Parliament of the Commonwealth of Australia

SENATE ECONOMICS REFERENCES COMMITTEE

A RECOMMENDED RESOLUTION AND SETTLEMENT

SECOND REPORT

INQUIRY INTO MASS MARKETED TAX EFFECTIVE SCHEMES AND INVESTOR PROTECTION

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TERMS OF REFERENCE

On 29 June 2000 the Senate referred to the Senate Economics References Committee the matter of mass marketed tax effective schemes and investor protection for inquiry and report with particular attention to:

i. The adequacy of measures to promote investor understanding of the financial and taxation implications of tax effective schemes;

ii. The conduct of, and the adequacy of measures for controlling, tax effective scheme designers, promoters and financial advisers; and

iii. The ATO's approach towards and role in relation to mass marketed tax effective schemes.

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DEFINITIONS

Amended Assessment

An amended assessment is when the ATO re-assesses a taxpayer's tax liability. Amended assessments involve a more detailed review than is the case with assessments which mainly involve the ATO accepting a taxpayer's return at face value.

Deductions

Money you spend to enable you to earn income. Allowable deductions include, among other things, stationery, equipment, rent, electricity, telephone and tools. The value of the deduction is subtracted from assessable income to calculate your taxable income.

Non- and Limited- Recourse Loans

In the ATO's view, a non-recourse loan (NRL) is an arrangement where the lender has no recourse or right to reclaim the loan beyond a specified security of the borrower. Usually the 'specified security' is tied to the scheme's earnings (eg, the sale of timber in afforestation schemes). In other words, with an NRL the borrower is not personally at risk to repay the loan, apart from the specified security.

A limited recourse loan (LRL) exposes the borrower to slightly more risk than an NRL. Under an LRL the lender may have recourse to other assets of the borrower's, beyond the specified security. For instance, the borrower may be required to repay the investment loan in full, even if the income from the scheme is less than the outstanding balance on the loan.

Round Robin Financing

A round robin arrangement involves a circular 'paper flow' where little real capital is at stake. It often involves, according to the ATO, the passing of documents such as cheques, promissory notes and so on among connected parties, usually on the same day, with no change to the overall level of cash. While it creates the appearance of a financial transaction, there is little or no cash generated that can go into the underlying business of the investment.

Private Binding Rulings

Private Binding Rulings (PBRs) provide certainty on the tax benefits or consequences of an investment to *individual* investors. These rulings only apply to the individual taxpayer who requested the ruling (compare with Product Rulings below). As with Product Rulings, PBRs provide no protection in circumstances where the investment arrangement is not carried out in accordance with the information provided to the ATO.

Product Rulings

The ATO issues Product Rulings for individual investment schemes. Product Rulings are intended to provide certainty for potential investors by confirming the tax benefits of the investment. Unlike Private Binding Rulings which apply only to individuals, Product Rulings apply to all participants in the investment. Product Rulings relate only to the tax consequences of the investment. They do not involve any ATO assurance as to the investment's commercial viability, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based. A Product Ruling only applies if the arrangement is carried out in accordance with the information provided to the ATO.

Promoters

'Promoters' is a general term which can include investment scheme designers, the principals behind schemes and their managers, and those involved in the marketing and promotion of schemes.

Tax Rulings

Tax rulings provide the ATO's view on general matters of tax law (such as the deductibility of expenditure in relation to investment schemes, for instance). These have wider application than Product Rulings which relate to single investments.

PREFACE

INQUIRY PROGRESS

On 29 June 2000, the Senate referred the Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection to the Senate Economics References Committee. This is the second of three reports the Committee intends to table on the matter.

As outlined in the introduction, the Committee has decided to publish its recommendations for a resolution and settlement of the mass marketed schemes affair in a stand alone report before the Parliament rises.

The final report providing a more detailed discussion of some broader systemic questions that have emerged during the inquiry will be tabled in due course.

Since tabling its first report in June 2001 the Committee has received additional submissions which bring the total number to 926. It has also held further hearings into the inquiry in Sydney (24 and 25 July) and Canberra (26 July and 21 and 23 August). The Committee will include full details of all submissions and witnesses who appeared at hearings in its final report.

