

CHAPTER SIX

HIGH WEALTH INDIVIDUAL PROGRAM

One adviser classified HWIs as ‘the meek, the bold and the normal’. The meek, on this analysis, would be found disproportionately among older HWIs, the bold among wealth-builders and the normal among mid-career HWIs. *Professor John Braithwaite*¹

6.1 The High Wealth Individual (HWI) program began in May 1996. It involves an ATO taskforce engaged in an extensive compliance program. The aim of the program is to enhance the ATO’s understanding of the tax planning techniques used by HWIs and the resulting compliance risks. The taskforce’s role is threefold:

- to act on the tax planning techniques already identified;
- to gain an expanded and comprehensive understanding of the techniques employed; and
- to continue to identify, monitor and address emerging techniques.²

6.2 The Government provided additional funding to the ATO for the program: \$9.7 million in 1996-97 and \$9.5 million for each financial year from 1997-98 to 1999-2000.³

6.3 The 1996-97 Budget papers justified the program by stating:

The revenue at risk from aggressive tax planning and minimisation arrangements used by some high wealth individuals, has been estimated at \$800 million a year.⁴

6.4 Both the targeting of HWIs and the alleged revenue at risk (the \$800 million per year) have been hotly disputed. Both issues give rise to questions of discrimination and the cost/benefit to the public interest of a program such as the HWI which targets a particular group in the community. The Committee examines these issues in turn as part of its assessment of the performance of the program.

Reverse discrimination against ‘the rich’?

6.5 Several witnesses argued or implied that the HWI Program is discriminatory, in particular criticising the manner in which it called into question the integrity and probity of wealthy individuals.⁵ Mr Liebler, a tax lawyer who has represented clients subject to the HWI

1 ‘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, p. 11.

2 Submission No. 83, p. 24.

3 Submission No. 83, p. 24.

4 Cited in Submission No. 83, p. 24.

5 For instance, see TIA Submission No. 17A, pp. pp. 11-13 and Mr Liebler’s claims of a ‘witch hunt’, Submission No. 85, pp. 3-5 and attachments.

taskforce's activities, claimed that HWIs are not only the 'most discriminated'⁶ group of taxpayers in Australia but also are treated inequitably:

There are some in the community who believe that high wealth individuals receive special treatment from the ATO. They are correct. No other taxpayers within the community are subjected to the same level of intense and intrusive scrutiny as are high wealth individuals. In this sense, it is clear that high wealth individuals do not receive equitable treatment from the ATO.⁷

6.6 This view omits several important factors that apply to HWIs but are not present in the case of other groups of taxpayers. The financial affairs and tax implications of HWIs are generally much more complicated than those for other groups, especially PAYE taxpayers whose financial circumstances tend to be relatively straightforward. As Mr Liebler notes, the complexity of many cases involving HWIs is such that it requires highly expert ATO auditors and, not infrequently, the involvement of senior officers.⁸

6.7 The degree of complexity is illustrated by the company structures and financial arrangements erected by some HWIs. For example, the taskforce's detailed analysis of 142 HWIs showed that these individuals had business or financial connections with 78 'associated individuals'. They also had arrangements involving 932 trusts, 1112 companies and 107 partnerships. In other words, auditing the HWI group is not simply a case of focusing on *individuals* but also involves a complex web of many other financial entities.⁹

6.8 Without taking into account the purported compliance risk posed by some HWIs, the financial arrangements for HWIs alone appear to warrant the commitment of a high level of ATO resources to ensure that tax is properly paid. To see the intensive audit treatment of HWIs as discriminatory or inequitable is to ignore the obvious complexity of the financial affairs and the taxation issues that arise in relation to HWIs.

6.9 The compliance risk of HWIs is examined in the section below. But it should be pointed out at this stage that the HWI program is not predicated on the view that *all* HWIs are engaged in aggressive tax planning and other minimisation or avoidance schemes. The focus of the program is to enhance the ATO's understanding of the tax planning techniques of HWIs, identify areas of risk and act accordingly, especially in response to emerging techniques.

