CHAPTER FOUR

MASS-MARKETED SCHEMES

4.1 The ATO's treatment of mass-marketed schemes has generated a significant degree of controversy. Described by the ATO as tax shelter arrangements, these schemes 'are often marketed to large numbers of taxpayers and are designed to achieve outcomes that are clearly not intended under the law'.[1]

4.2 The risk to revenue is significant. At 30 June 1999, the ATO had finalised its position on 134 schemes, disallowing tax deductions worth $1.5 billion claimed by 22,000 taxpayers. The ATO forecasts finalising in 1999-2000 a further 120 schemes involving 36,000 investors and the disallowance of potentially $2 billion in deductions.[2]

4.3 According to the ATO, the tax problem or 'mischief' with these schemes is that they use tax revenue to fund private investments, often with minimal investment risk. Aggressive schemes are capable of creating tax deductions larger than both the amount invested and the actual sum of money flowing to the business. Tax savings can be generated in some instances from artificial arrangements that produce no business income or profit.[3] To illustrate the aggressive nature of these schemes, the ATO cited as 'typical' an example where a taxpayer on the top marginal rate acquires a tax saving of $14,000 for a cash outlay of $10,000. In other words, in addition to the tax system refunding the initial $10,000 investment, the taxpayer in this scenario receives a 'a bonus of $4,000'.

> Even the most innocent of investors on the top marginal rate with that type of scheme face a situation, if they have used a 221D variation, of being able to fund an investment and yet have a take-home pay of $100 a week more than they had before they went into it. I would think that that type of situation would raise alarm bells, or at least seem too good to be true.[4]

4.4 The ATO portrays its actions as being consistent with the principles of the Taxpayers' Charter, ie, balancing the interests of compliance with those of individual taxpayers:

> The ATO has sought to strike a balance in its responses to mass-marketed schemes. In some cases, it agreed to defer issuing amended assessments until it worked with the promoters to get cases before the courts. This approach was taken out of concern for investors, many of whom are retirees or people approaching retirement age and who seemed to be unaware of the full implications of the arrangement into which they had entered. They now face the prospect of real financial losses.

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1 Commissioner of Taxation, *Annual Report 1998-99*, pp. 19-20

2 Commissioner of Taxation, *Annual Report 1998-99*, pp. 19-20.

3 Commissioner of Taxation, *Annual Report 1998-99*, pp. 19.

4 Evidence, p. 193.

> Participants in a range of schemes were offered the opportunity to come forward and take advantage of reduced penalties for voluntary disclosure, without foregoing their right to object and appeal.[5]

4.5 Nevertheless, the ATO's clampdown has been challenged and criticised by both promoters and those caught up in the schemes. Over 40 per cent of the submissions to the inquiry concentrated on two schemes known as Budplan and Sentinel. As well, the ground swell of complaints – amounting to around 1600 taxpayers – to the Ombudsman's office over the ATO's handling of Budplan prompted the Ombudsman to investigate the issue.

4.6 While unrelated as investment schemes, there are common points to the taxpayer criticism of the ATO's handling of each. The most significant charge alleged that the ATO's actions contravened the Taxpayers' Charter. In particular, the imposition of penalties, with its implication of tax avoidance and wrong doing by taxpayers, was seen as reflecting an ATO 'presumption of guilt' towards scheme participants, rather than the presumption of innocence contained in the Charter.

4.7 In this chapter the Committee examines the Budplan and Sentinel cases separately before drawing several general points from the ATO's handling of mass-marketed schemes.

Budplan

4.8 The Budplan investment scheme essentially involved arrangements to develop tea tree oil for use by pharmaceutical and cosmetic companies.[6] Investors sought tax variations on the grounds that it was a legitimate business investment. These variations – known as 221Ds – were processed by the ATO in 1996 and 1997. All told, the scheme involved 9,842 investors and claimed deductions of $372.5 million.[7]

4.9 However, in June 1998 the ATO issued notices to investors disallowing deductions for 1996 and 1997 on a number of grounds, including:

- that the investors were not themselves carrying on a business;
- that, even if they were considered to be involved in a business, the claimed losses occurred prior to the establishment of a business; and
- that the investment was made for the dominant purpose of obtaining a tax benefit.

