effective' investments should have a Tax Office product ruling. This means the Tax Office has examined the investment to see if it is okay.

A product ruling does not mean that the investment will make money. It just means investors can legally claim the tax deductions for their investment as long as the arrangement is carried out as described in the ruling.

'A top lawyer and/or accountant have looked at the investment and they think it's great.'
In many cases the 'top lawyer' may have seen a different investment to the one you are being sold, so their advice will be meaningless.

Always seek independent advice from a tax adviser who has no connection with the person selling the investment.

ATTACHMENT 6

INVESTIGATE BEFORE YOU INVEST

Before signing up to any investment, ask yourself:

Does the salesperson work for a licenced business?
People who offer financial products and who offer advice must work for a business that holds an Australian financial service licence, issued by ASIC.

You can check licence details for free at **www.fido.gov.au** or by calling ASIC's Infoline on **1300 300 630**.

Does the investment have a product disclosure statement or a prospectus?
By law, investors must be given either a product disclosure statement or a prospectus.

Contact ASIC at **infoline@asic.gov.au** or phone **1300 300 630** if you don't get a current product disclosure statement or prospectus.

Have I got an independent second opinion on the investment scheme?
If your investment passes the first two tests you should still ask the person if they are getting a commission for selling you the investment.

Many accountants and financial advisers are not independent because they get commissions for selling investment schemes.

Before you sign anything get independent advice about the investment from an adviser who has no connection with the seller, or the investment scheme.

YOUR TAX OBLIGATIONS

Our tax system is based on self-assessment. This means that you are responsible for your tax return – even if it was prepared by your tax agent.

So if you invest in a dodgy investment scheme you could be left with the tax bill after the scheme promoter is long gone with your money.

MORE INFORMATION

If you need more information about whether a taxpayer alert has been issued concerning the arrangement or whether we have issued a product ruling for the arrangement, you can:

- visit our website at **www.ato.gov.au/atp** or
- phone us on **1800 177 006**.

© COMMONWEALTH OF AUSTRALIA 2006

This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth available from the Attorney-General's Department. Requests and enquiries concerning reproduction and rights should be addressed to the Commonwealth Copyright Administration, Attorney-General's Department, Robert Garran Offices, National Circuit, Barton ACT 2600 or posted at **http://www.ag.gov.au/cca**

The information in this publication is current at May 2006.

JS 5342

TIPS FOR INVESTING FROM ASIC

When you are making important decisions about your money whether it's taking out a loan, buying a house or deciding which super fund to go with, it can be hard to know where to start.

One of the best places is the Australian Securities and Investments Commission (ASIC) consumer website FIDO at **www.fido.gov.au** ASIC wants you to be well-informed and confident about making important financial decisions.

ASIC's FIDO website is an excellent starting point if you are thinking of investing. And it doesn't matter whether you are starting small or planning an investment strategy for the rest of your life. The issues you need to consider will fundamentally be the same.

FIDO can help you:

- develop your financial strategy
- develop your own ground rules for investing so you can stay in control
- avoid the latest scams and dodgy sales practices
- decide whether you should borrow to invest
- decide which tax and social security issues you need to consider, and
- much more!

www.fido.gov.au

NAT 8625-05.2006

ATTACHMENT 7

NO.004

GOVERNMENT PROVIDES EXTRA FUNDS TO COMBAT TAX SCAMS

The Treasurer today announced that the Government would provide an additional $305 million over the next 6 years to further resource a multi-agency operation directed at promoters of and participants in off-shore tax schemes and fraud.

Under the label of Operation Wickenby, the Tax Office, the Australian Crime Commission, the Australian Federal Police, the Australian Securities and Investments Commission and the Commonwealth Director of Public Prosecutions have been working closely together over the past 6 months to get to the bottom of these arrangements. The arrangements are alleged to involve falsification of tax deductions or hiding, and not declaring income.

The detail of these arrangements came to light through Australian Crime Commission action, after a referral by the Tax Office of information obtained in a tax audit. Participants and promoters who are shown to be involved in this sort of conduct can expect the full force of the laws of the Commonwealth to be applied to them.

This may involve action under civil, tax or criminal laws, for example: tax avoidance under the *Income Tax Assessment Act 1936*; false and misleading statements under the *Taxation Administration Act 1953*; defrauding the Commonwealth under the *Crimes Act 1914*; obtaining a financial advantage by deception under the *Criminal Code 1995*; confiscation of criminal assets under the *Proceeds of Crimes Act 2002.*

The Treasurer noted the close involvement of the Attorney-General and the Minister for Customs and Justice in ensuring a comprehensive whole of Government response.

This is the latest initiative of the Government to ensure the integrity of Australia's revenue system. Other recent initiatives have included:

- an increased focus on business compliance and field services ($173 million allocated over 4 years from 2002-03);
- a range of taxation and superannuation compliance activities including a focus on employer obligations, capital gains, rental reductions, tax agents and superannuation guarantee ($326 million allocated over 4 years from 2004-05);
- additional revenue compliance activities on import duties and goods and services tax assessments ($28 million allocated over 4 years from 2005-06);
- hosting of the OECD sponsored 2005 Global Forum on Taxation, the principal forum for progressing efforts toward effective exchange of information between countries on criminal and civil tax matters; and
- commencement of a comprehensive programme of negotiations with tax havens to enter into bilateral Tax Information Exchange Agreements. Australia signed its first such agreement, with Bermuda, in November 2005.

CANBERRA
8 February 2006