

MINORITY REPORT

LIBERAL SENATORS

1.1 The Liberal Party Senators on the Committee have decided to issue a dissent to the Majority Report in order mainly to address imbalances in the analysis, assessment and recommendations contained in that report.

1.2 We wish to make it clear at the outset that we share many of the concerns and views included in the Majority Interim Report. We are concerned to see fair treatment extended to the many taxpayers caught unwittingly in mass marketed arrangements. We strongly support the introduction of appropriate counter-measures dealing with aggressive tax planners and scheme promoters.

1.3 It is common ground that the ATO should have acted sooner. This is now agreed by the Commissioner. Indeed, the Commissioner stated on 1 May 2001 that:

Looking back the result for everyone would have been better if we could have taken the 1997 initiatives earlier and, with the benefit of full knowledge of the magnitude of the issue and techniques employed we have adopted new strategies, for example, the product ruling system introduced in 1998.

1.4 Where we part company with the Majority Report is that we believe a fair and objective assessment requires that all of the factors contributing to the mass marketed scheme phenomenon be taken into account in order to achieve a proper appreciation of the rise and handling of the mass marketed schemes problem.

1.5 The Committee decided to issue an interim report in order to establish that special concessions for investors are required. The ATO has now agreed with the requirement for special concessions, and recently announced a range of initiatives. We therefore consider that the reason for issuing an interim report has disappeared.

1.6 We consider that the greater priority for the Committee is on assessing the appropriateness of the concessions offered, and whether more needs to be done.

1.7 It is a pity that the Majority Report spends so much time establishing what is now accepted, and fails to constructively examine how this matter could be appropriately brought to finality, the impact of the concessions offered by the Commissioner, and the lessons for avoiding similar occurrences in the future.

1.8 The Majority Report fails to properly acknowledge the very significant role of designers, promoters and advisers in mass marketed schemes. The conduct of, and the adequacy of measures for controlling, tax effective scheme designers, promoters and financial advisers is one of the Committee's three terms of reference. The failure to consider this has resulted in an unbalanced Majority Report. This risks playing into the hands of those parties with a vested interest in deflecting attention away from

themselves: the aggressive scheme designers, promoters and their associates, as well as serial tax avoiders.

1.9 The Majority Report also fails to consider in detail the major concessions to participants that the ATO has announced in recent months. In our view, the Committee has a responsibility to closely consider the adequacy of these concessions. The Committee should have moved rapidly to take evidence on these concessions to ensure that the particular problems were adequately addressed before issuing a report. This did not happen. The Committee should ensure proper consideration is given to this issue in the final report.

1.10 In addition, there are some fundamental misconceptions in the majority report:

1. the Majority report does not appreciate the self-assessment system. Changes to self-assessment would be fundamental to our tax system and may ultimately work to the disadvantage of taxpayers.
2. the Majority Report carries an underlying assumption that if the ATO does not publicly state that certain arrangements are not legal before taxpayers enter into them, then the ATO cannot enforce the law when they are found to be illegal. If such a principle were generally applied, it would jeopardize the integrity of the tax system and assist blatant tax avoiders.
3. the Majority Report fails to properly recognise the role of promoters and advisers in the mass marketed scheme phenomenon. We consider that as the originators and profiteers of mass marketed schemes, the blame for the obvious pain and distress caused by these schemes can be laid with the promoters and advisers.
4. in examining the ATO's approach to the emergence of mass marketed schemes, it is necessary to maintain a sense of perspective. It needs to be remembered that the ATO is responsible for administering the overall tax system, a task that entails addressing at any one time a spectrum of risks to the revenue. Such risks differ not only in nature but also in scale. In seeking to counter these risks the ATO has adopted a risk management approach that tailors strategies and resources to the level of identified risk. The Auditor-General has approved this approach.

ATO concessions

1.11 Participants in schemes repeatedly told the Committee how they object to being classified as tax avoiders. The Committee understands the concerns that unwitting investors have in being classified in this manner.

1.12 However, regardless of investors' motives, when the ATO invokes Part IVA in respect of a scheme it has classified as a tax avoidance vehicle, the Tax Law

prescribes the penalties that apply to participants in the arrangement. The law provides that the investor must pay the tax shortfall, a penalty up to 50% of the shortfall and interest (currently at a rate of 13.86%) on the shortfall from the date the payment should have been made. Interest also applies to the penalty, from the date the penalty first becomes payable.

