

eJournal of Tax Research

Volume 4, Number 2 December 2006

CONTENTS

- 97 Preface – Editors' Note
Binh Tran-Nam and Michael Walpole
- 98 Eulogy
Bob Deutsch
- 101 Refocusing on Fundamental Principles of Stamp Duty
Bill Cannon and Peter Edmundson
- 117 Promoter Penalties
Gordon S. Cooper, AM
- 132 Taxing Financial Arrangements: Harmonising Tax and Accounting?
Rodney Fisher
- 153 Testamentary Trusts: Not Just “Another” Trust?
Arlene Macdonald

In Memory of
JOHN RANERI
1957-2005

Atax
UNSW
Faculty of Law

Promoter Penalties

Gordon S. Cooper, AM*

Abstract

This article critically evaluates the rules applicable to the new Promoter Penalties regime. The article explains the background to the rules and describes the elements of the rules and the manner in which they will operate. Throughout, the article raises queries in relation to how the rules will work and identifies concerns with their operation. An example is the article's review of the operation of the Promoter Penalty regime alongside rules which essentially allow taxpayers to adopt positions that provide them with a "reasonably arguable" position. The article also queries the meaning of "promoter" explaining that it may not be clear-cut that a professional adviser is not a promoter.

INTRODUCTION

He's not the messiah; he's a very naughty boy.

(From the Life of Brian (1979), Monty Python)

The Promoter Penalty Provisions are a response to the debacle of the mass marketed schemes in the 1990s.¹ The intention to introduce such provisions was announced by the then Minister for Revenue and Assistant Treasurer, Senator Helen Coonan, in Press Release No C117/03 of 5 December 2003.

In paragraph 3.3 of the EM the need for the Promoter Penalty Regime is justified as follows:

Currently, there are no civil or administrative penalties for the promotion of these schemes with the result that promoters can obtain substantial profits while investors may be subject to penalties under the TAA 1953. This represents a significant asymmetry in risk exposure.

Division 290 is the revised version of the initial proposed legislation which was criticised for having a potential application which was too broad. There were submissions from the professional bodies and others as well as extensive consultation with respect to the initial proposed legislation and the Bill.

* Gordon S Cooper is an Adjunct Professor at Atax, Faculty of Law, University of New South Wales and the Principal at Cooper & Co. He can be contacted at gordon.cooper@whkgreenwoods.com.au.

¹ See for example "Beware the Magic Pudding" (Commissioner's address to Conference held by the Australian Society of CPAs) 12/06/98, "Walking the tightrope" (Commissioner's address to Monash University, Law School Foundation Lecture) 30/06/98, "Tax is in the Air" (Commissioner's address to Chartered institute of company secretaries) 11/08/98, "A New Tax System – Changing Cultures", (Commissioner's address to Chartered Accountants in Business Congress 1998) 19/11/98, "Investment Schemes" (Address by Assistant Commissioner, Peter Smith to the Australian Taxation and Management Accountants Workshop) 20/11/98, "A Question of Balance" (Commissioner's address to the American Club) 17/09/99, "The Heat is On" (Commissioner's address to Freehills and Australian Council of Business Women) 09/06/00, "The Tax Reform Wave – Challenges & Opportunities" (Commissioner's speech) 20/07/00.

The Promoter Penalty Provisions

The objects of the Promoter Penalty Provisions are set out in Section 290-5. It provides that:

The objects of this Division are:

- (a) to deter the promotion of tax avoidance *schemes and tax evasion schemes; and
- (b) to deter the implementation of schemes that have been promoted on the basis of conformity with a *product ruling in a way that is materially different from that described in the product ruling.

A number of the concerns that were expressed with respect to the original proposal have been addressed. Those that have not studied the Promoter Penalty Provisions could be forgiven for thinking that because they are not involved in promoting mass marketed schemes the Promoter Penalty Regime will not have any potential application to their activities.

Although the original announcement regarding the introduction of the Promoter Penalty Regime may have referred to mass marketed arrangements there appears to be no such limitation within the Promoter Penalty Regime.

This article will seek to demonstrate that such a complacent attitude is not justified.

Parts of the EM may be likened to William Congreve's words that "*Music has charms to sooth a savage breast*".² This article will suggest that there can be a significant disjunction between the soothing language in the EM and the words used in a particular proposed provision.

Scope of the article

This article will look at:

- the definition of a "*tax exploitation scheme*";
- the definition of a "*promoter*"; and
- the potential penalties.