A RECOMMENDED RESOLUTION AND SETTLEMENT

1.1 Since June 2000, the Senate Economics References Committee has been inquiring into the issue of mass marketed tax effective schemes and investor protection. During the course of the inquiry, evidence has been presented on a wide range of issues and many important matters have been raised.

1.2 Of these, the two most important issues have been, first, the situation of thousands of investors in mass marketed schemes whose deductions have been disallowed by the ATO, and second, the measures taken to deal with the promoters of schemes.

1.3 Because of the significance of these two issues, the Committee has decided to publish its recommendations concerning them in a stand alone report before Parliament rises. The Committee will bring down a further report on some of the broader, systemic issues raised by its inquiry in due course.

1.4 At the outset, the Committee emphasises a number of points. First, as in the Interim Report, the Committee notes that it cannot determine the validity at law of the ATO's actions. A test case involving the Budplan scheme is currently underway in the Federal Court.

1.5 Second, the Committee is of the view that 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 has been especially disturbed by its sense that the lives of many of these people are 'on hold' or are being consumed by anxiety, anger and uncertainty about the final consequences of their scheme participation and the ATO's decision to disallow scheme related deductions.

1.6 Third, 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. The Committee makes recommendations to government about measures to address the aggressive tax planning behaviour of promoters at the end of this report.

1.7 In the first instance, however, the Committee turns to the situation of the many investors currently caught up in ATO recovery action. The reason for doing so is that judicial decisions about the validity of the ATO's actions in relation to each scheme may not be finalised for a number of years. The Committee considers that scheme participants must be given the opportunity to resolve their individual debts independently of that process and thus to get on with their lives.

1.8 Accordingly, in the first part of this report, the Committee outlines recommendations to the Government and the ATO which, it believes, will provide a just settlement option for the majority of investors in mass marketed tax effective schemes.[1]

The Bottom Line

1.9 The Committee considers that investors whose deductions in mass marketed schemes (MMS) have been disallowed should have two options.

1.10 The first option is to await the outcome of test cases or individual appeals. If investors choose this course, they remain eligible for the interest rate concession announced by the ATO on 23 July 2001.[2] If they lose their cases, however, they remain liable for repayment of the full primary tax plus penalties.

1.11 The Committee recommends that the maximum penalty payable for eligible investors who take this option should be at the rate of five per cent.[3]

1.12 The second option that the Committee recommends builds on the 'cash outlays basis' of settlement, already adopted by the ATO, in respect of some investors.

Cash Outlays Basis of Settlement

1.13 The 'cash outlays' basis of settlement was explained by the ATO in its July 2001 edition of the 'Facts' newsletter.[4] It constitutes a settlement offer by the ATO for investors in schemes with an underlying business activity. The ATO has said that this settlement arrangement is available to 'most' schemes 'that have a real underlying agricultural activity', but would 'generally not be acceptable for most of the non-agriculture investment schemes'.[5]

1.14 In this kind of settlement, the ATO agrees to allow a deduction for the actual cash that was paid under the terms of the original contract, even if the actual cash came from the tax refund rather than directly from the investor's pocket. This agreement does not mean that the ATO considers the deductions to be genuinely allowable: it means that it is prepared to deem them allowable in the interests of settling these cases.

1.15 An example of these arrangements is provided in the ATO's newsletter of July 2001. Diagram 1 illustrates their effect.

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1 The Committee specifically excludes employee benefit arrangements (EBAs) and other tax avoidance schemes including financial products, such as linked bonds and capital protected products, from its discussion of mass marketed tax effective schemes.

