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Audit Report No.23 2003–04  
Performance Audit

# **The Australian Taxation Office's Management of Aggressive Tax Planning**

**Australian Taxation Office**

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of Australia 2004

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Canberra ACT  
29 January 2004

Dear Mr President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *The Australian Taxation Office's Management of Aggressive Tax Planning*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'P. J. Barrett'.

P. J. Barrett  
Auditor-General

The Honourable the President of the Senate  
The Honourable the Speaker of the House of Representatives  
Parliament House  
Canberra ACT

## AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

For further information contact:

**The Publications Manager**  
**Australian National Audit Office**  
**GPO Box 707**  
**Canberra ACT 2601**

**Telephone:** (02) 6203 7505  
**Fax:** (02) 6203 7519  
**Email:** [webmaster@anao.gov.au](mailto:webmaster@anao.gov.au)

ANAO audit reports and information about the ANAO are available at our internet address:

<http://www.anao.gov.au>

### Audit Team

Peter White  
Anne Cronin  
Christian Anderson  
Dianna Smith

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## Abbreviations/Glossary

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ANAO	Australian National Audit Office
ASIS	Australian Special Information Service
ATO	Australian Taxation Office
ATPSC	Aggressive Tax Planning Steering Committee
CE	Compliance Executive
CSM	Compliance Strategy Meeting
CTSI	Centre for Tax System Integrity
E2E	End-to-End
FAC Aggressive Tax Planning	First Assistant Commissioner Aggressive Tax Planning
HWI	High Wealth Individuals
JCPAA	Joint Committee of Public Accounts and Audit
LB&I	Large Business and International business line
MMIS	Mass marketed investment schemes
MoU	Memorandum of Understanding
NEI	New and emerging intelligence
NTLG	National Tax Liaison Group
Part IVA	Part IVA of the <i>Income Tax Assessment Act 1936</i>
PASTO	Promoters Associates Schemes Taxpayers and Other issues
RRP	Risk Review Panel
SB	Small Business business line
SERC	Senate Economics References Committee
SIA	Strategic Intelligence and Analysis unit





# **Summary and Recommendations**



# Summary

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## Context

1. The management of aggressive tax planning is an important issue in tax administration because it bears on the integrity, efficiency and effectiveness of the operations of the tax system. Aggressive tax planning poses a risk to a significant amount of revenue and it can affect community confidence in the tax system. The ATO considers aggressive tax planning to be a priority corporate risk.
2. For the ATO, aggressive tax planning is the point where tax planning goes beyond the policy intent of the law. Its 'aggressive' or 'abusive' nature makes it illegal, or contrary to the spirit of the law. Aggressive tax planning has been generally structured around financing arrangements designed to inflate tax deductions and exploit concessions in the tax law designed to encourage certain types of investments.
3. Aggressive tax planning can be found in 'boutique' / 'one-off' arrangements tailored for high income or high wealth individuals and large corporate entities and also in generic arrangements and products marketed widely to taxpayers (mass marketed arrangements<sup>1</sup>).
4. Aspects of the topic have been reviewed previously, and our audit takes account of those reviews. There have been three reports by the Taxation Ombudsman, focussing, in particular, on mass marketed investment schemes (MMIS)<sup>2</sup>. These are the reports on the Budplan scheme,<sup>3</sup> the Main Camp scheme<sup>4</sup>

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<sup>1</sup> Examples of mass marketed arrangements include:

- round-robin schemes, including non-recourse financing, often in agriculture, afforestation and franchises;
- certain film schemes, with guaranteed returns that are, in effect, a return of part of the invested funds; and
- employee benefit arrangements.

*ATO Submission to Senate Economics References Committee's Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection.* No.845, p.1.

- <sup>2</sup> The ATO describes MMIS as schemes usually sold through a prospectus and, in some cases, information memoranda, in respect of 1998–99 and earlier years. They include round-robin schemes, including non-recourse financing, often in agriculture, afforestation and franchises; as well as certain film schemes with guaranteed returns that are, in effect, a return of part of the invested funds.
- <sup>3</sup> *The ATO and Budplan—Report of the Investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a tax-effective financing scheme known as Budplan.* Report under section 35A of the *Ombudsman Act 1976*, June 1999.
- <sup>4</sup> *The ATO and Main Camp—Report of the investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a mass marketed tax effective scheme known as Main Camp.* Report under section 35A of the *Ombudsman Act 1976*, January 2001.

and an investigation of a complaint by a promoter of film schemes<sup>5</sup>). Many of the matters in the Main Camp investigation were also reflected in the Senate Economics References Committee (SERC) inquiry into mass marketed schemes and investor protection.

5. The SERC's extensive inquiry into aggressive tax planning-related matters was reported in its *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*.<sup>6</sup> The Government has not formally responded to the Committee's recommendations. However, the ATO has implemented settlement offers to investors based on the recommendations of the Committee and has undertaken work on a number of matters highlighted by the Committee.

## Objective and scope

6. The objective of the audit was to assess how well the ATO manages aggressive tax planning. To do this, we explored the nature of aggressive tax planning and the ATO's approach to its management. We looked to ascertain whether the ATO had:

- identified lessons from its experience with aggressive tax planning, particularly MMIS, to improve its administration of aggressive tax planning;
- formulated a strategy, and supported this, with an appropriate organisational framework and sound management and operational approaches;
- implemented effective mechanisms to gather and analyse relevant, and real-time, intelligence from ATO sources and external stakeholders, and to provide to taxpayers early warnings of ATO concerns about possible tax arrangements. We did this by looking at the management of the Strategic Intelligence and Analysis unit (SIA) which deals with intelligence gathering and analysis;
- developed an appropriate approach to the identification and management of promoters, given the significant role of promoters in aggressive tax planning, and the significance of the Promoters Taskforce as part of the ATO's response to MMIS. We did this by examining the role and management of the Promoters Taskforce, which is a focus for ATO action on tax promoter<sup>7</sup> activities; and

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<sup>5</sup> *Report on Investigation of a complaint by a promoter of a series of films about ATO decisions*, Report under section 35A of the *Ombudsman Act 1976*, February 2001.

<sup>6</sup> There were three reports: Interim Report (June 2001); Second Report (September 2001); and Final Report (February 2002).

<sup>7</sup> A tax promoter is defined as someone who earns income from the design, sale, marketing or implementation of tax schemes.

- addressed relevant issues highlighted in the significant external reviews of MMIS.

## Key findings

### Background and context—Chapter 1

7. Aggressive tax planning management is an important issue in tax administration (in Australia and overseas tax administrations), because aggressive tax planning poses a significant risk to revenue and community confidence in the tax system.

8. Taxpayers have the right to arrange their financial affairs to minimise tax, but it is not acceptable to do so by avoiding the intent of the law or by not following the law itself. Tax planning is the process by which the affairs of a taxpayer, or group of taxpayers, are organised so that, as legally and/or commercially as possible, the liability of the taxpayer to income and other taxes is minimised.<sup>8</sup>

9. The difference between tax planning and tax avoidance is not necessarily clear in all circumstances. It may well be a matter of subjective judgement and legal interpretation as to where tax planning reaches the point of aggressive tax planning or tax avoidance. Community attitudes as to what are considered to be acceptable tax planning arrangements to minimise tax liability may differ from the ATO's and may also change over time. Although not amenable, in practical terms, to a precise definition, the ATO has indicators that it regards as 'red flags', or 'warning lights', of aggressive tax planning.

10. We found that the ATO's strategy and approaches for managing aggressive tax planning, and the operational methods it employs, reflect the lessons it has learned from its experience with mass marketed schemes as well as from associated academic research work and reviews by the Taxation Ombudsman and the SERC. These lessons have resulted in the ATO revising its approach to the management of aggressive tax planning. The ATO's approach now involves a cross-business line group for organisational leadership and integration; stronger networks to gather and share intelligence; a particular focus on promoters; more timely management of tax issues; clearer and earlier communication with the taxpayers and tax agents; and a greater preparedness to differentiate the treatment of promoters, agents and taxpayers according to circumstances.

11. As at mid 2003, there were some 400 full-time equivalent staff across the ATO involved in aggressive tax planning management activities, who report

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<sup>8</sup> See *Australian Master Tax Guide 2003*, para. 31–000.

directly to the senior executive in the ATO with particular accountability in relation to aggressive tax planning, at an estimated staff cost of \$39 million in 2002–03.

## Strategic direction and governance arrangements— Chapter 2

12. The ATO's strategy in managing aggressive tax planning is given expression and support in its organisational arrangements, conceptual frameworks, management approaches and support mechanisms. The ATO seeks to better engage with the community as part of its strategic approach to managing aggressive tax planning.

13. We found that the effectiveness of the ATO's cross-business line organisational approach depends on the extent to which the relevant steering committee and the business lines effectively engage and support one another in managing aggressive tax planning. It also depends on the business lines: devoting sufficient resources to identify and manage new and emerging aggressive tax planning risks in a comprehensive, integrated and holistic way; having effective communication and information sharing across the ATO; and implementing effective strategies with external stakeholders, such as Commonwealth agencies and the community.

14. Since August 1999, when it established a steering committee as an organisational focus for the management of aggressive tax planning, the ATO has developed and refined a conceptual framework for managing such planning, reflecting the notion that its management is an End-to-End (E2E) process. The E2E process emphasises the need for timely and systemic responses to aggressive tax planning risks through collaboration across, and within, business lines. The ATO also seeks to take into account the linkages between key elements in the aggressive tax planning 'landscape', and how aggressive tax planning occurs in the tax system, by considering Promoters, their Associates, the Schemes, Taxpayers involved and Other issues (the PASTO model).

15. We found that the concepts of the E2E process and the PASTO model provide a sound basis for managing aggressive tax planning. This is because they acknowledge the linkages the ATO needs to take into account to manage the activity in a comprehensive and appropriate manner. However, relevant ATO staff are not fully implementing these concepts as intended. Appropriate measures are required to clarify the roles and expectations of staff and reinforce these with suitable training and performance management support.

## Aggressive tax planning data management

16. Accurate, comprehensive and current data is vital for the ATO to understand and manage aggressive tax planning issues properly. Data quality depends on the ATO having an overall strategy for aggressive tax planning data management. It also depends on the various aggressive tax planning segments' willingness to support the processes and systems being used to manage aggressive tax planning data in an holistic way. We found that the ATO does not have an overall strategy for managing aggressive tax planning data in an holistic way, although the ATPDatabase has been established to capture data around the PASTO elements.

17. We found problems with the ATPDatabase. These include some segments not using the Database as intended; it containing incomplete and out-of-date data, it not having inbuilt quality assurance processes to assure the integrity of data; and limitations in its capacity around case monitoring and the collation of management information on aggressive tax planning. These problems mean that there are gaps in the comprehensiveness and currency of aggressive tax planning data, and that manual processes and cross checking are required to deal with the shortcomings of the Database's functionality.

18. The ATO has devised two measures since August 2002 to address some of the problems with aggressive tax planning data management. These relate to the intelligence and management reporting modules for the ATPDatabase and processes to improve use of the ATPDatabase. However, these are yet to be fully implemented. In August 2003, the ATO took a further initiative, involving a strategic review of systems support needs, looking at aggressive tax planning business support requirements and the ATO's corporate direction for information systems development. The ANAO supports the ATO's consideration of current and future aggressive tax planning data management, particularly if it serves to develop a strategy for the best use of the ATPDatabase; clarifies the expectations and needs of staff; and, most importantly, leads to action to improve the management and reporting of aggressive tax planning information.

## Corporate planning, risk management and performance review

19. We found that the ATO has a well-developed framework for corporate planning and performance review. However, improvements could be made in planning and risk assessment processes. Planning can be improved by the ATO taking account of, not only *technical* aggressive tax planning risks, but also taking more explicit account of *operational* risks in conducting activities, i.e. 'business risks' such as the quality of data supporting aggressive tax planning.

20. The ATO has a comprehensive framework for risk management in relation to aggressive tax planning. The risk assessment part of the risk management process would be improved by: having all risks (including risks managed by the business lines) recorded on the Aggressive Tax Planning Risk Register, as intended; and having all aggressive tax planning risk assessments done on a consistent basis, with aggressive tax planning segments using the aggressive tax planning risk matrices when conducting their risk assessments (of promoters, for example).

### **Strategic Intelligence Analysis—Chapter 3**

21. We found that the SIA now has a sound framework to identify and address aggressive tax planning by gathering and analysing relevant and real-time intelligence from ATO sources, including external stakeholders. However, the intelligence database used by the SIA could be used more effectively. During the audit, the ATO enhanced the capacity of the ATPDatabase to allow the ATO to monitor and report on the timeliness of completion of intelligence analysis conducted.

22. The SIA has corporate responsibility for providing early warnings to the community about new and emerging aggressive tax planning arrangements, using Taxpayer Alerts. While Taxpayer Alerts have been widely acknowledged as a useful tool to communicate the ATO's view on potential aggressive tax planning arrangements in a timely and considered manner, the timeliness of publishing the ATO view on a matter raised in an Alert was identified by the ATO and tax professionals as needing improvement. The ATO is seeking to improve the timeliness of its processes in this area with continued attention to project management issues.

### **Promoters Taskforce—Chapter 4**

23. The Promoters Taskforce was formed as part of the ATO's response to dealing with the MMIS issues. The Taskforce provides a corporate focus for ATO action to identify and address new and emerging issues in aggressive tax planning relating to the activities of tax promoters who actively develop, encourage participation in, or sell, arrangements that result in tax avoidance.

24. There are many areas within the ATO that deal with promoters, but we found that the functions of the Promoters Taskforce, and its functions in relation to these other ATO areas, are not clearly specified. Effective coordination, to avoid duplication of effort or gaps in activities around promoters of aggressive tax planning, requires that the various responsible organisational segments are clear about their roles, particular functions and interrelationships.



25. We found that the Taskforce has a challenging range of activities to manage; that it had been active in doing so; and that it achieved its two specified objectives in 2002–03 (identifying from its promoter management work \$400 million revenue at risk and working on 30 integrated audits).

26. Improvements in planning and management of the Promoters Taskforce’s activities in some areas, including its use and maintenance of the ATPDatabase, would allow the Taskforce to better assure itself and others to whom it is answerable, that it is undertaking the most pressing activities in the most efficient way. We found that there are gaps in the list of promoters maintained by the Taskforce. Many of the risk assessments of promoters documented in the list are not current. As well, where the risk assessments are done by different aggressive tax planning segments, they are not conducted on a consistent basis. We also found that the ATO is not actively managing referrals of new information, or referrals of new promoters, to its list of promoters, with delays in dealing with information and gaps in documentation in many areas. Slow action, or inaction, on the management of the promoter list undermines the ATO’s ability to identify and address risks in a comprehensive and integrated way, taking account of the interrelationships between the parties concerned.

## Mass marketed investment schemes—Chapter 5

27. We found that handling MMIS was a major administrative task for the ATO in the late 1990s and early 2000s, with a significant impact on taxpayers who invested in these schemes and intensive scrutiny by external review bodies (the Taxation Ombudsman and the SERC). We noted that the ATO has implemented processes to settle with MMIS investors, although some contentious issues continue to be raised by some taxpayers. These issues include the time the ATO took to amend self-assessed tax returns, aspects of the test litigation process, and the application of the General Interest Charge. The finalisation of MMIS will continue to be an important, though less resource intensive, task for the ATO in 2003–04.

28. We also found that the ATO has implemented a range of measures to address some of the issues raised by the SERC (e.g. better intelligence gathering and analysis, better and more timely information flow and warnings to the public, and work on devising a regime of promoter sanctions).

## Overall conclusion

29. Managing aggressive tax planning well is a complex, ongoing task. It is a priority area for the ATO as well as being a test of tax administration that bears on the integrity and efficiency and effectiveness of the operations of the whole tax system.

30. Aggressive tax planning is a 'grey' concept (by its nature). Its management may therefore require subjective judgements and legal interpretation. There is also an important social dimension to managing compliance in this area: community views of what constitutes aggressive tax planning may differ from the ATO's and may change over time. One of the challenging aspects of managing aggressive tax planning is that it requires the ATO to deal with technical matters in the tax system (involving legal and accounting issues), as well as to anticipate, shape and respond to taxpayers' changing attitudes and behaviours.

31. There have been problems in the past with the ATO's management of aggressive tax planning. Consequently, the matter has been the subject of keen public and parliamentary interest and other external review. The ATO's strategic approach reflects the lessons it has learned. Overall, we conclude that the ATO has now developed the necessary strategies, structures and processes to permit the effective management of aggressive tax planning. The challenge is to apply these and have them properly supported with systems and related tools that facilitate the identification, assessment, treatment and monitoring of aggressive tax planning risks and facilitate coordinated activities. Action in a number of areas to give greater operational force, in practice, to the ATO's strategy for the managing aggressive tax planning, would help the ATO in its ongoing management task. Success of the ATO's approach crucially relies on the continued support of the business lines and their commitment to work in a coordinated and purposeful way. Actions which would improve the ATO's management of aggressive tax planning are to:

- consistently apply the conceptual frameworks in practice for an integrated, holistic and robust approach in managing aggressive tax planning, as intended;
- enhance the ATPDatabase so that it can better support the efficient management of aggressive tax planning;
- improve aggressive tax planning risk assessment processes, including risk assessments of promoters; and
- clarify the functions, and enhance the management processes, of the Promoters Taskforce.

32. The ATO has responded positively to the problems it has had in managing aggressive tax planning. Since 1999, it has made considerable efforts to improve its management of such planning, with changes of approach in significant ways. We have taken this into account in constructing our five recommendations. The ATO agreed with all the recommendations.

## **Summary of ATO response**

33. Overall the ATO supports the thrust of the recommendations. The ATO's full response is reproduced at Appendix 1 of the audit report.

# Recommendations

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*Set out below are the ANAO's recommendations aimed at enhancing the ATO's management of aggressive tax planning. Report paragraph references are included here. The ANAO considers that the ATO should give priority to Recommendations 1, 2, 4 and 5.*

## **Recommendation No.1 Paragraph 2.16**

The ANAO recommends that, to improve the implementation of strategies and approaches designed to manage aggressive tax planning in an holistic way, the ATO:

- clarify the roles, and its expectations, of staff implementing the strategies and approaches; and
- support staff appropriately in these respects with suitable training and performance management measures, including structured checklists and follow-up review.

## **Recommendation No.2 Paragraph 2.28**

To provide better support for aggressive tax planning management, the ANAO recommends that, as a matter of priority, the ATO:

- develop and implement a strategy for the best use of the ATPDatabase that also specifies clearly the role of the Database in the management of aggressive tax planning;
- clarify expectations and needs of aggressive tax planning staff who are expected to use the ATPDatabase; and
- implement measures to improve the management and reporting of aggressive tax planning data.

**Recommendation  
No.3  
Paragraph 2.53**

To improve aggressive tax planning risk management processes, the ANAO recommends that the ATO:

- incorporate business risks into future business planning around aggressive tax planning;
- conduct all aggressive tax planning risk assessments on a consistent basis; and
- record all aggressive tax planning risks on the Aggressive Tax Planning Risk Register, as intended.

**Recommendation  
No.4  
Paragraph 4.19**

The ANAO recommends that, for enhanced clarity about responsibilities, the ATO specify the role and associated functions of the Promoters Taskforce more explicitly, including in relation to other areas of the ATO that also have responsibilities regarding promoters.

**Recommendation  
No.5  
Paragraph 4.49**

To provide greater accuracy and consistency of the promoter risk assessments on the ATPDatabase as the basis for appropriate work selection, the ANAO recommends that the ATO:

- systematically review its list of promoters and conduct all risk assessments on a comparable basis that reflects the current aggressive tax planning risk management approach; and
- review risk assessments of promoters on the list from time to time so that they remain accurate, given changing circumstances.



# **Audit Findings and Conclusions**





# 1. Background and Context

*This Chapter outlines the relevance of the topic of aggressive tax planning, its characteristics, its significance for the tax system, and the ATO's organisational approach to addressing this issue in the context of the self-assessment system. It also highlights overseas practice, other reviews, and lessons the ATO learnt from its experience with mass marketed schemes. It also outlines the audit approach.*

## Introduction

**1.1** The Australian Taxation Office (ATO) is responsible for the administration of Commonwealth taxation law and for the collection of Commonwealth taxation revenue. In 2002–03, the ATO collected \$185 billion in revenue.<sup>9</sup>

**1.2** A key priority of the ATO is to secure taxpayer compliance under the self-assessment system.<sup>10</sup> One aspect of this task is to manage aggressive tax planning. Managing aggressive tax planning is important not only in protecting the integrity of the revenue collections, but also in helping to maintain community confidence in the tax system. The potential financial impact of aggressive tax planning is significant, and while the ATO does not have a precise figure, it would be at least \$1.7 billion.<sup>11</sup>

## Concepts—tax planning, avoidance and aggressive tax planning

**1.3** Taxpayers have the right to arrange their financial affairs to minimise tax. However, it is not acceptable to do so by avoiding the intent of the law or by not following the law itself. Tax planning is the process by which the affairs of a taxpayer, or group of taxpayers, are organised so that, as legally and/or commercially as possible, the liability of the taxpayer to income and other taxes is minimised.<sup>12</sup> In undertaking action to 'minimise' the payment of tax, however,

<sup>9</sup> (in cash terms). See Australian Taxation Office, *Commissioner of Taxation Annual Report 2002–03*, ATO, Canberra, 2003, p.43.