In so doing it will consider whether the provisions ever can apply.

It will not look at:

- injunctions;
- voluntary undertakings; or
- the failure to comply with a product ruling.

TAX EXPLOITATION SCHEME

*Under capitalism, man exploits man.
Under communism, it's just the opposite.*

John Kenneth Galbraith (1908 - 2006)

² W. Congreve. "The Mourning Bride", I.i.

Long has it been necessary to differentiate between tax avoidance and tax evasion. Often drawing the line between the two has been difficult even if the difference is accepted as being the legality or otherwise of the arrangement. Frequently the boundary between avoidance and evasion has been in the eye of the beholder. The Promoter Penalty Provisions introduce the new concept of “*a tax exploitation scheme*”. It is to those who promote “*tax exploitation schemes*” that the Promoter Penalty Provisions are directed.

Definition

A “*tax exploitation scheme*” is defined in Section 290-65. It provides that:

290-65 Meaning of tax exploitation scheme

(1) A *scheme* is a **tax exploitation scheme** if, at the time of the conduct mentioned in subsection 290-50(1):

(a) one of the conditions is satisfied:

(i) if the scheme has been implemented – it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a *scheme* benefit from the scheme;

(ii) if the scheme has not been implemented – it is reasonable to conclude that, if any entity (alone or with others) had entered into or carried out the scheme, it would have done so with the sole or dominant purpose of that entity or another entity getting a *scheme* benefit from the scheme; and

(b) one of these conditions is satisfied:

(i) if the scheme has been implemented – it is not *reasonably* arguable that the *scheme* benefit is available at law;

(ii) if the scheme has not been implemented – it is not *reasonably* arguable that the *scheme* benefit would be available at law if the scheme were implemented

Note: The condition in paragraph (b) would not be satisfied if the implementation of the scheme for all participants were in accordance with binding advice given by or on behalf of the Commissioner of Taxation (for example, if that implementation were in accordance with a public ruling under this Act, or all participants had private rulings under this Act and that implementation were in accordance with those rulings).

(2) In deciding whether it is *reasonably* arguable that a *scheme* benefit would be available at law, take into account any thing that the Commissioner can do under a *taxation* law.

Example: The Commissioner may cancel a tax benefit obtained by a taxpayer in connection with a scheme under Section 177F of the Income Tax Assessment Act 1936.

There should be no problem in identifying a “*tax exploitation scheme*”. As paragraph 3.52 of the EM blithely states that:

Tax exploitation schemes are schemes that exploit the tax system through avoidance or evasion. The terms and concepts used to define a tax exploitation scheme in this Bill are taken from the anti-avoidance provisions of the ITAA 1936, the ITAA 1997 and the TAA 1953. These terms and concepts are well established in case law and administrative practice.

If the “*concepts are well established*” it does seem strange that with respect to the application of Part IVA the Full Federal Court and the Full High Court came to such

different conclusions in *Hart's Case*. Particularly is this so given the roles played by Gleeson CJ and the late Hill J in the development of Part IVA.³

Presumably the “*sole or dominant purpose*” requirement is the same as that in Part IVA. That is purpose will be a matter of objective determination rather than the subjective motives of the promoter. However the EM at paragraph 3.55 refers to the penalty provisions in the TAA 1953 rather than Part IVA. It states that:

The purpose tests in paragraph 290-65(1)(a) is modelled on the tests that apply to taxpayers in the scheme penalty provisions in subsection 284-145(1) of Schedule 1 to the TAA 1953.

For there to be a “**tax exploitation scheme*” there must be a purpose of “*getting a *scheme benefit from the *scheme*”. “**Scheme benefit*” is defined in Section 284-150(1). It provides that:

An entity gets a “**scheme benefit**” from a *scheme if:

- (a) a *tax-related liability of the entity for an accounting period is, or could reasonably be expected to be, less than it would be apart from the scheme or a part of the scheme;

It may be reasonable to conclude that by the time the Promoter Penalty Provisions have come into play it will be clear that there is a “**scheme*”. Also it may be clear that there is “*a *scheme benefit*”. However it is important to note that “*a tax-related liability*” must “*reasonably be expected to be less*” as a result of participation in “*the scheme*”. Presumably this means that the scheme must have a reasonable prospect of actually reducing the tax liability.

The definition of a “*scheme benefit*” would appear to exclude effectively any tax evasion scheme. This is because tax evasion does not change the tax liability. The object of tax evasion is to hide from the ATO the fact that there is such a tax liability. At its simplest, tax evasion may involve no more than deliberately not including cash income receipts in the assessable income declared in a tax return.