6.10 In principle, this approach is consistent with the general compliance model employed by the ATO across all taxpayer segments.¹⁰ It also is no different to other targeted programs conducted periodically by the ATO, such as that for the cash economy for instance. Indeed, as Mr Liebler states:

6 Evidence, p. 142.

7 Submission No. 85, pp. 12-13.

8 Submission No. 85, p. 12.

9 Figures from ATO, Submission No. 83, p. 25.

10 See Chapter Two and Appendix X.

The Commissioner targets restaurants, taxi drivers and various others. He targets builders and subcontractors. Why shouldn't he target high wealth individuals? He should; that is part of his job.¹¹

6.11 A further bone of contention is the initial estimate that \$800 million in revenue per year was at risk. Calling it a 'mythical figure' the TIA stated:

An amount of \$800 million per annum was originally suggested in 1996 as being collectible from 100 wealthy Australians.¹²

6.12 A careful reading of the Budget Papers announcing the program reveals that it was *not* asserted that \$800 million would be *collected* per year.

Treasury and the ATO caution that this estimate is subject to uncertainties about wealth data, remedial measures, utilisation of losses and behavioural responses by the affected taxpayers. This figure should be seen as an order of magnitude estimate of the 'revenue *potentially at risk*' rather than as the 'sum of gains from particular measures'. [emphasis added]¹³

6.13 As this statement shows, the announcement is quite specific that the figure of \$800 million does not represent an amount expected to be recovered or collected as a result of the HWI program. Rather, the \$800 million was an indicative figure postulated on a range of 'uncertainties' surrounding the tax affairs of HWIs. A major aim of the HWI program is to reduce this degree of uncertainty about the tax planning of HWIs and assemble a more precise picture of the compliance risk at stake. It is against that aim and the measures adopted to treat HWI risk, rather than the misunderstood figure of \$800 million, that the performance of the program should be assessed.

Performance

6.14 The HWI Program's performance can be broken down into four components:

- Case work
- Risk assessment
- Revenue
- Administrative and legislative responses.

6.15 The Committee examines each in turn. The analysis includes the findings of the recent mid-term evaluation of the operation of the taskforce based on two reports, one by an internal officer,¹⁴ the other an external academic consultant.¹⁵ These reviews provide the most detailed and insightful assessment of the program's performance to date. The Committee

11 Evidence, p. 149.

12 Submission No. 17A, pp. 11-12.

13 Cited in Submission No. 83, p. 24.

14 Alice Dobes, 'High Wealth Individuals Taskforce: Mid-Term Evaluation Report', 10 June 1999.

15 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.

considers that both reviews should serve as a valuable basis for the current performance audit of the HWI Program being done by the ANAO.

Compliance work

6.16 Influencing compliance behaviour over the long term is a major objective of ATO operations generally. HWIs are subject to ongoing audit work, the use of expanded returns and ‘targeted enforcement in the highest risk cases’.¹⁶ According to the ATO, its stated preparedness to devote resources to litigating issues through the courts is also designed to improve HWI compliance.

6.17 Since its establishment the taskforce has examined approximately 300 HWIs, of which 179 and their associated entities have been subject to detailed analysis. As an initial step, the taskforce issued questionnaires to 291 HWIs in order to assemble a profile of each HWI’s business structure and tax strategies and identify common approaches to tax planning.¹⁷ Consequently, a number of HWIs and associated entities have been required to lodge more detailed information – known as Current Year Data Collection Strategy or Expanded Tax Return Strategy – in their annual tax returns as a means of enhancing compliance. This is a vital component of the Taskforce’s approach to HWIs: ‘The information collected allows the taskforce to track shifts in tax planning undertaken by particular HWIs, and to use information to develop new administrative and legislative options’.¹⁸

6.18 The expanded tax return strategy is also viewed by tax advisers as a real deterrent against aggressive tax planning: ‘the more information the Commissioner has, the more difficult it is for HWIs to be aggressive in their tax planning. This is a major advantage of the expanded returns.’¹⁹

6.19 In terms of fieldwork and audit activity, in August 1998 the taskforce had audited 73 HWIs and entities, with 20 audits completed.²⁰ The ATO’s Annual Report for 1998-99 indicates that a further 38 cases were finalised during that financial year with 81 audit cases in progress at 30 June 1999.²¹

