MINORITY REPORT

Preface

1.1 The Committee has already issued two reports on the Mass Marketed Tax Effective Schemes fiasco.

1.2 The first – the Interim Report (June 2001) – was highly critical of the ATO's management of and approach to the mass marketed schemes affair.

1.3 The second report (September 2001) proposed an alternative resolution and settlement option with a view to allowing taxpayers and the ATO to resolve their differences without proceeding to court.

1.4 The recommended resolution and settlement was proposed following consultations with taxpayers and the ATO.

1.5 Despite giving a commitment to respond to the second report promptly, the ATO are yet to advise the Committee of their views on the recommendations.

1.6 Many of the issues canvassed in the Interim Report have become clearer and only add to the concerns initially raised by the Committee.

1.7 The ATO is the manager of Australian Taxation Law and as such is required to interpret and apply those laws – fairly and equitably.

1.8 Under the self-assessment tax system, taxpayers are required to abide by the law and the ATO view of the law, although they do have a right to challenge the ATO view in the Courts.

1.9 This type of system places great onus on the ATO to ensure clarity in both the law and their view of the law.

1.10 The ATO's task can be made more difficult by government policy objectives, which may impact on the application of the law.

1.11 The mass marketed schemes debacle is a good example of how things can go horribly wrong where a lack of clarity and action exists.

1.12 There is no question that ATO administrative practices have been found wanting on these matters for some time.

Background

1.13 Evidence to the Committee clearly shows that the ATO was aware of problems associated with claimed deductions in mass marketed schemes as early as 1982.

1.14 Indeed the ATO audited some twenty-eight schemes between 1987 and 1997. Fourteen of those audits were completed by 1994 with nine schemes having deductions disallowed primarily on the basis of round robin non-recourse financing.

1.15 As can be seen from the table below, scheme deductions grew at an exponential rate from 1993 to 1998, but it is worth noting significant increases in 1987 and 1988.

Table 1: Increasing Scheme Deductions 1987-1998

YEAR	SCHEME DEDUCTIONS $M
1987	13
1988	113
1989	73
1990	2
1991	7
1992	54
1993	54
1994	176
1995	288
1996	666
1997	1095
1998	960

Source: ATO Supplementary Submission No. 845B, Attachment 1[1]

1.16 Furthermore, historical evidence shows that both Governments and the ATO had concerns over claimed deductions associated with mass marketed schemes.

1.17 A press release from the Federal Treasurer as far back as the 30th December 1982 shows that the very problem used by the ATO in 1997-1998 to support retrospective action was a concern then. The press release says:

> "On 30 December 1982 I announced that the Commissioner of Taxation, who has independent statutory responsibility for administration of the income tax law, had decided to take assessing action under the general anti-avoidance provisions of Part IVA of the Income Tax Assessment Act to disallow claims arising from participation in certain film production arrangements **where deductions are substantially leveraged by associated loan arrangements**"(emphasis added).

1.18 Moreover, during the 1980s the media regularly featured articles on tax effective investments. These articles, as shown below, clearly demonstrate that knowledge and concern about such activities did exist.

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1 It should be noted that the annual scheme deductions in Table 1 do not include deductions for EBAs.

1.19 *The Australian*, March 1981:

> "Several schemes involve costs **related to special loans to investors which are structured so as to induce them into projects at no real financial cost to themselves**"(emphasis added).

1.20 *The Financial Review*, December 1984:

> "Even the Federal Government implicitly recognises the extent of the investment distortion caused by high marginal tax rates by two blatant examples of tax shelters for high marginal tax payers – the film tax deductibility rort and the licensed management investment companies (MICs)…In recognition of these factors the previous Government introduced what may have been seen by some as extremely generous tax concessions so that the industry could be funded through the tax system and by direct government handouts."

1.21 Furthermore, in relation to the history of agribusiness investments in particular, the same article went on to say:

> "The combination of tax shelter and capital gain has produced widespread interest in a variety of primary industry pursuits. The conventional route is to buy a rundown farm, build it up with tax deductibility investments over some years, sell it for a capital gain during a good season. There has been investment in angora goats, avocadoes, guava fruit, mangoes, macadamia nuts, afforestation, jojoba nuts, the babaco fruit from Ecuador, lychee fruit, blueberries or the pepino."

1.22 *The National Times*, 7th of June 1985 said:

> " PAY TAX OR GROW A FOREST? – very attractive taxation benefits."

1.23 Added to that was the 1991 statement by then ATO Commissioner Boucher, which said in part,

> "I would strongly recommend that in order to be assured of their tax position, investors obtain detailed and comprehensive advice on the full tax implications from promoters or their own advisers prior to committing funds."[2]

1.24 In many cases the financing structures designed for schemes during the 1980s were exactly the same, and had the same objectives, as those now subject to retrospective action. That is, they aimed to limit the investor's risk, leverage a tax deduction, and by doing so make the overall investment much more attractive.

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2 ATO Media Release, 'Tax Shelters – Why Some Umbrellas Sometimes Have Holes', 91/26, 2 June 1991.

1.25 Given the concerns raised by the Federal Treasurer in 1982, ATO statements and numerous newspaper articles, it is difficult to accept the ATO argument that it lacked information on or knowledge of Mass Marketed Schemes and their alleged abusive features when they emerged during the 1990s.

Effective Signalling

1.26 The ATO maintains that its concerns about abusive features in schemes were obvious to the market place well prior to the prolific growth in claimed deductions in the years 1993-1998.

1.27 However, evidence would suggest differently with the ATO's position being ambiguous at best. This is highlighted by the ATO approving thousands of 22ID applications, and issuing a number of Private Binding Rulings which approved the deductions sought in schemes now subject to the application of Part IVA. Moreover, a pre ruling consultative document (PCD9) issued by the ATO in December 1995 and claimed by them to represent a signal also fails the test of providing clarity and certainty to taxpayers.

1.28 This failing was pointed out in a 1996 internal ATO report which focused on the very issue of limited recourse financing. The report stated:

> "The PCD does not significantly address the limited recourse financing issue other than with respect to early termination of the loan and the application of section 82KL."

1.29 As stated earlier, the ATO did conduct some audit activity in the late 1980s-early 1990s. The following list outlines some of the schemes audited by the ATO and the reasons their deductions were disallowed.

<u>**Scheme 24** – Viticulture / Horticulture Scheme</u>
1987

- **Part IVA Application**
- Investors were not carrying on a business
- Expenditure by investors was of a capital nature
- Arrangement was a sham
- **Non-Recourse Financing**
- **Round-Robin Transactions**

<u>**Scheme 25** – Viticulture / Horticulture Scheme</u>
1988

- **Part IVA Application**
- **Round-Robin Transactions**
- **Non-Recourse Financing**

<u>**Scheme 21** – Viticulture / Horticulture Scheme</u>
1989

- **Part IVA Application**

- Taxpayers were not carrying on a business
- Taxpayers were passive investors
- **Borrowers borrowed 100% of the funds from an in-house financier**

Scheme 28 – Crayfish Breeding
1989

- ATO disallowed deductions claimed
- **Financing arrangements were considered artificial flowing in a round-robin between the in-house finance company, the borrower and the manager.**

Scheme 26 – Afforestation Scheme
1992-93

- **Scheme had a mixture of full and non-recourse loan arrangements**
- **Non-Recourse loan element was not allowed**

Scheme 22 – Viticulture / Horticulture Scheme
1993-94

- **Part IVA Application**
- Significant artificial management fee
- **Income as a result of round-robin and non-recourse financing**
- **Whole scheme based on round-robin and non-recourse financing**

1.30 Again the question arises that following the disallowance of deductions in nine out of fourteen schemes on the basis of non-recourse finance and large upfront fees, why didn't the ATO issue a tax ruling? Why did the ATO allow schemes with exactly the same non-recourse financing and fee elements to continue throughout the 1990s to the extent that so called non allowable deductions rose to $1.5 billion in 1998/1999? Finally, why did it take until 1998 before any decisive action was taken?