Moreover it would seem that if a scheme does not have a reasonable prospect for success there will be no “**scheme benefit*”. If that is so the more “*aggressive*” mass marketed schemes which perhaps had little chance of success will not be caught by the Promoter Penalty Regime. This would be so even though such schemes, together with tax evasion schemes, apparently are the primary target of the Promoter Penalty Regime.

For example in *Vincent v FCT* 2002 ATC 4742 the Full Federal Court stated at 4744 that:

The application to the Court was a test case in the sense that there were several hundred people who had in one way or another become involved

³ “When both were at the Bar, Gleeson CJ and Hill J were retained to advise the government on a replacement for s 260 of the *Income Tax Assessment Act* 1936 (Cth). Part IVA was the ultimate result.” I. Gzell, (2006) “The legacy of Justice Graham Hill”, (http://www.lawlink.nsw.gov.au/lawlink/Supreme_Court/ll_sc.nsf/pages/SCO_gzell010506 accessed 11/1/06).

with a cattle breeding project involving a number of companies associated with an accountant ...

In *Vincent's Case* the Full Federal Court went on to note at 4645 that:

... there was a critical finding of fact made by the learned primary Judge that Ms Vincent was not carrying on a business

and then held at 4758 that:

In our view once the conclusion is reached that Ms Vincent did not carry on a business it followed that the costs that were necessarily incurred to produce the six calves promised was an outgoing of capital and simply not deductible.

Was there a reasonable prospect of success in obtaining the tax deductions promised from the cattle breeding project in which Ms Vincent participated? If so, then such a project now would have the potential to come within the Promoter Penalty Regime. However if the inept way that the project was implemented meant that there was no reasonable prospect of there being a reduction to Ms Vincent's tax liability it would appear that the Promoter Penalty Regime would not apply to such a "scheme".

The apparent requirement of a reasonable prospect for success in reducing a tax liability is considered further at paragraphs 2.19 and 2.20 as far as tax avoidance schemes are concerned.

As with Part IVA, under the Promoter Penalty Provisions it may be less clear that the "sole or dominant purpose" was to obtain the "scheme benefit". However even if that can be demonstrated there is a further condition to be satisfied before the Promoter Penalty Regime will apply.

Not reasonably arguable

Under Section 290-65(2)(b) the Promoter Penalty Provisions will not apply unless "it is not *reasonably arguable* that the scheme benefit is available at law". The significance of this when coupled with the requirement discussed in paragraphs 2.6 to 2.11 is considered at paragraphs 2.19 and 2.20.

"*Reasonably arguable*" is defined in Section 284-15. It provides that:

- (1) A matter is "**reasonably arguable**" if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.
- (2) To the extent that a matter involves an assumption about the way in which the Commissioner will exercise a discretion, the matter is only "**reasonably arguable**" if, had the Commissioner exercised the discretion in the way assumed, a court would be about as likely as not to decide that the exercise of the discretion was in accordance with the law.
- (3) Without limiting subsection (1), these authorities are relevant:
 - (a) a *taxation law*;
 - (b) material for the purposes of subsection 15AB(1) of the Acts Interpretation Act 1901;
 - (c) A decision of the court (whether or not an Australian court), the *AAT* or a Board of Review;

(d) A *public ruling.

A cynical view of the ATO interpretation of what constitutes “*reasonably arguable” might be summed up as “*you would not be facing promoter penalties if what you had done was reasonably arguable*”. However a more measured view of what constitutes “*reasonably arguable” is set out in Taxation Ruling TR 94/5.

It should be noted that before 29 June 2005 the test of “*reasonably arguable was “*as likely to be correct as incorrect*”. Taxation Ruling TR 94/5 does refer to “*about as likely as not*”. Paragraph 9 Taxation Ruling TR 94/5 states that:

The explanatory memorandum to the Taxation Laws Amendment (Self Assessment) Act 1992 , at pages 83 to 87, should be used as a general guide for administering sections 226K and 160ARZD. The following points expand on the matters covered by the explanatory memorandum:

- (a) the reasonably arguable test does not require that the treatment given a particular matter by a taxpayer must be the better view, or be more likely than not the correct treatment. The test is "about as likely as not". This requires that the prospects that the taxpayer's treatment will be upheld by a court or Tribunal as being the correct treatment must be substantial, whether or not those prospects are less than or greater than 50 per cent;
- (b) the list of authorities in subsection 222C(4) is not exhaustive. In broad terms, the authorities that may be taken into account for the purpose of determining whether the treatment of a matter is reasonably arguable are those that would be accepted by a court as bearing upon the correct treatment of a matter. The relevance of any authority is a matter to be weighed against other authorities. An authority that has some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts or is otherwise inapplicable to the tax treatment at issue. An authority that merely states a conclusion is ordinarily less persuasive than one that reaches its conclusion by cogently relating the applicable law to the pertinent facts. It will be relevant, however, to consider the source of an authority. For example, a High Court decision on all fours with the tax treatment in question will be accorded more weight than a Federal Court decision, which in turn would be accorded more weight than a decision of the AAT. Authorities could also include, for example, statements in texts recognised by professionals as being authoritative about how the law operates, particularly in cases where there are few authorities on the correct treatment of a matter apart from the legislation itself. The relative weight to be given to each authority would depend on the circumstances. A taxpayer may have a reasonably arguable position for the tax treatment of an item despite the absence of authorities other than the legislation itself. What is required in such cases is that the taxpayer has a well-reasoned construction of the applicable statutory provision which it could be concluded was about as likely as not the correct interpretation;
- (c) while a Public Ruling issued by the Commissioner under Part IVAAA of the Taxation Administration Act is an authority (subsection 222C(4)), the mere fact that a Public Ruling has issued does not necessarily mean that alternative treatments to that suggested by the Public Ruling cannot be reasonably arguable. For example, a taxpayer's treatment could be reasonably arguable if there was a line of court decisions (which had not been overturned by any subsequent decisions) that supported the taxpayer's treatment as opposed to the treatment suggested by the Commissioner. Whether the taxpayer's treatment was reasonably

arguable would depend on its relative strength when compared with the Commissioner's and other possible treatments. In other words, taxpayers should take particular note of the Commissioner's views on the correct operation of the law as expressed in a Public Ruling, but may adopt alternative treatments provided there are sound reasons for doing so;

- (d) the reasonably arguable test only applies to tax shortfalls caused by a taxpayer treating an income tax law as applying in a particular way. A taxpayer treats an income tax law as applying in a particular way where the taxpayer concludes that, on the basis of the facts and the way the law applies to those facts, a particular consequence follows (for example, an amount of expenditure incurred is deductible). Subject to the other preconditions of section 226K, the reasonably arguable test is designed to encourage taxpayers to ensure that the conclusions they reach are sound ones. However, in some cases, a taxpayer's conclusions on a particular matter may have been based on incorrect primary facts which the taxpayer did not know and could not reasonably be expected to have known were not the proper facts, such as where a taxpayer relies on a bank to provide details of the amount of interest earned on a deposit. In other cases, the statements in a taxpayer's return may not represent conclusions of the taxpayer, but might reflect errors in calculation or transposition errors. As a broad rule, where a tax shortfall was caused by an error of fact or calculation section 226K will not apply since the taxpayer will not have treated an income tax law as applying in relation to a matter in a particular way. In this context, errors of fact are errors of primary fact and not wrong conclusions of fact which a taxpayer may make which bear on the correct application of a tax law, such as whether the taxpayer is carrying on a business. Whether the statements in a taxpayer's return represent conclusions of the taxpayer or were caused by errors of fact or calculation should be determined on the basis of all the available evidence;
- (e) identical matters are treated as a single matter for the purposes of section 226K (paragraph 226K(b)). This rule is designed to prevent single matters being split into smaller components to avoid the operation of the section. It should not be used to treat as a single matter numerous similar but distinct items of adjustment. For example, in the case of repairs to similar but distinct items of plant, the application of the law to each repair will turn on the particular facts, so that each repair would need to be considered separately to determine the correct tax payable. On the other hand, in the case of lease payments made in respect of a single item of plant, the same considerations would ordinarily be relevant to the treatment of each lease payment, so that the sum of the lease payments for the year would be treated as a single matter in relation to which the correct application of the law needed to be determined;
- (f) the words "another matter" and "the other matter" used in subsection 222C(1) refer to the operation of the reasonably arguable test as it applies in sections 224, 225 and 226 and do not affect its operation in respect of section 226K;
- (g) where the application of section 226K (and 160ARZD) results in an unduly harsh outcome in all the circumstances of the case then the penalty otherwise attracted may be remitted in whole or in part (see Taxation Ruling TR 94/7);
- (h) taxpayers have the right to object against a decision by the Commissioner that the reasonably arguable position standard has not

been met and to have the Commissioner's decision on the objection reviewed by the AAT or the Federal Court;

- (i) a taxpayer will only be liable for penalty for not having a reasonably arguable position where the shortfall caused by the position taken is greater than the higher of \$10,000 or 1% of the tax that would have been payable on the basis of the taxpayer's return;

Also it should be noted that in considering whether for the purpose of Section 290-65(2) it is "*reasonably arguable that a scheme benefit would be available at law*", it is necessary to consider whether such a benefit could be cancelled by the Commissioner by applying Part IVA. This is stated specifically in the Example in Section 290-65(2).