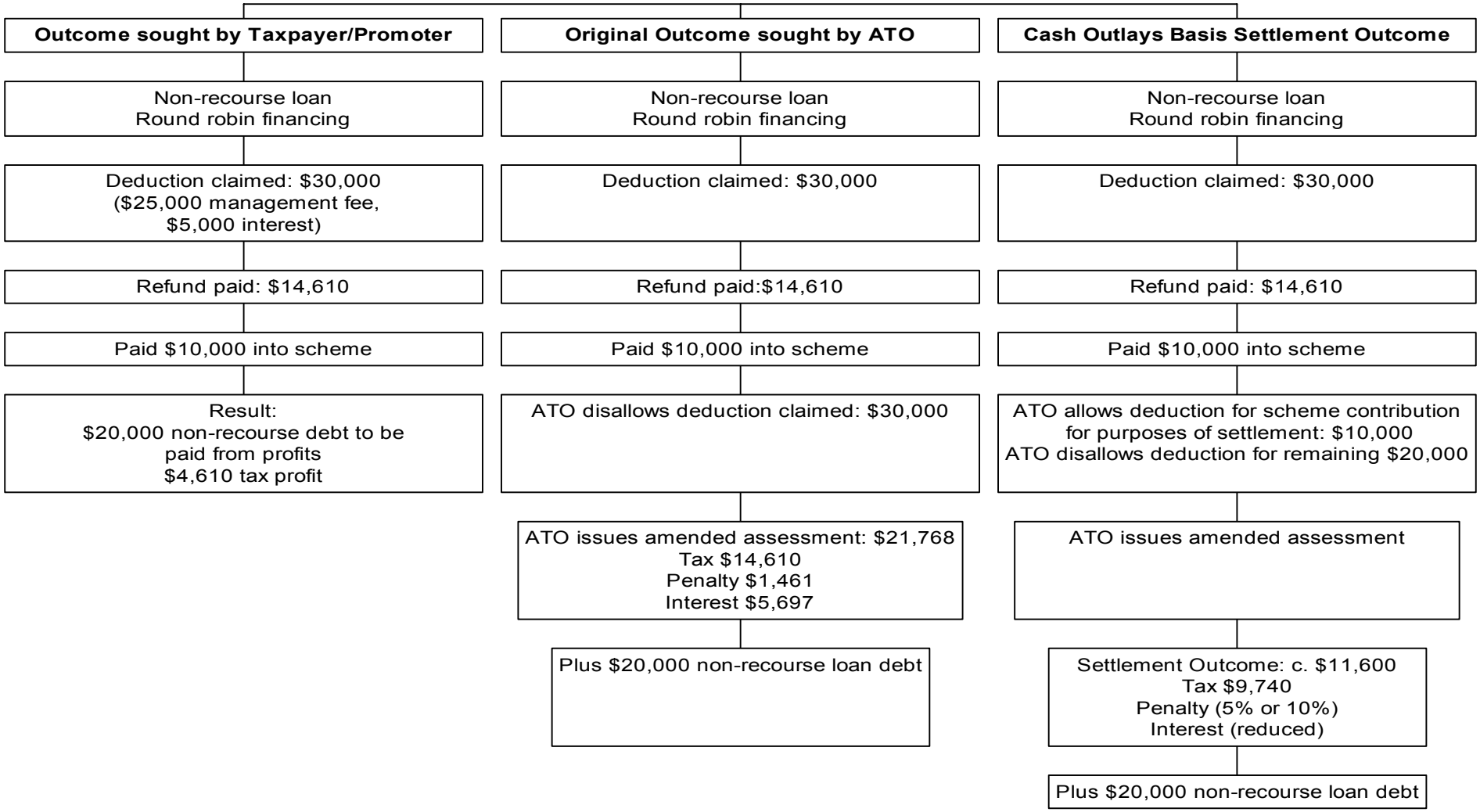
2 This concession entitles eligible investors to an interest reduction from the full general interest charge, currently 11.89 per cent, to a rate reflecting the time value of money of 4.72 per cent.

3 The 'eligibility' guidelines are outlined in the following section.

4 'FACTS on "tax effective" investments', Australian Taxation Office, Issue Number 2, July 2001.