<sup>10</sup> The self-assessment system means that the onus is on the taxpayer to comply with the taxation laws. Taxpayer returns are not generally subject to scrutiny by the ATO prior to an assessment being issued. Generally, there is a four-year limit on the ATO amending assessments. The limit is six years when the Commissioner determines that the general anti-avoidance provisions apply. The Commissioner can amend an assessment at any time when the Commissioner considers that there has been tax evasion or fraud. The ATO is responsible for ensuring that taxpayers have a good understanding of the taxation law in order to fulfil their taxation obligations.

<sup>11</sup> The ATO advises that to October 2003, it raised assessments to the value of \$1.7 billion in respect of certain mass marketed investment schemes. Chapter 5 provides revenue figures in the five years 1996–97 to 2000–01, that resulted from the ATO disallowing certain deductions claimed in respect of mass marketed investment schemes.

<sup>12</sup> See *Australian Master Tax Guide 2003*, para. 31–000.

there is a continuum of behaviour ranging from legal, through more aggressive postures, to tax evasion.<sup>13</sup>

**1.4** Tax avoidance is a different concept from that of tax evasion. Tax avoidance has been characterised as ‘... a misuse or abuse of the law rather than a disregard for it. It is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by the Parliament but also includes manipulation of the law and a focus on form and legal effect rather than substance’.<sup>14</sup> The difference between tax planning and tax avoidance is not necessarily clear in all circumstances. It may well be a matter of subjective judgement and legal interpretation as to where tax planning reaches the point of aggressive tax planning or tax avoidance.<sup>15</sup>

**1.5** According to the ATO, aggressive tax planning is the point where tax planning goes beyond the policy intent of the law. Its ‘aggressive’ or ‘abusive’ nature makes it illegal, or contrary to the spirit of the law. Aggressive tax planning has been generally structured around financing arrangements designed to inflate tax deductions and/ or to exploit concessions in the tax law designed to encourage certain types of investments.

**1.6** By its nature, aggressive tax planning is a ‘grey’ area of tax administration because it cannot be precisely defined. Although not amenable in practical terms to a precise definition, the ATO has indicators that it regards as ‘red flags’ or ‘warning lights’ of aggressive tax planning.<sup>16</sup> Some of these include: complex structures and intra-group transactions associated with generating tax benefits unrelated to the economic substance of a commercial activity (if any); and transactions that involve tax havens.<sup>17</sup> A more comprehensive list of indicators is at Appendix 2.

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<sup>13</sup> The concept of ‘tax evasion’ has been described as ‘... illegal; it involves taxpayers undertaking actions which are expressly forbidden under tax or other legislation.’ See *The Review of Business Taxation, A Tax System Redesigned*, July 1999, p.46.

<sup>14</sup> *The Review of Business Taxation, A Tax System Redesigned*, July 1999, p.243.

<sup>15</sup> Community attitudes as to what are considered to be acceptable tax planning arrangements to minimise tax liability also change over time. The ATO has regard to the (evolving) social context of aggressive tax planning when seeking to secure taxpayer compliance. See later section in this Chapter for information on the research work undertaken by the Centre for Tax System Integrity to extend the ATO’s understanding of taxpayer behaviour and community attitudes relevant to tax administration.

Also reflecting the social context of aggressive tax planning are the concepts of the compliance continuum, mentioned earlier, and the concept of a divergence of views between the ATO and taxpayers as to where along that continuum ‘acceptable’ behaviour ceases and ‘unacceptable’ behaviour commences.

<sup>16</sup> See K Fitzpatrick, *The Australian Taxation Office’s Approaches to Aggressive Tax Planning*, Centre for Tax System Integrity Third International Research Conference Responsive Regulation: International Perspectives on Taxation: Canberra 24 and 25 July 2003.

<sup>17</sup> Tax havens exist in countries where minimal or no tax is paid. This allows foreigners to invest assets in economies that attract better than favourable returns. Countries that are used as tax havens include Bermuda and the Cayman Islands.

1.7 Aggressive tax planning can be found in 'boutique' / 'one-off' arrangements, tailored for high income or high wealth individuals and large corporate entities, and also in generic arrangements and products marketed widely to taxpayers (mass marketed arrangements<sup>18</sup>). Mass marketed investment schemes (MMIS),<sup>19</sup> a subset of mass marketed arrangements, were prevalent in the 1990s. They affected many Australian taxpayers. As a consequence, MMIS became a very significant and contentious issue for the ATO (see Chapter 5).

## Significance of aggressive tax planning to the tax system

1.8 The Commissioner of Taxation's priorities for 2002–03 identified aggressive tax planning as a corporate risk<sup>20</sup> to the ATO.<sup>21</sup> Aggressive tax planning is a very important issue in tax administration as it poses a risk to a significant amount of revenue. While the revenue at risk is uncertain, given the complex and often imprecise nature of what constitutes aggressive tax planning arrangements, as noted earlier, the ATO advises that to 21 October 2003, it raised assessments to the value of \$1.7 billion in respect of certain MMIS.

## The ATO's organisational and management approach

### *Organisational approach*

1.9 The ATO is structured into business and service lines.<sup>22</sup> The ATO does not have a single, specific organisational unit for aggressive tax planning management, because aggressive tax planning behaviour can be apparent in virtually any area of tax administration. The ATO has a cross-organisational

<sup>18</sup> Examples of mass marketed arrangements include:

- round-robin schemes, including non-recourse financing, often in agriculture, afforestation and franchises;
- certain film schemes, with guaranteed returns that are, in effect, a return of part of the invested funds; and
- employee benefit arrangements.

*ATO Submission to Senate Economics References Committee's Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection.* No. 845, p.1.

<sup>19</sup> The ATO describes MMIS as schemes usually sold through a prospectus and in some cases, information memoranda, in respect of 1998–99 and earlier years. They include round-robin schemes, including non-recourse financing, often in agriculture, afforestation and franchises; and certain film schemes with guaranteed returns that are, in effect, a return of part of the invested funds. MMIS do not include employee benefit arrangements or financing products such as linked bonds.

<sup>20</sup> The Commissioner identified international aggressive tax planning as a priority in 2003–04.

<sup>21</sup> The Commissioner of Taxation's 2001–02 Annual Report and the 2002–03 and 2003–04 Compliance Programs also identify aggressive tax planning as a key corporate priority for the ATO (see Chapter 2). See Australian Taxation Office, *Commissioner of Taxation Annual Report 2001–02*, Australian Taxation Office, 2002, p.86; Australian Taxation Office, *Compliance Program 2002–03*, Australian Taxation Office 2002, p.16 and Australian Taxation Office, *Compliance Program 2003–04*, 2003, p.40.

<sup>22</sup> For example, business lines include Large Business & International, Small Business and Personal Tax. Service lines include ATO Technology and ATO Resource Management.

approach, with leadership coming from the First Assistant Commissioner (FAC Aggressive Tax Planning) who has particular accountability in relation to aggressive tax planning management in the ATO. The FAC Aggressive Tax Planning chairs a steering committee (the Aggressive Tax Planning Steering Committee (ATPSC)),<sup>23</sup> which provides strategic direction for managing aggressive tax planning. (See Chapter 2 for discussion on the ATO's strategic and governance framework.)

**1.10** The ATPSC is made up of representatives from 'segments' in the ATO with a focus on aggressive tax planning.<sup>24</sup> Some of these segments report *directly* to the FAC Aggressive Tax Planning (e.g. the Promoters Taskforce which focuses on tax promoters<sup>25</sup>), while other segments report to the FAC Aggressive Tax Planning *via* their respective business lines (e.g. the Office of the Chief Tax Counsel,<sup>26</sup> parts of the Personal Tax line and parts of the Financial Services Industry<sup>27</sup> and National Client Groups<sup>28</sup> in the Large Business & International business line). The organisational approach is illustrated in Figure 1.1.

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<sup>23</sup> The ATPSC was established in October 1999 to provide organisational leadership across business lines and to ensure ATO responses to aggressive tax planning are coordinated and strategic. It meets every two months.

<sup>24</sup> The aggressive tax planning segments are responsible for gathering and analysing intelligence, developing and implementing compliance plans to address high-level risks and undertaking regular reviews of compliance plans. For example, the Strategic Intelligence Analysis unit is responsible for gathering and analysing all aggressive tax planning intelligence such as intelligence relating to aggressive tax planning arrangements using capital gains tax.

<sup>25</sup> A tax promoter is defined as someone who earns income from the design, sale, marketing and/ or implementation, of tax schemes.

<sup>26</sup> The Office of the Chief Tax Counsel is involved, for example, by supporting the Part IVA Panel. The Part IVA Panel was established to ensure consistent application of the ATO's general anti-avoidance provision, Part IVA of the *Income Tax Assessment Act 1936* (sec 177A to 177F). The Panel is relevant to aggressive tax planning management, as it can be an important advisory body in the ATO establishing views on aggressive tax planning matters (see Chapter 2 and Appendix 4).

<sup>27</sup> The Group runs the Finance Houses project, which is relevant to aggressive tax planning matters.

<sup>28</sup> The Accounting and Legal project, which is relevant to aggressive tax planning management, is part of the National Client Group.

**Figure 1.1**  
**Aggressive Tax Planning Management Across Business and Service Lines**

	Direct involvement in ATP management	Indirect involvement in ATP management
Office of the Commissioners	FAC Aggressive Tax Planning	
Large Business and International	<ul style="list-style-type: none"> <li>•Strategic Intelligence Analysis</li> <li>•Promoters Taskforce</li> <li>•High Wealth Individuals Taskforce</li> </ul>	<ul style="list-style-type: none"> <li>•Financial Services Industry Group</li> <li>•National Client Group</li> <li>•International Strategy &amp; Operations</li> </ul>
Small Business	SB ATP	
Operations		Debt & Lodgement
Office of Chief Tax Counsel		Built into business line practice (no dedicated area)
Superannuation		Superannuation ATP
Goods and Services Tax		GST ATP
Personal Tax		Personal Tax ATP
Serious Non-compliance		Built into business line practice (no dedicated area)
ATO Relations		
Policy Management Division		
Excise		
ATO Technology		
ATO Applications Solutions		
ATO Resource Management		

Source: ANAO depiction of ATO information

**1.11** As at mid 2003, 402.5 full-time equivalent (FTE) staff<sup>29</sup> across the ATO, who report directly to the FAC Aggressive Tax Planning, were involved in aggressive tax planning management activities.<sup>30</sup> The ATO estimates that \$39 million was spent in 2002–03 on these staff.

### *Management approach*

**1.12** The ATO's approach to managing aggressive tax planning is to focus on arrangements that attempt to avoid any type of tax, superannuation or excise duty. It aims to respond quickly to aggressive tax planning by focussing on patterns, trends and drivers in order to provide early warnings to the community, using, for example, Taxpayer Alerts,<sup>31</sup> where the ATO considers the arrangements to be outside the law. Its approach is supported by an intelligence system that the ATO uses to help identify, analyse and address issues and communicate its view.<sup>32</sup>

## **Overseas experiences in aggressive tax planning**

**1.13** The ANAO considered practices in relevant overseas jurisdictions (United States of America, United Kingdom, Canada and New Zealand) to ascertain whether aggressive tax planning featured in those jurisdictions and to identify how they addressed the matter.<sup>33</sup> The ANAO found that aggressive tax planning is an issue for other major revenue jurisdictions and has been reviewed by some overseas audit agencies.

### **Overseas revenue agencies**

**1.14** The United States, the United Kingdom and Canada all have some form of anti-avoidance legislation in place to restrict the use of tax avoidance schemes.<sup>34</sup> We found that in two of the jurisdictions examined, the United States of America and Canada, aggressive tax planning management issues were prominent. Some of the management tools used were similar to those applied in Australia.

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<sup>29</sup> Comprising 220.5 FTEs from the Small Business business line (Schemes–141.5; Field–48; and Product Rulings–31) and 182 FTEs from the Large Business & International business line (HWI Taskforce–103; Promoters Taskforce–55; and SIA–24). In addition to these FTE staff with a 'dedicated aggressive tax planning focus', other ATO staff work on aggressive tax planning matters as part of their functions.

<sup>30</sup> The business lines fund the management of aggressive tax planning work.

<sup>31</sup> Taxpayer Alerts give the public an early warning about a matter of potential concern to the ATO (see Chapter 3).

<sup>32</sup> See Australian Taxation Office, *Compliance Program 2003–04*, Australian Taxation Office, 2003.

<sup>33</sup> The United States refer to aggressive tax planning as 'Abusive Tax Schemes' while the United Kingdom and Canada refer to it as 'tax avoidance'.

<sup>34</sup> We were advised that the anti-avoidance provisions in the United States are legislatively different from Australia's Part IVA anti-avoidance provisions. They are not 'general' anti-avoidance provisions such as Australia has.

**1.15** The United States Internal Revenue Service (IRS) has a Criminal Investigations Tax Scams/Fraud Alerts web page and a site to indicate red flags that might be present in an abusive tax shelter. These websites are similar to the ATO's Taxpayer Alert and investor advice web pages. Revenue Canada is concerned with taxpayers intentionally avoiding Canadian federal and provincial taxes. Penalties for non-compliance by promoters have been legislated in Canada. The ATO and the Treasury have worked on the development of the Government's legislative proposal for promoter penalties in Australia since 2001–02 (see Chapter 4).

**1.16** To increase awareness and knowledge of aggressive tax planning management issues, some taxation jurisdictions (New Zealand, the United States of America, Canada, the United Kingdom and Australia) participate in telephone conferences every six months. The conferences canvass the status of litigation, joint efforts against tax avoidance, updates on tax planning issues, and initiatives and developments in each of the jurisdictions. The ATO's participation in these telephone conferences builds good relationships between it and overseas revenue agencies and allows it to gain insight into the work of those agencies.

## Overseas audit agencies

**1.17** The ANAO reviewed reports published on the websites of overseas audit agencies for their relevance to aggressive tax planning. We found some reports were relevant in that they highlight the significance of aggressive tax planning on potential revenue collections. Some recommend practices already in place, or being considered, in Australia. For example, the Office of the Auditor General of Canada (OAG) report *Combating Income Tax Avoidance*,<sup>35</sup> looks at the cost of tax avoidance and the specific initiatives undertaken to combat and deter tax avoidance. This report recommended the penalties for non-compliance by promoters that have now been legislated.

**1.18** The United States General Accounting Office (GAO) report *Internal Revenue Service Efforts to Identify and Combat Abusive Tax Schemes Have Increased, but Challenges Remain*,<sup>36</sup> primarily focuses on abusive tax schemes that are used by individuals. It looks at how the IRS estimates the number of taxpayers involved and the amount of potential revenue lost in abusive trusts and offshore schemes. The subsequent GAO report, *Challenges Remain in Combating Abusive Tax Shelters*,<sup>37</sup>

<sup>35</sup> The Office of the Auditor General of Canada report, *Revenue Canada Combating Income Tax Avoidance*, OAG, 1996.

<sup>36</sup> The United States General Accounting Office report, *Internal Revenue Service Efforts to Identify and Combat Abusive Tax Schemes Have Increased, but Challenges Remain*, GAO, 2002.

<sup>37</sup> The United States General Accounting Office report, *Challenges Remain in Combating Abusive Tax Shelters*, GAO, 2003. This report of October 2003 foreshadows that the GAO will release a report on abusive tax schemes in the near future.

examines the IRS' strategy for dealing with abusive tax shelters.<sup>38</sup> As well as highlighting some managerial challenges for the IRS in combating abusive tax shelters, the report also outlines elements of the IRS' overall management strategy for dealing with abusive tax shelters. Several aspects of the IRS' reported strategy are similar to elements of the ATO's overall strategy in managing aggressive tax planning.<sup>39</sup>

## Reviews

### Ombudsman

**1.19** The Commonwealth Ombudsman can investigate complaints about Commonwealth departments' and authorities' actions and decisions to ascertain whether they are wrong, unjust, unlawful, discriminatory or unfair. The Ombudsman has been actively involved in reviewing and contributing to the shape of aggressive tax planning management by the ATO, in part as a result of his inquiries into prominent MMIS, as discussed later in this section. When dealing with complaints about the ATO and tax administration, the Ombudsman may refer to himself as the Taxation Ombudsman.<sup>40</sup>

**1.20** The number and type of complaints paint a mixed picture of the ATO on 'schemes-related' matters.<sup>41</sup> Since mid 2001, the Taxation Ombudsman has dealt with approximately 700 complaints about the ATO on scheme-related matters.<sup>42</sup> These complaints raised approximately 1000 issues, of which 267 have been investigated. While defective administration was found in 158 of these issues,<sup>43</sup>

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<sup>38</sup> Described at p.4 of the report *Challenges Remain in Combating Abusive Tax Shelters*, as 'the very complicated transactions that sophisticated tax professionals promote to corporations and wealthy individuals, exploiting tax loopholes and reaping large and unintended tax benefits'.

<sup>39</sup> Namely the emphasis on promoters, efforts to deter, detect and resolve abuse, coordination of effort across the revenue agency, and measures for taxpayers to try to expedite the timely resolution of cases (such as settlements, penalty concessions and alternative dispute resolution).

<sup>40</sup> The Taxation Ombudsman can investigate all complaints related to tax administration. These include: debt recovery actions; conduct of audits; provision of advice; methods of handling inquiries; remission of penalties; handling of correspondence; delays in decision making; and handling of private and public rulings. If a complaint discloses an element of defective administration, the Taxation Ombudsman can recommend that the ATO reconsider its decision; give further reasons for its decisions; pay compensation ; and/or change existing procedures.

<sup>41</sup> While numerous, the number of complaints is not large relative to the numbers of people and their involvement in MMIS. See Chapter 5 for the numbers of taxpayers and settlements offered by the ATO in relation to MMIS.

<sup>42</sup> Although the complaints relate to MMIS as well as schemes such as employee benefit arrangements and linked equity bonds, the Ombudsman's office advised that the bulk of complaints would relate to MMIS. In considering the number of complaints about schemes over the period, it should be noted that the numbers of complaints made to the Ombudsman declined significantly in 2002–03 compared to those in 2001–02 (140 and 848, respectively).

<sup>43</sup> It should be noted, when considering the proportions of investigations finding defective administration, that the Ombudsman has discretion to decline to investigate a complaint, and may be inclined to investigate if there is *prima facie* evidence of some agency defect or error.



145 issues of complaint related to the same issue, that was an ATO letter to scheme participants that became the subject of a campaign. Having conducted follow-up work on these issues, the Taxation Ombudsman's office found that the ATO has made efforts to remedy most of the problems.

**1.21** There have been three Taxation Ombudsman reports relevant to aggressive tax planning focussing, in particular, on MMIS (the Budplan scheme,<sup>44</sup> the Main Camp scheme<sup>45</sup> and an investigation of a complaint concerning the ATO, by a promoter of film schemes<sup>46</sup>). (See Chapter 5 for a description of these reports.) The Taxation Ombudsman's Main Camp inquiry overlapped with the Senate Economics References Committee (SERC) inquiry into mass marketed schemes. Many of the matters in the Main Camp investigation were also reflected in the Parliamentary Committee's inquiry (outlined in the next section).<sup>47</sup>

## Senate Economics References Committee

**1.22** The SERC conducted an inquiry into aggressive tax planning-related matters, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*.<sup>48</sup> The Committee recommended, among other things, that the ATO:

- enhance its internal and external strategic intelligence capability to address the risk of aggressive tax planning;
- implement a 'real-time intelligence' capability to provide early warning of compliance risks from external sources such as accounting and legal firms, financial institutions and other elements of the tax and finance industry;
- better educate taxpayers about their obligations under the self-assessment system and the ATO's powers to review and amend assessments; and
- adopt promoter sanction measures into legislation as a matter of urgency.

<sup>44</sup> *The ATO and Budplan—Report of the Investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a tax-effective financing scheme known as Budplan*. Report under section 35A of the *Ombudsman Act 1976*, June 1999.

<sup>45</sup> *The ATO and Main Camp—Report of the investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a mass marketed tax effective scheme known as Main Camp*. Report under section 35A of the *Ombudsman Act 1976*, January 2001.

<sup>46</sup> *Report on Investigation of a complaint by a promoter of a series of films about ATO decisions*, Report under section 35A of the *Ombudsman Act 1976*, February 2001.