4.10 The latter reason for disallowance meant that the general anti-avoidance provisions of the *Income Tax Assessment Act 1936*, known as Part IVA provisions, applied to the investors and therefore tax penalties were imposed. Although involvement in a tax avoidance scheme carries a standard penalty of 50 per cent, the ATO offered to reduce the penalty to five per cent if investors came forward to make a full disclosure of their involvement in the scheme.

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5 Commissioner of Taxation, *Annual Report 1998-99*, p. 20.

6 For an outline of the various plans and arrangements comprising Budplan, see the Ombudsman's report into the matter, *The ATO and Budplan: Report of the Investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a tax-effective financing scheme known as Budplan*, June 1999, p. 3.

7 Commissioner of Taxation, *Annual Report 1998-99*, p. 20.

4.11 Despite this concessional treatment, many taxpayers challenged the ATO's position, in particular claiming that the ATO had overlooked case law and its own rulings. Some saw the offer of concessional penalty treatment as tantamount to blackmail. A major issue of grievance was the belief that the ATO's disallowance reversed its earlier 'approval' of Budplan as indicated by processing 221D variations. The ATO's inaction over a request by a director of the scheme for a private ruling involving an 18 month delay was also seen as implicating the ATO in the investors' plight, a criticism similar to the view that the ATO was in some way to blame for not acting sooner on Budplan and other schemes.

4.12 As a result of the complaints received by his office, the largest ever on a single tax matter, the Ombudsman investigated the ATO's handling of Budplan. The principal findings of the investigation mostly validated the ATO's response. Although the Ombudsman did identify a number of administrative deficiencies, these were considered immaterial to the ATO's ruling on the matter. The Ombudsman's overall conclusion was that:

> …the Commissioner's interpretation of the law as it applies to Budplan is reasonable and that the Commissioner's subsequent actions including amending the assessments of the Participants for the 1996 and 1997 financial years, and identifying the likely application of Part IVA were not retrospective, unjust or oppressive.[8]

4.13 The Ombudsman did qualify his endorsement of the Commissioner's interpretation of the law, noting that it was ultimately a matter for the courts to decide.

4.14 The Ombudsman's investigation into Budplan also shed light on two more general points of importance to the functioning of the tax system. The first concerns the low level of awareness on the part of taxpayers of their obligations under the self assessment system, of how the system operates and of the need to seek certainty when investing tax effective schemes. As the former Special Taxation Adviser to the Ombudsman, Mr Peter Haggstrom observed:

> You had people like teachers and people on taxable incomes of $40 000 to $50 000 investing in these schemes and not really understanding the underlying mechanics of the scheme, not really understanding the tax issues and not really understanding self assessment.[9]

4.15 The poor level of knowledge is highlighted by the widespread belief that the processing of a 221D tax variation amounted to the ATO approving the tax effective legitimacy of a scheme such as Budplan. As the Commissioner stated to the Committee, being granted a variation 'does not by law mean we have accepted the *reason* for the variation'. [emphasis added][10]

4.16 The second major finding of the Ombudsman relates to the role played by tax agents and financial advisers in the promotion of mass-marketed schemes. As noted already in the context of tax penalties, the Ombudsman's investigations of taxpayer complaints are

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8 Ombudsman, *The ATO and Budplan*, p. 1.

9 Evidence p. 254-5.

10 Evidence, p. 293. The ATO's investigation of 221D variations is detailed in Evidence, pp. 190-191.

increasingly finding that the cause of disputes lies with tax agents rather than the ATO's administration.

4.17 Although some witnesses were critical of the Ombudsman's conclusions, the Committee notes that the Ombudsman's office, particularly the Special Taxation Adviser, performed a highly constructive role in the Budplan affair. The Ombudsman's intercession enabled taxpayers to have their voices heard at senior levels in the ATO. The Ombudsman was also instrumental in brokering an agreement between the ATO and Budplan representatives to run a test case in the courts.

4.18 The Committee is disturbed to see, however, delays in the finalising of preparations for test cases on Budplan.[11] It understands that a timetable for proceeding with test cases was agreed to by the ATO and Budplan representatives in August 1998.[12] However, the ATO has informed the Committee that, on the basis of advice from the Australian Government Solicitor, at best a hearing will occur in the last quarter of 2000.[13] The cause of the delay has largely been over the selection of representative cases to take to court.