5 ATO newsletter, 'FACTS', July 2001, p.3.

Diagram 1: AGRIBUSINESS SCHEME WITH UNDERLYING BUSINESS ACTIVITY



1.16 'Tim' claimed deductions of $25,000 for management fees and $5,000 for interest for an investment in a tea tree scheme. These deductions reduced his taxable income from $100,000 to $70,000. The management fees were funded by a non-recourse loan from the promoter's finance company, but Tim paid the interest in cash and also repaid $5,000 of the loan. No further payments on the loan were required except from future profits. Tim's deductions of $30,000 were disallowed, and hence liability for repayment of primary tax was $14,610.[6]

1.17 Under the cash outlays basis of settlement, Tim would be allowed the equivalent of a deduction for the $10,000 that actually went into the scheme. Thus, the amount of the deduction disallowed becomes $20,000 and the amount of the primary tax owed is reduced to $9,740.[7]

1.18 The Committee, however, does not believe that the concession goes far enough in two respects.

1.19 First, the Committee considers that there is an argument for making this basis of settlement available to all eligible scheme investors, and not simply to those who invested in schemes with an underlying business activity. The Committee is of the view that most investors were not in a position to distinguish between schemes that had genuine underlying businesses and those that did not, and that many were victims of unscrupulous promotion techniques. Thus, the Committee considers that to distinguish between investors on the basis of the nature of the scheme could be fundamentally unfair.

1.20 However, the Committee also recognises two difficulties associated with a blanket extension of this concession:

- the nature of film scheme arrangements; and
- the Budplan test cases.

1.21 Due to the nature of the film scheme arrangements, it would not be appropriate to offer settlement to these schemes on a cash outlays basis. There are, however, opportunities for settlement on film schemes based on allowing deductions for interest.

1.22 The Committee accepts the importance of the test case currently before the Federal Court and agrees with the ATO that the matter must be finally determined at law.

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6 Originally penalty and interest liabilities would have been added to this.

7 ATO newsletter, 'FACTS', July 2001, p.3. This taxation settlement does not affect the loan arrangement between the investor and the scheme operator. That is, the balance of the investor's non-recourse loan remains $20,000 to be paid, according to the original contractual arrangements, from profits from the scheme.

1.23 Therefore the Committee recommends that the settlement it proposes not be made available to the four litigants in the test case until after its conclusion.

1.24 The second respect in which the Committee does not believe that the current cash outlays concession goes far enough is in its treatment of the situation of investors in profit generating, commercially viable schemes.

1.25 The Committee considers that where an investor has invested in a scheme that is assessed to have commercial viability, the ATO should be prepared to settle with the investor by allowing the deduction claimed to stand in the first instance.

1.26 The criteria for assessing the commercial viability of the scheme are:

- that the income from the investment is sufficient to have repaid the non-recourse loan used to establish the deductions within the half-life of the scheme or the term of the loan agreement, whichever is the lesser;
- if, at the half-life point of the scheme or at the end of the term of the loan agreement there is outstanding debt on the loan, this amount will be treated as a disallowable deduction and reassessed on the cash outlays basis of settlement. The reassessed amount will be payable to the ATO within twelve months of the reassessment and will have interest applied to it at the reduced rate. No penalty tax is to apply.

1.27 The assessment of the commercial viability of schemes is to be made by an independent group of experts agreed between the ATO and scheme representatives. The group should include industry experts as well as accountants. The Committee considers that the assessment group should publish its findings in respect of each scheme. The Committee further considers that the findings of the assessment group should be non-appellable.

1.28 The details of the assessment process would need to be worked out on a case by case basis. The Committee envisages that the cost of the assessment would be borne equally by the Commonwealth and the promoter seeking to have their scheme assessed. The Committee further envisages that it will be the responsibility of promoters to put their schemes forward for assessment if they consider their scheme to be genuinely viable, although this does not preclude the ATO from initiating such an independent assessment. The expert group may need to make a judgement about whether detailed assessment of a scheme is justifiable and should be given sufficient latitude to make such a judgement.

1.29 The Committee emphasises that this recommended treatment of commercially viable schemes is to be understood as a *settlement* between the ATO and the eligible taxpayers. It does not constitute a concession that the claimed deduction was allowable in the first place. As with the cash outlays basis of settlement arrangements in general, it means simply that the ATO *deems* the deduction allowable for the purposes of settling the matter.

1.30 The Committee recognises that in these cases the ATO may have to wait to issue amended assessments until the loan repayment period agreed between the investor and scheme operator has passed. Although this means that there will not be immediate resolution or settlement of these cases, the Committee considers that any earlier disallowance of deductions would be unjust to the investors involved in profit generating schemes.