6.20 Despite the targeting of HWIs, the impact of the Taskforce’s operations on their long-term compliance behaviour appears to be mixed. While the mid-term evaluation of the Taskforce assessed that it has ‘done very well’ to develop innovative compliance approaches particularly in the absence of international models, the feedback from HWI tax advisers mostly suggests that these approaches have made little difference to HWIs.²² The ATO has

16 Commissioner of Taxation, *Annual Report 1998-99*, p. 16.

17 Submission No. 83, p. 24.

18 Dobes, ‘Mid-Term Evaluation Report’, p. 9.

19 Braithwaite, ‘Through the eyes of the advisers’, pp. 9-12 and 46.

20 Submission No. 83, p. 24.

21 Commissioner of Taxation, *Annual Report 1998-99*, p. 16.

22 Dobes, ‘Mid-Term Evaluation Report’, pp.10-11 and Braithwaite, ‘Through the eyes of the advisers’, pp. 9-12.

suggested that this may reflect a belief among advisers that their clients were already complying with the law.²³

6.21 However, there also appears to be a widespread view among advisers that there is now a lower expectation that clients will be audited. This has repercussions for compliance behaviour: ‘Some [advisers] reported as a result that their clients were often willing to operate on the fringe of the law, taking the odds against being audited’.²⁴

6.22 As a consequence of the mid-term evaluation, the Taskforce is strengthening its compliance strategies and in particular has stated its commitment to using ‘stronger and more severe’ compliance methods on high risk HWIs. The Committee considers that the ATO must monitor closely the response of high risk HWIs to the Taskforce’s strengthened approach. If no improvement in compliance behaviour is detected, then it will be necessary for the ATO to reconsider the best mix of strategies required to influence HWI compliance patterns.

Risk assessment

6.23 Enhancing the ATO’s understanding of the compliance risks posed by the tax planning of HWIs is a key objective of the program. The Taskforce has developed a number of strategies to achieve this goal. These include, in addition to the measures such as the expanded tax returns discussed above:

- profiling and analysing HWIs and their groups to assemble a picture of each HWI’s business structure and tax strategies;
- a Risk Assessment Review which covers HWIs, groups and taxation issues;
- a Key Risk Persons Focus which analyses HWI business networks and identifies ‘possible tax arbitrage opportunities in complex structures and intra-group arrangements’; and
- a Macro Research Unit which, among others things, identifies and analyses trends across HWI segments.²⁵

6.24 In general, the taskforce’s findings appear to confirm several pre-existing views about the tax behaviour of HWIs. According to the ATO’s annual report, ‘some [HWIs] consistently adopt an aggressive tax planning approach’ and ‘some HWIs seem to have a philosophy of paying little or no tax’.²⁶ These conclusions are unexceptional and could be said to apply equally to all other taxpayer segments.

6.25 However, the taskforce has identified common strategies that enable HWIs to reduce their taxation. The first operates within the terms of existing laws, such as:

- tax free distributions from trusts;
- non-cash benefits and loans from both trusts and companies to individuals;

23 Dobes, ‘Mid-Term Evaluation Report’, p. 11.

24 Braithwaite, ‘Through the eyes of the advisers’, p. 47.

25 Dobes, ‘Mid-Term Evaluation Report’, p. 9.

26 Commissioner of Taxation, *Annual Report 1998-99*, p. 16.

- Capital gains not liable for tax;
- Tax deductible gifts;
- Negatively geared property holdings generating annual interest deductions;
- Tax concessions such as deductions for research and development and building construction expenditure;
- Accumulation of wealth offshore and no evidence to prove avoidance of Australian tax;
- Acquisition of companies and trusts with tax losses which are able to be used to shelter income; and
- Genuine tax losses from business operations, eg, primary production activities which shelter income from profitable activities.²⁷

6.26 The ATO's legislative response to this strategy is discussed below.

6.27 Some HWIs also use losses as another means to reduce taxation. In aggregate terms these losses were calculated as \$3.5 billion being carried forward at 30 June 1997.²⁸ The two key areas of concern were research and development syndication and film investment schemes. In both areas, HWI groups are claiming sizeable losses based on artificial means, such as 'grossly inflating' valuations for research and development core technology and establishing non-commercial film schemes for tax minimisation purposes.²⁹