<sup>47</sup> In July 2000, the Taxation Ombudsman commenced a separate investigation into the Budplan test case process but decided to terminate his investigation in March 2003. He took this decision in light of the SERC's inquiry and the ATO's remedial action for MMIS investors through its settlement offer (in particular, the Commissioner settling with Budplan investors through the remission of interest and penalties) and the ATO's intention to fund a number of test cases, involving Part IVA, in the courts on arrangements involving the splitting of personal services income. The Taxation Ombudsman considered that the ATO had learnt its lessons from the Budplan test cases.

<sup>48</sup> There were three reports: Interim Report (June 2001); Second Report (September 2001); and Final Report (February 2002).

1.23 The Government has not formally responded to the inquiry's recommendations. However, the ATO has implemented settlement offers to investors, based on the recommendations of this inquiry, and has undertaken work in a number of areas highlighted by the Committee (see Chapter 5).

## Centre for Tax System Integrity

1.24 The Centre for Tax System Integrity (CTSI)<sup>49</sup> is a specialised research unit set up to extend the ATO's understanding of how and why taxpayers may cooperate with, or contest, the tax system. CTSI has produced several reports around aggressive tax planning,<sup>50</sup> with some of the key findings being that:

- 64 per cent of respondents said they would not touch a tax scheme without a valid product ruling from the ATO;<sup>51</sup>
- investment in the MMIS industry in Australia is, in general, supply driven with 69 per cent of investors surveyed claiming they got the idea to invest in MMIS from a financial adviser;<sup>52</sup>
- ninety per cent of respondents stated that they felt the ATO was 'a lot', or 'completely', to blame for the situation surrounding their amended tax returns;<sup>53</sup> and
- taxpayers involved in aggressive tax planning are less committed to the tax system; are more resistant in their dealings with the ATO; and are more likely to feel disengaged from tax authorities.<sup>54</sup>

1.25 These findings provide useful insights and perspectives for the ATO in managing aggressive tax planning. In respect of the CTSI preliminary report of the survey of tax scheme investors, the ATO advised that it would review the

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<sup>49</sup> CTSI is a research partnership between the Australian National University and the ATO, established in August 1999. The work of CTSI examines the needs, values, attitudes and behaviours of all key players in the tax system from tax officers themselves through taxpayers and tax agents, to those who are beneficiaries of the tax system.

<sup>50</sup> See CTSI website (<http://ctsi.anu.edu.au>) for the reports on aggressive tax planning matters. CTSI's work on aggressive tax planning has included: analysing and identifying the possible reasons why taxpayers invested in tax minimisation schemes; why there was such widespread taxpayer resistance to the ATO's debt recovery procedures; and whether the aggressive tax planning market in Australia is 'supply' or 'demand' driven.

<sup>51</sup> Murphy, K. & Byng, K., *Preliminary findings from the Australian Tax System Survey of tax scheme investors*, 2002, pp.4, 34–35.

<sup>52</sup> Only 16 per cent directly approached a tax expert to put the idea into practice. See Murphy, K. & Byng, K., *Preliminary findings from the Australian Tax System Survey of tax scheme investors*, 2002, pp.4, 34–35.

<sup>53</sup> Murphy, K. & Byng, K., *Preliminary findings from the Australian Tax System Survey of tax scheme investors*, 2002, pp.4, 34–35.

<sup>54</sup> Murphy, K. & Sakurai, Y., *Aggressive Tax Planning: Differentiating those playing the game from those who don't*, 2001, p.18.

findings once CTSI has further analysed the investor responses. The ATO said that this analysis is expected to provide greater insight into investors' comments than the preliminary results.

## **ATO lessons from its experience with mass marketed schemes and relevant reviews**

**1.26** We do not suggest that the ATO's administrative issues in relation to MMIS are completely resolved.<sup>55</sup> However, the ATO has a strategy for managing aggressive tax planning. The operational methods it employs reflect the lessons it has learned from its experience with mass marketed schemes, reviews by the Taxation Ombudsman and the SERC, and the research work of CTSI.

**1.27** Given the significance of these lessons in shaping the ATO's whole approach to managing aggressive tax planning, we list these lessons here as follows:

### *Strategic and management approaches*

- Establishment of a cross-business line group to provide organisational leadership and to have an integrated and strategic approach to managing aggressive tax planning.
- Appointment of a senior ATO executive located outside the business lines, with a particular accountability for aggressive tax planning management in the ATO.
- A particular focus on promoters, given effect with the establishment of the Promoters Taskforce for current and timely action on those on the 'supply-side' of aggressive tax planning.
- Strong networks and work practices across the ATO to share intelligence and analyse arrangements, with areas of the ATO recognising their interrelationships to identify patterns and trends, and to understand and to deal with risks in a systemic and timely way.

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<sup>55</sup> Matters emanating from experience with MMIS and other types of mass marketed arrangements that are of ongoing concern to some taxpayers include the time the ATO took to amend self-assessed tax returns, aspects of the test litigation process, and processes around the application of the General Interest Charge. Similar issues are reported as matters of concern in Issues Paper Number 4, *ATO Law Enforcement and Governance*, Inspector-General of Taxation, 2003, p.3. In December 2003, the Inspector-General of Taxation announced that, at the request of the Assistant Treasurer and Minister for Revenue, he will conduct a review of the administration of the General Interest Charge in disputed tax situations. See Press Release by the Inspector-General of Taxation, *Inspector-General of Taxation Reports Back*, 7 December 2003. The Government's current review of aspects of the self-assessment tax system will also consider some of the matters of concern. See later section in this Chapter for an outline of the Government review.

### *Operational approaches*

- The need to deal proactively with issues—not just employ strategies relying solely on the deterrence of audits and reviews within the statutory period of four to six years under the self-assessment tax system.
- Linked with this, the need to improve voluntary compliance, including by:
  - getting information out to the community to help compliance with the tax law, with clear and early communication with taxpayers and tax agents and, as appropriate, communicating directly with the investor;
  - communicating in ways investors can understand (e.g. in ways that are not too legalistic);
  - introducing strategies to improve community awareness of issues and risks and to improve communication of the ATO view on how the law operates. For example: introducing the product rulings system to provide more certainty for taxpayers as to the tax consequences of particular investment proposals; introducing Taxpayer Alerts to give early warnings of schemes about which the ATO has concerns; developing a dedicated aggressive tax planning website; using media releases; speeches; and newsletters; and
  - enhancing taxpayers’ understanding of the self-assessment system and what that means for them in practical terms with increased visibility in TaxPack, Tax Returns and Notices of Assessment.
- Informing taxpayers and advisers of the features of arrangements causing concern, thereby providing early notice that the ATO is likely to challenge arrangements showing such features.
- Differentiating the treatment of promoters, agents and taxpayers according to circumstances, e.g. in terms of remitting penalties; determining who is eligible and who is ineligible for the ATO’s settlement offer; and remitting interest.

## **Government review**

1.28 In November 2003, the Treasurer announced<sup>56</sup> a government review of aspects of the income tax self-assessment system. The review, to be conducted

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<sup>56</sup> See Treasurer’s Press Release, *Review of Aspects of Income Tax Self-Assessment*, 98/2003, 24/11/03.

by the Treasury, aims to identify whether the laws achieve a fair balance between protecting the rights of individual taxpayers and protecting the revenue. As noted previously, many of the issues to be canvassed in the review<sup>57</sup> are ones about which taxpayers had complaints in the context of the ATO's management of MMIS. The review will involve, among other things, release of a public discussion paper in early 2004, with the final report to the Government due in mid-2004.

## ANAO reports

**1.29** The ANAO has not previously conducted an audit of the ATO's management of aggressive tax planning. There have, however, been previous ANAO audits covering some related matters. These are highlighted below.

**1.30** *The High Wealth Individuals Taskforce* audit report<sup>58</sup> made three recommendations on the operations and management of the High Wealth Individuals (HWI) Taskforce. We followed up, in this audit, on the ATO's progress in implementing the report's recommendations. We found that the ATO has fully implemented each of the recommendations of the audit report (see Appendix 3).<sup>59</sup>

**1.31** *The Australian Taxation Office's Administration of Taxation Rulings* audit<sup>60</sup> reviewed, among other things, the ATO's product ruling system. We did not revisit this audit in detail. It was conducted in 2001–02 and it is anticipated that a separate follow-up audit will be undertaken by the ANAO.<sup>61</sup> However, the ATO's use of product rulings in better managing aggressive tax planning schemes is canvassed in Chapter 5.

**1.32** *The Australian Taxation Office's Management of its Relationship with Tax Practitioners* audit report<sup>62</sup> highlights the very important role of tax practitioners (especially tax agents) in the tax system.<sup>63</sup> Of relevance to aggressive tax planning

<sup>57</sup> The review is to consider, among other things, protection for taxpayers from unreasonable delays in enforcing the tax law; statutory timeframes for amending assessments; the length of tax audits; aspects of the operation of the General Interest Charge; the level of reliance taxpayers can, and should, be able to place on taxation rulings and other forms of ATO advice.

<sup>58</sup> *The High Wealth Individuals Taskforce* Audit Report No.46 1999–2000.

<sup>59</sup> The Joint Committee of Public Accounts and Audit (JCPAA) examined the HWI Taskforce audit report and recommended that the ATO 'make further efforts to promote greater public awareness of the HWI Taskforce's activities and achievements by disseminating more widely, the information contained in the Commissioner's annual report.' JCPAA Report No.382, *Review of Auditor-General's Reports 1999–00, Fourth Quarter*, p. xviii.

<sup>60</sup> *The Australian Taxation Office's Administration of Taxation Rulings* Audit Report No.3 2001–02.

<sup>61</sup> The JCPAA examined the Rulings audit report, but did not make any recommendations on the topic. See JCPAA Report No.390, *Review of Auditor General's Reports 2001–02: First, Second and Third Quarters*.

<sup>62</sup> *The Australian Taxation Office's Management of its Relationship with Tax Practitioners*, Audit Report No.19 2002–03.

<sup>63</sup> The JCPAA examined, but did not make any recommendations on the topic. See JCPAA Report No. 396 *Review of Auditor-General's Reports 2002–2003 First, Second and Third Quarters*.

management is that tax agents and other practitioners can be an important point of leverage in the tax system and play a significant role in the ATO securing compliance.<sup>64</sup> Also relevant is our observation that the relationship between the ATO and tax practitioners is multi-dimensional and complex and that, although the roles and interests differ, each party depends on the other to play its part within the tax system.<sup>65</sup> See related discussion of the ATO's strategy and views of tax practitioners' responsibilities in Chapter 2.

## The audit

### Audit objective and scope

1.33 The objective of the audit was to assess how well the ATO manages aggressive tax planning, a priority area for the ATO bearing on the integrity, efficiency and effectiveness of the operations of the tax system. To do this, we explored the nature of aggressive tax planning and the ATO's management task. We also looked to ascertain whether the ATO had:

- identified lessons from its experience with aggressive tax planning, particularly MMIS, to improve its administration of aggressive tax planning;
- formulated a strategy, and supported this, with an appropriate organisational framework and sound management and operational approaches;
- implemented effective mechanisms to gather and analyse relevant, and real-time, intelligence from ATO sources and external stakeholders, and to provide to taxpayers early warnings of ATO concerns about possible tax arrangements. We did this by looking at the management of the Strategic Intelligence and Analysis unit (SIA) which deals with intelligence gathering and analysis;
- developed an appropriate approach to the identification and management of promoters, given the significant role of promoters in aggressive tax planning, and the significance of the Promoters Taskforce as part of the ATO's response to MMIS. We did this by examining the role and management of the Promoters Taskforce, which is a focus for ATO action on tax promoter activities; and
- addressed relevant issues highlighted in the significant external reviews of MMIS.

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<sup>64</sup> *The Australian Taxation Office's Management of its Relationship with Tax Practitioners*, Audit Report No.19 2002–03, pp.7–40.

<sup>65</sup> *The Australian Taxation Office's Management of its Relationship with Tax Practitioners*, Audit Report No.19 2002–03, pp.7–40, pp.45–46.

#### 1.34 Our scope included:

- the ATO's overall strategy, its organisational and governance arrangements to give effect to this strategy, and the processes and tools used;
- the application of strategy in two important, operational areas directly bearing on aggressive tax planning management, namely the SIA and the Promoters Taskforce; and
- the ATO's action on the MMIS issue following the significant external reviews.

1.35 The scope of the audit did not include consideration of the ATO's measures to counter particular aggressive tax planning devices, such as tax havens. The topic of tax havens is of such a magnitude that it could be the subject of an audit in its own right. Nor did the scope of the audit include examination of the approach the ATO uses to 'implement its view' via an assessment, penalties or litigation action. Our audit concentrated on the earlier steps of the ATO's approach to managing aggressive tax planning (outlined earlier in this Chapter) because we consider that the extent to which the ATO successfully manages aggressive tax planning is crucially influenced by its approaches at the earlier stages of the process.

### **Audit methodology and cost**

1.36 The ANAO conducted fieldwork between March and September 2003. In addition to document and file reviews, we interviewed staff at the ATO's National Office in Canberra and offices in Sydney and Melbourne. We also interviewed a range of parties with an interest in the ATO's management of aggressive tax planning. They included:

- staff from the Office of the Taxation Ombudsman, the Australian Competition and Consumer Commission, the Australian Securities and Investments Commission and the Commonwealth Director of Public Prosecutions;
- representatives of professional tax and accounting associations (CPA Australia, the Corporate Tax Association, the Taxation Institute of Australia and the Institute of Chartered Accountants in Australia); and
- tax practitioners (comprising tax lawyers, tax consultants and tax specialists of a major bank).

1.37 The audit was conducted in accordance with ANAO auditing standards at a cost of \$347 000.

## Audit report structure

1.38 The structure of the report is as follows:

- Chapter 1: sets out the context of the topic (in Australia and overseas) and outlines the audit objective and methodology.
- Chapter 2: reviews the ATO's strategic framework, management approach and arrangements and governance arrangements for managing aggressive tax planning.
- Chapter 3: reviews the SIA's planning, activities and performance review.
- Chapter 4: reviews the Promoters Taskforce's planning, activities and performance review.
- Chapter 5: outlines the reviews by the Taxation Ombudsman and the SERC related to the MMIS issue, ATO settlement processes and action on the SERC's concerns regarding MMIS.



## 2. Strategic Direction, Management and Governance Arrangements

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*This Chapter reviews the ATO's strategic direction, management and governance arrangements for managing aggressive tax planning, referring to: strategic, organisational and management arrangements, including the application of the Part IVA anti-avoidance provisions; and governance arrangements including planning, risk management, monitoring and reporting on performance.*

### Background

**2.1** Key elements of the ATO's strategic framework guiding its management of aggressive tax planning are:

- the **ATO Compliance Model**—the Compliance Model is based on the principles of supporting taxpayers to comply with the law and giving appropriate responses to taxpayer behaviour (including by undertaking audits and imposing sanctions such as penalties and prosecution action, if necessary), taking into account their compliance history and circumstances. The ATO considers that taxpayers engaging in aggressive tax planning typically show non-compliance of a serious nature.<sup>66</sup> The ATO would seek to respond to their behaviours accordingly; and
- the **ATO Plan**—details activities necessary to deliver outputs, achieve the agreed outcome and mitigate risks. It provides a framework for the ATO's strategic activities. The ATO Plan comprises a suite of Sub-Plans<sup>67</sup> (see corporate planning arrangements later in this Chapter).

**2.2** A crucial element of the ATO's strategic approach to managing aggressive tax planning is to deal with the issue in an appropriate, integrated and timely way. The ATO seeks to support, and give effect to, this strategy, with its organisational arrangements, particular conceptual frameworks, and methodological approaches. These supporting elements of its strategic approach, and associated issues, are examined in the following sections.

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<sup>66</sup> In determining this, the ATO's compliance model takes account of factors such as taxpayers' behavioural, psychological and economic disposition.

<sup>67</sup> The ATO Plan 2002–03 comprises four Sub-Plans: Compliance; Operations; People and Place and Information Technology. The ATO proposes to introduce a fifth Sub-Plan, *The Change Program*, to the ATO Plan in 2003–04. The Change Program Sub-Plan will cover corporate activities that endeavour to make it easier for taxpayers to comply with their tax obligations by providing products and services that are easier, cheaper and more personalised.

## Aggressive tax planning organisational and funding arrangements

2.3 As noted in Chapter 1, the ATO adopts a cross-business line approach, designed to provide a coordinated and consistent response to aggressive tax planning in the tax system. A point of corporate accountability for the management of aggressive tax planning is the FAC Aggressive Tax Planning. Other key elements of the organisational structures to give effect to its aggressive tax planning management strategy are the ATPSC, which is chaired by the FAC Aggressive Tax Planning, and the Risk Review Panel (RRP), a sub-committee of the ATPSC, that is responsible for managing aggressive tax planning risks. The FAC Aggressive Tax Planning is accountable to the Compliance Strategy Meeting (CSM)<sup>68</sup> for the ATO having in place the processes and systems to efficiently and effectively detect, escalate and address, aggressive tax planning risks.

2.4 The ATO's cross-business line approach provides a basis for the ATO to meet the challenges in managing aggressive tax planning. The effectiveness of the approach depends on the extent to which the ATPSC and the business lines effectively engage and support one another. It also depends on the business lines devoting sufficient resources to manage new and emerging aggressive tax planning risks, having effective communication and information sharing across the ATO,<sup>69</sup> and implementing effective strategies with external stakeholders, such as Commonwealth agencies and the community.

2.5 The next section focuses on the ATO's aggressive tax planning management process and arrangements in selected stages of that process. It covers the:

- conceptual frameworks applied;
- key management processes—namely the management of aggressive tax planning data and the ATO's application of the Part IVA<sup>70</sup> (the general anti-avoidance) provisions to communicate the ATO's view on aggressive tax planning arrangements; and
- strategies for gathering information on aggressive tax planning from external stakeholders (e.g. Commonwealth agencies, tax professionals and the community) and communicating ATO views and warnings to these groups.

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<sup>68</sup> The Compliance Strategy Meeting is responsible for managing the implementation of the Compliance Sub-Plan.

<sup>69</sup> The ATO has several mechanisms for sharing information between aggressive tax planning staff and relevant parts of the ATO, including the LB&I Distributive Intelligence workshops, through e-mails, informal feedback (telephone) and networking (see Chapter 3).

<sup>70</sup> Part IVA of the *Income Tax Assessment Act (ITAA) 1936*.

## Aggressive tax planning management approach and arrangements

2.6 Since the late 1990s and early 2000s, the ATO has developed and revised its approaches to managing aggressive tax planning. The ATO's conceptual framework for managing aggressive tax planning is the notion that its management is an End-to-End (E2E) process. The E2E process emphasises the need for timely and systemic responses to aggressive tax planning risks through collaboration across, and within, business lines. The E2E process involves:

- identifying risks through real-time intelligence gathering and analysis;
- assessing and prioritising risks;
- providing early warnings to the community about potential aggressive tax planning arrangements;
- developing the ATO view on aggressive tax planning arrangements; and
- communicating and implementing the ATO view.<sup>71</sup>

2.7 As well as considering the management of aggressive tax planning as an holistic, E2E process connecting the business lines, the ATO also seeks to take into account the linkages in key elements in the aggressive tax planning 'landscape'; and how aggressive tax planning occurs in the tax system, by considering Promoters, their Associates, the Schemes, Taxpayers involved and Other issues.<sup>72</sup> The ATO calls this way of thinking, the PASTO model.

2.8 We consider that the concepts of the E2E process and the PASTO model provide a sound basis for managing aggressive tax planning, because they acknowledge the linkages the ATO needs to take into account to manage aggressive tax planning in a comprehensive and appropriate manner. The following section discusses the ATO's implementation of the E2E process and the PASTO model.

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<sup>71</sup> e.g., the E2E process could involve the following steps: identify and analyse intelligence to identify an aggressive tax planning arrangement; assess and prioritise the risk of this arrangement; issue a Taxpayer Alert to provide an early warning to the community about the new and emerging aggressive tax planning arrangement; refer the aggressive tax planning arrangement to the Part IVA Panel to develop a formal view on the arrangement; communicate a view on the aggressive tax planning arrangement via a Taxation Ruling; and use litigation to enforce the ATO's view on the aggressive tax planning arrangement on taxpayers.

<sup>72</sup> Other issues might relate to consumer protection issues and corporations law issues.

## Implementation of the E2E process and PASTO model

**2.9** The ATO intends that all aggressive tax planning staff should know of, and apply, the E2E process and the PASTO model. We found that the ATO had not fully achieved this, at this stage.

**2.10** When we looked at the way ATO staff have implemented the E2E and PASTO processes, we saw that there were some limitations in their implementation due, in part, to the way the concepts have been supported and because of other work priorities.