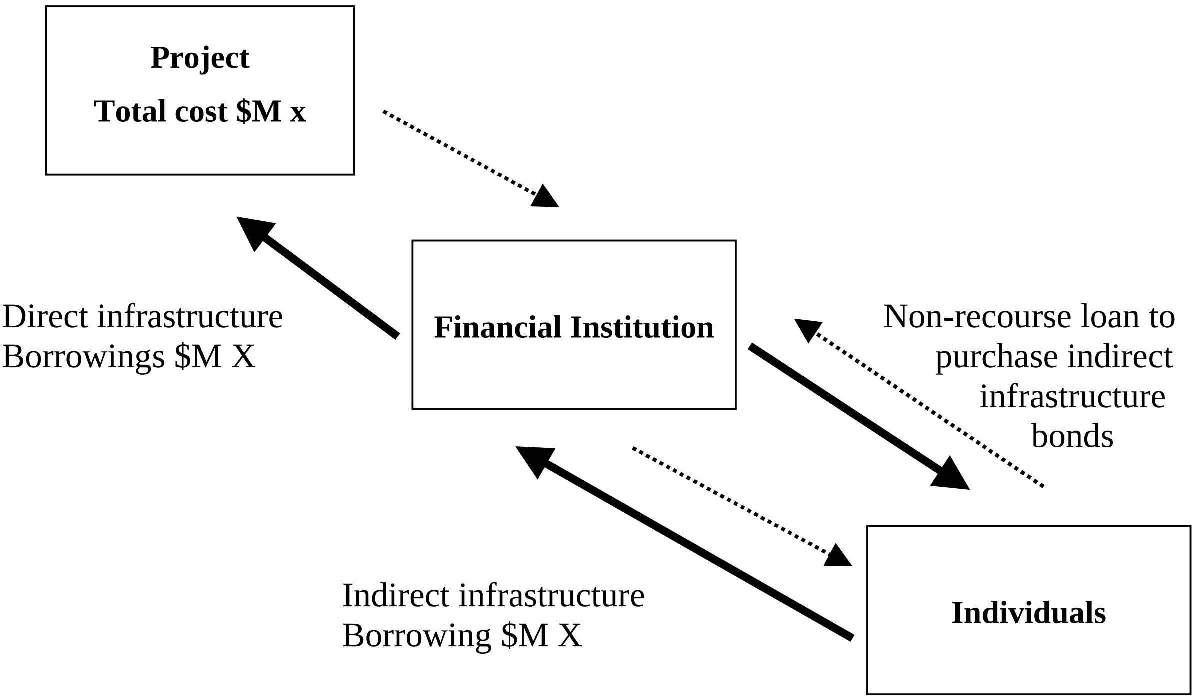
1.31 Across the board evidence presented to the Committee suggests that, at best, confusion reigned supreme and, at worst, the management and application of the tax laws of this country was downright incompetent.

1.32 What is also clear now is there has been no consistent application of Part IVA, and the obligation on the ATO to provide certainty and security for taxpayers has not been met in many areas. A demonstration of such inconsistency arises in the Infrastructure Bonds and Unit Trusts areas.

Infrastructure Bonds

1.33 During the early 1990s the Federal Government adopted a number of legislative and policy initiatives through the establishment of Infrastructure Bonds. Combined with generous legislative based tax concessions the objective was to facilitate and promote greater investment in large infrastructure developments. While essentially based on good policy and sound initiatives, infrastructure investments were viewed as a favourable way to invest, as the adoption of certain financing arrangements or structures allowed not only for a leveraged tax deduction but also a limited level of risk to the investor.

1.34 The structure and financing arrangements of infrastructure bonds were provided to the Committee by the ATO and illustrated by Figure 1.[3]



1.35 As Figure 1 shows the financing structures developed to market infrastructure bonds to retail investors are not dis-similar to those employed within the mass marketed area. In essence the retail investor took out a non-recourse loan, which achieved two objectives. Firstly, the investor could not only limit their overall risk but claim an immediate tax deduction. Secondly, the loan in many instances would have been paid out through proceeds often derived after the completion of the project; for instance, from tollgate revenue on a freeway project.

1.36 Many large organisations were involved in Infrastructure Bonds including, for example:

The Commonwealth Bank

1.37 The Commonwealth Bank's 'Infrastructure Investment Package for Develop Australia Bonds' is one such example worthy of investigation. In their Offering Memorandum dated the 23rd of April 1996 the Commonwealth Bank stated:

> "The loan provided by CBA (Commonwealth Bank of Australia) is non-recourse to the investor".

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3 Economics References Committee Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection, Written Reply by Mr Fitzpatrick to the Committee dated 15 June 2001.

1.38 The investment was constructed in such a way as to provide an investor with:

> "an entitlement to a tax deduction for management fees incurred on the investment and interest on the loan".[4]

1.39 Furthermore, the Offering Memorandum went on to say:

> "For a cash outlay of $70,048 by 14 June 1996, an investor should be able to obtain a tax refund of $80,048".

1.40 The last point is a clear issue of leveraging which should surely bring into question the 'dominant purpose' of any investor. However, as far as I am aware not one investor in these investments was ever issued with an amended assessment – similar to the current ATO action – on the grounds that their dominant purpose was to obtain a tax deduction or that the loan arrangements were designed to limited the investor's overall risk.

Legal and General

1.41 Another relevant example is an offering from Legal and General Financial Services, in relation to the following products:

'Legal and General Infrastructure Fund 1996-2';
'Legal and General Infrastructure Fund 1996-3';
'Infrastructure Investment Offer'; and
'Taxation Advice – Individual Investors'

1.42 Advice on these products from Price Waterhouse, dated 27 May 1996, stated:

> "The financing facility will be repaid from the redemption proceeds of the units in the Infrastructure Funds and the expected non-assessable distribution of $25,000 per unit made to the unit holders. The financing facility will be non-recourse to the investors."[5]

1.43 As mentioned previously, the ATO has consistently argued that in many instances the nature of the financing arrangements in the current mass marketed area resulted in little if any risk to the investor and hence warranted the application of Part IVA. However, both the Commonwealth Bank and Legal and General Infrastructure investments sought exactly that – to limit the investors exposure to risk through the use of non-recourse financing. It could also be argued that, in both these cases, high fees were set in order to leverage a substantial tax benefit for the investor.

1.44 There also appear to be inconsistencies in the ATO's treatment of infrastructure bonds relative to mass marketed schemes on the issue of their

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4 Commonwealth Bank, 'Infrastructure Investment Package for Develop Australia Bonds', Offering Memorandum 1996:2. (See also page 5 where they say the Loan is non-recourse to the borrower).

5 Advice from Price Waterhouse to Legal and General Financial Services Limited on 27 May 1996, p5.

underlying commerciality. First Assistant Commissioner Kevin Fitzpatrick, in response to questions put to him by the Committee in regard to Infrastructure Borrowings, said:

> "Infrastructure borrowings are distinguishable from mass marketed tax schemes. In the latter, round robin, non-recourse financing arrangements have the effect that little of the funds find their way into any productive activity."[6]

1.45 If, as Mr Fitzpatrick alludes, the main reason for the ATO applying Part IVA to mass marketed schemes is the fact that money **does not go** into 'productive activity', why then have commercially successful schemes which export their products world wide and which pay large amounts of company tax to the Commonwealth, had all of their investors' claimed deductions disallowed under Part IVA?