1.13 To assist investors who have claimed income tax deductions under mass marketed schemes which have subsequently been denied, the ATO introduced settlement guidelines, offered participants reduced penalties for coming forward (down from 50% to 10% or 5% in all but the most blatant schemes), established a project team to deal with tax planners, and where there is evidence of fraud or breaches of other laws, referred cases to other law enforcement agencies, including National Crime Authority, the Australian Federal Police and ASIC.

1.14 To combat the future development of offensive tax effective schemes, the ATO introduced a product ruling system to give investors certainty about tax benefits arising from particular schemes.

Recent ATO concessions

1.15 The ATO's approach towards the tax schemes issue has shifted significantly since it first moved to disallow deductions in late 1997. Important developments have occurred relatively recently, namely:

- on 5 April 2001, the ATO announced a new communication strategy designed better to meet the needs of taxpayers caught in schemes. This strategy included regional visits by ATO officers to provide 'face to face' contact; allocating a case manager to each taxpayer with scheme related tax debt; sending improved information to scheme participants, in part to dispel the misinformation in circulation; and promoting the ATO's helplines for investors;¹ and
- on 26 April 2001, the ATO announced three further measures:
 - ATO test case funding for four cases relating to the Budplan scheme and a representative group of cases in relation to a film scheme;
 - allied to test case funding, a halt on recovery action on outstanding scheme debts where an objection has been lodged provided there are no signs of attempts by taxpayers to reduce their assets to avoid meeting their tax liability; and
 - a reduction in the interest charge for taxpayers with generally good tax records who were caught unwittingly in schemes and suffered significant financial losses (from the statutory level of 13.86 per cent to 5.86 per cent).²

1 ATO Media Release, 5 April 2001.

2 ATO Supplementary Submission No. 845B.

Fairness in taxation

1.16 It is important that members of the community pay their fair share of taxation.

1.17 This is essential to ensure that governments are able to provide public services. It is also important that the tax burden not fall disproportionately on some, which will occur if other taxpayers are able to avoid paying their share. This is essential to ensure that faith in the integrity of the tax system is maintained across the community.

1.18 It is therefore extremely important that blatant and aggressive tax avoiders be pursued.

1.19 In short, the tax system should be fair and it should be seen to be fair.

1.20 There is no dispute that those who abuse the tax system should be pursued with the utmost vigour. But the dilemma facing the Committee is how to deal with investors who have unwittingly become caught up in what the ATO considers to be tax avoidance schemes.

Special circumstances of mass marketed tax scheme participants

1.21 The evidence to the Committee has caused us to conclude that the current mass marketed scheme experience is unprecedented in that it involves a large number of taxpayers who have not set out to avoid their taxation obligations but have become involved, as a result of aggressive marketing campaigns by promoters and advisers, in what the ATO considers to be tax avoidance schemes.

1.22 The overwhelming evidence is that many of the investors in these schemes thought that they were undertaking genuine investment in worthwhile projects with a realistic expectation of receiving returns in the future. Whilst not unaware of the taxation benefits arising from the initial investment, many investors believed that these taxation benefits were acceptable to the ATO because they were more than outweighed by the potential tax on future returns. These investors were unaware that most, if not all, of their initial investment would go to cover fees and that very little, if any, would go to the underlying activity. These investors were therefore unaware that it was extremely unlikely that there would be future returns from these investments.

1.23 These schemes were often marketed with a high degree of sophistication. There were impressive looking prospectuses, often including positive opinions from apparently eminent experts.

1.24 Many investors have very limited financial expertise and so have relied solely on professional advice in entering into these schemes. Their investment in a mass marketed scheme may have been one part of a broad range of various investments undertaken over a period of years, with the other investments being entirely acceptable to the ATO. They may not have invested to such an extent as to reduce their taxable income from a very high amount to a very low amount. However, penalties and interest may have increased their debt significantly, particularly given

the length of time between the initial investment and notification by the Commissioner of disallowance of the deductions.

1.25 The ATO itself has concluded that unwitting investors should not be treated as typical tax scheme participants. We agree that unwitting investors should not be treated in the same manner as investors who have deliberately set out to evade tax.

1.26 The issue the Committee should have considered in detail is whether the ATO concessions are sufficient to deal with the problems facing unwitting investors. We are disappointed that the Committee has not moved to gather evidence of the adequacy of the recent ATO concessions. The Committee has a role to play and contribution to make in both the development of the eligibility criteria for the concessions, and in considering the adequacy of the concessions. Neither of these has been done. Again, the Committee should ensure proper consideration is given to this issue in the final report.