6.28 The Taskforce's results in terms of risk identification reflect, according to research with HWI tax advisers, an overall improvement in the ATO's risk assessment work:

The general view in the accounting profession is that the ATO is better geared than it ever was to detect where the [revenue] leakage is. Therefore it should be possible for the ATO to keep a clamp on the most aggressive activity.³⁰

6.29 The taskforce is also focusing on the global tax strategies employed by HWIs, although the findings of this activity appear to be only at a formative stage. The ATO states that 'it has found it difficult and resource intensive to gather information and evidence to determine whether these offshore dealings comply with Australian tax laws'.³¹ The Committee asked the ATO to clarify the degree of compliance risk related to HWI offshore strategies.

6.30 The ATO responded that, notwithstanding the difficulty in tracking international capital flows and assessing compliance, the indication is that generally the wealthier the individual or group the greater the risk, although it varies across the HWI population. Recent research among HWI advisers produced mixed findings with the majority believing that

27 Commissioner of Taxation, *Annual Report 1998-99*, p. 16.

28 Commissioner of Taxation, *Annual Report 1998-99*, p. 17.

29 Commissioner of Taxation, *Annual Report 1998-99*, p. 18.

30 Quoted in Braithwaite, 'Through the eyes of the advisers', p. 12.

31 Commissioner of Taxation, *Annual Report 1998-99*, p. 19.

offshore investment is not a significant risk to revenue while others see it as the major risk posed by HWI, not least because of the degree of difficulty involved in addressing it.³²

6.31 Australia is involved at the international level with bodies such as the Organisation for Economic Cooperation and Development (OECD) working on issues such as defining tax havens and opening up 'secretive countries and administrations' in order to improve the transparency of financial transfers. Cooperation with like-minded countries is recognised as crucial if international taxation risks are to be resolved.³³

6.32 The Committee also asked the Commissioner if the ATO was now, after three years of HWI operations, able to more accurately calculate the revenue at risk from HWIs. The Commissioner restated the point that the \$800 million was not considered to be collectable tax but rather a 'broad macro risk assessment figure – enough for us to determine that we needed to do something'.³⁴ The tax reforms under the New Business Tax System (NBTS), particularly those that address existing systemic flaws, are also expected to minimise significantly the risk associated with HWIs. But any revision of the \$800 million would have to wait until the NBTS is implemented and its impact assessed.³⁵

Revenue results

6.33 The ATO reports that since the establishment of the HWI program, its overall compliance operations have 'resulted in additional revenue of \$136 million and reductions in losses of \$878 million'. The ATO also claims that indications suggest that the tax paid by HWI associated companies has increased by approximately \$180 million over the 1997-99 period.³⁶

6.34 The average tax paid by the 179 HWIs subject to in-depth examination increased by 62 per cent in the first two years of the program; over the same period the average annual tax paid by their associated entities increased by 35 per cent.

6.35 The Committee also notes the ATO forecast that improvements to the tax laws as embodied in the impending New Business Tax System should also generate significant additional revenue, particularly where existing systemic flaws and leakages have been addressed.³⁷

6.36 For 1998-99, the ATO reported that 41 HWIs received amended assessments, increasing tax payable by \$191 million, although \$103 million is in dispute. The large amount of tax in dispute highlights a concern of the TIA's that it is unclear from public information how much of the reported increases in HWI revenue has been collected as opposed to simply assessed or remains in dispute.³⁸

32 Braithwaite, 'Through the eyes of the advisers', pp. 23-24, 47.

33 Evidence, p. 303.

34 Evidence, p. 303.

35 Evidence, p. 303.

36 Commissioner of Taxation, *Annual Report 1998-99*, p. 17.

37 Dobes, 'Mid-Term Evaluation Report', p. 10.

38 Submission No. 17A, p. 11.

6.37 This question about assessed tax in dispute is underlined by a suggestion that the ATO does not pursue disputed tax strongly enough, resulting in reduced revenue collection. Research on the views of HWI advisers found that:

There was also cynicism that when HWI assessments were made for substantial increases in tax, the ATO rarely made them stick. Any appearance of large gains in revenue quickly melted during the settlement process.³⁹

6.38 On the other hand, evidence to the inquiry indicated that the Taskforce in negotiations displayed a determination to pursue difficult issues.⁴⁰ The Committee has not been able to investigate this issue further but considers it to be of such significance as to warrant closer examination. The current performance audit of the Taskforce by the ANAO could be expanded to address the question of how tax in dispute is handled, particularly in view of its implications for performance in relation to revenue collection.