1.46 It is farcical for Mr Fitzpatrick to promote such an argument. If it were the case that the ATO assessed the application of Part IVA on the grounds of commerciality or that funds actually find their way into productive activity, then surely it would have been better for the ATO to have 'sifted the wheat from the chaff' in regard the mass marketed schemes sector. Instead, the ATO has issued amended assessments to any investor or scheme based not on commerciality but on the financing and fee structures.

Macquarie Bank – Geared Equity Investment Portfolio

1.47 Further inconsistencies in ATO action are evidenced by a number of Macquarie Bank Investment portfolios. Macquarie's 'Geared Equity Investment' is one such example. In the first instance, the promotional material for the investment clearly shows investors that the investment portfolio is 'APPROVED' by the ATO with a Product Ruling (PR 2000/70).[7] More importantly though, the promotional material says:

> "A Geared Equities Investment from Macquarie is an ideal way to build wealth over the long term through the share market. Macquarie will lend your clients 100% of the value of their selected portfolio…Best of all, your clients don't need to take any capital risks…Macquarie offers your clients 100% protection against the risk of losing their loan capital, giving them maximum peace of mind." [8]

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6 Economics References Committee Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection, Reply by Mr Fitzpatrick to the Committee dated 15 June 2001.

7 Macquarie Geared Equities Investment – Macquarie Bank Ltd. Sourced: http:///www.macquarie.com.au/adviser/geared_equities_investment.htm, p1.

8 Ibid, 1.

Macquarie Bank – Apollo Trust

1.48 Macquarie Bank has another investment highlighting similar anomalies and complexities in the ATO's administration of the tax law. The Apollo Trust is an investment which allows investors to access returns subject to the performance of hedge funds. With the Apollo Trust, Macquarie offers investors two loan facilities, of which one, a 'Capital Protected Loan':

> "fully protects themselves (the investor) against any fall in the value of their investment capital (provided their units are not redeemed before maturity).[9]

1.49 Furthermore, in relation to risk specifically, Macquarie Bank's promotional material goes on to say:

> "The structure of the investment aims to offer you an opportunity to increase the returns from your investment portfolio, **while reducing your overall portfolio risk**".[10]

Concluding remarks

1.50 In assessing these issues it is understandable why investors caught up in the mass marketed agribusiness investment fiasco feel the 'big end of town' has gained preferential treatment from the ATO. This point has further credence when the ATO themselves point out that 97 per cent of all investors now issued with amended assessments in relation to the Mass Marketed schemes area – with associated penalties and interest – sought the advice of a tax agent in making their claims.[11] Questions relating to what actually constitutes due diligence by the ATO need to be seriously addressed, particularly given the onus placed on individual tax payers by a self assessment tax system. With this to one side, the point still remains that the financing structures used by many of the current scheme designers have been utilised for over 20 years with only spasmodic and inconsistent application of Part IVA.

1.51 The reasons for the ATO applying Part IVA are complex but are summarised in a speech by Second Commissioner Mr Michael D'Ascenzo to the Taxation Institute of Australia on 22-24 March 2001. He argued that there are a number of aspects which trigger the application of Part IVA namely:

i. Grossly excessive/inflated fees;
ii. The mechanisms employed to discharge investor liabilities;
iii. Financing arrangements;
iv. Investor business risk;
v. Source and amount of cash funds applied to the underlying activity;

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9 Macquarie Bank 'Apollo Trust' Prospectus – Investment Highlights, 8

10 Ibid, 9.

11 Second Commissioner Mr D'Ascenzo, Senate Economics References Committee Hearings, Hansard 23-08-01, p.826.

vi. Commerciality of the project; and
vii. The financial position of the promoter and promoter related entities.

1.52 Similarly, Mr D'Ascenzo made the following comment before the Senate Committee hearings on 23 August 2001:

> "Again, the existence of non-recourse finance is a factor that we take into account. We make it very clear that, when we see non-recourse financing, the level of risk associated with the activity starts to give rise to whether or not what you are really after is a tax deduction."[12]

1.53 It is undoubtedly the case that a number of schemes and investors now having Part IVA applied, entered into non-recourse financing arrangements. This subsequently leveraged a tax deduction to the investor and limited their overall financial risk. However, so did a number of schemes marketed in the mid to early 1980s.

Infrastructure Borrowings and Part IVA

1.54 On the 14th of February 1997 the Federal Treasurer Peter Costello issued a statement, which said in part:

> " a number of measures [are being introduced] to prevent abuse of the infrastructure borrowings (IB) taxation concession instituted by the Labor Government, which if left unchecked would pose a major threat to the revenue."

1.55 At the time IBs approved by the Development Allowance Authority (DAA) had an estimated value in excess of $4 billion dollars. According to the Treasurer, the DAA had been monitoring applications and found that:

i. schemes being proposed are exploiting the concession for tax minimisation schemes; and
ii. these additional taxation benefits are principally being accessed by financial packagers and high marginal tax rate investors.

1.56 Essentially, a legitimate process designed to encourage infrastructure development was being leveraged and aggressively marketed to such an extent that the Treasurer felt legislation had to be implemented to curb the abuse. The Treasurer alluded to this abuse in the same Press Release saying that:

> "As a result of this transaction (i.e the re-engineering of the accepted model), for an investment of $36,000, they (the investor) get $85,000 worth of tax deductions."

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12 Ibid, p.820.

1.57 The fact that Part IVA was never applied to infrastructure investments, despite such evidence of aggressive leveraging, must seem remarkably unjust to those investors in mass marketed schemes who have had deductions disallowed and Part IVA penalties applied. This is particularly so, given that many invested in projects that are still operating and in many instances making good profits.

1.58 From a legal perspective the abusive developments of IBs and the associated concerns raised by the Treasurer bring into question the 'dominant purpose' of investors. Did they invest to see infrastructure projects developed or to gain a tax deduction? This question is answered by the Development Allowance Authority's findings that IB schemes were being exploited for tax minimisation purposes and taken up by high marginal tax rate investors.

1.59 Lastly, it could be argued that the abusive concerns in regard to IBs raised by the Treasurer himself in 1997, trigger all 7 points which facilitate the application of Part IVA, as identified by Second Commissioner Mr Michael D'Ascenzo in his speech to the Taxation Institute in 2001. Why then were the Government and the ATO content – in the case of IBs – only to implement legislation to curb tax abuse but not address whether Part IVA applied as it does in the case of mass marketed schemes?

1.60 In fact, First Assistant Commissioner Kevin Fitzpatrick, in written evidence to the committee on June 15 2001, said that in one particular IB scheme, Part IVA did apply. He said:

> "I am advised that we obtained advice from Senior Counsel in respect of one [IB] project in which counsel concluded on the facts of that case that there were reasonable prospects for the operation of Part IVA to some of the retail investors."[13]

1.61 To my knowledge, however, the ATO did not apply Part IVA penalties to any of the retail investors alluded to by Senior ATO counsel. Furthermore it must be noted that given the sheer size of many infrastructure projects, one IB scheme alone could involve hundreds of millions of dollars worth of investment capital. Again why was Part IVA not applied either to scheme designers or retail investors in this instance? This argument gains momentum when one considers the fact that investors involved in IBs could in most instances be considered 'sophisticated investors', unlike the great bulk of investors in the mass marketed schemes.