**2.11** When introducing the E2E process and the PASTO model across the ATO in 2001–2002, the FAC Aggressive Tax Planning issued a minute and accompanying narrative to staff, outlining the 12 stages in the E2E process, and the requirement that all ATO staff are expected to implement aspects of the E2E process that relate to their aggressive tax planning roles and responsibilities. The minute also outlined the ATO's expectation that all aggressive tax planning staff would use the PASTO model to identify, assess and treat aggressive tax planning.

**2.12** The ATO developed the E2E process map and explanatory narrative, provided exposure training to aggressive tax planning staff on the broad application of the E2E process and the PASTO model, and supplemented this with speeches and liaison meetings to reinforce key messages. However, we could not ascertain where these outlines of the concepts were reinforced with clear, practical measures to train staff and incentives to encourage them to apply the E2E process and the PASTO model effectively. (The ATO advised that the Promoters Taskforce ran joint exercises with various teams to support and embed the PASTO and E2E in practice.) The ATO plans to continue in 2003–04 what it calls the 'roll out' of the E2E process to all aggressive tax planning staff.

**2.13** We also saw that a key aspect of the ATO's implementation of the E2E process (the timely analysis and actioning of new and emerging intelligence by aggressive tax planning segments) has been affected by competing aggressive tax planning work priorities. For example, pressures on the Small Business business line (SB) to finalise the settlements of MMIS have meant that it has not been able to devote the resources it intended to the analysis of, and action on, new and emerging intelligence relating to SB matters. As a result, some new and emerging SB intelligence has not been analysed and actioned in real-time to determine the extent of potential risks at hand.<sup>73</sup>

**2.14** The limitations in the ATO's implementation of the E2E process and the PASTO model, have meant that some staff are uncertain about their roles and responsibilities in the E2E process, and about particular aspects of the application

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<sup>73</sup> The ATO advised that SB has allocated resources to this activity in 2003–04.

of the PASTO model. Some staff are not implementing the approaches as intended. This results in the potential for duplication of work and the partial, or inconsistent, treatment of aggressive tax planning risks.<sup>74</sup>

**2.15** To work effectively, the roles and responsibilities of ATO staff who are expected to implement the E2E process and the PASTO model must be clear. It would also be helpful for the ATO to supplement information about the conceptual frameworks, with measures to encourage and train staff to implement the E2E process and the PASTO model. For example, conducting training workshops and incorporating appropriate measures and incentives into staff performance management arrangements might help. This could involve some checklists to assist staff structure their approaches and some follow-up processes by the ATO to obtain assurance that these approaches are being implemented as intended. These measures might encourage staff to recognise the broader view of aggressive tax planning management, when scoping their work activities. They might also help all ATO staff to be aware of, and discharge, their aggressive tax planning responsibilities and to take account of all aggressive tax planning elements, when applying the PASTO model.

## Recommendation No.1

**2.16** The ANAO recommends that, to improve the implementation of strategies and approaches designed to manage aggressive tax planning in an holistic way, the ATO:

- clarify the roles, and its expectations, of staff implementing the strategies and approaches; and
- support staff appropriately in these respects with suitable training and performance management measures, including structured checklists and follow-up review.

### *ATO response*

**2.17** Agreed. The ATO's strategies in managing aggressive tax planning have evolved over recent years as we have learned from our experiences in dealing with the mass marketed schemes of the 1990s. These strategies continue to evolve and we will continue to improve the implementation of strategies and

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<sup>74</sup> e.g., staff who are responsible for managing the treatment of aggressive tax planning risks (known as product managers) are expected to apply the PASTO model in a consistent and comprehensive manner when developing compliance plans. We reviewed examples of compliance plans and found that the PASTO model was not consistently and comprehensively applied. We found that staff who were responsible for managing the treatment of promoter risks were not necessarily considering, on a risk management basis, the promoter's associates, related schemes and taxpayers when assessing the risk to compliance of the promoter.

approaches. The skilling aspect of this recommendation will be included in the ATO's Active Compliance Development Program.

## **Aggressive tax planning data management**

**2.18** The 'distributed' organisational approach, processes, and systems, that underpin the ATO's management of aggressive tax planning, influence the quality of data used to support the identification, assessment and prioritisation of aggressive tax planning risks. The responsibility for providing quality data is shared between the aggressive tax planning segments that are represented on the ATPSC. In practice, data quality depends on the ATO having an overall strategy for aggressive tax planning data management and segments' willingness to support the processes and systems being used to try to manage data in an holistic way. We found that the ATO does not have an overall strategy for managing aggressive tax planning data in an holistic way, although a database<sup>75</sup> (the ATPDatabase<sup>76</sup>) has been established to capture data around the PASTO elements.

**2.19** The ATO advised that it does not expect the ATPDatabase to be the only database that captures and records aggressive tax planning data. When we looked at data management and the ATPDatabase, we found that:

- the ATO has not clearly specified the role of the ATPDatabase in the management of aggressive tax planning;
- the ATO does not have formal, documented business rules governing the use of the ATPDatabase by aggressive tax planning staff (e.g. to cover matters such as who should be using the Database, how the Database should be used, and when the Database should be used). The ATO advised that processes are determined at the work place level;
- the ATPDatabase does not have inbuilt quality assurance processes to provide certainty around the integrity of data in the Database;
- some aggressive tax planning segments are not using and maintaining the ATPDatabase, and therefore the Database does not comprehensively capture data around the PASTO elements as it is supposed to do;
- the Database contains incomplete and out-of-date data;

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<sup>75</sup> Data around aggressive tax planning was initially captured on a database managed by SB for project work around schemes (the Schemes Database). However, the ATO later saw a need to extend its focus beyond schemes and to have the other elements of the aggressive tax planning landscape recorded on a database as well (reflecting the PASTO way of thinking about aggressive tax planning).

<sup>76</sup> SB is the custodian of the ATPDatabase. SB is expected to maintain the system and provide corporate support regarding its use.

- minutes from a RRP meeting show that some staff consider they have not received adequate training to effectively use the ATPDatabase;
- the ATPDatabase does not, and is not expected to, contain all of the ATO's aggressive tax planning data. We appreciate that it may not be practical to have only one system that records all aggressive tax planning information across the ATO. However, having more than one system means that any picture of aggressive tax planning issues and management activity across the ATO must come from separate databases. We found that the processes that the ATO undertook to compile its composite picture of aggressive tax planning management were time-consuming and awkward, in part because the ATPDatabase is not linked to databases used by aggressive tax planning segments. The ATO intends to establish linkages between the ATPDatabase and other ATO databases, such as LB&I's HealthCard system<sup>77</sup> to promote staff entering appropriate data onto the ATPDatabase; and
- in terms of case management, the ATPDatabase does not have the capacity to monitor and report the progress of aggressive tax planning matters, nor collate management information on aggressive tax planning work done. Some segments use their own databases and spreadsheets to monitor and report on the progress of their activities. This means that summary reports on aggressive tax planning management activities must be collated manually from those databases and spreadsheets used by individual segments.

**2.20** These problems with the ATPDatabase have meant that there are gaps in the accuracy, comprehensiveness and currency of data and that manual processes and cross checking are required to deal with the shortcomings of the Database's functionality.

### *ATO remedies for aggressive tax planning data management*

**2.21** The ATO has recognised the deficiencies with aspects of its aggressive tax planning data management.<sup>78</sup> It attempted to address some of the problems around the ATPDatabase and aggressive tax planning data in general, in two proposals endorsed by the ATPSC. The first proposal<sup>79</sup> involved incorporating an intelligence module and management reporting module into the ATPDatabase, to improve the management of aggressive tax planning risks, and the integrity

<sup>77</sup> LB&I's HealthCard system is used to capture and record risk assessments of LB&I clients, including aggressive tax planning risks in those clients. The intention to link the ATPDatabase and the HealthCard system would suggest that the ATO sees some particular benefit in streamlining access to LB&I risk assessment information in managing aggressive tax planning.

<sup>78</sup> Internal reports to the highest levels of ATO management acknowledge this.

<sup>79</sup> The ATPSC endorsed the first proposal in August 2002.

of aggressive tax planning data.<sup>80</sup> The second proposal<sup>81</sup> (some 10 months later) made separate recommendations to improve the management of aggressive tax planning data,<sup>82</sup> and reiterated the need for the proposed intelligence and management reporting modules for the ATPDatabase to be completed.

**2.22** The ANAO reviewed the two proposals and found that they embodied good intentions to address some of the ATO's aggressive tax planning data management problems. However, issues such as the role of the ATPDatabase and the lack of general business rules governing its use have not been addressed in the proposals. We also found that there were delays in the full implementation of the first proposal<sup>83</sup> and that timeframes for addressing the majority of the measures outlined in the second proposal have not been specified.<sup>84</sup>

**2.23** The processes to address the problems with the ATPDatabase, to make it an effective tool to support aggressive tax planning management, go to the heart of the ATO's management approach to aggressive tax planning. Enhancing aggressive tax planning data management bears on matters for which the FAC Aggressive Tax Planning is accountable. However, in the absence of reallocating his dedicated resources from their particular activities to data management, implementing improvements such as those proposed, depends on the business lines' supporting these measures.

**2.24** In our view, aggressive tax planning data management is an area requiring the ATO's continued attention and action, given the delays in finalising the corporately endorsed proposals and the partial response provided by the proposals to addressing problems around aggressive tax planning data management. The resolution of its current data management problems will encourage aggressive tax planning staff to use the ATPDatabase as intended. Resolution of problems will also allow it to provide more comprehensive and

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<sup>80</sup> The intelligence module will implement a management information system to enable the tracking of aggressive tax planning intelligence from detection to resolution. The management reporting module will produce a range of reports covering strategic and operational aspects of aggressive tax planning management (e.g. new and emerging issues reports and the list of promoters and schemes identified from access visits).

<sup>81</sup> The ATPSC endorsed the second proposal in June 2003.

<sup>82</sup> These included: the use of the ATPDatabase becoming mandatory for all aggressive tax planning staff; clarifying expectations of aggressive tax planning staff regarding the E2E process; developing training and work practices for staff to use the ATPDatabase; providing ongoing support for staff using the ATPDatabase; and ensuring quality assurance of data in the ATPDatabase.

<sup>83</sup> The intention was to implement the first proposal by November 2002. The ATO advised in January 2004, that the intelligence module is due for release in February 2004 and the management reporting module changes are expected to be in place before June 2004.

<sup>84</sup> Apart from timing issues, we also looked at what was proposed in the training element of the second proposal. We reviewed a draft training plan in August 2003 and found that it had some practical limitations, e.g. in terms of focus (which staff will receive training) and timing (when training will be completed). The ATO agreed that the draft training plan required further work.



accurate data, that can be used more readily and confidently, to support the management of aggressive tax planning.

**2.25** Recognising the need to give further consideration to current and future data management issues in managing aggressive tax planning, in August 2003, the ATPSC initiated a strategic review of systems support needs for aggressive tax planning.<sup>85</sup> The review is to:

- gain an understanding of the ATO's corporate direction for information systems development (as part of the ATO-wide Change Program<sup>86</sup>) and how that direction fits with the business requirements for aggressive tax planning management;
- completely review aggressive tax planning business systems and what is required to support them;
- devise a map to show how aggressive tax planning information will be incorporated into the ATO's corporate systems;
- identify opportunities for the analysis of aggressive tax planning data using 'new tools'<sup>87</sup> introduced as part of the Change Program; and
- identify short-term strategies to manage current information needs.

**2.26** In terms of results, the ATO advises that the strategic review is intended to produce a:

- clear statement on the facilities required of the ATPDatabase by users in the future;
- clear set of business rules for any upgrade/ construction of the ATPDatabase; and
- timetable for development (which will then contribute to the ATO's IT and Change Program, and a priority determined for any development, along with other ATO systems developments).

**2.27** The ANAO considers that the review foreshadows worthwhile attention to pressing issues in aggressive tax planning data management and supporting systems, and appropriately puts these issues in the larger context for the ATO. The review was expected to be completed and accepted by the ATPSC in December 2003. The ATO advised in January 2004 that the ATPSC endorsed the concept brief for the way forward and a cross-line project team has been formed to progress systems development and integration into the ATO-wide Change Program.

<sup>85</sup> The ATPSC has designated SB to lead the strategic review into aggressive tax planning systems support needs.

<sup>86</sup> See earlier outline of the Change Program as part of the ATO Plan 2003–04.

<sup>87</sup> Such as data mining tools for identifying and interpreting patterns in data, to produce business intelligence.

The ATO's two other aggressive tax planning data management enhancement proposals dating from 2002 and 2003 have been scoped but only very partially implemented. Given the rate of progress on these other projects, it is important that the current review is managed effectively in order to secure the short term and longer-term benefits promised, in a timely way.

## Recommendation No.2

**2.28** To provide better support for aggressive tax planning management, the ANAO recommends that, as a matter of priority, the ATO:

- develop and implement a strategy for the best use of the ATPDatabase that also specifies clearly the role of the Database in the management of aggressive tax planning;
- clarify expectations and needs of aggressive tax planning staff who are expected to use the ATPDatabase; and
- implement measures to improve the management and reporting of aggressive tax planning data.

### *ATO response*

**2.29** Agreed. The ATO is currently redesigning its information management and compliance reporting processes and systems. Through this process the role and position of the ATPDatabase as well as the input and integrity processes for the data will be defined and, if necessary, changed. In the interim, the ATO will ensure that business practices and rules and quality assurance processes in relation to the ATPDatabase are properly documented.

## Application of the Part IVA anti-avoidance provisions

**2.30** The general anti-avoidance provisions, Part IVA of the *Income Tax Assessment Act (ITAA) 1936* are a powerful tool the ATO uses as part of its aggressive tax planning management (E2E) process. This part of the E2E process is essentially the process of the ATO determining its view as to whether an aggressive tax planning arrangement amounts to tax avoidance. Given the concepts of aggressive tax planning and tax avoidance (see Chapter 1), all tax avoidance falls within the scope of the concept of aggressive tax planning.

**2.31** We looked at the processes by which the general anti-avoidance provisions are applied, and how they are used for compliance management, because of the significant impact these provisions can have on the ATO's process of managing aggressive tax planning and on taxpayers. (We did not examine the legal application of the provisions.)

2.32 Our review shows that the ATO's processes for applying Part IVA, including comprehensive guidance for staff, technical support (including by an expert panel – the Part IVA Panel) and review mechanisms, are reasonable. We found that there was some uncertainty among some stakeholders in the community about the ATO's processes involved in applying Part IVA. However, the ATO is working to increase information and thereby transparency and understanding of the processes. While recognising the complexity of the legal issues involved, we consider that the fact that the ATO's view, in cases heard in the courts, appears to be generally upheld, is a positive indication of its processes in applying the Part IVA provisions.

2.33 For more information on the processes by which the general anti-avoidance provisions are applied and how they are used for compliance management, see Appendix 4.

## **Strategies with Commonwealth agencies to manage aggressive tax planning**

2.34 One of the ATO's aggressive tax planning management strategies is to engage with key Commonwealth agencies<sup>88</sup> to try to obtain an integrated, whole-of-government approach to managing aggressive tax planning through compliance and enforcement action, as appropriate.

2.35 We found that the ATO has established relationships with agencies to gather information to identify, assess and deal with aggressive tax planning risks. One matter that arose from our discussions with Commonwealth stakeholders, was that the current legislation regarding exchange of information has restricted the amount and type of information the ATO can gather and provide to other Commonwealth agencies, due to privacy considerations.<sup>89</sup> This issue was also the subject of a recommendation in the SERC inquiry into MMIS<sup>90</sup> (see Chapter 5). The ATO advised that policy proposals to enhance information exchange are being considered by the Government.

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<sup>88</sup> These agencies are the Australian Securities and Investments Commission (ASIC), the Australian Competition and Consumer Commission (ACCC), the Australian Crime Commission (ACC), the Australian Federal Police (AFP) and the Commonwealth Director of Public Prosecutions (CDPP).

<sup>89</sup> Exchange of information by the ATO with other Commonwealth agencies is based on section 16(4) of the *Income Tax Assessment Act* or section 3E of the *Tax Administration Act 1953*.

<sup>90</sup> The Committee's final report recommended that the Government consider amending current legislation regarding exchange of information to allow the ATO to provide information relating to civil cases or to non-tax related offences to appropriate regulatory agencies, such as ASIC or the ACCC.

## Strategies with tax professionals and the community to manage aggressive tax planning

2.36 The ATO seeks to gather from tax professionals and the wider community, aggressive tax planning information to identify aggressive tax planning risks (e.g. information on particular products being developed or marketed). It has several avenues to inform tax professionals and the community of its views on aggressive tax planning.

2.37 An issue facing the ATO, and its relationship with tax professionals in obtaining information about emerging or current aggressive tax planning issues, is the extent to which tax professionals are willing to provide information relating to aggressive tax planning, because of their professional and ethical responsibilities to their clients. While recognising the issues for tax professionals in this regard, the ATO has sought to engage the cooperation of tax professionals in obtaining information about aggressive tax planning by appealing to tax professionals' sense of responsibility to the larger tax system. This issue has been a source of some discussion (and tension) at the peak consultative bodies from time to time, with different professional bodies taking somewhat different views as to the practicality of the ATO's approach.<sup>91</sup>

2.38 The issue of the responsibilities of tax professionals to the wider tax system was canvassed in the SERC's inquiry into MMIS. The Committee made a recommendation on the matter.<sup>92</sup>

2.39 The matter was also raised in a previous audit report. The audit report, *The Australian Taxation Office's Management of its Relationship with Tax Practitioners*,<sup>93</sup> highlighted the different roles the ATO and tax practitioners play in the tax system and identified how different perceptions as to the nature and scope of tax practitioners' responsibilities bear on the relationship in particular ways.<sup>94</sup> In our view, and as noted in that audit report, although the roles and interests of the ATO and tax practitioners differ, each party depends on the other to play its part within the tax system.<sup>95</sup>

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<sup>91</sup> e.g., the roles and responsibilities of tax practitioners in the tax system with respect to aggressive tax planning was raised at the National Tax Liaison Group (NTLG) in 2001. The NTLG is the ATO's peak consultative forum for discussion and resolution of broad issues of procedures and policy in tax administration. The NTLG is chaired by the Commissioner of Taxation and members comprise senior ATO executives and representatives of the major tax, accounting and legal professional associations. For further discussion of its role and activities, see Audit Report No.19 2002–03 *The Australian Taxation Office's Management of its Relationship with Tax Practitioners*, 2002.

<sup>92</sup> The Committee's Final Report recommended (p. xiii) a review into the nature and extent of the public interest responsibility that tax professionals should adopt for the integrity of the tax system and that the review should include consideration of the issues of tax planning and mass marketed schemes.

<sup>93</sup> *The Australian Taxation Office's Management of its Relationship with Tax Practitioners*, Audit Report No.19 2002–03.

<sup>94</sup> *ibid.*, p.64.

<sup>95</sup> *ibid.*, pp.45–46.

**2.40** The ATO advised that it continues to seek the cooperation of professionals in the market place to obtain information to alert it to matters of potential concern. The ATO has indicated that it enjoys a measure of support in that respect, from tax professionals and the wider community. The ANAO recognises these efforts and notes the support offered by tax professionals and the community to the ATO in its approaches to manage aggressive tax planning. For the tax system to function effectively in this area and other areas for the community's benefit, all the parties must play their part.

**2.41** As to the ATO informing tax professionals and the community about possible aggressive tax planning issues and its concerns, the ATO provides information via the ATO Compliance Program,<sup>96</sup> the Commissioner's annual reports, Taxpayer Alerts, the ATO website, broadcasts and newsletters for tax practitioners, the ATO's Aggressive Tax Planning website, and speeches by the Commissioner and other senior tax officers. The ATO also uses the NTLG and the Aggressive Tax Planning Hotline<sup>97</sup> to inform tax professionals about aggressive tax planning matters and to gather information from them. Our discussions with tax professionals indicated that, while they complained at the length of time the ATO can take to make known its views about some aggressive tax planning arrangements, they are highly supportive of Taxpayer Alerts and product rulings, as a way for the ATO to promote its views on particular aggressive tax planning arrangements in a timely and consistent manner.

## Governance framework for managing aggressive tax planning

**2.42** In looking at the aggressive tax planning governance framework, we focused on planning, risk management and performance monitoring, evaluation and reporting.

### Planning framework

**2.43** As noted previously, the ATO's corporate planning is based on the ATO Plan (comprising four Sub-Plans in 2002–03 and five Sub-Plans in 2003–04). These Sub-Plans determine corporate priorities and allocate resources by setting out the highest-level risks to ATO business outcomes relevant to their areas of focus. Aggressive tax planning is covered by the Compliance Sub-Plan<sup>98</sup> and,

<sup>96</sup> The ATO Compliance Program is a public document that outlines the trends, major compliance risks and remedies across various segments of the community. The ATO also released a document in June 2003 outlining its approach to managing compliance with large business, with a particular focus on aggressive tax planning.