Nugatory legislation?

If paragraph 2.6 correctly states the Section 284(150)(1) requirement that the "*scheme*" must have a reasonable prospect for success, how does this fit with the Section 290-65(2)(b) exclusion if the position taken in a "*scheme*" is "*reasonably arguable*". Does it render the Promoter Penalty Regime nugatory? Alternatively will the Promoter Penalty Regime apply only when the reasonable prospect for success falls short of "*reasonably arguable*"? If so, it may leave a very narrow band of operation.

If and when the Promoter Penalty Regime falls for consideration by the Federal Court there is the intriguing prospect of Counsel arguing that it was "*reasonably to be expected*" that the scheme would reduce the tax liability but that the position taken by the scheme was not "*reasonably arguable*". This might require the use of doublethink. George Orwell defined doublethink as:

... the power of holding two contradictory beliefs in one's mind simultaneously, and accepting both of them.⁴

On reflection that is the daily currency of Counsel.

Potential application of Part IVA

Of some concern is an implication in the EM that there needs to be a judicial split decision on Part IVA with respect to the relevant scheme for it to have been reasonably arguable that Part IVA would not apply. In Example 3.4 in paragraph 3.66 of the EM it states that:

Some years later, the Commissioner disallows the tax benefits claimed under Part IVA of the ITAA 1936. The company challenges the Part IVA determination in the Federal Court and loses; however, it is clear from the split decision in the case and the reasons that it was a close call and that Rona's opinion was not seriously flawed.

As a pedant it is noted that it is doubtful whether the tax benefits would have been claimed under Part IVA. Clearly the EM means to convey that the tax benefits would have been disallowed under Part IVA.

The consideration, by reference to subsequent events, of whether it was "*reasonably arguable*" that Part IVA would apply is contrary to Section 290-65(1). The definition

⁴ G. Orwell, (1949), *1984*, Chapter 1, Part II, ix.

of a “*tax exploitation scheme” requires consideration of what was “*reasonably arguable” “at the time of the conduct” of the “*promoter”.

Indeed determining what is “*reasonably arguable” by reference to subsequent events, is contrary to what is stated in the opening sentence in paragraph 3.66 of the EM. It states that:

When examining what is reasonably arguable **at the time of the promoter’s conduct**, the Federal Court may take into account anything that the Commissioner can do under a taxation law, including issuing a determination under Part IVA of the ITAA 1936 or exercising a discretion. (emphasis added)

It is considered to be quite clear that the determination of what is “*reasonably arguable” has to be done at the time that the scheme is being promoted. Subsequent events are not relevant. Obviously in a situation similar to that set out in Example 3.4 in paragraph 3.66 of the EM a “*promoter” will be happy to accept a decision that what they did was “*reasonably arguable” regardless of how that decision was reached.

Even if subsequent events were relevant there is the problem that a matter may never be litigated so that there can not be “a split decision” to make it clear that “it was a close call”. Even if a matter is litigated there may be judicial unanimity that Part IVA applies as happened in the Full High Court in *Hart’s Case*. Such unanimity does not of itself mean that it was not “a close call”. The earlier quoted paragraph from Example 3.4 in paragraph 3.66 of the EM does say that in addition to there being a “split decision” consideration needs to be given to “the reasons”. Do both requirements have to be satisfied? Would it be enough if “the reasons” in a unanimous decision make it clear that indeed it was “a close call”. Of course the EM is not the law, merely a guide to understanding the Promoter Penalty Provisions.

PROMOTER

*By adverting to the dignity of this high calling,
our ancestors have turned a savage wilderness
into a glorious empire; and have made the
most extensive and the only honourable
conquests, not by destroying, but by promoting
the wealth, the number, the happiness
of the human race*

Edmund Burke (1729 – 1797)

Not all promoters wear white shoes and bedeck themselves with gold chains.