1.62 In many respects the inconsistencies in treatment between IBs and mass marketed schemes goes to the heart of the self assessment tax system and what the ATO constitutes as due diligence.

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13 Senate Economics References Committee into Mass Marketed Tax Effective Schemes and Investor Protection. Written evidence from First Assistant Commissioner Kevin Fitzpatrick in response to Committee questions, 15th June 2001, p.3.

MMS and Part IVA

1.63 The inconsistencies in applying Part IVA have engendered a serious public image problem for the ATO, as well as confusion in the market. For instance, Colin Thomas from Hudson Croft and Thomas Accounting firm in Sydney argued in evidence to the Committee:

> "In my view no tax professional with specialist knowledge in this area believed that Part IVA would apply to genuine business transactions where limited recourse or indemnified loans were used to finance the transactions. This is on the basis that the loans were properly documented and the funds flowed to evidence the transactions. The existing rulings and tax cases gave a clear indication."[14]

1.64 In support of this view Robert K. O'Connor QC argued in evidence provided to the Committee that:

> "In my opinion, the ATO failed to ensure that new laws were introduced to amend the Tax Act to overcome tax schemes. At law, the Courts had held that round-robin transactions are valid. Similarly, non-recourse funding was accepted in Lau's case (1984) 84 ATC 4929."[15]

1.65 Other aspects that need to be raised in regard to the inconsistencies and vagueness of the ATO's action are the following.

1.66 In October 2001, the Committee asked Assistant Commissioner Peter Smith why Part IVA was never applied to a plantation timber company which, in offering investors investment opportunities, clearly exhibited a round-robin financing structure.

1.67 In answering the Committee's concerns Mr Smith said:

> "In considering the application in respect of the year ended 30 June 1997, it was evident that the loans involved a round robin arrangement but due to the size of the fees and the full recourse nature of the loans this was not considered to be a problem at the time."[16]

1.68 According to tax ruling TR 2000/8 a round robin arrangement "includes any mechanisms employed to effect the discharge of liabilities…".[17] Furthermore TR 2000/8 questions the use of round robin arrangements by asking: "Are mechanisms of this kind commercially explicable and not part of arrangements to inflate, or

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14 Senate Economics References Committee Enquiry into Mass Marketed Tax Effective Schemes and Investor Protection, Sydney Hearings 24-07-2001, Hansard transcript, p.535.

15 Robert K. O'Connor, written submission to the Senate Economics References Committee Enquiry into Mass Marketed Tax Effective Schemes and Investor Protection, 25 July 2001, para 14, p.4.

16 Assistant Commissioner Mr Peter Smith, Response to the Senate Economics References Committee 19 September 2001, p.1.

17 Taxation Ruling TR 2000/8, clause 27

artificially create, tax deductions?"[18] In conclusion, the answer given by Mr Smith raises the question that if the up-front fees had been higher, or, in the ATO terms, were 'Grossly Excessive', would the ATO have applied Part IVA in regard to this project? The answer to this question is clearly NO and the following section demonstrates why.

Grossly Excessive Fees

1.69 The ATO has been repeatedly asked by the Committee to verify what it considers to be grossly excessive in regard to commercial rates and fees described in TR 2000/8. The Committee has also asked the ATO to explain how it determines, through Product Rulings, the validity of claimed tax deductions and, therefore, how it assesses the question of Part IVA's application and the investors' dominant purpose. The Chair of the Economics Committee asked Senior ATO representatives:

> "I would specifically like to know how you determine what are commercial rates, fees and charges."[19]

1.70 Mr Bersten (former Deputy Chief Tax Counsel of the ATO) answered:

> "Senator if I can refer you to paragraph 134 of the ruling itself, it says: A commercially realistic rate is usually fixed by looking at fees charged by bona fide operators in respect of the actual activity and range of services to be provided."[20]

1.71 In addition, Mr Peterson (Assistant Commissioner for Small Business) pointed to such things as **'a fair margin'**, or **'what you would normally expect to find in the market place'** and so forth.[21] However, in discussing the level of management fees and up-front charges and the associated deductibility of these fees, Mr Peterson emphasised that the ATO assesses such fees within a **'fairly broad band width'.**[22]

1.72 This 'band width', in regard to vineyard investments, according to Mr Peterson:

> "is probably anywhere like several hundred thousand dollars."[23]

1.73 In other words, the ATO will allow claimed deductions for an investment in a vineyard anywhere from the average fee, let's say $40,000 to $340,000!

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18 ibid, clause 61 (iii) Financing Arrangements.

19 Senate Economics References Committee into Mass Marketed Tax Effective Schemes and Investor Protection Hearings 11 December 2000, Hansard transcript E5.

20 Ibid, E5.

21 Ibid, E6.

22 Ibid, E7.

23 Ibid, E7.

1.74 Of greater concern was Mr Peterson's **suggested 'band width'** for an investment in Paulownia plantations. He argued that the band width acceptable in this area was as narrow as $500 or $600.[24]

1.75 However, the ATO has issued Product Rulings for Paulownia plantations with subscriptions ranging up to $52,500 per hectare, which is clearly outside the band width set by the ATO. This amount would also seem to fall into the grossly excessive fees category, as it in no way reflects normal market rates.

1.76 Given that the ATO has, on numerous occasions, used 'grossly excessive fees' as a justification for applying Part IVA, it is puzzling as to why they have issued Product Rulings for projects, such as Heritage Paulownia, which appear to have fees which exceed the market norm.

1.77 Moreover, it demonstrates that failings continue to exist in the ATO when it comes to dealing with mass marketed tax effective schemes.

1.78 It also highlights the major failings that existed within the ATO's risk assessment process in regard to earlier scheme deductions now the subject of Part IVA action.

Additional Concerns

1.79 Throughout this saga the ATO has sought to lay the blame squarely at the feet of promoters, advisers, scheme developers and investors. However, and as previously stated, the evidence simply does not support that position.

1.80 The ATO and some members of the Committee promote a view that to allow deductions for investors involved in mass marketed schemes to stand would be unfair on the rest of the community. There are two things that need to be said about that view.

1.81 Firstly, the general community were never offered the opportunity to participate but had they been offered, most would have probably taken the offer given the approach taken in the promotion of them and the type of professional people involved in the process.

1.82 The reality is, though, that the great bulk of the community does not have the level of income necessary to attract these types of investment offers.

1.83 It is my view that this approach is simplistic and seeks to avoid the real issue behind the problem.

1.84 The culture of tax professionals and taxpayers has been drawn more into focus as a result of the ATO's actions relating to mass marketed schemes. A number of issues need to be considered in this context.

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24 Ibid, E7.

1.85 As stated in the main report, the ATO has turned its attention to the attitudes of the culture of tax professionals.