4.19 Although the Committee appreciates the complexity involved in selecting representative cases, it nonetheless considers a continued delay in getting test cases to court as inimical to all concerned. The ATO has already been criticised by the Ombudsman for defective administration over the inordinate delay involved with responding to a private ruling request on Budplan. In the Committee's view, further delays on the test case threaten to turn a potential solution to the matter into part of the wider problem.

Sentinel

4.20 On the surface the Sentinel case appears similar to Budplan. It involved investments in cultural productions such as films and stage shows, for which investors sought tax variations. The ATO processed the 221D variation applications of Sentinel investors for the financial years 1995-1997. However, Sentinel differs from the Budplan scheme on a number of counts. Sentinel involved a smaller number of investors (around 600-700), many of whom are airline pilots. More significantly, the scheme appears to largely have been fraudulent with the principals behind the investment company absconding with all of the investors' funds.

4.21 The Commissioner also indicated two further areas of difference between the schemes. First, the ATO saw Sentinel as a blatantly aggressive tax avoidance arrangement. Second, several of the investors were said to have a history of investment in similar avoidance vehicles:

> In our view these arrangements [ie, Sentinel] tend to be at the more extreme end of the market. Unlike Budplan, for example, there was no prospectus and what business plans there were projected very little, if any, profit outside of the leveraged tax benefit. Further, while I do not wish to characterise investors – and I speak here of tendencies only – it is true that those participants had relatively high

11 Evidence, pp. 204 and 221-221.

12 Information provided to Committee by Minter Ellison, 17 November 1999.

13 ATO response to questions on notice, 17 February 2000.

> incomes, relatively high levels of claim deductions to income and a pattern of involvement in planning arrangements over some years.[14]

4.22 Since the ATO viewed Sentinel as a blatant tax avoidance scheme, standard penalties of 50 per cent were applied and concessional treatment was not extended to participants.[15]

4.23 As with Budplan, Sentinel investors objected to the ATO's treatment on the basis that it was retrospective and that the imposition of penalties implied a presumption of guilt, not innocence, by the ATO. The imposition of a 50 per cent penalty, in contrast to the concessional treatment extended to Budplan investors, gave rise to a perception that the ATO was acting inconsistently towards the investors in the two schemes. Furthermore, because the Sentinel investors had already lost significant sums of money due to the fraudulent actions of the company directors, the ATO's clawing back of earlier deductions and penalty treatment were said to be unduly harsh. This impression was compounded in cases where the ATO appears to have garnisheed some investors' salaries.

4.24 While the ATO's response seems warranted insofar as the Sentinel *scheme* amounted to being a tax avoidance arrangement, the treatment of *some* investors seems to have been at odds with ATO policy to avoid 'broad-brushing' taxpayers. The Commissioner characterised a 'tendency' among the Sentinel investors to have a history of participation in tax planning arrangements.[16] However, based on the evidence to the Committee little account appears to have been given to those investors without such a record and who invested in Sentinel unaware that it was a tax avoidance vehicle.

4.25 The ATO appears now to be aware of this problem of indiscriminate treatment of Sentinel investors and is addressing it in an appropriate manner. The Commissioner advised the Committee that the recently issued consultative draft of settlement guidelines for mass-marketed schemes will apply to Sentinel investors. The Commissioner also indicated that Sentinel investors have started to approach the ATO to discuss settlement arrangements.[17]

4.26 A further charge against the ATO is that it acted with duplicity by not warning taxpayers of its suspicions about the legality of the Sentinel operation when these first surfaced. Despite ATO intelligence supposedly raising concerns about Sentinel as early as 1995,[18] the ATO continued to process 221D variations while concurrently investigating the scheme. In late 1997, following the collapse of the Sentinel group, the ATO declared that the Sentinel investments were non-deductible and began to recover revenue from the investors.

4.27 The precise timing of when the ATO first detected issues of concern over Sentinel – the Commissioner indicated that the 'first warning signal' the ATO detected was in late 1996

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14 Evidence, p. 266. For a detailed account of the ATO's decision making on Sentinel, see Evidence, pp. 288-289.

15 Evidence, p. 289.

16 Evidence, p. 266.

17 Evidence, p. 267.

18 I*n camera* Evidence published by order of the Committee, p. 8.

(as opposed to 1995)[19] – is not the real issue here. The important question raised by the delay between when the ATO began investigating Sentinel and when it stopped issuing 221D tax variations for Sentinel-related deductions is whether the ATO had a duty of care to warn taxpayers of its concerns about the Sentinel scheme.