1.27 We have grappled with the need to assist these unwitting investors with the difficulties in which they now find themselves, and the need to ensure that members of the community who have not entered into these schemes do not bear an unfair burden of tax.

1.28 On the one hand are investors who have been unwittingly caught up in mass marketed schemes. On the other hand are taxpayers who have not invested in these schemes – some of whom will have deliberately chosen not to invest in these schemes because either they were not confident that the projected returns would be achieved, or they were not confident that the tax treatment as advised by the promoters was correct.

1.29 We recognise that there will also be a third group: those who are aggressive and blatant serial tax avoiders who will always be on the look-out to evade paying their fair share of tax and will be prepared to knowingly partake of any scheme to achieve this.

1.30 Because there is this third group, we cannot favour a general ‘line in the sand’ approach as we do not consider that aggressive and blatant tax avoiders should be treated concessionally. We consider that aggressive and blatant tax avoiders should be aggressively pursued by the ATO.

1.31 The question remains, however: how should investors who do not fall within this third group - the unwitting investors - be treated by the ATO?

Finalising this issue

1.32 While welcoming the decision of the Commissioner to fund test cases, we are concerned that these cases may ultimately take years to conclude and be extremely costly. There may well be appeals from court decisions and disputes on how widely a particular test case can be applied, particularly as there are many separate projects that could potentially be the subject of a court case.

1.33 In the meantime, unwitting investors in mass marketed schemes will continue to suffer from the lack of resolution.

1.34 Further, an industry seems to be growing up around providing advice to investors who have received notice from the ATO that their deductions are denied. This may cause the cost to unwitting investors of participation in these schemes to increase; we understand that some of the current advisers were previously promoters or advisers.

1.35 Even with the concessions offered by the Commissioner, interest penalties will continue to accrue where payment is not made.

Conclusions and recommendations

1.36 We consider that the mass marketed schemes phenomenon is unprecedented, and therefore that it calls for unprecedented steps by the ATO to assist investors who have been unwittingly caught up in what are considered by the ATO to be tax avoidance schemes.

1.37 We believe that every effort should be made to finalise this matter as quickly as practicable. It is in everybody's interests that a settlement be reached, to avoid the costs - both financial and human - which will continue for as long as this issue continues.

1.38 We would urge the Commissioner to investigate as a matter of urgency whether it is possible to reach settlements with individual investors where their particular circumstances are such that it would be reasonable to conclude that they are innocent of any intention to cheat the tax system.

1.39 Settlements with unwitting investors could include remission of all penalties, and application of the reduced interest rate to reflect the time value of the tax which is due and which the investors have been able to use while the tax remains unpaid. Further concessions may be required in more needy cases.

1.40 If test cases cannot be resolved within a reasonable time, we suggest the ATO consider suspending interest charges for unwitting investors.

1.41 In the meantime, we urge the ATO to make the reduced interest concession announced in April available to as wide a group of investors as possible, whilst ensuring that the tax system is protected against blatant tax avoiders.

1.42 The eligibility criteria for the reduced interest concession are currently subject to consultation. In this regard, the minority members do not consider that participation in more than one scheme over more than one year is necessarily a sign of an aggressive tax avoider, and so urges the ATO to not disqualify such investors from the concession by reason of this extended participation alone.

1.43 We consider that the primary cause of the mass marketed scheme phenomenon is scheme promoters who by a combination of aggressive marketing

techniques and incorrect advice concerning ATO clearance were able to create a culture in certain geographical areas, and within certain occupations, of investment in these schemes. We condemn such behaviour and those who have engaged in it. They have caused an immeasurable amount of damage to investors who trusted their advice. We urge investors to consider what legal action they may have against those who have engaged in these practices.

1.44 Some investors have contributed to fighting funds to support court cases against the ATO concerning the eligibility of deductions claimed. We question whether fighting funds could be established to support actions against unscrupulous promoters of these schemes. If investors have difficulties setting up fighting funds for this purpose, we urge the Committee in its future hearings to look at the possibility and practicality of organising such a fund.

1.45 We note that the Majority signals its intention to closely examine in the Committee's final report the conduct of scheme designers and promoters, as well as their networks of financial and legal advisers. We believe this is an important task before the Committee and strongly support it. Most importantly, we consider that the Committee should focus on what can be done to further assist unwitting investors, and work towards a settlement of this whole matter.

Senator the Hon. Brian Gibson

Senator Grant Chapman