Recommendation

1.31 The Committee recommends that the deductions claimed by investors in commercially viable schemes should be allowed to stand to the extent that the non-recourse loan which formed the basis of the original claim is or is indisputably able to be repaid out of profits generated by the scheme.

Recommendation

1.32 The Committee recommends that eligible investors and the ATO agree to settle on the following terms:

- the ATO is to agree to full remission of penalties and interest on mass marketed investment scheme debt arising from deductions claimed in 1998/99 and earlier years;
- investors eligible for the 'cash outlays' basis of settlement as outlined by the Committee will receive further concessions on the amount of primary tax payable;
- investors, benefiting substantially from the remission of all penalties and interest, are to undertake to fully repay the adjusted primary tax on disallowed scheme deductions; and
- there will be no further objections or appeals lodged against the ATO in relation to that matter.

1.33 Eligible investors, who have already repaid their full tax liability including penalties and interest, will receive a refund for all but their adjusted primary tax liability.

Eligibility Guidelines

1.34 It is expected that the vast majority of affected taxpayers will be eligible for the remission of penalties and interest. For the sake of fairness, administrative efficiency and in the interests of resolving this issue quickly, investors will be deemed eligible unless they fall into the following categories:

- scheme promoters, including the directors and office bearers of the entity which managed the investments;
- tax advisers, financial planners and tax agents; and

- taxpayers with a tax history pattern of reducing their incomes to very low levels (thereby avoiding Medicare levy, superannuation surcharge, claiming social security benefits, etc).

1.35 Investors in these categories are not automatically eligible for the concession and would need to have their circumstances considered on a case by case basis.

1.36 Participation in schemes over three or more years does not necessarily disqualify investors from the concession. However, these investors too would need to have their circumstances considered on a case-by-case basis.

1.37 For those who do not qualify for the concession, the Committee considers that the ATO should retain the discretion to vary rates of penalties and interest payable. Factors influencing these rates will include:

- the tax history of investors;
- the extent to which individuals should, by virtue of their professional qualifications or scheme involvement, have had knowledge of the tax system and the financial structures of the investments; and
- the commercial viability of the scheme established (it is assumed that the culpability of promoters of viable or potentially viable schemes will be less than that of schemes that were never intended to succeed or were shams).

1.38 Investors should be aware that the ATO has provisions which allow for the long-term repayment of debt in accordance with individual financial circumstances. These include provisions for varying the rates or remitting entirely the interest payable on the agreed debt.[8]

Recommendation

1.39 The Committee recommends that, for all eligible investors, there be an interest free period of two years on debt to be repaid under the concessional arrangements. The Committee further recommends that, for all eligible investors, interest be charged in later years at a rate reflecting the time value of the money.

1.40 The two-year interest free period should serve as an incentive for encouraging taxpayers to repay their debt as quickly as possible.

1.41 Investors who are in financial difficulty are encouraged to contact their ATO case managers to discuss their situation. The ATO's Taxation Relief Board has the power to remit debt relating to primary tax in cases of severe financial hardship. The Committee urges the ATO to actively inform affected taxpayers of the existence and powers of the Taxation Relief Board.

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8 Although the Committee has recommended full remission of the interest payable on the tax liability which accrued from the time deductions were claimed to the time they were disallowed by the ATO, the question of interest payable on outstanding debt over a repayment period is a separate matter.

Reasoning and Underlying Principles

1.42 The Committee recognises that its recommended solution to the MMS crisis may cause controversy in some quarters because of the perceived special treatment of one group of taxpayers, and in others because it has not recommended a complete amnesty on the repayment of primary tax. The Committee makes the following comments in anticipation of these and other criticisms.

Undue Leniency

1.43 Some members of the community may feel that, insofar as participants in mass marketed schemes are excused from paying penalties and interest for wrongfully claiming deductions, they are being treated more leniently than other classes of taxpayer. In particular, those who have not benefited from the use of such deductions or those who face penalties and interest following the disallowance of deductions in other arrangements, may feel that they are comparatively disadvantaged by this concession.