Definition

“*Promoter” is defined in Section 290-60. It provides that:

- (1) An entity is a **promoter** of a *tax exploitation scheme if:
 - (a) the entity markets the scheme or otherwise encourages the growth of the scheme or interest in it; and
 - (b) the entity or an *associate of the entity receives (directly or indirectly) consideration in respect of that marketing or encouragement; and

- (c) having regard to all relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.
- (2) However, an entity is not a **promoter** of a *tax exploitation scheme merely because the entity provides advice about the *scheme.
- (3) An employee is not to be taken to have had a substantial role in respect of that marketing or encouragement merely because the employee distributes information or material prepared by another entity.

It should be noted that to be a “*promoter” there has to be marketing or encouragement of the “*scheme” which potentially generates income. Moreover the role of the marketing and encouragement has to be “substantial”.

Leaving aside for the moment the specific exclusion in Section 290-60(2) for providing tax advice, paragraph 3.44 of the EM seeks to differentiate between a “*promoter” and a professional adviser. It states that:

Scheme promoters generally undertake promotional activities to earn higher financial rewards than would be available for providing independent and objective tax advice. Those scheme profits constitute consideration received from the marketing or encouragement of a tax exploitation scheme and help to establish that any entity is a promoter.

At this point most tax practitioners may well feel that it is crystal clear that they fall outside the definition of a “*promoter” and hence that they need have no further concern about the potential application of the Promoter Penalty Provisions to their activities. Consideration below of the exclusion with respect to the provision of tax advice suggests that it may not be quite so clear cut.

Tax advice exclusion

Section 290-60(2) excludes from the definition of “*promoter” situations where an “entity provides tax advice about the scheme”. This would appear to be making explicit what paragraph 3.44 of the EM quoted above suggests is implicit in the basic definition of “*promoter”.

The tax advice exclusion is explained in the EM as follows:

- 3.49 An entity is not a promoter merely because they provide advice about the scheme. As a result, financial planners, tax agents, accountants, legal practitioners and others are not promoters merely because they provide advice about a tax exploitation scheme, even if that advice provides alternative ways to structure a transaction, or sets out the tax risks of the alternatives. [Schedule 3, item 1, subsection 290-60(2)]
- 3.50 The civil penalty regime is not intended to inhibit the provision of independent and objective tax advice, including advice regarding tax planning. Advisers who advise on tax planning arrangements, even those who advise favourably on a scheme later found to be a tax exploitation scheme, are not at risk of civil penalty to the extent that they have merely provided independent, objective advice to clients.

The comfort to be gleaned from the statements in paragraphs 3.49 and 3.50 of the EM may be illusory. This is because Section 290-60(2) requires advice to be given “about the *scheme”. It would appear that there has to be a pre existing scheme with respect to which the tax professional is requested to opine on its efficacy. Indeed paragraph 3.49 of the EM repeats the statutory requirement that the provision of advice be

“*about the scheme*”. The Section 290-60(2) exclusion does not appear to extend to advice given which includes the development of “*the scheme*”.

The conclusion which can be drawn is that proactive advice to a client may be regarded as promoting a “**tax exploitation scheme*”. Indeed Example 3.1 in paragraph 3.50 of the EM suggests that is the case. It is that:

Example 3.1: When are tax advisers at risk of being promoters?

A partner (Graeme) in a major accounting firm approaches a high wealth client (Matthew) to advise him on an arrangement to minimise his tax liability by moving taxable income to an offshore tax haven.

The tax haven arrangement was initially developed by another partner (Brett) for another of the firm’s clients and the firm decided it should offer similar arrangements to other clients in similar circumstances.

Brett receives a fixed percentage of the fee obtained by other accountants in the firm who offer the arrangement to other clients. The other partners - including Graeme — who offer the scheme to clients receive a fee that is significantly higher than the billing rate for routine tax advice and that partly reflects the magnitude of the tax savings for scheme participants.

Graeme is able to persuade Matthew to adopt the tax haven arrangement because Matthew will be paying much less tax. Graeme puts in place the offshore financial facilities to enable Matthew not to declare income in Australia

Barbara takes the initiative to contact the accounting firm mentioned by Matthew. Graeme is not taking on new clients and therefore Barbara goes to Deborah, in another firm.

Deborah explains to Barbara how the offshore tax haven works, including the tax risks involved. Deborah bills Barbara her usual fee for advice.

In this example, Graeme and Brett would be likely to satisfy the criteria for being a promoter. This is because they have played a substantial role in marketing the scheme and encouraging client interest, and have also received consideration related to their promotional role. Deborah is not a promoter because she has only advised her client and would qualify for the advice exception.