6.39 The Committee requests that the ANAO consider examining the HWI Taskforce's approach towards handling tax in dispute in the context of its current performance audit of the Taskforce.

Legislative and administrative responses

6.40 Tightening aspects of the law through tax reform is possibly the most crucial strategy employed by the ATO to address areas of identified HWI risk. As noted above, the taskforce's analysis of HWI affairs has revealed tax strategies that exploit loopholes or grey areas in the law. According to the Commissioner, the taskforce's findings provided important input to the Ralph Review of Business Taxation: 'the intelligence gathered from our operations has contributed significantly to the outcomes of the business tax review'.⁴¹ These included, among other things, proposals to remove flaws in the law that allowed for tax avoidance. Additional tax reform measures introduced by the Government that affect HWIs include:

- taxing trusts in the same manner as companies;
- strengthening the accrual taxation rules and transfer trust arrangements that apply to foreign trusts;
- removing the scope to create artificial losses and to duplicate losses, including moving towards consolidated tax treatment for wholly owned groups of companies and trusts; and
- extending fringe benefits tax to benefits provided to shareholders and beneficiaries.⁴²

6.41 The mid-term evaluation of the Taskforce praised its performance against the program objective to develop administrative and legislative responses to address undesirable tax minimisation practices. In addition to noting the Taskforce's role in the business tax

39 Braithwaite, 'Through the eyes of the advisers', p. 10.

40 Mr Liebler, Submission No. 85, p. 12.

41 Evidence, p. 267.

42 Commissioner of Taxation, *Annual Report 1998-99*, p. 19.

review, the evaluation stated: ‘The Taskforce has done exceedingly well in advising the Government on various tax minimisation practices and areas for law improvement. It has assisted in improving the law by providing advice to other parts of the ATO’.⁴³

Effectiveness

6.42 The benefit to the public interest of the HWI Program is questioned in some quarters. Several witnesses argued that public resources could be better spent on more effective measures, such as targeting areas of higher revenue risk⁴⁴ or tax reforms that remove the incentives for aggressive planning.⁴⁵

6.43 The Committee notes the important role the HWI Taskforce has played in recent tax reform, particularly its advice to both the Government on legislative measures and the Ralph Review of Business Taxation in 1999.

6.44 That said, the Taxation Institute of Australia (TIA) raised concerns about the cost/benefit of the program, arguing that the net cost of the HWI Program was ten times that of the average net cost of recovery of all ATO activities.⁴⁶

6.45 Net cost is generally regarded as an imprecise measure of efficiency. In the case of the HWI Program, it is less than helpful as it overlooks important factors such as the complexity of the audit work required, the need for senior level involvement and the extent to which the taskforce was required to build a clearer understanding of the HWI population in order to target compliance issues. The Taskforce’s work can in fact be seen as ground breaking in that ‘there were and still are no international HWI compliance strategies in other taxing authorities to follow or benchmark’.⁴⁷

6.46 In contrast to the TIA view, Mr Liebler, a highly experienced tax practitioner who has dealt with the taskforce, praised its operations. The establishment of the taskforce had, in his view, led to a ‘radical change’ in the conduct of HWI audits, with closer attention being paid to legal application, established ATO practice and the impact if litigation were to be pursued. Mr Liebler also pointed to the important role of senior ATO staff, particularly the head of the taskforce, in expediting and resolving audits and settlements.

... the High Wealth Individuals Task Force is quite remarkable in terms of the level of professionalism, objectivity and consistency which it is bringing to bear in relation to the tax affairs of high wealth individuals. ... I believe that the High Wealth Individuals Task Force is working well, and I have no doubt it will achieve its basic objectives. If all other areas of the ATO could operate along the lines of the High Wealth Individuals Task Force, then the ATO would be much improved.⁴⁸

43 Dobes, ‘Mid-Term Evaluation Report’, p. 10.

44 The TIA suggested that the cash economy, for instance, poses a graver risk than HWIs and could be targeted more effectively. Submission No. 17A, p. 11.