4.28 There are two parts to answering this question. The first concerns the obligation the ATO has to be responsible in making public decisions on investment schemes that might influence the market place. As the Commissioner stated:

> This is always a difficult area for us. We detect something. Even though on an initial look we have some concerns, we have to be very careful about racing out and saying, 'Don't invest in this', because of commercial realities and other things.[20]

4.29 Before issuing a public warning on a scheme, the ATO must gather information and be sure of the facts relevant to the situation. Accessing information can be a lengthy and arduous task in some cases, particularly where scheme planners and promoters are less than cooperative. In others, such as Budplan for instance, the issues can be complex and not readily resolved.[21]

4.30 The ATO therefore needs to strike a balance between, on the one hand, addressing aggressive schemes in a way that protects the interests of taxpayers and the revenue, and on the other, not distorting the market. The Commissioner indicated that the ATO is conscious of the need to find a solution to this dilemma. In addition to product rulings (see below), the ATO has in one case approached the scheme developers directly to forewarn them of their concerns and seek their cooperation in assisting the ATO to reach a concluded view.[22]

4.31 The Committee considers that the ATO can extend its approach towards scheme promoters to include requiring them to pass onto scheme participants and prospective investors advice that the scheme is under consideration by the ATO. If the ATO's concluded view were that the scheme was legitimate, then both investors and promoters would benefit from the ATO's assurance. If the scheme were not considered a legitimate tax effective arrangement, then investors would be protected and the ATO would face a lower case load for recovery action than if no preventive warning had been issued.

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19 Evidence, p. 288. Among the arguments advanced to support the 'late 1995' claim is the suggestion that a former head of ATO Strategic Intelligence and Analysis (SIA), Mr Nick Petroulias, claimed to have briefed the ATO executive on Sentinel in late 1995. However, Mr Petroulias was not employed as permanent a ATO officer until November 1997; prior to that time he was engaged as a contract consulting solicitor. He was appointed to head SIA after November 1997. In view of the disparity between these dates, it is hard to accept that Mr Petroulias was in a position to brief ATO management about Sentinel in late 1995.

20 Evidence, p. 288.

21 Evidence, p. 288.

22 Evidence, p. 288.

Recommendation

4.32 **The Committee recommends that the ATO require tax effective scheme promoters to advise existing and prospective scheme participants that a scheme is under consideration by the ATO due to concerns about the scheme's compliance with the law.**

4.33 This leads onto the second aspect of the duty of care question. In the ATO's view, the responsibility for protecting investor/taxpayer interests lies with scheme developers, promoters and financial advisers – that is, the tax and financial industries – not the ATO. The Commissioner stated:

> I think the duty of care should rest with the devisers, promoters and advisers on these schemes. That is where the duty of care rests.[23]

4.34 The role of tax practitioners, including lawyers and accountants, in subverting the tax system through a range of activities – from aggressive tax planning through persistent tax debt to providing questionable advice – is of grave concern. In a self assessment environment, tax practitioners lie between many taxpayers and the ATO. They are therefore in a position of influence and responsibility, not only in relation to their clients' interests but also the overall functioning of the tax system. As a recent report relating to the High Wealth Individuals Program shows, tax advisers possess considerable influence in securing compliance by warning clients of practices which are illegal.[24] This implies that the reverse holds true: that advisers can be equally influential in promoting non-compliance. The Committee shares the following concern expressed by the Commissioner in relation to the development and promotion of aggressive tax planning schemes:

> It seems unfortunate to me that there have not been found administrative penalties in the tax law that might act as a deterrent to this activity, particularly some of the activity we have seen in recent times. I believe this is an area that is worthy of study.[25]

4.35 In the absence of regulatory or legislative sanctions, the ATO is pursuing a strategy of examining the affairs of scheme architects and promoters, particularly as these agents have a pattern of tax sheltering scheme profits. The Commissioner indicated that this program has identified promoters who have breached laws such as the Crimes Act and the Corporations Law and that the ATO has referred several cases to the National Crime Authority for action.[26]

ATO responses

4.36 The ATO's approach to handling mass-marketed schemes has modified during the time of the Committee's inquiry. At the Committee's final hearing with the ATO in February 2000, the Commissioner indicated that the ATO had reviewed its approach to these schemes. The review was prompted partly by the realisation of the large number of investors who had

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23 Evidence, p. 290.