<sup>97</sup> See Chapter 3 for further discussion on the Aggressive Tax Planning Hotline.

<sup>98</sup> There are two parts to the Compliance Sub-Plan: In 2002–03, Part A is the ATO Compliance Program and Part B is an internal document that reports the Sub-Plan according to corporate requirements.

to a lesser extent, the Operations Sub-Plan. The ATO's planning for aggressive tax planning (in the Compliance Sub-Plan), reflects a two-way process whereby the CSM sets the corporate priorities and allocates resources, based, in part, on input from the FAC Aggressive Tax Planning, aggressive tax planning segments and business lines. The FAC Aggressive Tax Planning, aggressive tax planning segments<sup>99</sup> and the business lines, in turn, develop individual plans reflecting those priorities.

**2.44** The ANAO reviewed the 2002–03 and 2003–04 Aggressive Tax Planning Business (Delivery) Plans. We found that they reflected the types of activities planned around aggressive tax planning (*technical risks*) more than the operational risks in conducting these activities (*business risks*). For example, business risks, such as the quality of data supporting aggressive tax planning management, and adequate resourcing to analyse and deal with new and emerging aggressive tax planning intelligence, were not reflected in the Business Plans we reviewed. The ANAO also reviewed a sample of business plans prepared by segments (e.g. the Promoter Taskforce 2002–03 Business Plan and the SIA 2002–03 Business Plan). They similarly did not include business risks.

**2.45** The ANAO recognises that it is important to identify and manage technical risks. However, we consider it is also important to identify and manage business risks, so that *all* risks relating to the management of aggressive tax planning can be identified and addressed appropriately. The ANAO suggests that the ATO incorporates business risks into future planning of aggressive tax planning management so that all aggressive tax planning risks can be identified and managed in a comprehensive and integrated manner.

## **Aggressive tax planning risk management process**

**2.46** At the organisational level, the ATO has a risk management framework and approach which is a common foundation for its risk management activities across the organisation. A formal risk management framework is useful in the ATO's management of aggressive tax planning because such a framework provides a basis for considering how particular aggressive tax planning risks should be managed, based on key stages of an interconnected cycle.<sup>100</sup> In looking at processes in this risk management cycle, we found that ATO has well-developed,

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<sup>99</sup> Aggressive tax planning segments only need to prepare one plan for contribution to both the Aggressive Tax Planning delivery plan and their business line's delivery plan.

<sup>100</sup> The ATO has developed a document for aggressive tax planning staff that outlines the key stages in the risk management cycle specific to aggressive tax planning. The key stages are to: establish the context for risk management based on business objectives; identify risks; assess risks; determine an optimal strategy to treat risks; and monitor and review the treatment of risks.

formal processes for monitoring<sup>101</sup> and treating<sup>102</sup> aggressive tax planning risks. However, there are some problems with the identification and assessment of risks. The areas of particular interest are outlined below.

### *Risk identification and assessment*

2.47 Aggressive tax planning risks can be identified by anyone within the ATO using a set of features that typify aggressive tax planning arrangements.<sup>103</sup> The intended steps involved in identifying and assessing aggressive tax planning risks are as follows:

- Information (or intelligence) identified by ATO staff that might relate to aggressive tax planning is forwarded to the relevant aggressive tax planning segment(s) and the SIA.
- The aggressive tax planning segments assess this information by applying the PASTO model, using a profiling template and various aggressive tax planning risk matrices.<sup>104</sup> If the assessment identifies intelligence relating to a risk that is being managed by a product manager, it is forwarded to that person. If the intelligence cannot be allocated to a product manager, it is forwarded to the relevant aggressive tax planning segment, business line or to the SIA to conduct further analytical work to determine whether it is a risk.<sup>105</sup>
- All intelligence and associated analysis is forwarded to the SIA for inclusion in the monthly New and Emerging Intelligence Report provided to the RRP.<sup>106</sup> The RRP uses this report to identify potential new aggressive tax planning risks. The RRP records all identified risks on the Aggressive Tax

<sup>101</sup> The RRP is responsible for monitoring the progress of compliance plans on a monthly basis by reviewing progress reports prepared by product managers based in aggressive tax planning segments. These progress reports are to be provided to the RRP on a two-monthly basis, with risks ranked as 'severe' reported on a monthly basis. We found that changes to reporting arrangements by product managers to the RRP have enhanced the RRP's ability to review the progress of risk treatments and have allowed it greater capacity to provide more strategic input into the management of aggressive tax planning risks.

<sup>102</sup> Aggressive tax planning risks are treated by product managers using compliance plans. In developing a compliance plan, product managers are expected to use a template, which defines and scopes the risk using the PASTO model, assess and rank the risk using the various aggressive tax planning risk matrices and escalate the risk to the RRP with recommended treatment strategies. We found that compliance plans are a useful way of setting out the proposed treatment strategy for identified risks.

<sup>103</sup> Features that typify aggressive tax planning arrangements are outlined in Practice Statement 2000/10—*Application of Part IVA*. These features are listed in Appendix 2 of this report.

<sup>104</sup> Aggressive tax planning risk matrices assist staff to identify, analyse, assess and rank aggressive tax planning risks, by outlining the bases, for example, for judging risk level and consequence.

<sup>105</sup> e.g., if the intelligence relates to an SB matter, it is forwarded to the SBATP unit.

<sup>106</sup> The New and Emerging Intelligence Report outlines the SIA's analysis of new and emerging aggressive tax planning intelligence and includes a list of all new and emerging intelligence identified in a particular month (see also Chapter 3).

Planning Risk Register.<sup>107</sup> Aggressive tax planning risks are also expected to be recorded on business line risk registers.

**2.48** On the whole, the ATO has a well-developed risk identification and assessment framework. There are two specific risk assessment matters that deserve ATO attention. These are:

- comparability of aggressive tax planning risk assessments; and
- comprehensiveness of the Risk Register.

**2.49** As noted previously, the ATO has a common risk management framework across the organisation. However, in respect of risk assessments specifically in relation to aggressive tax planning, some segments do not use the specific, aggressive tax planning risk matrices when doing their risk assessments (of promoters, for example), using different bases to conduct their risk assessments.<sup>108</sup> This means that a risk ranked by one segment may be ranked differently from a comparable risk, ranked in another segment. In our view, risk assessments should be done on a consistent basis. Using the aggressive tax planning risk matrices would appear to provide a practical way to do this.

**2.50** We found that the Aggressive Tax Planning Risk Register does not contain all risks, as intended. We found that, although the Register should<sup>109</sup> record strategic risks, technical risks and internal capability (e.g. business) risks, it only records strategic and technical risks.<sup>110</sup>

**2.51** We are aware, too, that the RRP has been concerned that the Aggressive Tax Planning Risk Register does not include risks dealt with directly in the business lines.<sup>111</sup> While the ATO has recently introduced a quality assurance process for the Register,<sup>112</sup> it does not include measures that promote risks being managed by the business lines being recorded on the Register.

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<sup>107</sup> The Aggressive Tax Planning Risk Register is used to track the progress of risks from detection through to resolution. Features of the Aggressive Tax Planning Risk Register include the category of aggressive tax planning arrangement, status of the risk treatment, risk level and the name of the product manager responsible for managing the risk.

<sup>108</sup> e.g., some areas use the aggressive tax planning-specific risk matrices, some use the LB&I Health Card for risk assessments and the basis for some other segments is not apparent.

<sup>109</sup> according to the aggressive tax planning risk management process document.

<sup>110</sup> An example of a strategic risk is implementation of promoter penalty legislation. An example of a technical risk is film schemes. See Chapter 4 for further discussion of the promoter penalty matter.

<sup>111</sup> The Aggressive Tax Planning Risk Register only reflects aggressive tax planning risks brought to the RRP. The RRP was advised that other aggressive tax planning risks dealt with directly by the business lines are not shown on the Aggressive Tax Planning Risk Register.

<sup>112</sup> Some of the measures include the quarterly (or on needs basis) updating of the Aggressive Tax Planning Risk Register by product managers and three- to six-monthly reviews of risk rankings by the RRP. These measures aim to ensure the risks recorded in the Aggressive Tax Planning Risk Register are relevant and up-to-date.



2.52 The ANAO considers that, for proper awareness of aggressive tax planning risks across the ATO and proper assessment of their significance, the ATO should implement measures to better support consistent and rigorous risk assessment and should record all aggressive tax planning risks on the Risk Register.

### Recommendation No.3

2.53 To improve aggressive tax planning risk management processes, the ANAO recommends that the ATO:

- incorporate business risks into future business planning around aggressive tax planning;
- conduct all aggressive tax planning risk assessments on a consistent basis; and
- record all aggressive tax planning risks on the Aggressive Tax Planning Risk Register, as intended.

#### *ATO response*

2.54 Agreed. Business risks have been taken into account in the ATO's Aggressive Tax Planning risk processes. However, the ATO accepts that these need to be more clearly articulated in the outputs from its aggressive tax planning risk management processes.

2.55 Our experience has shown that in relation to aggressive tax planning risk assessments, different approaches are required for different levels of complexity. While this may give the appearance of inconsistency, all risk assessments are based on the foundations of the ATO Risk Consequence Rating Matrix.

### Performance monitoring, evaluation and reporting

2.56 The body involved in aggressive tax planning performance monitoring, evaluation and reporting at the highest level is the Compliance Executive (CE). The CE monitors and reports on the progress of the Compliance Sub-Plan to the ATO Executive based on reports provided by a range of different groups and focus areas, such as the ATPSC. The monitoring process requires the FAC

Aggressive Tax Planning to prepare four types of governance reports<sup>113</sup> for the CSM.<sup>114</sup> These reports are prepared from contributions by the aggressive tax planning segments<sup>115</sup> that are represented on the ATPSC. The FAC Aggressive Tax Planning uses these reports and the ATPSC meetings, to monitor and evaluate the ATO's performance in managing aggressive tax planning.

2.57 The ANAO reviewed the reports prepared for the CE and found that they provide a comprehensive basis for reporting the ATO's performance, in terms of coverage and timeliness. The Health of the System Assessment (HOTSA) report allows the ATO to monitor and evaluate its performance in addressing the overall, strategic objectives in managing aggressive tax planning, as outlined in the Aggressive Tax Planning Business Plans.<sup>116</sup> We found that the format for the plenary governance report has changed on a regular basis since July 2002, sometimes reporting against the Aggressive Tax Planning Business Plan and now reporting against the Compliance Sub-Plan. Given these changes, we found it difficult to compare the plenary governance reports directly with the Compliance Sub-Plan and to assess, on a consistent basis, how well aggressive tax planning was being managed.<sup>117</sup> We see merit in the current format for the plenary governance report, because the Compliance Sub-Plan is a significant reference point in the ATO's management of aggressive tax planning. The Compliance Sub-Plan is a key document in ATO planning, outlining what the ATO is doing to secure compliance and maintain community confidence.

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<sup>113</sup> Four types of reports prepared for the CE are:

**Quarterly plenary governance report**—outlines the progress of strategies used to manage aggressive tax planning risks identified in the Compliance Sub-Plan.

**Monthly exception report**—prepared if the FAC Aggressive Tax Planning does not expect to meet his commitments in the Compliance Sub-Plan in a particular month.

**Monthly Active Compliance report**—provides a statistical overview of compliance activities presented from a market segment and revenue product perspective.

**Health of the System Assessment (HOTSA) report**—provides a holistic way of describing the ATO's performance in managing aggressive tax planning, reflecting Outcomes (Risk to the Revenue, Cost to Operate and Community Confidence); and Operating features (the market, promoters, risk identification, risk treatment, ATO internal capability and effectiveness of the law). The intention is to prepare HOTSA reports for the FAC Aggressive Tax Planning on a two-monthly basis, with annual reports prepared for the CSM.

<sup>114</sup> The sequence involved in preparing aggressive tax planning governance reports is similar to the sequence involved in the planning process described earlier.

<sup>115</sup> The ANAO notes that, while the aggressive tax planning segments are not required to produce segment performance reports, the SIA did produce a performance report for 2002–03. This report outlines the SIA's achievements and activities undertaken to contribute to the ATO's management of aggressive tax planning.

<sup>116</sup> The HOTSA report provides a good summary of the outcomes of activities undertaken by aggressive tax planning segments to achieve strategic objectives such as improving community confidence and reducing risk to revenue.

<sup>117</sup> The ATO advised that plenary governance reporting is currently under review.

## *Performance measures*

**2.58** The Aggressive Tax Planning Business Plan specifies the measures used to assess the ATO's performance in managing aggressive tax planning. Measures include the number of access visits and product ruling reviews to be conducted. The ANAO found that performance measures in the 2002–03 Aggressive Tax Planning Business Plan were not quantified with targets. In the 2003–04 Aggressive Tax Planning Business Plan, the ATO attempts to quantify some of its performance measures with targets (workload projections). For example, in 2003–04, the ATO expects to conduct: profiles and risk assessments of 50 promoters; 60 access visits; and 81 reviews of successful and unsuccessful product ruling applications.

**2.59** We recognise that it is not possible to assess overall performance readily. Targets, in respect of particular performance measures, are only very partial indicators of performance, given the nature of some of the ATO's aggressive tax planning management functions (e.g. intelligence gathering and assessment and compliance improvement).<sup>118</sup> That said, we consider that setting targets can be helpful at the 'activity level', because they show the level of activity against what was planned. They can prompt some useful reflection on what has been done, the factors that have influenced the level of activity conducted and possible ATO responses. In this context, we support the ATO's efforts to quantify some of its performance measures in the 2003–04 Aggressive Tax Planning Business Plan with workload projections. We also encourage the ATO to continue, where possible, to quantify its performance measures with measurable targets.

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<sup>118</sup> Chapter 3 also mentions the difficulty of performance evaluation.

## Figure 2.1

### Case study illustrating the ATO's approach to managing aggressive tax planning—analysing patterns, trends and drivers and subsequent action

In 2002, the Strategic Intelligence Analysis Unit (SIA) undertook an analysis of Capital Gains Tax (CGT) risks across the ATO, with particular regard to aggressive tax planning-related issues. The objective was to analyse and report on patterns, trends and drivers and systemic risks relating to CGT issues and to consider whether the ATO should communicate any concerns to the wider community.

#### Intelligence gathering, consultation and analysis

The SIA gathered initial intelligence by undertaking searches of the various ATO databases that contain information on CGT issues, including SIGNUM (the ATO's corporate repository of significant issues) and LB&I's HealthCard (that business line's risk assessment tool).

The SIA analysed selected CGT arrangements to show the essential elements and key tax planning issues. The SIA also had discussions with relevant ATO staff, including each LB&I aggressive tax planning segment, the High Wealth Individuals Taskforce, LB&I's intelligence area (Strategic Business and Intelligence), the Small Business (SB) and Personal Tax lines.

The SIA identified a wide spectrum of possible CGT risks. These included compliance-related issues (through either deliberate avoidance or a lack of understanding by the taxpayer), tax planning around the law and aggressive tax planning (where the general anti-avoidance provision (Part IVA) may apply. The SIA analysis paper reported the six main trends in CGT risk where taxation appeared to be the major driver; the analyses of selected CGT arrangements as case studies; and suggested treatments, including whether the ATO should communicate concerns to the community, in some areas.

#### Use

The CGT analysis paper was widely distributed within the ATO, including all segments in LB&I, relevant Centres of Expertise, SB and the Tax Counsel Network. There was broad consensus across the ATO on the issues and appropriate treatment.

The paper contributed to the ATO's understanding of CGT planning and risks. The paper has been used to support the public statements that the Commissioner of Taxation and the FAC Aggressive Tax Planning have made on several occasions about the ATO's concerns around CGT planning. The ATO's compliance plans concerning CGT also reflect these statements of concern and the ATO advised that it is increasing its compliance focus in this area. It is actively working on a number of cases where the general anti-avoidance provision might apply.

Source: ATO information

## 3. Strategic Intelligence Analysis

*This Chapter reviews the ATO's Strategic Intelligence Analysis unit, including its planning, intelligence gathering and analysis activities; and monitoring and reporting on performance.*

### Introduction

**3.1** The SIA is the aggressive tax planning segment responsible for developing and maintaining a corporate capability to identify and address aggressive tax planning in real-time. As such, the capabilities and good management of SIA (to gather all aggressive tax planning intelligence and interpret this intelligence in response to constant changes in the aggressive tax planning environment), are critical to the ATO's revised approach to managing aggressive tax planning.

**3.2** The SIA's objectives are to have:

- an holistic understanding of the aggressive tax planning market and patterns, trends and drivers;
- the capability to 'make sense' of raw data;
- effective internal and external working relationships; and
- the ability to articulate what success is and measure it for the management of aggressive tax planning.

**3.3** The SIA gathers and analyses aggressive tax planning intelligence<sup>119</sup> from other ATO areas and external sources, to inform the RRP<sup>120</sup> of new and emerging aggressive tax planning intelligence and the ATPSC about the health of the aggressive tax planning management system.<sup>121</sup>

**3.4** As of 30 June 2003, the SIA had 24 staff performing functions including: analysing intelligence to identify patterns, trends and drivers in aggressive tax planning; providing support to Promoters Taskforce visits; and liaising with external stakeholders.<sup>122</sup> To effectively perform these functions, the SIA needs to manage its resources so that, among other things, it can achieve the right balance between its intelligence gathering and analysis responsibilities.

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<sup>119</sup> Intelligence results from the process of collecting, evaluating (and re-evaluating), collating and analysing information. This process is known as the intelligence cycle. See Auditor General Audit Report No.38 1999–2000, *Coastwatch*, Australian Customs Service, p.79.

<sup>120</sup> The head of the SIA is the chair of the RRP.

<sup>121</sup> The SIA prepares the aggressive tax planning HOTSA reports to inform the ATPSC of the health of the aggressive tax planning management system. This report is discussed later in this Chapter.

<sup>122</sup> External stakeholders include ASIC and professional associations such as the Taxation Institute of Australia.

3.5 This Chapter focuses on key elements of the SIA's management framework: planning; intelligence gathering and analysis activities; performance monitoring; and reporting.

## Planning arrangements

3.6 The SIA prepares a Business Plan specifying the type of activities it will conduct to achieve its stated objectives. SIA planning contributes to the Aggressive Tax Planning Business Plan. The ANAO reviewed the SIA's Business Plans for 2002–03 and 2003–04 and found they are well-structured and highly detailed,<sup>123</sup> allowing for the head of the SIA to review the progress of staff and their responsibilities against specific activities.

## SIA activities—intelligence gathering

### Identifying aggressive tax planning intelligence

3.7 In aggressive tax planning, two types of intelligence are produced:

- **tactical intelligence**—new and emerging issues identified by ATO and external sources; and
- **strategic intelligence**—resulting from undertaking analysis and synthesis (or making sense) of new and emerging issues.<sup>124</sup>

3.8 The SIA is responsible for gathering tactical intelligence from all ATO staff and identifying strategic intelligence. The ATO has no standard process for identifying aggressive tax planning tactical intelligence. Instead, staff are encouraged to use their experience, judgment, intuition and a list of features that typify aggressive tax planning arrangements, to make informed decisions around identifying tactical intelligence. The process of identifying aggressive tax planning is reinforced to staff through the Practice Statement on the application of Part IVA general anti-avoidance provisions, intelligence training provided by the SIA,<sup>125</sup> and regular exchanges of intelligence between the SIA and other ATO intelligence staff (see next section regarding exchanges of intelligence). We consider that the SIA has strategies to gather relevant and timely tactical intelligence, using intelligence training and regular feedback arrangements.

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<sup>123</sup> The Business Plan links the type of activities to specific outcomes and outputs, identifies which staff are accountable for conducting these activities and identifies the resources dedicated to undertaking these activities.

<sup>124</sup> Examples of strategic intelligence developed by the SIA relate to the analysis of Capital Gains Tax issues and finance issues.

<sup>125</sup> The SIA conducted two training sessions during 2002–03, one for staff of Personal Taxes ATP and one for staff of ASIC and Commonwealth Director of Public Prosecutions in Western Australia.

## Sources of aggressive tax planning intelligence

**3.9** The ATO has a decentralised framework for managing intelligence, whereby all staff are responsible for gathering, analysing and sharing relevant intelligence. The ATO does not have one intelligence area, but it has intelligence functions based in various business lines.<sup>126</sup>

**3.10** The SIA gathers tactical intelligence in two ways: referrals from aggressive tax planning segments and other ATO areas; and interrogation of ATO and external databases.<sup>127</sup> Examples of referral sources include: HWI Taskforce; Promoters Taskforce; and the relevant unit in the Small Business line (SBATP). Examples of ATO and external databases include: the ATPDatabase (see Chapter 2); the ATO Intelligence icon;<sup>128</sup> and AUSTRAC.<sup>129</sup>

**3.11** The ATO has implemented strategies for gathering tactical intelligence from external stakeholders. In December 2001, the ATO established the Aggressive Tax Planning Hotline for tax and superannuation professionals to provide information, and raise issues, regarding aggressive tax planning.<sup>130</sup> The ANAO reviewed examples of intelligence gathered from the Hotline and found they provide the SIA with useful information.<sup>131</sup> The ATO also proposed regular dialogue with tax practitioners representing professional associations, to discuss aggressive tax planning issues and give tax practitioners the opportunity to provide intelligence. However, tax practitioners have not generally acted on this proposal.