45 Arthur Andersen, Submission No. 6, p. 5.

46 Submission No. 17A, p. 11.

47 Dobes, ‘Mid-Term Evaluation Report’, p. 9.

48 Submission No. 85, p. 12.

6.47 This suggests there could be benefits for the ATO overall by studying the operation of the taskforce to identify better practice principles and apply where relevant lessons learnt. While the operational context of the taskforce may differ from some business lines (the Individuals Non-Business Division, for instance), aspects of the taskforce's approach and performance are likely to be applicable to the Large Business and International Division generally. The extension of the compliance model developed by the Cash Economy Taskforce to the whole of the ATO points to the organisation's ability to apply specific innovations to wider operational requirements.

6.48 Elements of the Taskforce's strategy that may prove useful or enhance the effectiveness of other business lines include targeted fieldwork, expanded tax returns for information collection and risk profiling to identify high risk business and industry segments. The Committee notes, for instance, that the ATO is using intensive targeted fieldwork as part of its strategy towards aggressive tax planning scheme designers and promoters (see Chapter Three). Cross-fertilisation of innovative strategies and lessons learnt across business lines may also yield improvements in the ATO's overall effectiveness and outcomes, not to mention enhancing organisational cooperation and morale.

Publicising HWI Issues

6.49 As a consequence of the recent mid-term evaluation, the Taskforce has moved to publish more widely its results and to improve communication with HWIs, their advisers and the public.

6.50 The Committee supports the Taskforce's publication strategy, and notes the coverage of HWI activities in the Commissioner's latest annual report to the Parliament. Publishing the results of and issues involved in the Taskforce's operations are important for community education and compliance. The debate about HWI tax practices is a high profile public issue. It is of concern not only to the Parliament and Government but the community in general, particularly due to the equity issues involved.

6.51 The Taskforce's role in managing HWI tax practices has significant implications for community compliance with the law which extend beyond the HWI population. It is important for voluntary community compliance that HWIs are seen to be conforming with the system and paying their fair and proper share of tax. Any erosion in community confidence that the tax burden is shared equally is likely to have ramifications for compliance behaviour across society.

6.52 However, it is clear that the complex nature of HWI taxation is not well understood in many quarters of the community. This is not surprising, particularly when it is considered that a major role of the Taskforce has been to assemble a clearer understanding inside the ATO of the tax practices and strategies employed by HWIs. The Committee believes that the ATO has an important role to play in educating the public about the nature and complexity of HWI tax issues.

6.53 In this context, the Committee notes a recent suggestion by Professor John Braithwaite that the ATO report to the Parliament the main reasons for the disparity between the accounting profits and taxable incomes of HWI controlled entities. In other words, why there may be legitimate reasons (eg, depreciation on property, research and development, franking credits and so on) for the perceived gap between the wealth of HWIs and the tax they pay. Publishing this information would have the benefit of not only clarifying the way

tax laws operate to allow individuals to reduce their taxable income but also providing the basis for a more informed and coherent debate about HWIs and the design of the tax system, compliance and overall equity.

The Parliament and the people would then have a more realistic understanding of why HWIs pay the level of tax they do. It would be clear why law breaking does not need to be invoked as an explanation. The major reasons would be plain to see. ...Confidence in the integrity of government and of HWIs might thereby be enhanced.⁴⁹

6.54 The Committee strongly encourages the ATO to take up the recommendation to disclose this information in the Commissioner's annual reports to the Parliament. It is in the interests of transparency and public confidence in the administration of the tax system and its integrity that public information on HWIs and their tax affairs be expanded beyond performance reporting to include explanations of the principles under which HWIs as a group legitimately reduce their taxable income.

Recommendation

6.55 The Committee recommends that the ATO include in the Commissioner's annual report to the Parliament an explanation of the principles which underlie differences between the accounting profits and taxable incomes of HWI controlled entities.

49 Braithwaite, 'Through the eyes of the advisers', pp. 29-30.