24 Professor John Braithwaite, 'Through the eyes of the advisers: A fresh look at tax compliance of High Wealth Individuals', Contract Paper prepared for the Interim Review of the HWI Taskforce, pp. 25-26.

25 Evidence, p. 267.

26 Evidence, p. 267.

been caught unwittingly in the schemes, and partly by the magnitude of the administrative load involved in addressing the revenue risk posed by mass-marketed arrangements.[27]

4.37 The ATO has also moved to address problems identified in the course of its operations against mass-marketed schemes. For instance, it was suggested to the Committee and the Ombudsman's investigation of Budplan that inconsistencies arose in the 221D processing by ATO regional offices. Although the ATO reported that an examination of this supposed discrepancy had failed to identify any evidence of it,[28] the ATO has nonetheless consolidated the function for issuing section 221D variations at its Upper Mt Gravat office.[29]

4.38 From a taxpayer perspective, the two most significant initiatives adopted by the ATO are the Product Rulings System and issuing of consultation draft guidelines on settlement of mass-marketed schemes.

Product Rulings System

4.39 As the Ombudsman pointed out in relation to Budplan, taxpayers face significant risks when investing in tax effective schemes without the certainty of a tax ruling.[30] The exposure to risk is illustrated even more graphically in the case of Sentinel, where investors suffered not only losing major life savings but also incurred hefty tax penalties in addition to the disallowance of deductions.

4.40 In June 1998 the ATO introduced a product ruling system which involves the ATO publishing 'rules on the availability of claimed tax benefits in relation to investments (products)'.[31] The intention of the system is to provide both promoters and investors with certainty about the taxation consequences of particular investment products and schemes.

4.41 It is also intended to protect investors from being ensnared in aggressive schemes of dubious propriety. In this regard, the system addresses to a significant extent the duty of care considerations that arise when the ATO detects and can rule on aggressive arrangements. According to the Commissioner:

> We were quite conscious of the fact that in offering this product it would promote a market force that would lead people, including advisers who might be worried about their responsibilities and potential liability, when faced with one of these arrangements, to ask whether there was a product ruling. That whole mechanism was out there to create a market force that, in the best way we could, would give people some comfort.[32]

4.42 The market appears to have embraced the product ruling system with investment promoters applying for rulings on 135 products in the system's first year of operation. Of these the ATO ruled on 92 products, 28 were withdrawn and 15 were undecided at 30 June

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27 Evidence, p. 267.

28 Evidence, p. 293.

29 Evidence, p. 196.

30 *Commonwealth Ombudsman Annual Report, 1998-99*, p. 41.

31 Commissioner of Taxation, *Annual Report 1998-99*, p. 53.

32 Evidence, p. 290.

1999.[33] Tax practitioners and others, including the Ombudsman have generally welcomed the product ruling system.[34] According to one taxation lawyer involved in the Budplan case:

> The move to product rulings takes away a lot of the problems and issues of these sorts of things. If you do not see a tax office product ruling, clearly you will not put your money into it [the investment scheme].[35]

4.43 The Committee believes that, to the extent that the product ruling system improves certainty in the market, it should reduce the risk of investors unwittingly getting caught in aggressive schemes such as Sentinel and running into tax problems with their investments.

Settlement guidelines for mass-marketed schemes

4.44 The Commissioner announced to the Committee that the ATO had in late January issued a consultation draft of guidelines for settlements in relation to mass-marketed schemes. The ATO has circulated the guidelines for comment and feedback from interested parties.

4.45 The Commissioner explained that the guidelines are intended as a mechanism which will enable the ATO to treat taxpayers according to the individual circumstances and the 'level of mischief' or aggressiveness of the scheme.[36] In this sense, the guidelines should allow the ATO to be more discriminating in its treatment of individuals, particularly in terms of penalties, than legal and technical constraints have allowed to date.