1.44 In response to these concerns, the Committee makes the following points. The MMS issue is unprecedented and its resolution calls for unprecedented action on the part of government and the ATO. It is unprecedented in both its scale and in the extent to which large numbers of ordinary people appear to have been caught unwittingly in the tax mischief of many of these arrangements, or have been the victims of the unscrupulous promotion of scams.

1.45 Often investors were the victims of high pressure sales tactics and aggressive marketing. Often the schemes in which they participated were scams, although investors were unaware that that was the case. Typically, investors lost a large part or all of the tax benefit they sought.

1.46 Furthermore, many invested on the basis of advice taken in good faith. The Committee believes that taxpayers should have been entitled to trust the expertise of financial advisors, accountants and lawyers. The great majority of the affected taxpayers appears to have had generally good tax records.

1.47 The Committee emphasises most strongly that this resolution in no way sets a precedent. Those who invest in future in tax effective schemes will be deemed to have no excuse for being unaware of the risks involved and, should such schemes be found not ‘effective’, will be exposed to the full force of the penalty regime.

Undue Harshness

1.48 By contrast, some scheme participants and promoters may criticise the proposed concession for not going far enough. They will argue that the deductions should be retained by the investors, and the entire tax liability wiped clean with a ‘line drawn in the sand’.

1.49 The Committee notes that it remains open to investors to pursue this option and to await the outcome of test cases, if they believe that their deductions are allowable at law.

1.50 It may be argued that, even if the deductions are not allowable at law, a line in the sand should be drawn because the ATO did not signal in a timely way that it had concerns about these types of arrangement.

1.51 The Committee has recommended that penalties and interest on scheme related tax debts be fully remitted, partly on the grounds that the ATO did not signal early enough that it would apply Part IVA anti-avoidance provisions to these arrangements. However, the Committee does not believe that a lack of clarity in the ATO's position on Part IVA justifies the retention by investors of a tax benefit to which they were not entitled. The retention of that 'bonus' by investors would clearly be unfair to the rest of the community.

1.52 For these reasons, the Committee condemns the actions of promoters who seem to be diverting attention from their own culpability in this episode by inciting investors against the ATO. In particular, the Committee condemns the spread of misinformation to investors suggesting that, by subscribing to promoter 'fighting funds', they will not have to repay more than 5 cents in the dollar of the primary tax owed. The Committee again emphasises that repayment of primary tax (adjusted as per the previous discussion) is non-negotiable.

Promoter Penalties

1.53 The Committee considers that it is crucial that any concession for investors be matched by tough measures to deter and penalise promoters of aggressive tax planning arrangements. Sanctions are necessary to prevent future raids on the revenue and outbreaks of large scale tax minimisation. However, evidence to the Committee indicates that the resources of the existing regulatory regime may not be adequate to identify and prosecute wrongdoing in the tax effective schemes market.

Promoters under Investigation

1.54 The ATO advised the Committee that 115 scheme promoters or advisors are currently under investigation in relation to agribusiness, franchise and research schemes. This number does not include those under investigation in relation to film, book, investment, live theatre and some other types of scheme.

1.55 These investigations operate at a number of levels. In relation to the promoters' compliance with taxation law, they aim to determine whether the promoter entity has fully declared its scheme derived income and whether its own claimed deductions against that income are allowable.

1.56 Mr Michael O'Neill, Assistant Commissioner, said:

> … the first level is to make sure the promoters returned all the income, and we have seen examples where the promoter has not returned all the income.

> The second is to make sure there is integrity in the deduction side, that there are not loss companies, for example … or there is not the wash of income through an exempt entity or an entity that is purported to be a charity, which is something we have seen. If there is the stripping of assets of the company then we can apply an anti-avoidance rule to undo that…[9]

1.57 Promoters and advisors are also under investigation for suspected breaches of the law ranging from non-compliance with aspects of Corporations and Trade Practices law to the serious criminal charge of defrauding the Commonwealth. The ATO advised that there are a number of joint investigations underway between it and law enforcement agencies such as the Australian Federal Police (AFP) and the National Crime Authority (NCA).[10] Further, a number of matters have already been referred to specific agencies. Mr O'Neill told the Committee that:

> There are six matters that we have referred to the AFP, there are seven matters that we have referred to the National Crime Authority, there are another six matters that we have referred to ASIC and there is one matter that we have referred to the ACCC.[11]

Prosecutions

1.58 Despite the fact that the actions of many promoters breach existing laws of various kinds, there seem to be three barriers to achieving effective or early prosecution in many cases. These barriers are:

- lack of resources;
- high threshold of proof; and
- inter-agency logistics.