## Mechanisms for gathering aggressive tax planning intelligence within the ATO

**3.12** The SIA's mechanisms for gathering tactical intelligence from ATO sources have changed over time. Between June 2001 and March 2002, the SIA used a template to gather tactical intelligence, which people providing intelligence were requested to complete on a monthly basis. The SIA indicated to us that this process was inflexible and did not necessarily provide intelligence that was relevant and real-time. Since March 2002, several mechanisms (formal and

<sup>126</sup> For example, LB&I has a Strategic and Business Intelligence area dedicated to facilitating intelligence. SIA is also located in LB&I.

<sup>127</sup> The SIA advised that approximately 74 per cent of tactical intelligence comes from referrals.

<sup>128</sup> An ATO-wide intelligence database designed to support the capture, moderation, escalation and analysis of information for intelligence creation. A fortnightly Intelligence Awareness Report prepared by SB is forwarded to the SIA.

<sup>129</sup> AUSTRAC (Australian Transactions Reports and Analysis Centre) is the Commonwealth agency responsible for reporting on suspect financial transactions and significant cash transactions.

<sup>130</sup> The ATO appointed the head of the SIA to be the contact officer for the Aggressive Tax Planning Hotline.

<sup>131</sup> The ATO gathered 12 pieces of tactical intelligence from the Aggressive Tax Planning Hotline during 2002–03.

informal) are used to gather (and exchange) tactical intelligence. These include telephone referrals, regular e-mails describing potential issues identified and networking through Distributive Intelligence Workshops.<sup>132</sup> The ANAO reviewed examples of referrals using e-mails and found that they are an adequate means of gathering intelligence that is more real-time and relevant than under the template approach.

## Recording aggressive tax planning intelligence

**3.13** An essential component of an effective intelligence framework is a well-structured and reliable intelligence system to store, sort, interrogate and analyse intelligence. The SIA uses an Excel spreadsheet to record and manage all new and emerging intelligence gathered (NEI Report).<sup>133</sup> One SIA staff member is responsible for ensuring all tactical intelligence gathered is recorded on the NEI Report, with the intelligence sorted on a monthly basis, as well as aggregated into one separate list that can be sorted into categories of aggressive tax planning arrangements.<sup>134</sup> This categorisation process limits the possibility of duplicating intelligence already gathered and analysed.<sup>135</sup>

**3.14** The ANAO reviewed the NEI Report and found that it has the capacity to manage intelligence by recording relevant features, such as the date intelligence is identified and the category of aggressive tax planning, i.e. the type of scheme. However, we found two key fields in the Report are not being effectively used (source of intelligence and whether the ATO stakeholder was notified).<sup>136</sup> As a result of these fields not being completed, the SIA cannot capitalise fully on its capacity to review the most productive sources of intelligence to maximise their contributions to intelligence gathering. As well, it is more difficult for the SIA to monitor the progress of new and emerging intelligence for reporting purposes.<sup>137</sup> The ANAO suggests the SIA encourage its staff to complete all relevant fields in the NEI Report, because they contain valuable information for managing intelligence and for maximising its value as an intelligence tool. The ATO accepts

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<sup>132</sup> LB&I conducts regular workshops to draw out and develop patterns, trends, drivers and future impacts from intelligence emerging from the work of intelligence areas within LB&I.

<sup>133</sup> Intelligence from the NEI Report is distributed to other parts of the ATO including the RRP and members of the LB&I Distributive Intelligence Workshop.

<sup>134</sup> Examples include offshore funds transfer and superannuation.

<sup>135</sup> The integrity of the Report is also enhanced through a six-monthly review of the Report to update the progress of issues. This review also provides an opportunity for the SIA to provide feedback to its sources on the progress of issues they identified.

<sup>136</sup> As of 30 June 2003, of the 417 new and emerging issues identified: 273 (or 65 per cent) did not identify the source of intelligence; and 175 (or 42 per cent) did not notify the relevant ATO stakeholder about the new and emerging issue.

<sup>137</sup> The SIA conceded that the two fields in question were not being completed. However, it advised that information pertaining to the source of intelligence could be obtained from other fields in the NEI Report and ATO stakeholders notified.



this and advised in December 2003 that staff are now completing all required fields in the NEI Report.

**3.15** The ANAO also found that the NEI Report is not linked to any other databases capturing and recording aggressive tax planning intelligence.<sup>138</sup> Therefore, the ATO does not currently have a database that contains all aggressive tax planning intelligence. To address this deficiency, the ATO is enhancing the ATPDatabase to incorporate an Intelligence module.<sup>139</sup> This will allow all aggressive tax planning staff to enter intelligence directly into the Database. The ANAO considers that the ATO's intention to centralise the collection of aggressive tax planning intelligence into the ATPDatabase is practical, given the need (and the ATO's strategy) to manage aggressive tax planning intelligence in an integrated way. The enhancements may also allow the SIA to focus more on developing strategic intelligence, rather than having to record, as well as gather, intelligence from referral sources and databases.

**3.16** The capacity of the ATPDatabase to be an effective aggressive tax planning intelligence tool will depend on the quality of intelligence found in the Intelligence module. As noted in Chapter 2, there is no process in place that provides assurance on the quality of data in the ATPDatabase. (The current outline of the proposed Intelligence module does not address that process either.)<sup>140</sup>

## SIA activities—intelligence analysis

**3.17** Intelligence analysis assists the ATO in its decision-making; contributes to policy development; and enhances resource planning around aggressive tax planning. Failures in intelligence analysis may lead to the ATO failing to recognise aggressive tax planning problems at an early stage, leading to inadequate monitoring and follow-up of risk assessments to rectify the problems. In managing aggressive tax planning, intelligence analysis is important to 'make sense' of the tactical intelligence gathered to provide the ATO with a greater understanding of aggressive tax planning issues.<sup>141</sup>

<sup>138</sup> This means that only SIA staff can directly input tactical intelligence into the NEI Report. Other staff record intelligence into their own databases, such as the HWI Taskforce database and LB&I's HealthCard system.

<sup>139</sup> The proposed Intelligence module will allow intelligence to be monitored from detection to resolution by incorporating extra functions into the ATPDatabase, such as the date identified and its current status. The ATO advised in January 2004, that the module is due for release in February 2004. See Chapter 2.

<sup>140</sup> In Chapter 2, the ANAO recommends that the ATO implement a quality assurance process for the ATPDatabase (including the Intelligence module).

<sup>141</sup> The ATO's emphasis on intelligence analysis is demonstrated by the SIA requesting an extra staff member to assist in its synthesis and analysis function for 2003–04.

**3.18** The SIA employs seven staff to ‘make sense of’ or analyse tactical intelligence gathered to create strategic intelligence.<sup>142</sup> The SIA adopts a flexible approach to deciding whether tactical intelligence is assessed or not. Among the factors coming into play are the experience and judgment of staff, the number of times a particular issue arises and the estimated size of the revenue at risk. The ANAO considers these factors provide a practical basis on which to decide whether further analysis of tactical intelligence should be conducted, given the need to exercise judgment on a case-by-case basis, in real-time.

**3.19** The process of developing strategic intelligence starts with the SIA conducting a preliminary risk assessment of the tactical intelligence gathered, using the PASTO model (see Chapter 2 for an outline of the PASTO model). The outcome of this assessment is recorded in the NEI Report, which is reported to the RRP. In developing strategic intelligence, the SIA uses ATO and external databases, various aggressive tax planning risk matrices<sup>143</sup> and other ATO intelligence areas. The ANAO reviewed examples of strategic intelligence. We found that the SIA’s work and its collaboration with other ATO areas, to make sense of tactical intelligence, is extensive and productive.<sup>144</sup>

**3.20** In reviewing the SIA’s intelligence analysis function, the ANAO found that there is a data field in the NEI Report to indicate when intelligence is *identified*, but no field to document when intelligence is *analysed*. This makes it difficult to determine whether intelligence analysis occurred and the timeliness of analysis. Given the importance of gathering and analysing intelligence in a timely manner, to provide early warnings to the community about aggressive tax planning arrangements, and given the NEI Report is the only tool used to manage intelligence activities, it is important that the SIA uses the Report to provide assurance that its intelligence and analysis work is timely. Some enhancements to the ATPDatabase to address these particular operational matters might assist the SIA achieving this. At the time of our fieldwork, the proposed Intelligence module within the ATPDatabase did not appear to contain a field that explicitly shows when tactical intelligence analysis has occurred.<sup>145</sup> The ATO advised in December 2003, that the module within the ATPDatabase will have the capacity to identify when intelligence analysis has been completed.

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<sup>142</sup> SIA staff have received extensive training in various intelligence analysis tools and through training courses provided by an external consultant. An intelligence analysis tool used by the SIA is Analyst’s Notebook, which is used to detect, interpret and display complex information in an easily understood format.

<sup>143</sup> As described in Chapter 2.

<sup>144</sup> Examples of SIA’s strategic intelligence work includes collaboration with AUSTRAC on the use of tax havens and with SB on risk assessments of product ruling applications.

<sup>145</sup> The Intelligence module proposes to contain a field titled ‘Date completed by ATP’, however, it is unclear whether this field will identify whether intelligence analysis has occurred or not.

## Intelligence analysis reports

**3.21** Intelligence analysis reports convey to key ATO stakeholders the issues resulting from intelligence analysis that can affect the ATO's management of aggressive tax planning.<sup>146</sup> The SIA produces several reports that aim to do this, as follows:<sup>147</sup>

- on a monthly basis, a report is prepared for the RRP, outlining the SIA's synthesis and analysis of new and emerging aggressive tax planning intelligence identified in the NEI Report, as well as a copy of the NEI Report itself;<sup>148</sup>
- six-monthly aggressive tax planning HOTSAs reports – provide an understanding of the patterns, trends and drivers affecting the aggressive tax planning market, trends from overseas tax jurisdictions and key ATO internal capability issues (e.g. issues relating to understanding the participants in aggressive tax planning and how they interact and the ATO's capacity to deal with intelligence at the analysis stage);<sup>149</sup> and
- on a regular basis, synthesis and analysis reports on a specific aggressive tax planning issue (e.g. on a high-risk promoter and exploring the extent to which capital gains tax (CGT) is an aggressive tax planning driver. See CGT case study in Chapter 2.)

**3.22** The ANAO reviewed examples of these reports. We found they are useful in providing the ATO with the capacity to understand the aggressive tax planning environment at a particular point in time and the key capability issues affecting its management of aggressive tax planning.

## SIA activities—Taxpayer Alerts

**3.23** An important corporate responsibility of the SIA is to provide early warnings to the community about new and emerging aggressive tax planning arrangements on a needs basis, using Taxpayer Alerts. The ATO commenced

<sup>146</sup> Twenty-five analysis reports were produced during 2002–03.

<sup>147</sup> These reports are provided to the RRP, the ATPSC and members of the LB&I Distributive Intelligence Workshop.

<sup>148</sup> Examples of aggressive tax planning patterns, trends and drivers identified include wealth creation and superannuation.

<sup>149</sup> HOTSAs reports are compiled using questionnaires completed by internal and external stakeholders. The SIA evaluates the stakeholders' responses and integrates them with its analysis, to present a view on the aggressive tax planning management system.

issuing Taxpayer Alerts<sup>150</sup> in December 2001 and as of 1 September 2003, has issued 13 Alerts, which are publicly available on the ATO's website.<sup>151</sup> The Taxpayer Alert preparation process is as follows:

- a potential new and emerging aggressive tax planning issue that might constitute a Taxpayer Alert is initially identified by the business lines and escalated to the SIA;
- the SIA is responsible for co-ordinating the preparation by the business lines<sup>152</sup> of draft Taxpayer Alerts along with associated submissions to the RRP. SIA advised that it has been predominantly responsible for preparing Taxpayer Alerts so far, although the business lines have started to prepare Alerts themselves; and
- once a draft Alert is prepared, it is forwarded to the RRP for review. The RRP is responsible for managing the progress of the preparation of Taxpayer Alerts.<sup>153</sup> Once the RRP decides that an Alert should be issued, a recommendation is forwarded to the FAC Aggressive Tax Planning for approval.<sup>154</sup>

**3.24** Once an Alert is issued, the business lines, in conjunction with the ATO's Tax Counsel Network, are responsible for finalising the ATO's view on an Alert. The ATO aims to publish the ATO view on the issues raised in the Alert, within two months of the Alert being issued. Publishing the ATO view in a timely manner provides the community with some confidence about the ATO's view on a potential aggressive tax planning arrangement.<sup>155</sup> The ANAO reviewed the Taxpayer Alerts issued so far and found that<sup>156</sup> the ATO view on five had not been published. As well, four of these Taxpayer Alerts were issued more than

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<sup>150</sup> Taxpayer Alerts are not legally enforceable. The ATO sought legal advice from the Australian Government Solicitor (AGS) on potential legal risks associated with issuing Taxpayer Alerts. The AGS advised that the ATO could lawfully publish Taxpayer Alerts, provided it took account of legal risks (e.g. unlawful disclosure of personal information under the *Privacy Act 1988*). The ATO appreciates the need to balance timeliness and accuracy in preparing a Taxpayer Alert, being aware that precipitate notice that a particular arrangement *might* be of potential concern to it, can detrimentally and inappropriately affect the interests of parties promoting or engaging in that arrangement.

<sup>151</sup> Australian Taxation Office, Taxpayer Alerts, viewed 1 September 2003, <<http://www.ato.gov.au/atp>>, 2003.

<sup>152</sup> A Practice Statement on Taxpayer Alerts and associated documentation provides a comprehensive basis on which staff develop Taxpayer Alerts.

<sup>153</sup> The RRP is also responsible for managing the progress of finalising the ATO's view on a Taxpayer Alert.

<sup>154</sup> Taxpayer Alerts can be approved and issued by either the FAC Aggressive Tax Planning or the Commissioner of Taxation.

<sup>155</sup> The ATO view can occur in many forms, including a Taxation Ruling and a Taxation Determination. In some instances, the ATO relies on a previously established ATO view to finalise its view on an Alert.

<sup>156</sup> As of 1 September 2003.

two months earlier.<sup>157</sup> We also found that the time taken by the ATO to publish its view on the remaining eight Alerts, ranged from the same-day to 18 months.

**3.25** Taxpayer Alerts have been acknowledged by the taxpaying community as a helpful tool in communicating the ATO's view on potential aggressive tax planning arrangements in a timely and considered manner. However, the timeliness of publishing the ATO view on matters raised in Taxpayer Alerts is an area identified by the ATO and tax professionals as needing improvement.

**3.26** It is difficult to measure the effect Taxpayer Alerts have in deterring aggressive tax planning in the community, because taxpayers' behaviour may be influenced by a wide variety of factors besides an Alert (e.g. personal circumstances or advice from other sources, even other ATO sources), making it difficult to directly attribute a taxpayer not participating in an aggressive tax planning arrangement to a Taxpayer Alert. Nevertheless, by continuing to provide early, and considered views on potential aggressive tax planning arrangements, the ATO is better placed to prevent aggressive tax planning adversely affecting the tax system, an issue also identified in the SERC report.<sup>158</sup>

### Figure 3.1

#### Case study—intelligence gathering and integrated responses

This case study illustrates the ATO's aggressive tax planning intelligence gathering and analysis, and networking and collaboration between SIA, other aggressive tax planning units, and other areas across the ATO.

##### Intelligence gathering and analysis

SIA had been undertaking intelligence gathering and analysis on the 'wealth creation' industry because of potential links to aggressive tax planning. While SIA formed the view that most of these were not of an aggressive tax planning nature, there were some that met the criteria. SIA received intelligence from the High Risk Refunds Unit in the Personal Tax Business Line about claims for large partnership losses. Further information revealed that the claims were related to a particular scheme being marketed as a 'wealth creation' arrangement. The particular arrangement appeared to have as its 'selling point', wealth creation by means of large tax deductions, with little cash being outlaid—thereby leading to large tax refunds.

Further intelligence gathering and analysis by SIA revealed more of the participants in the arrangement and indeed a network of partnerships. SIA interviewed some of the participants to gather further intelligence and to gain a better understanding of the particular arrangement. SIA undertook further analysis, including using sophisticated computer-based analytical tools that draw links from external and internal intelligence and data between the promoter, their associates, the scheme and the investors. The picture painted by the analysis revealed a much broader network beyond the particular arrangement.

<sup>157</sup> The ATO indicated that, for two of the five Alerts not finalised, the reasons for the delay were difficulties in obtaining further information required to develop a considered ATO view on the issues raised in the Taxpayer Alerts.

<sup>158</sup> See, for example, Senate Economics References Committee, *Mass Marketed Tax Effective Schemes and Investor Protection Final Report*, 2002.

SIA shared this intelligence with appropriate areas in the ATO including Small Business (International), the Promoters Taskforce and the Personal Tax Aggressive Tax Planning area.

### **Early warning to the community**

SIA concluded that the arrangement involving large partnership losses was a significant tax planning issue and that the community should be notified of these concerns. SIA commenced preparing a Taxpayer Alert on the particular arrangement and made a submission to the Aggressive Tax Planning Risk Review Panel recommending to the First Assistant Commissioner (Aggressive Tax Planning) that a Taxpayer Alert be issued.

The analysis of the promoters, their associates, the scheme and the investors was referred by SIA to the Promoters Taskforce along with the analysis from the computer-based analytical tool. The Personal Tax Aggressive Tax Planning area took responsibility for the preparation of ATO view on the issues raised in the Taxpayer Alert. The ATO published its view on the arrangement in a Tax Determination.

### **Further action, intelligence gathering and response**

Meanwhile, the promoter, under the guise of another firm, wrote to the Commissioner of Taxation seeking a cessation of ATO action. ATO intelligence analysis on the firm revealed that no such firm could be identified. The 'firm' also made complaints to the Taxation Ombudsman and other senior officers in the ATO.

Further, the promoter, again under the guise of a different firm, sought a ruling from the ATO. ATO staff in SIA's intelligence network brought this to the attention of SIA. On the face of it, this ruling request had no connection with the promoter behind the arrangement. However further intelligence analysis by SIA established links to individuals and entities of interest. Other, apparently unrelated ruling requests were identified through SIA's intelligence networks. SIA internet searches established further links with an offshore 'virtual' law firm and the activities of other parties based in other tax jurisdictions. All ATO stakeholders were notified.

SIA became aware of the activity of other law enforcement agencies in relation to some companies involved in the arrangement. Information was exchanged, to the extent that the law allows.

The ATO commenced compliance action on the promoters.

Source: ATO information

## **Performance monitoring and evaluation**

**3.27** The SIA has a process for monitoring and evaluating its performance in a timely manner, based on:

- six-monthly reviews of the SIA Business Plan by the head of the SIA and two SIA directors. The results of this process (e.g. decisions on the allocation of SIA resources to intelligence activities) are provided to the FAC Aggressive Tax Planning for review and they contribute to aggressive tax planning governance reporting (see Chapter 2); and
- fortnightly telephone meetings involving staff located across Australia and monthly meetings involving staff located in the Melbourne offices to facilitate regular discussion of issues.

**3.28** In an ideal world, to effectively monitor performance, targets should be established to encourage continuous improvement in staff and to better assess the performance of a business/function.<sup>159</sup> The ANAO reviewed the 2002–03 and 2003–04 SIA Business Plans and found that they contain measures that provide a reasonable basis for assessing how the SIA is performing, in terms of activities being undertaken.<sup>160</sup> However, no targets have been established for these activities.<sup>161</sup>

**3.29** For the reasons discussed in Chapter 2, having targets to measure the performance of aggressive tax planning activities only provides partial indications of overall performance. Despite their limitations, we consider that setting targets can benefit the SIA's performance monitoring and evaluation process, because they can show something about activity against plan,<sup>162</sup> and prompt some useful reflection on what has been done, the factors that have influenced the result and what the SIA might choose to do in response.

## Performance reporting

**3.30** The SIA's performance reporting arrangements replicate the reporting obligations of the other aggressive tax planning segments (see Chapter 2). In addition, the SIA prepared a performance report for 2002–03, which covers its achievements and its successes in contributing to the ATO's management of aggressive tax planning.<sup>163</sup> The ANAO considers that this report is a positive initiative by the SIA to: articulate and measure its success in managing aggressive tax planning by reporting the outputs of its activities; help improve the ATO's awareness and understanding of its contribution to managing aggressive tax planning; and provide the FAC Aggressive Tax Planning with a clear indication of the SIA's contribution to managing aggressive tax planning.