1.86 In speeches to the community of taxation professionals, Mr Carmody and other ATO officers have asked that community to consider its role in maintaining the integrity of the tax system and have asked for its help in monitoring and controlling the activities of aggressive tax planners.[25]

1.87 In addition, a speech to the Taxation Institute of Australia by Assistant Commissioner Michael O'Neill concluded with the following exhortation:

> "If taxation is the price we pay for civilisation, we tax advisers, lawyers and accountants, each have a key role in advancing our community. Your advice will assist clients when considering the legal and financial benefits of investing in year end schemes."[26]

1.88 Mr Carmody told the Committee that:

> "In my view, the community's tax system would be best protected by others supporting the tax office in meeting this objective. In particular, the tax profession, which is at the coalface on a day-to-day basis, could provide a valuable role in bringing developments to our attention. There are mixed views on this in the profession, some preferring the view that their only responsibility is to their client and that this would be compromised by taking a community responsibility. **This view raises for me a number of responsibility issues that are worthy of considering. In saying that, is it saying that tax professionals know or knew the schemes were ineffective but, because the tax office had yet to act, they would recommend our support claims made for them? Otherwise, why not make them available to us? If so, is there no responsibility to the community for the integrity of the tax system, even when they know or expect the arrangements will not pass muster under the law?"** (emphasis added)[27]

1.89 Additionally, Mr Carmody told the Institute of Chartered Accountants:

> "It is one thing to approach an interpretation of the law from the perspective of advising a client, particularly where the whole objective is to minimise tax payable. It is another thing to approach the law from the perspective of a responsibility to the community for the integrity of the law."[28]

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25 See the Commissioner's speech, "A New Tax System – Changing Cultures", 19 November 1998, Sydney; and Assistant Commissioner Michael O'Neill's speech, "Taxes, Death & Civilisation: a look at year end "tax effective products", 15 May 2001, Brisbane.

26 Michael O'Neill, "Taxes, Death & Civilisation: a look at year end "tax effective products", 15 May 2001, Brisbane.

27 Evidence, pp.798-799.

28 "A New Tax System – Changing Cultures", 19 November 1998, Sydney.

1.90 The statement in this last paragraph is interesting in that it seems to seek to confuse the responsibility of the tax professional to their client and an act of breaking the law.

1.91 Under the self-assessment tax system, it is the responsibility of the tax professional to advise their client of every deduction to which the client is legally entitled – that after all is what they are paid for.

1.92 Responsibility to the rest of the community and the integrity of the law can only be at issue when the tax professional advises the client to break the law.

1.93 These are clearly two different things and it is simply not good enough for the ATO to endeavour to muddy the water by mixing the two together.

1.94 If the Commissioner and the ATO believe that tax professionals have knowingly advised clients to break the law, then they should prosecute them or support action by taxpayers for breach of duty against the tax professionals so involved.

1.95 The self-assessment system also allows for a reassessment of a taxpayer's affairs for up to four years in general terms and up to six years if the ATO deems that Part IVA applies and indefinitely in cases of fraud. Where the law is clear and concise, these measures should suffice for the ATO to collect the revenue to which it is entitled.

1.96 Any effort to employ morality as a solution to the interpretation of tax law is doomed to failure as has been witnessed over the life of the self-assessment tax system. Two witnesses to the Committee made important points in this regard.

1.97 Mr Robert O'Connor QC stated:

> "If morality had to be taken into account in interpreting the meaning of the law, whose morals should be applied? The answer to what the law is would vary and depend on the morals of the particular person giving the opinion."[29]

1.98 Mr Richard Gelski of Blake Dawson and Waldron said:

> "…not only is it our obligation to advise on the law as it is – we can be sued if we do anything else – but if we fail to advise a client that a transaction can be carried out in a more tax effective manner we can be sued for negligence by that client."[30]

1.99 The Committee Report draws on a submission by Mr Michael de Palo from Deloitte Touche Tohmatsu as contrast to the above views. In my view, Mr de Palo's

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29 Mr Robert O'Connor QC, Submission No. 891, pp.8-9

30 Evidence, p. 524

comments are not at odds with these remarks, but represent another way of stating the same thing.

1.100 Moreover, no number of reviews into the nature and extent of the public interest responsibility that tax professionals should adopt for the integrity of the tax system will adequately replace clarity in the law.

1.101 Clarity in the law is the key solution, and where clarity does not exist then it should be sought or determined by the Courts or legislation.

1.102 In the case of tax effective investment products, the law should be amended to require ATO approval for the products prior to their public marketing and sale.

1.103 If this had been the case in the past the thousands of investors now caught in the ATO action would not be in that position and at least $1.5 billion of tax revenue would not be at risk.

Summary

1.104 As has been highlighted in earlier parts of this report, abusive tax activity is not a new phenomenon and the ATO has had plenty of experience in dealing with it.

1.105 What is interesting is how the ATO have dealt with past problems. In areas such as Unit Trusts and Infrastructure Bonds, the ATO, Government or both moved to end abusive activities but in both cases they did it prospectively, not retrospectively.

1.106 When this was raised with the ATO, they argued there were important differences between Unit Trusts and Infrastructure Bonds and Mass Marketed Schemes.

1.107 The ATO stated that in relation to afforestation schemes, the ATO public position was that deductions would not be allowable if Part IVA applied, but that it had not made any comparable statement in respect of Unit Trusts and as such a clear signal existed in one area and not in the other.

1.108 The ATO also stated that the prospective decision on Unit Trusts was based on the arrangements being implemented in line with the information provided to the ATO on which it based its advanced opinions.

1.109 In contrast, the ATO allege that in the case of Private Binding Rulings for Mass Marketed Schemes, the promoters neither provided all of the facts nor implemented the arrangements according to the facts presented.

1.110 However, the ATO never produced any evidence to support these claims and it was remiss of myself and the Committee not to have pursued this matter further as it is fundamental to the equitable application of our tax laws.

1.111 Moreover even without greater scrutiny, the ATO position is found wanting. For example, in the case of one Private Binding Ruling issued to an investor in Main

Camp Tea Tree Oil, the investor provided what can only be considered as all relevant information, including information that the investments involved limited/non-recourse financing. Indeed, the applicant asked the ATO if they needed any further information to which they responded in the negative.

1.112 Moreover, if the ATO felt that it didn't have all the relevant information, why didn't it ask for it?

1.113 Why didn't the ATO – given their alleged concern about financing arrangements - specifically ask about them?

1.114 To try and hide behind a position that a clear signal existed in one area over another simply because you have mentioned Part IVA does not hold water.

1.115 There is no requirement for the mentioning of Part IVA for it to apply, indeed Part IVA is there for the purpose of dealing with breaches of the tax law, the "general anti-avoidance provision".

1.116 In addition, I doubt the ATO ever investigated all of the arrangements associated with Unit Trusts to determine whether or not they were implemented exactly in accordance with the advance opinions issued.

1.117 As is cited earlier in this report on Infrastructure Bonds, the government took prospective action in bringing to an end the rorts occurring in that area, which given the nature of the abuse as highlighted by Treasurer Costello, makes the ATO action in the Mass Marketed area even more questionable. In my view, it smacks of the old 'Animal Farm' theory.

Concluding Remarks

1.118 There is no doubt that many features of the Mass Marketed Tax Effective Schemes were tax abusive and needed to be stopped. However there is also no doubt that such activities developed and flourished as a result of identical or similar practices in other areas of the market place. Add to that a systemic failure by the Tax Office to clarify their position 'at law' and therefore their application of the law, and you have a recipe for disaster which is what happened.

1.119 One could be forgiven for concluding that the ATO's action in the Mass Marketed area had more to do with the Government's February 1997 decision in regard to Infrastructure Bonds than anything else! It is also a fact that – from a historical perspective - where the ATO has not formulated a view on the application of the law, or where the ATO or Government have changed their view in regard to particular taxpayer action, they have consistently acted prospectively!

1.120 The ATO and its Commissioners have an obligation under the Taxpayers Charter to treat all taxpayers equally and equitably, and it is my view that this obligation must be upheld at all cost. It is also my considered view that the ATO is seeking to treat one group of taxpayers (the Mass Marketed group) in an entirely different fashion to those involved in the same or similar activities in other areas.