1.59 Investigating and prosecuting wrongdoing by promoters can be an extremely resource intensive exercise. In many cases, promoters use sophisticated accountancy techniques to 'wash' their income through trusts and other entities, or to set up fraudulent loan arrangements.

1.60 Even where the offences are not related to high level financial misconduct, agencies may lack the resources to pursue them. For example, the Committee took evidence from Mr Brian Dunigan, Vice-Chairman, North Queensland Essential Oils Cooperative, who had complained to ASIC about the inflated and misleading projections of the mass marketed tea tree oil schemes. He said:

> For example, on page 19 of appendix 1 of oil growers prospectus No. 1 issued June 1997 there is a statement to the effect that the price of oil was $58 a kilogram with annual increases to $85 a kilogram in 15 years, whereas

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9 Evidence, p.815.

10 Evidence, p.800.

11 Evidence, p.801.

> the industry at that time indicated the price to be less than $25 a kilogram – … Projected yields on oil growers prospectuses are 375 kilograms a hectare as against the industry standards taken from page 47 of the … Australian Tea Tree Industry Association, audit report, appendix 3, which showed the majority being between 51 and 200 kilograms a hectare.[12]

1.61 ASIC's response to Mr Brian Dunigan's complaint was as follows:

> The Australian Securities and Investment Commission … has conducted an assessment of the issues raised in your letter and has made further enquiries to see if we should take any action, and we have decided not to investigate this matter.
>
> We understand that your complaint is of great concern. We would like to be able to investigate every matter that is reported to us, but unfortunately we do not have resources to deal with all of them.
>
> The ASIC appreciates the effort you have made to bring this matter to our attention. We have recorded the information you have provided to us on our confidential database for future reference. This information will be useful if we receive further similar complaints.[13]

1.62 In addition to the resources required to pursue promoters for a variety of misconduct, the ATO noted that it can be difficult to gather sufficient evidence to provide grounds for investigation or to ensure successful prosecution. Mr Michael d'Ascenzo, Second Commissioner, said:

> There is a reality about pursuing prosecution. I remember being involved in some of the bottom-of-the-harbour situations, where we had a Commonwealth task force involving a whole range of agencies. We did end up putting into jail a handful of promoters, but there were many that – [escaped]… it just got too late and too long in the piece, and the Director of Public Prosecutions made the decision that it was not in the public interest to pursue those matters.[14]

1.63 For all agencies, given limitations on their resources, judgements about the significance and the likely success of particular prosecutions need to be made. Further, often such successful prosecution will rely on cooperation between agencies, each of which have different primary responsibilities and different priorities. While pursuing the promoters of Budplan, for example, was a major priority for the ATO, the Budplan case fell short of the NCA criteria of serious crime.[15]

1.64 Mr O'Neill told the Committee:

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12 Evidence, p.683.

13 Mr Brian Dunigan, Additional Information, 26 July 2001, p.2.

14 In-camera evidence, 23 August 2001, p.11.

15 File Note, 30 August 2001.

> The NCA is the peak enforcement body. The NCA needs what they describe as relevant criminal activity … There are some matters which they will not take on because they do not think they come into their statutory definition of relevant criminal activity and those other cases then are referred to the AFP.[16]

1.65 However, the AFP too may be restricted in its capacity to prosecute sophisticated fraud cases and, in any case, the secrecy provisions under which the ATO operate make it difficult for it to share the necessary information in some circumstances.[17]

1.66 For example, the ATO advised that Section 16 of the *Income Tax Assessment Act* prohibits the disclosure of taxation information by a tax officer other than in the performance of his or her duty as an officer.