<sup>159</sup> Auditor General Better Practice Guide, *Performance Information in Portfolio Budget Statements*, ANAO, Canberra, May 2002, pp. 24–5.

<sup>160</sup> Examples of measures include: the number of Taxpayer Alerts issued; the number of new and emerging issues identified; and the number of analysis reports.

<sup>161</sup> Some aggressive tax planning segments, including the SIA, were involved in setting targets for conducting certain key activities of the E2E process (including the timeliness of intelligence analysis). These targets were incorporated into a draft document reviewing aggressive tax planning staff work practices in February 2003. However, the ATO does not expect targets, even when finalised, to become mandatory.

<sup>162</sup> Also, by looking at the targets and 'actuals' achieved over time, the numbers may also show the relative emphasis in activities/ priorities over time.

<sup>163</sup> This report is provided to the FAC Aggressive Tax Planning and it supplements the reports the SIA is required to produce.

## 4. Promoters Taskforce

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*This Chapter reviews the management of the ATO's Promoters Taskforce, including its strategies and planning, operations and review processes.*

### Background

4.1 The ATO considers that promoters can exhibit a spectrum of behaviour, ranging from conservative,<sup>164</sup> through highly aggressive<sup>165</sup> to criminal/fraudulent. It also considers that promoters who derive significant profits from the sale of tax schemes are key drivers of tax avoidance in the tax system.<sup>166</sup> Administratively, promoters are considered to be key points of leverage in the tax planning landscape. By 'up-streaming' attention from taxpayers to the people selling, marketing or promoting schemes, the ATO can deal with things closer to the 'source', before the product or scheme is marketed widely. These factors are the rationale for the ATO establishing the Promoters Taskforce and devoting specific attention to promoters in managing aggressive tax planning.<sup>167</sup>

4.2 As noted earlier, a tax promoter is defined as someone who earns income from the design, sale, marketing or implementation of tax schemes. Promoters can include financiers, accountants, lawyers, tax agents and financial planners.

4.3 The ATO's Tax Planners project of the late 1990s, focussed on dealing with intelligence about high risk tax planners and providing advice and support to business line teams examining tax planners. In February 2002, the Commissioner announced the establishment of the ATO Promoters Taskforce (following from the Tax Planners project) as part of the ATO's response to mass marketed investment schemes (MMIS). The Taskforce was set up in May 2002.

4.4 The Promoters Taskforce was set up with 25 staff but it has grown since that time. In 2002–03, the Taskforce received additional funding of \$2 million to increase staffing to 55 people.

### Strategy, objectives and roles

4.5 The Promoters Taskforce is intended to be a corporate focus for ATO action to reduce the entrepreneurial activities of tax promoters, who actively develop,

<sup>164</sup> For example, seeking rulings from the ATO on technical matters.

<sup>165</sup> For example using round robin arrangements and manipulating other structured finance arrangements and cross-border issues.

<sup>166</sup> CTSI analysis of people involved in mass marketed investment schemes (MMIS), found that promoters were important players in MMIS. See Chapter 1.

<sup>167</sup> The ATO's major focus under its early approach to managing aggressive tax planning was to focus on the participant (i.e. the taxpayer) and the promoter tended to be dealt with only if they were involved in the scheme as a participant.



encourage participation in, or sell arrangements that result in the avoidance of tax. The Taskforce is also intended to improve compliance, particularly of promoters, their associates and clients, and to assist in identifying and addressing new and emerging issues in aggressive tax planning. The Taskforce focuses on the schemes that promoters market and promoters' own compliance with the law.

4.6 The ATO does not expect the Taskforce to do everything required regarding promoters. There are at least nine areas in the ATO reviewing the affairs of promoters, and therefore responsibility for implementation and compliance improvement is shared across various market segments and teams.<sup>168</sup>

4.7 The nature and scope of the Taskforce's work were set out originally in a 2002 Discussion Paper, written at the inception of the Taskforce. In similar vein, though with less detail, the Taskforce Business Plans<sup>169</sup> indicate that the Taskforce is responsible for leading and coordinating the ATO's tailored strategies with regard to tax promoters.

4.8 The key objectives the ATO has set for the Promoters Taskforce are:

- decreased incidence of aggressive tax planning (including taxpayers involved, schemes developed and promoter activity);
- increased community confidence in the fairness and equity of the tax system and the role of the ATO in administering this system;
- increased compliance by promoters with their legal obligations (tax and other laws);
- ongoing development of strategic intelligence, consultation and stakeholder liaison and development of policy advice for systemic improvements;
- expeditious joint investigations with other agencies leading to appropriate sanctions against promoters; and
- enhanced internal capability in effectively dealing with aggressive tax planning, particularly around intelligence (real-time, developing strategic intelligence with analysis of patterns, trends and drivers), risk assessment, investigation, legal and policy development.

4.9 The Taskforce advised that 'its role includes:

- at a strategic level, to develop strategies and methodology (and to roll out to the ATO and wider agencies);

<sup>168</sup> As well as the Promoters Taskforce, in LB&I there is LB&I Internationals, SIA, HWI Taskforce, the Financial Services Industry Group and the National Client Group. In Ptax, there is High Risk Refunds and the Tax Agent Investigation Unit. In SB, there is SBATP and SB Internationals. The new line called Serious Non-Compliance also deals with promoters.

<sup>169</sup> Taskforce Business Plans 2002–03 and 2003–04.

- operationally, to target some high risk cases;
- to participate in the development of systemic change initiatives and solutions; and
- to engage in coordination and exercise leadership.’

**4.10** The ANAO considers that the ATO’s strategic approach of having a particular focus on promoters in its management of aggressive tax planning is appropriate. As they are important players in devising and marketing tax schemes, measures to improve and secure promoters’ compliance represent a way for the ATO to address some of the causes of aggressive tax planning, rather than just addressing the ‘symptoms’ of aggressive tax planning (by amending taxpayers’ returns).

**4.11** The ANAO considers it is important that a role to lead and coordinate aggressive tax planning promoter strategies is assigned to *one* area in the ATO. Given the range of parties in the ATO dealing with promoters, effective action and compliance management requires consistency of approach, especially with regard to methodology, and communication and information sharing across areas dealing with promoters. As well as sharing information about compliance risks, communication and information sharing is also helpful in identifying and sharing better practice.

**4.12** Our review shows that the Taskforce’s activities are directed to its role and objectives, as enunciated. There are joint activities between the Taskforce and other areas of the ATO involved in reviewing aspects of promoters. There is evidence of mutual support and instances of the Taskforce offering advice and leadership in promoter management matters in other areas dealing with promoters, efforts to enhance internal capability, and contributions to the development of policy advice for systemic improvement.<sup>170</sup>

**4.13** Given the range of areas of the ATO reviewing promoters, and given the ATO’s goal that it has an integrated and appropriately tailored response to promoters in dealing with aggressive tax planning, there needs to be effective coordination between areas dealing with promoters. This in turn requires, among other things, clarity around responsibilities, effective communication and commitment. We could not see, however, where the functions and responsibilities of the Taskforce are specified in detail, particularly, relative to other areas. We consider, therefore, that there would be benefit in specifying in more detail, the Taskforce’s particular functions.

**4.14** For example, although the Discussion Paper sets out features of the Taskforce’s intended approach and operations, it does not specify in detail, the

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<sup>170</sup> e.g. training for Ptax staff and presentations to HWI staff on methodology and the Taskforce.

particular functions of the Taskforce that would particularly distinguish<sup>171</sup> it from other areas of the ATO dealing with promoters. As a 'taskforce', it would be reasonable to expect some clarity around particular functions. This detail may not have been practical for the 2002 Discussion Paper, but we consider that it would help the Taskforce and other parties to have it outlined now.

**4.15** We saw some instances highlighting where a greater measure of clarity around the specific functions and orientation of the Taskforce could be useful (e.g. whether, and to what extent, the Taskforce has an orientation to highest risk promoters<sup>172</sup> or, in order to provide a whole of ATO insight into promoters and ATO activities at a strategic level, it is required to be aware broadly of all promoters<sup>173</sup>). We also found other instances highlighting the need for the ATO to clarify how the Taskforce is expected to function in relation to some other ATO areas dealing with promoters.<sup>174</sup>

<sup>171</sup> One exception is a Taskforce leadership strategy (under the heading of 'strategic management'). That is the statement that 'Not all promoter work will be undertaken by the Taskforce. Of critical importance, is an appropriate mechanism for Taskforce control in direction setting and prioritisation of promoter work, without also having to take accountability for the actual management of all aspects of each case'.

<sup>172</sup> This orientation is spelt out in the goal statements in some of the Taskforce's performance reports. For example, the ATO's compliance monitoring report indicates that the Taskforce is committed to focusing on the highest risk planners and promoters. Similarly, demonstrating a view that the Taskforce focuses on higher risk promoters, the FAC Aggressive Tax Planning indicated to a Parliamentary Committee, when explaining how the ATO pursues the use of offshore tax havens that 'We look at tax havens in different areas of the Office. We have a Promoters Taskforce which looks at higher risk promoters more generally, not just tax haven promoters'. See Senate Estimates Economics Legislation Committee 3 June 2003, p. E244.

<sup>173</sup> i.e. to be aware of all promoters operating in Australia, (including those using international mechanisms and transactions as part of their operational practices) to be in a position to 'lead and coordinate ATO strategies with regard to promoters' which is one of the Taskforce's roles and responsibilities.

<sup>174</sup> e.g., the ATO indicated in discussions that the LB&I areas of 'Accounting and Legal' and 'Finance Houses' focus on large market promoters whereas the Taskforce focuses on other promoters. However, this division of responsibilities in functional terms is not made explicit in role statements and planning documentation, although they could be useful inclusions to show how the parties are envisaged to interact. The Taskforce outlined its view of the relative areas of responsibility as 'Finance Houses and Accounting and Legal have responsibility for managing compliance for large businesses in those patches. The Taskforce role in respect of these markets is to support the implementation of the PASTO and E2E strategy and coordinate reporting on a whole of promoter basis to the ATO.' More generally, in relation to its activities in various areas, the Taskforce has said that its operations have focussed on higher risk promoters from various markets, in particular filling an initial gap with regard to promoters of MMIS, generally in the small and medium enterprise segment.

Another example of a lack of clear specification of responsibilities of the various participants is the statement in the Taskforce Discussion Paper regarding the strategy to have a list of promoters. The document states that 'There will need to be on-going monitoring of promoters on the list to assess real time promoter risk level and risk level. This monitoring will need to include both high and medium-low risk cases to ensure risk levels are maintained or shifting downwards.' However, it does not set out which areas are responsible for that or specify the nature or extent of the Taskforce's responsibility in that regard. (The Taskforce's Business Plan 2003–04, however, states that 'the Taskforce will be responsible for maintaining the corporate list of promoters and evaluating the risks associated with them'. However, we found that the Taskforce has not been 'maintaining' the corporate list, seeing it as the collective responsibility of all areas dealing with promoters. Problems with the corporate list of promoters and the Taskforce's views as to its responsibilities in this matter are outlined later in this chapter.)

**4.16** The Tax Planners Project, the predecessor to the Taskforce, had quite a detailed set of functions associated with its role.<sup>175</sup> The ATO says that it sees a continuity and consistency between the roles of the Tax Planners Project and that of the Taskforce. We agree that there is a continuity; while also recognising, too, the important developments the ATO has made in formulating its methodological approach in seeking to manage aggressive tax planning in an integrated way. We consider, therefore, that the specification of the various functions of the Tax Planners Project could help the ATO draw up a more detailed outline of the role and associated functions of the Promoters Taskforce than currently exists in the 2002 Discussion Paper or subsequent Taskforce Business Plans.

**4.17** The risk of not having the responsibilities and functions clearly specified and delineated is that there may be misunderstandings about what is expected of the Taskforce and other areas, possibly leading to duplication or gaps in effort.<sup>176</sup>

**4.18** We recognise that, in specifying roles and functions for a body such as the Taskforce, a balance must be struck between, the need, on one hand, to provide sufficient detail and precision to communicate expectations clearly, and, on the other, to be able to operate flexibly and appropriately in a dynamic and complex environment. This is particularly the case in the context of the compliance management of promoters of aggressive tax planning. In our view, it may be necessary to specify the role only broadly to account for changing circumstances. However, it is important to specify at a particular point in time, the specific 'content' associated with this role, in role statements and planning documentation. Clarifying its role and functions would also mean that the Taskforce would be better placed to enunciate its allocation of resources against these, in its Business Plans.<sup>177</sup>

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<sup>175</sup> The role of the Tax Planners project was, among other things, to co-ordinate what is being done in the business lines, maintain an overview and provide a quick response to the highest-risk cases. It was made clear that not all tax planners were to be subject to scrutiny, but consistent with the compliance model, the emphasis was to be those higher-risk planners involved in devising or supporting aggressive tax planning arrangements. Other corporate functions of the Tax Planners project were strategy setting, profiling and prioritisation, strategic responses, advice and evaluation and link to the ATPSC. The Tax Planners Team's remit was to provide a whole of ATO insight into planners (although business lines were also asked to identify, analyse and risk assess tax planners from their 'patch'), and building on intelligence work of SIA, draw a profile of the tax planner and associated entities, in order to risk assess planners and decide on appropriate strategic responses based on risk.

<sup>176</sup> As noted previously, we saw evidence of lack of clarity over responsibility for monitoring promoters. In another instance, we saw that the Taskforce itself has expressed concerns that the appropriate coordination of focus across promoters is not being achieved. We noted, however, that the Taskforce and LB&I were seeking to embed a more integrated approach to the management of promoters in the practical and rigorous application of the PASTO approach.

<sup>177</sup> We note in the next section when reviewing the Taskforce's plans, that the Business Plans do not outline the resources intended to be allocated to various types of activities.

## Recommendation No.4

**4.19** The ANAO recommends that, for enhanced clarity about responsibilities, the ATO specify the role and associated functions of the Promoters Taskforce more explicitly, including in relation to other areas of the ATO that also have responsibilities regarding promoters.

### *ATO response*

**4.20** Agreed. We will communicate more clearly how the Promoters Taskforce works with other areas in the ATO and, in particular, the respective responsibilities of different areas in managing promoters in the different taxpayer markets.

## Promoters Taskforce planning

**4.21** We reviewed the Taskforce's Business Plans for 2002–03 and 2003–04. Details of the planning documentation and how it has changed, are set out below.

**4.22** The Promoters Taskforce Business Plan 2002–03 comprises two parts, a Business Statement which sets out functions, responsibilities and directions of the Taskforce,<sup>178</sup> and a table listing the sorts of activities the Taskforce would undertake, the planned outcomes from these activities, Taskforce products and measures.<sup>179</sup> The focus of the Plan is at a high level of generality. It does not specify, in much detail, the actions the Taskforce planned to undertake.

**4.23** The Taskforce Business Plan 2003–04 is an advance on the previous Plan. It gets closer to outlining a role statement for the Taskforce (indicating that it is responsible for leading and coordinating tailored strategies across aggressive tax planning, maintaining the corporate list of promoters, and evaluating the risks associated with them). Although it still gives only staffing numbers for the Taskforce in aggregate, the 2003–04 Business Plan provides more detailed information on the activities the Taskforce intends to undertake, including the planned number of some of its key activities, than the previous Plan did. This additional detail offers increased transparency and accountability operationally.

**4.24** Another additional feature of 2003–04 Business Plan compared to the previous Plan, is that it sets out the Taskforce's planned outcomes for the

<sup>178</sup> The Business Statement says the Taskforce will target its activities to highest risk, be timely and tailored to the risk situation and its coordination effort will be supported by the use of standardised methodologies (e.g. in relation to integrated insights to the players, profiling, compliance plans and risk criteria) and information sharing especially in relation to new strategies.

<sup>179</sup> The generality of the Taskforce Business Plan 2002–03 contrasts markedly with the highly structured and detailed content of the SIA Business Plan 2002–03. See Chapter 3 for comments on the SIA Business Plan.

period. These are typically very broad in scope,<sup>180</sup> only one of the planned outcomes includes a specific quantitative target.<sup>181</sup> Although the breadth of these planned outcomes will make it difficult for the Taskforce's performance against desired outcomes to be assessed, the planned outcomes give a sense of the underlying purpose of the Taskforce's activities, if not the 'deliverables' in specific terms. At the level of planned activities, as opposed to planned outcomes, the Taskforce 2003–04 Business Plan includes quantitative targets for several activities (namely, the number risk assessments, access visits and audits). The Plan also includes quantitative measures relating to other activities such as the number of returns included in the early lodgement program. Performance review is discussed in a later section.

**4.25** We acknowledge the increased detail the Taskforce has incorporated into its Business Plan documentation during the course of the audit. We support these enhancements and recommend that the Taskforce develop its business planning documentation somewhat further, by the Business Plan showing: how the Taskforce's planned activities relate to other areas of the ATO reviewing promoters; and how the Taskforce will contribute to a coordinated approach to the wider promoter population.

## Promoters Taskforce activities and management

**4.26** The Taskforce is a key player in the ATO's strategy of actively managing aggressive tax planning as an integrated process that recognises the interrelationships between the various steps in the management process (the 'end to end process' described in Chapter 2).<sup>182</sup>

**4.27** In applying its approaches, the Taskforce seeks to recognise and examine the interrelationships and patterns between the parties in the aggressive tax planning landscape, by applying the 'PASTO' integrated approach (as outlined in Chapter 2).

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<sup>180</sup> The planned outcomes for 2003–04 include 'reducing entrepreneurial approach to aggressive tax planning, improving compliance, enhancing community confidence in the fairness and integrity of the tax system, broadening community awareness of schemes and awareness of responsibilities in the self assessment regime.'

<sup>181</sup> Through its active compliance efforts, to reduce revenue at risk by \$400 million in 2003–04.

<sup>182</sup> The importance of the active management of the steps and elements in the end-to-end process is illustrated in two examples. For example, if the ATO takes 'too long' to make clear its view of an arrangement or scheme and occurs 'too late' in the process, what might have started as a contained, aggressive tax planning issue might, in the absence of guidance to the general public and tax professionals, become a wide-spread problem. Similarly, if consideration of a promoter's debt and lodgement behaviour occurs too late in the process, e.g. after the tax assessment has been issued to the promoter, it will become more complex for the ATO to devise properly-targeted strategies to prompt proper compliance with the assessment made, with the risk that the promoter also becomes 'debt management problem' for the ATO as well as a potential compliance management problem.

4.28 In summary, the Taskforce's intended activities involve:

- managing intelligence relating to promoters;
- maintaining a corporate list of promoters, including profiling promoters to make a risk assessment, taking account of all PASTO elements;
- developing compliance plans with appropriate strategic and operational responses based on the level of risk;
- undertaking integrated audits on strategic, high risk cases itself and coordinating integrated activities in promoter projects being conducted in other parts of the ATO;
- working, in line with other areas of the ATO, to finalise and communicate the ATO view on the tax matters disclosed and working with other government agencies to secure a whole of government approach to promoter management;
- identifying patterns, trends and drivers in promoter activities; and
- contributing to the formulation of policy options for systemic improvements in managing promoter compliance.

## Intelligence gathering

4.29 Effective intelligence gathering and information sharing with relevant stakeholders in the ATO and externally, are important if the Taskforce is to accomplish its objective to coordinate promoter work and be an effective player in the ATO managing aggressive tax planning. We noted that the Taskforce is involved in aggressive tax planning intelligence networks, participating in the intelligence sharing and discussions conducted by the Strategic and Business Intelligence area of LB&I, as well as receiving intelligence from SIA and providing intelligence to it.

4.30 Closely linked to the notion of intelligence, are 'referrals'<sup>183</sup> –matters relating to promoters highlighted by areas of the ATO, that are input to the ATO's corporate list of promoters. The ATO uses the ATPDatabase to record its corporate list of promoters (and PASTO connections) and referrals to the corporate list.

4.31 The ATO can draw on the ATPDatabase to produce a report of referrals to the corporate list of promoters that have not been resolved or handled. This report is called the 'list of new and unallocated promoters'. This report is 'indicative'

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<sup>183</sup> 'Referrals' are essentially reports of information about promoters which are recorded on the ATPDatabase. Referrals do not mean that responsibility for the promoter or management of the risk has been transferred. A 'referral' (i.e. a note providing some information thought to be of possible interest in ATO management of the promoter population), should be addressed in some way by a relevant stakeholder as quickly as possible.

only, because some cases listed in the report may be linked to other promoter files on which work *is* being undertaken. (However these links are not apparent in the information recorded in the report.)<sup>184</sup>

**4.32** Our analysis of the ATO's June 2003 list of new and unallocated promoters suggests that the ATO is not dealing with referrals to the corporate list as quickly as it should. At that time, approximately 200 cases<sup>185</sup> had not been allocated, some being quite recent referrals, but some others dating from some years earlier. Our analysis of ATO data also highlighted data quality problems, with many instances of the date of the referral not being entered on the ATPDatabase, as required, or incorrect dates being entered.<sup>186</sup>

**4.33** The delays in referral processing suggest that the ATO should pay increased attention to the timeliness of its activities in managing the promoter population, including reducing the backlog in its new and unallocated promoters. Acting quickly on referrals is paramount to the ATO achieving its operational objectives of dealing with aggressive tax planning in a timely and effective way, with tailored strategies targeted to the higher risk cases. The longer the time between a referral and ATO action on the matter, the less 'value' the referral has and the more likely that the potential problem will have grown in size and potential significance.