1.121 Consequently the ATO's action should be condemned and viewed as unjust, and the Government should request the ATO to refrain from taking any further action against these taxpayers. The ATO's action goes to the very heart of the integrity of the tax system and if allowed to continue, will only increase the distrust in both the tax system and ATO now so evidently clear.

The Managed Investment Industry – Product Rulings

Protecting the Commonwealth Revenue

1.122 Over the past 22 years threats to the tax revenue have operated in various forms, with the use of certain financing structures and high management and lease fees perhaps the most prominent examples. It is now clear that high wealth individuals have consistently been able to gain large net cash benefits through a range of varied investments by leveraging tax deductions through the use of limited and non-recourse financing.

1.123 Such activities occurred in the issuing of Infrastructure Bonds (IBs), Unit Trusts as well as Mass Marketed Agribusiness and Franchise schemes. Of most interest is the fact that in 1997 the Government moved to block abuses in the IB area where investors were leveraging large tax benefits and in some instances gaining a net cash benefit after tax. Similarly, in 1998 the ATO moved to end exactly the same problems evident in the MMS area. It is clear that limited and non-recourse financing and excessively high management and lease fees were the more common tools used for leveraging large tax deductions.

1.124 In June 1998 the ATO introduced the Product Ruling system which was designed to better protect the revenue base while providing greater certainty for taxpayers. Whether this has been achieved is highly questionable and is an issue now canvassed by this report.

Commissions

1.125 Even though the Corporations Act clearly stipulates that commissions must be disclosed this area of corporate governance still exhibits many transparency related concerns. The Australian Securities and Investment Commission (ASIC) told the Committee that out of 91 prospectus documents investigated by ASIC:

> "30% did not disclose the commissions payable or the percentage of commission payable."[31]

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[31] Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection, Sydney Hearing 25 July 2001 p.601.

1.126 A further illustration of this is found in a 2000-2001 Prospectus for one of Australia's largest plantation timber companies where the percentage or level of commissions paid by the company to associated entities is unclear. The prospectus says:

> "In addition, from their own funds, the responsible entity or other companies within the same group of companies might pay additional fees to licensed dealers in securities who have provided particular assistance of an administrative or promotional nature in connection with the projects."[32]

1.127 It is difficult to sustain a legal argument that this vagueness over fees breaches Section 849 of the Corporations Act. However, it does go to the heart of mandatory disclosure and the right of an investor to know exactly how the responsible entity spends or uses their money. The investor should be entitled to know exactly how much the company is paying in commissions to outside entities. Is it 10% or 25% in total? Only then can an investor make an informed judgement as to how much of their money is actually going into the project.

Recommendation

1.128 Legislative changes need to be implemented which force responsible entities and directors etc to clearly disclose the total amount of commissions payable. It is clear that in a number of circumstances the softer parts of the law are exploited by promoters to hide the true extent of fees and commissions paid.

Large Up front Fees

1.129 Concerns with disclosure and transparency are similarly evident with the use of large up-front management and lease fees by companies. In the first instance, while classified as 'Management and Lease fees', close scrutiny shows that in reality only a very small proportion of the up-front fee exhibits a management and lease fee component. In fact, a significant proportion of the fee – sometimes in excess of 40-50% – is used by the company to purchase land or other assets to establish the project. This is rarely disclosed to investors and raises a number of serious concerns.

1.130 In regard to blue gum plantations, some plantation companies charge investors an up-front fee in excess of over $9,090 per hectare. Credible research from Government agencies such as the Department of Conservation and Land Management (CALM) in Western Australia, and academic departments such as ANU Forestry, show that it should cost no more than about $3,000 (maximum) to establish one hectare of blue gums on leased land over a 10-12 year rotation period.[33]

1.131 Allowing large up-front management and lease fees to be charged poses a number of problems. In the first instance, there is significant drain on the

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32 Ibid, 21-08-01, p.761.

33 Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection, Dr Ryde James ANU Forestry, Canberra Hearing 31 January 2001, p.119.

Commonwealth revenue by allowing scheme promoters to classify the funds contributed by investors as management and lease fees, when in most instances nearly half of the money is used to purchase land as a capital item. Consequently scheme managers use someone else's money in the guise of management and lease fees, to buy land which they can sell and take a profit.

1.132 In essence the whole arrangement is an inefficient mechanism by which the Commonwealth helps facilitate investment and therefore is not dissimilar to the concerns and comments made by the Treasurer in 1997 when putting a stop to the abuses found with IBs. On this point the Treasurer said:

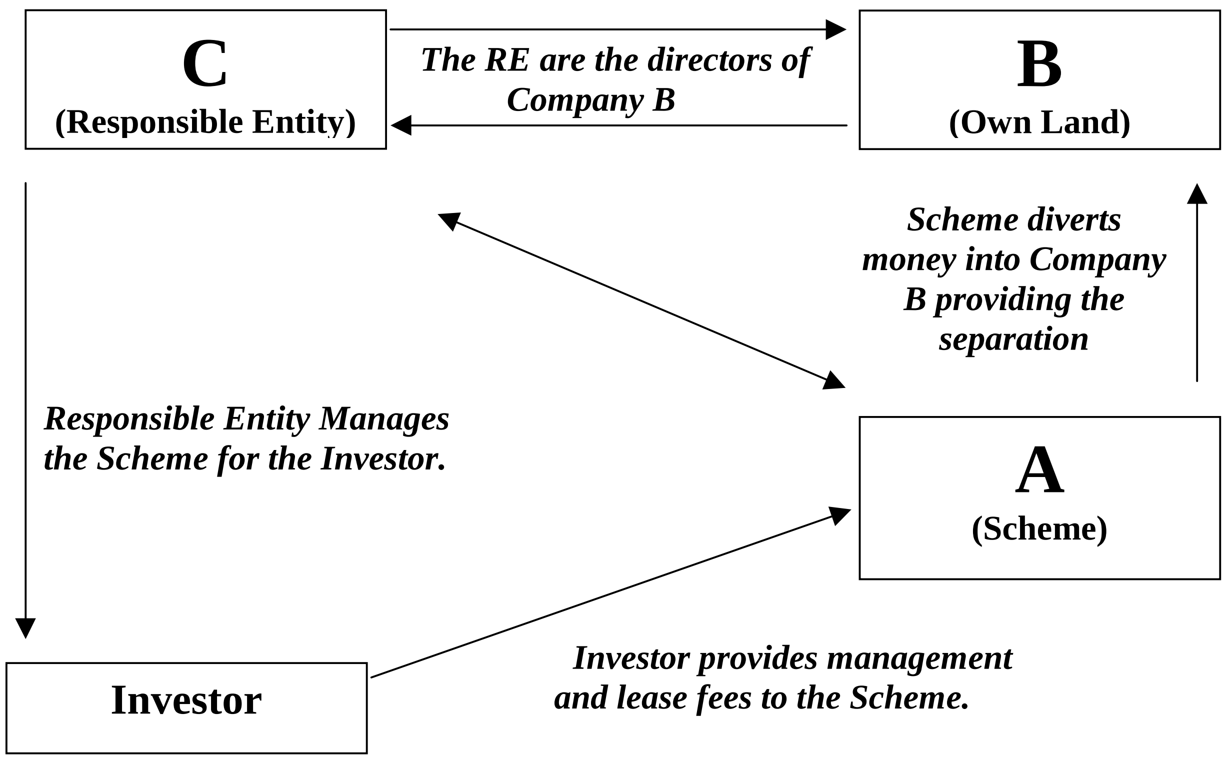
> "Now, I want to make it clear that the Government is not being critical in any sense of the projects. The vice, however, with infrastructure borrowings is that the taxpayer is not getting value. This is a very expensive way of getting money into those projects. It's tax expensive because instead of, as was the original plan, the borrower foregoing their right to have a tax deduction and the tax foregone by the borrower equalling the tax benefit received by the lender on some kind of symmetric one-to-one ratio, you're getting in these sorts of examples ratios of one-to-seven or higher. That is, the benefit to high marginal taxpayers in terms of their ability to save themselves tax is extreme multiples of the tax rights foregone by the borrowers. What that means is that this is not an effective scheme for taxpayers." [34]