4.46 It is clear, however, that other strategic factors have influenced the decision to develop the guidelines. The ATO considers that it is opportune to settle cases where appropriate and free up resources to concentrate on high risk cases or precedent-setting matters that will provide 'leverage' over other schemes. This reflects the ATO view that it has made significant inroads into countering aggressive tax planning.[37]

4.47 The new guidelines flow from the Code of Settlement Practice adopted by the ATO in September 1999 (see Chapter Seven). In particular, the Code states that the circumstances in which it may be appropriate to settle includes where:

> A participant or group of participants in a tax avoidance arrangement has come to accept the Commissioner's position and settlement is around the steps necessary to unwind existing structures or arrangements.[38]

4.48 The draft guidelines for mass-marketed schemes establish the principles and measures to give effect to the above provision. A feature of the guidelines is that they define the role of settlements within the broader scope of the ATO's strategy towards aggressive tax

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33 Commissioner of Taxation, *Annual Report 1998-99*, p. 53.

34 *Commonwealth Ombudsman Annual Report, 1998-99*, p. 41.

35 Evidence, p. 205.

36 Evidence, p. 267.

37 Consultation Draft, Addendum to the Code of Settlement Practice, 'Mass-marketed Aggressive Tax Planning Schemes – Guidelines on Settlement Principles', 25 January 2000, p.5 (hereafter 'Draft ATP Settlement Guidelines').

38 Section 3.5.1.IV, *Code of Settlement Practice*, p. 6.

planning. This has the benefit of making clear to staff the range of measures being used in countering aggressive schemes and should reduce the risk that settlements will be resorted to as an easy way out of addressing difficult cases. A further check on inappropriate settlements is the requirement that corporate approval from the Deputy Chief Tax Counsel (National Office) and relevant business line Assistant Commissioner is necessary in most settlement cases.

4.49 The guidelines also define levels of mischief, how these are to be determined and the corresponding levels of penalty and interest charges. Similarly, the 'special circumstances' of scheme investors are defined and matched to penalty and interest provisions. Clear distinction is made between settlements with scheme investors and those with scheme promoters: 'the ATO recognises that culpability will often differ according to different roles and levels of participation'.[39]

4.50 The guidelines should provide relief for investors caught unwittingly in schemes such as Budplan and Sentinel, particularly those with sound histories of tax compliance and no involvement in avoidance arrangements. As the examples in the table below show, scope is provided for a relaxation of the penalties imposed on scheme participants depending on their special circumstances. In particular, those investors in Sentinel who had no prior involvement in schemes and/or who cooperated with the ATO or other agencies such as the Australian Securities and Investments Commission should expect some degree of concessional treatment from the ATO.

Special Circumstances	**Possible Consequence**
Scheme participant unaware of the true nature of the scheme or how it will be executed	May be a factor justifying a reduced penalty but if participant has a schemes investment history or should have been aware of the true nature of the scheme or how it will be executed there would be a presumption against a penalty reduction.
Scheme participant has been defrauded by the promoter	May be a factor justifying a reduced penalty.
Scheme participant satisfied requirements of a reduced penalty rate for voluntary disclosures (s226Z ITAA36).	Penalty capped; need to consider whether any concessional treatment is appropriate in respect of penalties not expressly covered.
Extent to which scheme participant co-operated with the ATO.	May be a factor justifying a reduced penalty.

4.51 The settlement principles applying to scheme promoters and associated entities are similar but stricter than those for scheme investors. As the guidelines state, 'a higher penalty would normally be expected to reflect the higher level of culpability of scheme promoters'.[40] However, special circumstances that might mitigate the promoter's culpability include the

39 Draft ATP Settlement Guidelines, p. 3.

40 Draft ATP Settlement Guidelines, p. 16.

degree to which a promoter cooperated with the ATO and encouraged scheme participants to cooperate as well.

4.52 The draft guidelines are sound in principle and particularly strong in specifying the settlement consequences that might flow from clearly defined levels of mischief and special circumstances. The strength of this detailed approach is that it narrows the scope for officer discretion in applying inappropriate settlements. This should also reduce the risk of inconsistent practice.

4.53 However, one potential weakness concerns the initial step in considering whether to settle with a scheme promoter. The guidelines state:

> It should be noted that settlement of a scheme with a promoter or associated entity will not normally be considered in cases of fraud on the revenue or other criminal or regulatory offences without appropriate prior consultation with applicable prosecutorial, law enforcement or regulatory authorities.