1.67 Information may be provided to some authorised recipients, generally government agencies, for specified purposes. For example, information may be provided to the Australian Prudential Regulation Authority (APRA) or the Australian Securities and Investments Commission (ASIC) for the purpose of administering the *Superannuation Industry (Supervision) Act 1993*.[18] Similarly, Section 3E of the *Taxation Administration Act* allows officers of the ATO to provide information to certain law enforcement agencies, including ASIC.

1.68 However, conditions applying to that provision include that the information must be relevant to the investigation of an indictable offence and that the information cannot be used as evidence in a prosecution of a non-tax related offence.[19] For that reason, the ATO is restricted in its capacity to provide information relating to the investigation and prosecution of civil offences to agencies such as ASIC and the ACCC.

1.69 In the light of this evidence about the range of difficulties faced in effectively investigating and prosecuting scheme promoters, the Committee makes the following recommendations.

Recommendation

1.70 First, the Committee recommends that the Government consider amending Section 16 of the *Income Tax Assessment Act* or Section 3E of the *Taxation Administration Act* to allow the ATO to provide information relating to civil cases or to non-tax related offences to appropriate regulatory agencies, such as ASIC or the ACCC.

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16 Evidence, p.825.

17 File Note, 30 August 2001.

18 ATO Correspondence, 21 September 2001, p.3.

19 ATO Correspondence, 21 September 2001, p.3.

1.71 The Committee notes that amendments to the secrecy provisions would represent a significant policy change. Accordingly, the Committee notes that any amendments to the secrecy provisions would need to be justified on public interest grounds. That is, it would need to be demonstrated that the interest in making certain information available outweighed the public interest reflected in the current secrecy and privacy provisions.

1.72 Second, the Committee notes that the Attorney-General's Department has advised that its guidelines for funding public interest cases do not allow it to fund class actions against scheme promoters. However, a major hindrance for many investors in bringing promoters to justice is the cost of doing so.

Recommendation

1.73 The Committee recommends that the Government either amend the guidelines for funding public interest cases by the Attorney-General's Department, or that it make available funding for such actions by investors through ASIC and/or the ACCC.

1.74 Third, the Committee considers that there is a need to review and possibly revise current approaches for dealing with promoters who have fallen foul of existing legislation. Evidence suggests that the problem here relates not so much to deficiencies in the law as to problems in prosecuting cases that cut across agency lines. As well as privacy or secrecy restrictions, those problems seem to include resource constraints, administrative procedures and differing organisational priorities. The Committee is concerned that these issues may hamper cases being taken to prosecution, despite the law having been broken.

1.75 Consequently, the Committee believes that there are grounds for establishing a special prosecutory task force to deal with promoter cases involving inter-agency issues which have arisen from the mass marketed schemes episode. This is necessary because of the thousands of taxpayers involved, the hundreds of schemes and the billions of dollars concerned. To be effective, such an agency may need specialist resources (possibly provided on a secondment basis) and special provisions at law to overcome secrecy and other intelligence sharing issues.

Recommendation

1.76 The Committee recommends that the Government establish a special prosecutory task force to investigate cases arising from the MMS episode. The task force should be designed to deal with promoter cases that involve inter-agency issues, and be backed by specialist resources and legal provisions for overcoming secrecy and other intelligence sharing issues.

1.77 Finally, the Committee recommends that specific measures designed to control and monitor any future promotion of tax effective schemes be adopted in legislation. The Committee notes that the ATO has provided the Government with preliminary proposals for dealing with promoters, partly based on Canadian and US models. These models include measures such as regulating the registration of 'tax

shelters', reporting requirements on the promoters of registered tax shelters, and 'at risk' rules relating to the extent to which an investor's own funds are required to be at risk in the investment in order to claim a tax deduction.[20]

1.78 The ATO has advised the Committee that it is currently consulting with community and industry representatives to finalise its recommendations in this regard. The Committee is strongly of the view that measures of this kind should be adopted as a matter of urgency.

Recommendation

1.79 The Committee recommends that the Government expeditiously implement measures designed to control and monitor the promotion of tax effective schemes.

Senator Shayne Murphy
Chair

20 ATO, Additional Information, 28 August 2001.