1.133 The concern with this arrangement should, in theory, be picked up by the Managed Investments Act. However, scheme promoters are able to smartly side step the legislative provisions. Under the MIA Act any land bought by the scheme or through investments by investors in the scheme should be classified as 'Scheme Property'. However, scheme managers (ie, the responsible entity) are able to circumvent Section 601 FC, *Duties of responsible entity*, of the MIA Act. Section 601 FC states:

> (1) In exercising its powers and carrying out its duties, the responsible entity of a registered scheme must:
>
> (i) ensure that scheme property is:
>
> (i) clearly identified as scheme property; and
> (ii) held separately from property of the responsible entity and property of any other scheme.

[34] Transcript of Press Conference, The Hon Peter Costello, Treasurer, 14 February 1997 Parliament House Canberra, 2.

Diagram 1



1.134 As per diagram 1, to circumvent Section 601 FC the responsible entity – or directors of the parent company running the scheme – divert investor funds into a sister company, of which the Directors of the parent company are themselves the principal shareholders. The directors then use these funds to buy land to establish the project. While technically the company complies with the law and there is no scheme property, the ethics of the transaction are questionable because of the lack of transparency. In most instances, it is nearly impossible to find acknowledgment of this process in any prospectus. Investors are therefore unlikely to be aware that up to 50% of their funds are going into the purchase of land which they do not own or have any control over. Consequently, the tax system is essentially paying for scheme managers to accumulate land assets which only they own.

1.135 The ability of scheme managers to circumvent legal obligations in this manner raises concerns about the adequacy of the rules for disclosing what a company does and does not do with investors' money. ASIC Policy Statement 56 'Prospectuses' in section 56.119 says:

> "Subsection 1021(6) specifies a more substantive information requirement, that is, the prospectus must disclose the interests of directors, proposed directors and experts in the promotion of, and the property to be acquired by, the corporation (s1021 (6))."

1.136 Furthermore, ASIC general disclosure requirements state that, except when s1022AA applies, a prospectus must contain all information investors and their professional advisers would reasonably require and reasonably expect to find in the prospectus. It is obvious that investors would 'reasonably' expect to know how every dollar of their investment monies is spent.

Registration and Review of Prospectuses

1.137 ASIC in evidence to the Committee said:

> "We have power to review prospectuses but, practically, we do not have the resources to look at all of them. The Government specifically removed the requirement to register a prospectus so our ability to stop prospectuses at the registration stage was removed." [35]

1.138 Currently ASIC vet only a small proportion of all prospectuses lodged with them and assess prospectuses only in regard to their compliance with the Corporations Law. ASIC therefore do not verify the forecasts and projections contained in prospectus documents or the validity of expert opinions.

1.139 This is a serious shortcoming which will inevitably get worse once the reforms initiated under the Financial Services Reform Act are implemented in March 2002. Under the new laws the responsible entity of a managed investment scheme will not be required to lodge a prospectus with ASIC. Instead the onus to comply with the law will rest solely with the responsible entity. This is a serious problem, especially given that under the current regime ASIC say:

> "ASIC found that some RE's had inadequate compliance monitoring and reporting systems that, in some cases, led to breaches of the law by the RE. Our findings demonstrated a lack of active implementation of compliance arrangements and a lack of strong management commitment to implementing them in some organisations."[36]

1.140 In analysing the FSR Act it is clear that the legislative changes were adopted to appease large financial institutions with diverse investment portfolios. However, the legislation has failed to clear up a number of anomalies at the lower end of the investment market that rely on issuing prospectus documents.

1.141 It is clear from ASIC statements that they simply do not have the resources to adequately monitor this sector and therefore provide investors with adequate protection. Without a significant increase in resources it can be predicted that the problems currently experienced by the regulator will get worse.

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35 Senate Economics References Committee, ASIC Answers to questions , 19 September 2001.

36 ASIC Information Release on Surveillance Outcomes for Responsible Entities, Wednesday 1 August 2001.

Recommendation

1.142 It is therefore recommended that the law be changed, or the implementation of the Financial Services Reform Act be delayed for a further 2 years until a review of compliance is conducted.

'Experts'

1.143 Another anomaly which must be addressed is the use of expert opinions in prospectus or offer documents. Investors understandably place a great deal of trust in not only the financial forecasts and projections included in a prospectus but also in the expert reports contained in them. However as the *Business Review Weekly* reported on August 30 2001:

> "Few investors would suspect, for example, that some promoters of investment products shop around for sympathetic professional opinions for their prospectuses." [37]

1.144 ASIC Practice Note 55, 'Prospectuses – citing experts and statement of interests', sets out clear guidelines on the use of expert opinions in prospectuses.

1.145 Practice Note 55 states that the expert is accountable for their advice cited in a prospectus,[38] and that the expert must give their written consent for their opinion to be cited.[39] If such consent is withheld but the expert opinion is nevertheless cited in the prospectus, then the directors are liable to indemnify the expert.[40]

1.146 While Practice Note 55 is fairly extensive, a number of serious concerns remain. First, the Practice Note does not stop promoters from shopping around for a favourable opinion. Second, ASIC do not at any stage verify whether the expert cited in a prospectus is in fact an 'expert'. Consequently, ASIC say:

> "If a prospectus mentions a person's view on a matter, the ASC will normally take the prospectus as holding the person out to be an expert on that matter." [41]

1.147 This raises serious questions as to the validity of claims of expertise. Who is an expert and how qualified are they to make judgements?

1.148 In the case of plantation forestry, this is a serious problem, particularly as nearly all 'experts' will endorse the Mean Annual Increment (MAI) growth rates reported in prospectuses. The MAI's underpin the forecasted returns to investors. The

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37 *Business Review Weekly,* August 30 – September 5, 2001, Michael Laurence, 42.

38 ASIC Practice Note 55 Prospectuses – citing experts and statement of interests, clause PN55.6.

39 ibid, PN 55.4 (c).

40 ibid, PN 55.6 (d).

41 ibid, 55.14.

concern is that most plantation companies forecast returns to investors on an average MAI of 30/c.m/ha/yr. This is extremely misleading, firstly, because an average MAI of 30 means that some of the trees will grow at a MAI of around 40. These figures are inflated. Sound evidence shows that in even the best growing conditions an average MAI of around 20-22 is achievable but very unlikely.[42] If the lower figure were used, the forecasted return to investors would be seriously diminished. However, so-called experts still sign off on average MAI's of 30. This is why some tax specialists argue that:

> "…independent expert opinions are so heavily qualified that their conclusions are almost meaningless."[43]

1.149 In short, reliable evidence demonstrates the misleading nature of many projections in prospectuses, which in turn casts into doubt the credibility of 'expert opinions' used to support the claims of such prospectuses.