4.54 Although the intent of this statement is reasonably clear, the Committee believes that consultation with the ATO's internal prosecution unit and other agencies should be mandatory in such cases. Taxation cases involving revenue fraud or criminal activity strike at the heart of issues of taxpayer equity. The ATO should ensure that, where issues of fraud, criminal behaviour or other offences arise, there is no chance for settlements to be concluded without consultation between audit teams and the relevant authorities.

Recommendation

4.55 **The Committee recommends that the ATO, in finalising the Guidelines on Settlement Principles for Mass Marketed Aggressive Tax Planning Schemes, ensure that in cases involving revenue fraud or other criminal or regulatory offences it is mandatory for case officers to consult with the relevant prosecution, law enforcement and regulatory authorities prior to concluding a settlement.**

4.56 The Committee also believes that it is important for transparency and good management that the guidelines be reviewed after a year of their coming into operation. As discussed in Chapter Seven, a recent audit of the ATO's settlement practices revealed widespread non-compliance by staff with established guidelines and other administrative deficiencies. Many of these problems could have been identified and remedied if the audit had occurred sooner rather than six years after the relevant guidelines were adopted. In view of this precedent and the revenue significance of mass-marketed schemes, it is crucial that the proposed guidelines be subject to early review and remedial action taken if problems are identified.

4.57 **The Committee requests that the Australian National Audit Office consider conducting a performance audit of the Guidelines on Settlement Principles for Mass Marketed Aggressive Tax Planning Schemes one year after they come into force.**

Committee observations

4.58 The Budplan and Sentinel case studies are important in as much for what they reveal about the conduct and attitudes of taxpayers and tax practitioners as they do about the ATO. Two issues in particular stand out.

4.59 The first is the general level of taxpayer knowledge and understanding of the requirements of the self assessment tax system. Budplan and Sentinel indicate that a large number of taxpayers do not understand fully the requirements that rest with them in a self assessment environment. For instance, it is alarming to see the number of taxpayers who assumed mistakenly that the issuing of a section 221D tax variation by the ATO meant that the ATO had investigated and approved the scheme in which they had invested.

4.60 Both cases also reinforce the Committee's finding in Chapter Three about the degree of confusion among taxpayers over the tax penalty system. This confusion stems in large measure from the complexity of the system and inconsistent ATO administration. A recent ANAO report pointed to a lack of public information on the penalty regime and recommended that the ATO address this by providing a clear statement on penalties as a guide to taxpayers.[41]

4.61 The Committee considers that the ATO should also provide more educational information about taxpayer obligations under the self assessment system. The Ombudsman identified this requirement in light of his investigation into Budplan.[42] It is also apparent from the evidence to this inquiry that misunderstandings on the part of taxpayers are fairly widespread. Poor levels of taxpayer knowledge lead not only to inadvertent mistakes but also leave taxpayers ill-equipped to deal with complex investment decisions and exposed to inappropriate advice from tax practitioners.

Recommendation

4.62 **The Committee recommends that the ATO produce improved information to educate taxpayers on their obligations under the self assessment tax system, with particular focus on taxpayer responsibilities when using tax advisers, exercising 'reasonable care' and Section 221D tax variations.**

4.63 The second issue of concern to the Committee is the standards of conduct of some tax professionals, notably developers and promoters of aggressive tax effective schemes. In particular, the Committee takes note of the Commissioner's comment that as it stands tax law carries no administrative penalties to deter those who design and promote aggressive tax planning.

4.64 Although the ATO currently is targeting this segment of the tax industry, the Committee considers that developing legislative measures to address the compliance and revenue threat posed by this group would reinforce this strategy. The Committee has already recommended in Chapter Three legislative responses to address persistent tax debtors. Legislative sanctions against those proliferating aggressive tax schemes would also signal the community's intention not to countenance such behaviour. It should also provide an adequate level of deterrence to aggressive planning without tying up ATO resources entailed in a targeted audit strategy against aggressive planners.

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41 ANAO, *Administration of Tax Penalties*, Audit Report No. 31 1999-2000, pp. 42-43.

42 See the Ombudsman's report, *The ATO and Budplan*, pp. 12, 16-17 and the *Commonwealth Ombudsman Annual Report, 1998-99*, pp. 41-42.

Recommendation

4.65 **The Committee recommends that the Government with input from the ATO formulate legislative measures including administrative penalties to deter aggressive tax planning, particularly in relation to persons responsible for designing and promoting such arrangements.**