Although Example 3.1 states that they “*receive a fee that is significantly higher than the billing rate for routine tax advice*”, that requirement does not appear to be explicit in Section 290-60. All that Section 290-60 requires is the receipt of “*consideration*”. However perhaps if what Brett has developed is a Wickenby⁵ style arrangement and the firm is promoting it, few may quarrel with Brett and Graeme being treated as “**promoters*”.

Consider what may be a far more common scenario than that outlined in Example 3.1 in paragraph 3.50 of the EM. A client comes to a tax professional for advice on how to structure the acquisition of a business. Clearly there are a number of possible ways of holding a business. The business could be held directly, in a partnership, through a

⁵ [Editors’ note - Such schemes appear to involve blatant evasion and involve the holding of funds overseas in secret. The funds are accessed by credit card and electronic transactions and the drawings are not declared for tax purposes. See *Operation Wickenby* a chronology and explanation at http://66.102.7.104/search?q=cache:YZFGTKC8ZeAJ:www.crimecommission.gov.au/content/media_re/2005/mr050615-acc.pdf+Wickenby+site:au&hl=en&gl=au&ct=clnk&cd=1 (accessed 1/11/06)].

company or a trust, perhaps even involving a superannuation fund. Also there may be options about the level of gearing etc. Does the advice regarding the appropriate structure to be used, level of gearing etc fall within the exclusion? It might be thought that it does. As is set out in paragraph 3.49 of the EM, advisers:

*are not promoters merely because they provide advice about a tax exploitation scheme, even if that advice provides **alternative** ways to structure a transaction (emphasis added).*

Unfortunately, as noted above, Section 290-60(2) and the EM are dealing with a pre existing “*scheme” not the development of a “*scheme”.

Perhaps if a client states that they are proposing to buy the business personally the adviser will not be a “*promoter” if they suggest that instead the acquisition should be made by a trust. Maybe. Even so that may not mean that the Promoter Penalty Regime could not impinge upon what may be regarded within the tax profession as normal advice.

Where will the tax adviser stand if they achieve what is often discussed, and seldom delivered, the provision of proactive advice to a client? The advice may be no more than suggesting to a client that they consider forming a consolidated group. Indeed the tax adviser’s firm may decide that all corporate group clients should be approached with this suggestion in order to generate substantial additional fees. Consolidation may not be regarded as being as offensive as the tax haven proposal in Example 3.1 in paragraph 3.50 of the EM. Indeed it may well fall outside the definition of “a *tax exploitation scheme”. But with respect to consolidations the ATO has indicated in “Part IVA and Consolidations” that there are a number of circumstances where they would seek to apply Part IVA. Consequently it is not as clear as it might appear to be that the Promoter Penalty Regime could have no application to normal professional advice.

The Promoter Penalty Provisions used “in terrorem”

Over the years there has been anecdotal evidence that sometimes when the ATO have audited a taxpayer and imposed penalties words have been said to the effect that “*under Section 251M you can recover the penalty from your tax agent*”. Moreover in the Taxpayer’s Charter Explanatory Booklet 2 it states at page 3:

If you’ve used the services of a registered tax agent, Business activity statement preparer, barrister or solicitor, and because of that person’s alleged negligence you’re liable to pay a fine, penalty or interest, the tax laws give you the right to sue for and seek to recover the amount from that person.

Let it be assumed that a diligent proactive tax partner persuaded one of his corporate groups to consolidate. There are favourable outcomes for the client group regarding losses and cost base step ups etc. The ATO audit the client. The ATO form the view that while the tax benefits are available Part IVA is applicable. The diligent proactive tax partner considers the application of Part IVA in such circumstances to be nonsense and in a full and frank exchange of views with the ATO auditor makes his position clear. The ATO auditor informs the diligent proactive tax partner to the effect that:

If your client does not drop these claims we will apply the promoter penalty provisions to you.

Where does that leave the diligent proactive tax partner? Clearly he has a potential conflict of interest and may no longer be able to act for the client. The ATO auditor may regard that as a satisfactory outcome. The diligent proactive tax partner and his client may not. Indeed outside the ATO it may not be an anticipated outcome of introducing the Promoter Penalty Regime. Hopefully it is not an intended potential outcome.