Recommendations

1.150 Like most aspects of the managed investment industry the area of expert opinion lacks integrity. It would seem that often experts are 'friends' or close business associates of the RE and therefore paid to give a favourable opinion. The entire system requires stronger measures to improve independence and objectivity. It is therefore recommended that ASIC consider either establishing a board of experts or a system for registering experts. Under this regime it should be mandatory for experts to disclose any conflict of interest in relation to the schemes for which they provide opinions. For investors these measures would provide a greater degree of certainty that the expert is indeed an expert. Currently no one including ASIC is in a position to assess claims to expertise.

1.151 It is further recommended that ASIC be given statutory responsibility for issuing expert opinions for all Mass Marketed investment schemes. The onus will be on the scheme promoters, designers and/or managers to provide ASIC with the investment proposal so that the proposal can be independently and 'expertly' assessed. An ASIC report on the proposal should include advice on general market conditions, the going market rates for establishment of the project, the yields and returns that could be realistically expected and the projections for the future of the industry. Furthermore, the ASIC report must be included in the final prospectus, or any other marketing information related to the project, and a copy must be provided to the ATO.

Product Rulings and Grossly Excessive Fees

1.152 A further concern is that the PR system is unable to support credible business investments and at the same time protect Commonwealth revenue. This is because the process by which the ATO determine whether management and lease fees are

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42 Evidence from Dr Ryde James ANU Forestry, see Hansard Transcript 30 –01 2001, p119.

43 *Business Review Weekly,* August 30 – September 5, 2001, Michael Laurence, p.46.

'Grossly Excessive' is seriously flawed. As a consequence the PR system is unable to prevent schemes which are extremely expensive and which exhibit unrealistic or un-commercial fees and charges from going ahead. Investors are then afforded tax deductibility for outgoings and the Commonwealth props up overly expensive schemes.

1.153 It is not the role of the ATO to determine how much a company can charge or how much an investor should outlay. Nevertheless, the ATO does have a responsibility to clearly assess whether scheme managers are charging fees that are, as the then Deputy Chief Tax Counsel Mr Bersten said in evidence, 'commercially realistic rates'.[44] The Part IVA anti-avoidance provisions require the ATO to examine the level of fees in arrangements with tax benefits. Grossly excessive fees are one of the eight factors that can trigger the application of Part IVA.[45] The problem is, however, that while the ATO cites grossly excessive fees as the reason for applying Part IVA in some cases, it continues in other cases to provide product rulings for schemes with management and lease fees far above the market norm.

Product Rulings and Business

1.154 The ATO has argued consistently that the PR process is primarily concerned with protecting investors not facilitating the needs of business. At the outset this position is accepted in that investors need greater protection and certainty. However, the fact that the PR process is not overly responsive to business requirements is of concern.

1.155 There are delays in processing PR applications which vary from 28 days to 2 years. Such inconsistencies pose considerable problems and frustration for businesses particularly those involved in the agri-business sector which rely heavily on planting regimes aligned to seasonal conditions.

1.156 The delays experienced by business from the application date of a PR to finalisation are exacerbated by the structure of PR drafting. The best way to explain this is to provide an example of what can occur.

PR Process Example – the 28 day clock

Example 1

- Promoters/Managers apply for a PR;
- Forward PR application to Melbourne ATO office;
- Application is assessed;
- Further information may be sought;

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44 ibid, E5.

45 As mentioned previously. See Deputy Commissioner Mr Michael D'Ascenzo, "Guidance provided by the ATO on the application of Part IVA" to the Taxation Institute on 22-24 March 2001.

- Further assessment;
- Melbourne office forwards the application to Perth for peer review;
- Further information may be sought;
- Perth office sends the application back to Melbourne for changes;
- Peer reviewer may well require to view changes before the Melbourne office sends the application to Brisbane for review by the Centre for Excellence;
- The Centre for Excellence may require more information and changes to be made;
- The Brisbane office then sends the application back to Melbourne with accompanying recommendations;
- Melbourne then send it to the applicant for their approval;
- For the PR to be gazetted in Canberra on a Wednesday the Melbourne office will have to have the application finalised in Melbourne the previous Tuesday.

Example 2

- Scheme has already been granted 2 PRs for the previous 2 years;
- Manager applies for an additional but identical PRr to expand the existing operation;
- Applicant has to go through the entire process again as listed in example 1.

1.157 The above two examples actually occurred to a medium to large agri-business company during the years 1999, 2000 and 2001. It is clear therefore that the PR 'sausage machine' is antiquated and very inefficient. In addition to delays is processing applications, the PR system suffers from serious communication breakdowns often experienced between the ATO and PR applicants, chronic staff shortages – our estimate is that the PR system has no more than 30 ATO staff working on PRs nationally. Serious questions need to be asked about the PR system and it's ability to respond to Australian business.

Time taken to produce PRs

1.158 The systemic inconsistencies and time delays experienced between the initial application date and the finalisation of the requested PR are unacceptable. As a consequence the entire PR system lacks credibility with the business sector because on many occasions the ATO give verbal guarantees to finish a PR within a set period of time but nearly always fail to deliver. This is exacerbated by the ATO consistently requesting new information from the PR applicant. On many occasions the applicant would question the ATO as to why they failed to ask for the information at the outset.

Structural concerns - The need to centralise the PR Process

1.159 The argument for centralising the PR system must, as a consequence, be seriously addressed. One solution would be to have two main offices, one in either Sydney or Melbourne and one in Perth dealing specifically with PRs. While specific locations can be negotiated and discussed at a later stage, the main objective should be to improve the integrity of the PR process for investors, with a greater commitment to designing a system which better responds to the needs of modern business.

Concluding comments

1.160 The constant delays evident in the PR process cause a number of problems. It unnecessarily constrains business and inhibits investment to the extent that investors – particularly international investors – may view the consistent delays as evidence of non-compliance with tax laws by scheme managers, rather than a sloppy bureaucratic process. As a consequence, schemes often lose investment capital and investor confidence.

1.161 There is no reason why the PR process cannot be redesigned to better facilitate business while continuing to provide investors with excellent protection. If the ATO addresses the time delays, communication and resourcing issues, there is no reason why the PR process could not be one of the best in the world in providing investors with protection and business with certainty.

Recommendations

1.162 It is recommended that the ATO adopt a similar time frame or commerciality approach with PRs as they have done with Private Rulings. The ATO gives an undertaking to provide a Private Ruling within 28 days from the application date. With PRs 28 days is simply not long enough. However, the ATO could realistically in most cases draft a PR from application to finalisation within a period of 3 to 4 months. The time period in essence however is irrelevant. What is relevant to business is that they are given some sense of certainty. As it stands they are inundated throughout the process with requests for more information and have absolutely no idea at all when the PR will be finalised. For most businesses it wouldn’t matter if each PR took 6-8 months as long as they knew. Only then can they forward plan their PR application according to the investment market and seasonal planting regimes.

1.163 Furthermore, it is recommended that the ATO be given a 28 day period starting from the application date to request further relevant information. As it stands the ATO consistently return to scheme managers with requests for more information some 6 months into the process. Most find this terribly frustrating particularly when they apply for back to back PRs for exactly the same investment project.

1.164 It is recommended that it be an offence, under the Trade Practices Act, to market and sell an investment product involving tax benefits without first obtaining a Product Ruling from the ATO.

1.165 It is recommended that the ATO disallow any part of a claimed deduction which relates to the purchase of a capital asset i.e. land – irrespective of whether that land is purchased for the investor or another party.

Senator Shayne Murphy