In “*A New Relationship with the tax profession*” the new Commissioner, Michael D’Ascenzo, made some comments about the application of the Promoter Penalty Regime. He said:

The promoter penalty legislation is aimed at eliminating unscrupulous operators who peddle unsustainable arrangements to the detriment of both the taxpayers and ethical advisers.

However, in achieving this objective we need to ensure that it does not unduly impact in an unintended way.

Accordingly, the ATO is committed to work with the NTLG to ensure that in practice this does not occur.

Even in the formative stage of this measure, we have agreed to co-design some important aspects of the administration of the measure, including the types of cases that should come under ATO focus and the governance arrangements within the ATO necessary to ensure that the new legislation is applied in a fair and proper manner. These additional checks and balances should give tax agents (and in-house advisors) comfort that the new law will be applied in accordance with its intent.

Undoubtedly comfort can be taken from these remarks. However as discussed in paragraphs 2.7 to 2.11 “*unsustainable schemes*” may not be within the Promoter Penalty Regime. Moreover other comments in that speech do not appear to accord with the actual Promoter Penalty Provisions even if they do reflect the apparent intended effect of the Promoter Penalty Regime.

PENALTIES

*Go to jail
Go directly to jail
Do not pass go
Do not collect \$200.*

Monopoly (1933) Devised by Charles Bruce Darrow (1889 - 1967)

The good news is that the penalties do not include going to jail. Here endeth the good news.

The potential penalty

Section 290-50(4) sets out the potential penalty if the promoter penalty provisions apply. It provides that:

The maximum amount of the penalty is the greater of:

- (a) 5,000 penalty units (for an individual) or 25,000 penalty units (for a body corporate); and
- (b) Twice the consideration received or receivable (directly or indirectly) by the entity and *associates of the entity in respect of the *scheme.

Note: See section 4AA of the Crimes Act 1914 for the current value of a penalty unit.

This means for an individual the current potential penalty is at least \$550,000 and for a company it is \$2,750,000. It should be borne in mind that they could be more than one “*promoter” with respect to a particular “*scheme”.

Onus of proof

Generally in tax matters there is a reverse onus of proof. That is a taxpayer has to prove that an assessment issued by the ATO is incorrect.

Section 290-50(3) provides that:

If the Federal Court of Australia is satisfied, on application by the Commissioner, that an entity has contravened subsection (1) or (2), the Court may order the entity to pay a civil penalty to the Commonwealth.

Because the ATO must initiate action in the Federal Court, it will bear the onus of proof. That was accepted by the Commissioner in “*A new relationship with the tax profession*”. He said that:

Both penalties require the Commissioner to prove his case before the Court. That is, the Commissioner bears the onus to prove, to the civil standard, his case. The decision to litigate in these circumstances will require careful analysis of the available evidence to ensure that there are reasonable prospects of success.

As a result it would appear that the ATO will have to prove that:

- there is a “*tax exploitation scheme” including the fact that the position taken was not “*reasonably arguable”;
- the entity was a “*promoter”; and
- the “*advice” exclusion does not apply.

It will be the civil onus of proof of “*on the balance of probabilities*” that applies rather than the criminal onus of proof of “*beyond reasonable doubt*”. However given the severe penalties, albeit falling short of a custodial sentence, the Federal Court may want the balance to be fairly heavily weighted against the alleged “*promoter”.

Unfortunately the Promoter Penalty Regime deals with strict liability offences. That is, if the ATO can demonstrate the three factors summarised in paragraph 4.6 it is irrelevant whether or not there was the intent to promote a “*tax exploitation scheme”.

Costs and damages

In the initial proposed legislation there was an exclusion from costs and damages being awarded against the ATO. No such exclusion appears in the Promoter Penalty Provisions.

Application

The Promoter Penalty Provisions applies to conduct since the Bill received royal assent. However there is a time limit on the Commissioner to bring an action where there is tax avoidance. However there is no time limit where there is tax evasion, assuming tax evasion comes within the scope of the Promoter Penalty Regime: see paragraph 2.7. Section 290-55 provides relevantly that:

- (4) The Commissioner must not make an application under section 290-50 in relation to an entity's involvement in a *tax exploitation scheme more than 4 years after the entity last engaged in conduct that resulted in the entity or another entity being a *promoter of the tax exploitation scheme.
- (5) The Commissioner must not make an application under section 290-50 in relation to an entity's involvement in a *scheme that has been promoted on the basis of conformity with a *product ruling more than 4 years after the entity last engaged in conduct in relation to implementation of the scheme.
- (6) However, the limitation in subsection (4) or (5) does not apply to a *scheme involving tax evasion.