**4.34** The Taskforce is responsible for maintaining the corporate list.<sup>187</sup> The ATO advises that the Taskforce is also responsible for managing referrals to the corporate list. Our analysis of referrals to the corporate list, as noted above, suggests that the Taskforce is not managing the process as actively as it might in order to be effective.

**4.35** The Taskforce advised that the matter of some areas not entering data into the ATPDatabase as intended, is being escalated to the RRP. It also advised that the Taskforce will follow up on cases on the referral list that lack referral details, to identify relevant stakeholders with responsibility for compliance

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<sup>184</sup> This means that a promoter listed as 'new and unallocated' may in fact be included in ATO work focussing on another, linked promoter. Consequently, this report from the ATPDatabase is not a reliable list of new and unallocated promoters on the ATO corporate list of promoters as the report may overstate the number of new and unallocated promoters.

<sup>185</sup> In considering the significance of this number of unallocated promoter referrals, it should be noted that, when these referrals come to be risk assessed, it would be expected that a number of these cases would not warrant further examination.

<sup>186</sup> Depending on the timing of these undated referrals, the picture of the ATO's problems with work overload and delays, may be more or less serious than the available data by year, indicates. The ATO advised in December 2003, that it is implementing a change in the ATPDatabase system so that it will automatically capture the date the new promoter was identified and the date of identification and also require the source of intelligence and reason for input. In our view, these fields will provide beneficial additional data to assist the ATO's management processes.

<sup>187</sup> As listed in the Taskforce Business Plan 2003–04.



improvement. The ANAO supports the measures that the ATO intends to take to deal with inaccuracies and incompleteness in the ATO corporate list of promoters. The fact that so many referrals of information relating to promoters appear to have been unattended or action not documented, suggests that the Taskforce's activity in maintaining the corporate list requires reinvigoration, with some increased attention by it to the timeliness and comprehensiveness of managing such referrals to the corporate list.

**4.36** Quite apart from work management issues, the statistics again underscore deficiencies in the ATPDatabase and the poor quality of data due, in part, to inadequate checks on the integrity, accuracy and completeness of data relating to promoters. The Taskforce advised that system changes to the ATPDatabase will mean, in future, that fields relating to the 'input date', 'source of information' and 'reason for input' will be mandatory. The capacities and limitations of the ATPDatabase and the various reform and review projects are discussed in Chapter 2.

### **Corporate list of promoters and the profiling of promoters for risk assessment**

**4.37** The basis for the Taskforce's work is the corporate list of promoters maintained on the ATPDatabase. The corporate list is intended to list all the promoters known to the ATO and be a repository for ATO information about them.<sup>188</sup>

**4.38** One of the key elements of the corporate list of promoters is the promoter profile. The profile is the risk assessment of the promoter in terms of their risk of involvement in aggressive tax planning and their compliance in their own tax affairs. The purpose of the profile is to risk-assess the promoter and to decide on appropriate strategic and operational responses based on the level of risk.

**4.39** The Taskforce says that it intends to undertake profiles of the highest risk promoters, to analyse publicly available data in conjunction with data available in the ATO to determine the level of risk. The Taskforce's profiling uses a standard template to support the structured review of PASTO elements, and it uses the aggressive tax planning risk matrix<sup>189</sup> (a refined version of the ATO risk matrix), as the basis for its risk assessment. The Taskforce completed 45 risk assessment profiles in 2002–03.

**4.40** The corporate list stemmed from the list of high risk planners manually maintained by the Tax Planners Team. In constructing the corporate list in 2002,

<sup>188</sup> The number of promoters on the corporate list changes over time. In April 2002, there were 209 entries. In May 2003 there were 346. Later in May, the Taskforce advised that there were 351 promoters.

<sup>189</sup> The ATO promulgated the standard aggressive tax planning risk matrix in March/April 2002.

the Taskforce sought input from other aggressive tax planning segments so that the corporate list could include all promoters, especially, high risk promoters.

4.41 We looked at the corporate list, including the promoter profile element, during the audit. We found that there were problems with both. There were gaps in the corporate list.<sup>190</sup> Many of the risk assessments noted on the list were not comparable, (because risk assessments done by different parts of the ATO over time were not done on the basis of the same, standardised aggressive tax planning risk assessment tool),<sup>191</sup> and were not current.

4.42 The Taskforce confirmed the problems with the promoter risk assessments on the promoter list, advising in July 2003 that the risk rankings for promoters on the ATPDatabase are not reliable, because various risk assessment tools were used in making those assessments. It also observed that, since any assessment is at a particular point in time, it may not be a reliable assessment of risk at a different point in time, if risk circumstances have changed. The issue of consistency of aggressive tax planning risk assessment is a governance matter discussed in Chapter 2.

4.43 The fact that the risk assessments on the promoter list are not always reliable,<sup>192</sup> calls into question the extent to which risk drives the Taskforce's work (e.g. in terms of selecting and prioritising work on the approximately 350 promoters on the corporate list as at May 2003). These concerns about the corporate list and the risk basis for the Taskforce's work are highlighted in our review of the promoters that the Taskforce documented as having worked on. We found that:

- as at May 2003, 58 promoters had been profiled since 2001: 22 were low to medium and 32 were high or above (four promoters did not have a rating listed);

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<sup>190</sup> When we reviewed the corporate list as at May 2003, we found that there were:

- many gaps in the list, especially in terms of the key item, the risk ranking; and
- very many promoters rated as high risk on the corporate list have been 'acted on' in some basic way (in a compliance plan, access visit, audit or other formal action), but some promoters rated as low risk have also been acted on.

The Taskforce responded to our observation about gaps in the corporate list saying that they are predominantly due to aggressive tax planning focus areas not conveying information or recording a matter on the ATPDatabase. We appreciate that, although the Taskforce is responsible for 'maintaining the corporate list' (the precise meaning of which is not explained in the Taskforce role and planning documentation), unless the many other areas of the ATO dealing with promoters record data appropriately on the ATPDatabase, the capacity of the Taskforce to meet its responsibility is compromised. See later section for ANAO comments about gaps in the ATPDatabase data relating to Taskforce cases.

<sup>191</sup> For example, LB&I's HealthCard risk assessments pick up aggressive tax planning but do not assess it on the same basis as the Promoters Taskforce which uses the aggressive tax planning risk profiling tool.

<sup>192</sup> For reasons such as timeliness, different risk assessment approaches and lack of data.

- when we looked at the risk patterns over time, although the numbers of promoters profiled differed quite markedly between the six month periods from 1 July 2001 to 30 June 2003, the patterns of risk in the profiles undertaken tended to remain fairly similar. While we appreciate that the Taskforce does not know the risk status of a promoter when it commences a profile, we note that the Taskforce allocating its effort in profiling to promoters who turn out to be low or medium risk, may not be the best use of scarce resources. There is merit in the Taskforce making a preliminary scan of the promoter prior to making a decision to invest the effort of conducting a full profile exercise of a promoter; and
- from the list of work by the Taskforce to May 2003, only 30 of the 79 promoters it addressed (by profiling and/or conducting access visits and/or audits and/or litigation work) were promoters on the list initially provided to it on the corporate list (i.e. 38 per cent). This suggests that the initial list of promoters is not a resource actively used by the Taskforce. Yet the initial list constitutes the bulk of the corporate list that the Taskforce is to 'maintain'.<sup>193</sup> The ATO advised, in December 2003, that in selecting cases for action, it gives priority to those cases where the current impact of the promoter in the market is highest.<sup>194</sup>

**4.44** To address the evident problems with the quality of the promoter risk assessments on the ATPDatabase, the Taskforce proposes undertaking a selective review, advising that it will conduct a quality assurance review of a random sample of 10 per cent of risk assessments of promoters on the ATPDatabase that were not done by the Taskforce. The goal is to determine the comparability and appropriateness of the risk rating, the currency of the risk rating on the ATPDatabase, and to identify the need for intervention by the Taskforce, given resources and relative risk.

**4.45** The ANAO considers that this random sample approach will not address the problems of incomparable risk assessments on the ATPDatabase and will not provide the assurance that the ATO requires, because such a randomly-selected sample will not necessarily be representative of the population to which it refers.

**4.46** In the ANAO's view, a better approach would be for the Taskforce to conduct its review on a stratified random sample (based on the risk categories). This means in practice, that the Taskforce must review the original risk assessment

<sup>193</sup> Not being driven by the initial list is not necessarily a problem so long as the Taskforce is making this operational decision based on an accurate appreciation of the risk assessment on the original list. However, the ATO has acknowledged that these risk assessments are not reliable.

<sup>194</sup> The ANAO appreciates this as a pragmatic operational approach, but notes that for this approach to be sound, the ATO must have a robust and reliable appreciation of the significance and risk ranking of the promoter, and this presents challenges for the ATO, as noted previously.

to check how reasonable it was. It must also seek to determine whether the risk picture has changed, such that even if this risk assessment were reasonable, it no longer reflects current circumstances. Checking whether there are relevant references in SIA's New and Emerging Intelligence Report to matters related to the promoter, for example, may offer some information to support this basic update exercise. The ANAO considers that the preliminary scanning of promoters before doing a full profile, suggested above, could be particularly relevant when the Taskforce tries to address the problem of the corporate list containing a stock of old and unreliable data.

4.47 The ANAO considers that review of the corporate list is a priority task for the ATO to resolve, given the significance of the corporate list to the ATO's intended promoter management approach, and given that the problem concerning the inconsistency of risk assessments was highlighted at very senior levels in 2002.<sup>195</sup>

4.48 In the ANAO's view, the ATO should review *all* promoter risk rankings on the corporate list, with particular emphasis on ones that were not done by the Taskforce, in order to: regularise the assessments of all cases on hand to see that they all conform to the standards of profiling and assessment required; and to update them in light of aggressive tax planning risk changes. In addition to this stocktake exercise, we also observe that the ATO would still require a review process of all risk assessments from time to time, given that the dynamic aggressive tax planning risk environment could make any assessment obsolete.

## Recommendation No.5

4.49 To provide greater accuracy and consistency of the promoter risk assessments on the ATPDatabase as the basis for appropriate work selection, the ANAO recommends that the ATO:

- systematically review its list of promoters and conduct all risk assessments on a comparable basis that reflects the current aggressive tax planning risk management approach; and
- review risk assessments of promoters on the list from time to time so that they remain accurate, given changing circumstances.

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<sup>195</sup> The Risk Review Panel, when considering the corporate list of promoters in April 2002, highlighted the need for continued verification and updating and determined that the risk ranking of promoters on the corporate list should be validated against the aggressive tax planning risk matrix. However, the Panel did not mention which parties were responsible for this. The Taskforce advised that the 'home' area of the ATO is responsible for the quality of the particular promoter risk assessment and that if the Taskforce were to be made responsible for 'regularising' all the promoter risk assessments, in the absence of additional resources, it would not have the capacity to fulfil any of its other functions. It is not appropriate for the ANAO to suggest any particular assignment of responsibility for this task to one area of the ATO rather than another. This is appropriately a matter for ATO management to determine.

## *ATO response*

4.50 Agreed. We will look at how we can improve consistency and comparability having regard to different approaches in different markets. While risk assessment of promoters should be on a comparable basis using the same guiding criteria, processes may vary depending on the nature and extent of a promoter's activities and impact on compliance behaviour.

4.51 Based on an ongoing assessment of risk, we are focusing on the higher risk promoters. Because of the complexity of this type of work, not all cases will be advanced at the same time.

## **Active compliance activities**

4.52 The corporate list of promoters and the promoter risk profile are basic tools in the ATO formulating its strategic and operational responses (which should be documented in a compliance plan). The Taskforce's intent<sup>196</sup> is that higher risk promoters are subject to integrated analysis (across the various ATO teams looking at promoters and across the whole pattern of interactions between the players—i.e. the PASTO elements), sometimes involving access to promoters' and other taxpayers' records and premises (via access visits).

## *Compliance plans*

4.53 Compliance plans set out the results of the Taskforce's integrated analysis and propose responses to manage compliance considered appropriate to the circumstances (e.g. gather more information, conduct an audit, or other investigative work). Compliance plans are intended to be a comprehensive basis for considered action in respect of a promoter, associates and related parties. We reviewed some of the Taskforce's compliance plans, noting that they give explicit consideration to risk management issues as well as technical matters.

4.54 We also observed that, although the plans have some very good task management features,<sup>197</sup> they do not include timing points (milestones). The compliance plan template specifies this information for the plan, but the plans we reviewed did not provide it. However, the ATO advises that this information is provided in some compliance plans (especially less complex cases, in which it is somewhat easier to define and to predict timeframes and timing points). Where such timing points (milestones) are not included, this means that managers are not able to monitor the process against a schedule set out in the approved compliance plan. It could be worthwhile for the Taskforce to have

<sup>196</sup> As per the Promoters Taskforce Business Plan 2002–03.

<sup>197</sup> For example, specifying stakeholders and accountabilities and estimating the resources estimated to be required to undertake the compliance action, such as the assess visit and subsequent analysis.

in the compliance plans information relating to milestones to better support project management. The Taskforce agrees that milestones and timeframes are necessary for effective management and case monitoring purposes where such timing points can be forecast with sufficient clarity. It undertakes to have all compliance plans include and address timeframes and milestones.

### *Access visits and follow up work*

**4.55** A key aspect of the Taskforce's management and operational strategy is to work on current information, using access visits (with or without<sup>198</sup> notice being given to the parties), to gather real-time information.

**4.56** Access visits require considerable planning and organisation, often across various parts of the ATO and perhaps other agencies, as well. The Taskforce has a well-developed set of processes to help it plan for, and conduct, access visits. High technology devices, such as scanners and machines to copy electronic records on promoters' computers, are important to the Taskforce's operations (especially for the real-time gathering and analysis of information).

**4.57** Access visits can be useful to the ATO. Psychologically, their use can have a strong impact in the community by showing that the ATO is active and operating in 'real time'. Functionally, access visits are an important tool in seeking to gain timely and highly relevant information on aggressive tax planning and the interactions between the parties.<sup>199</sup>

**4.58** The Taskforce advised that 20 high risk promoters were subjected to access visits, involving 57 premises, in 2002–03. Although it can be said that the mechanism is a very valuable one, it is not possible to judge the Taskforce's performance in undertaking this particular number of access visits, as the Taskforce had not specified a target for the number of access visits it planned to undertake. Although a particular numerical target, in itself, may be of limited relevance in terms of judging overall Taskforce performance, specifying a target for activities establishes at least some benchmark for activity. A target could be relevant for access visits, as this is one of the main tools the Taskforce uses in seeking to deal with aggressive tax planning in a timely and comprehensive way. The Taskforce has a target to undertake access visits to 60 promoter premises in 2003–04.<sup>200</sup> The ANAO considers that the specification of its target for access visits provides for greater clarity in intended operations and transparency in review.

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<sup>198</sup> Section 263 of the *Income tax Assessment Act 1936* gives the ATO right of access.

<sup>199</sup> e.g. the promoter, the schemes they are selling, to whom are they selling them, what else are these parties doing that might go to aggressive tax planning or broader questions of compliance.

<sup>200</sup> Promoter Taskforce Business Plan 2003–04.

**4.59** Having conducted an access visit, and gathered information and records, the Taskforce's approach is to make an initial assessment of that information ('first cut analysis') using a team of staff. Sometimes this analysis is done in the Taskforce and at other times it is done in other parts of the ATO, or with the help of other parts of the ATO. Information derived from the analysis of material obtained from an access visit may provide information and insights relevant to the Taskforce (e.g. suggesting audit work, amendment of a tax assessment or prosecution action) or other parts of the ATO. Information would be taken into account in a revised risk profile and compliance plan.

**4.60** It is important that this analysis be done as quickly as possible, in order to gain maximum benefit from this real-time information source. There are not specific targets for the time in which the analysis of material from access visits will be conducted. However, the Taskforce has an internal target to complete its first cut analysis of material from access visits within one month of gaining access to the data. The Taskforce uses this target as a guide only, as the time taken for analysis can be affected by many factors.<sup>201</sup> We recognise the power of the Taskforce's analytical approach, involving focussed analysis, while looking at issues in an integrated way, taking on board the PASTO elements. However, the timeliness of the analysis process has been identified by the head of the Taskforce, and the Risk Review Panel as a crucial point in the management of the Taskforce's activities; and as a matter requiring ongoing attention, because there will always be pressure to have the analysis of data done quickly.

**4.61** The Taskforce pointed out that the time taken to analyse data from access visits is heavily influenced by the volume of data, resources (capacity and capability of people) and IT infrastructure for capture, analysis and storage. It has reported, internally, that it intends to obtain new software to assist evidence management and intelligence analysis to better cope with the increased data it has collected from its access visits. We discuss the Taskforce's processes for case management and monitoring processes, including its access visit activities, in a later section.

### *Other compliance tools—debt and lodgement processes, early warning letters and audits*

**4.62** The ATO seeks to adopt tailored debt and lodgement requirements according to the compliance characteristics of taxpayers. The Taskforce's activities support this approach as part of its management of promoters. Promoters with

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<sup>201</sup> Clearly, the time required would be affected by the volume of material, the technical and procedural complexity of obtaining and assessing the matters at hand and the availability of staff to conduct this analysis. In some cases, there have been extensive procedures between the ATO and taxpayer parties to resolve claims of legal professional privilege—a legal privilege which the promoter claims prevents the ATO gaining access to that material.

certain risk features may be treated differently from other taxpayers without such a risk profile (perhaps requiring information in early and expanded income tax returns for certain promoters, or treating them in a more expedited and focussed way in relation to debt management matters). The ATO employs dedicated resources and tailored work practices for such promoter cases.

**4.63** The ANAO supports this approach in applying the principles of the compliance model in dealing with taxpayers, taking account of their circumstances and compliance behaviour.

**4.64** Another compliance tool the Taskforce uses is to issue early warning letters to clients/ contacts of promoters. Early warning letters are designed to tell people 'linked' to the promoter, of aggressive tax planning schemes and issues that the ATO is examining, that have come to light in the ATO looking at a promoter with whom they have had contact. We saw evidence indicating that some recipients appreciate the ATO's efforts in this regard. The ANAO considers that this is a proactive, operational approach that puts real-time compliance management into effect.

**4.65** The Taskforce also undertakes audits. Typically, these audits involve complex technical matters and operational issues. The Taskforce's aim in 2002–03 was to undertake 30 audits<sup>202</sup> that address the aggressive tax planning landscape, using the PASTO framework, to consider, in an integrated and comprehensive way, the risk picture of the promoter and related parties. The Taskforce undertook 30 integrated audits in 2002–03, completing six. Given that the Taskforce did not have a goal for the number to be completed in the period, it is not possible to make a judgement on the number of audits completed, other than to note that it represents a substantial overhang of work into 2003–04.

**4.66** The Taskforce has reported internally that the ATO has, to mid 2003, undertaken only limited real time audit work in the large business market, with most integrated audits focussing on the small and medium market. This suggests that the audit area might be one area of aggressive tax planning compliance effort that needs continuing attention, providing the compliance risk features of the promoters justify this expensive compliance tool.

## Interagency work

**4.67** When announcing the Taskforce, the Commissioner announced a renewed commitment to the relationships between the ATO, the Australian Federal Police (AFP) and the Commonwealth Director of Public Prosecutions (CDPP). These

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<sup>202</sup> An audit may consider all aspects of the PASTO framework in one audit, or an audit may seek to address one element (and may even have a particular focus, such as fees derived by the promoter from the sale of schemes), but after having assessed the overall risk picture using the PASTO framework.



relationships are supported by Memoranda of Understanding (MoU) between the ATO and the other agencies outlining administrative processes, where relevant. These relationships are also given effect in links at the operational level (e.g. with joint exercises and liaison meetings with the CDPP and the AFP and even the secondment of an AFP officer to the Taskforce).

**4.68** We also saw that the Taskforce interacts (and has MoUs) with several other government agencies, such as the Australian Securities and Investments Commission (ASIC)<sup>203</sup> and with various revenue offices in the States. The ATO is also looking to conduct data matching activities with relevant agencies to better support an integrated, whole of government approach to promoter compliance management.

**4.69** Although practical issues of resourcing and priorities in work will require on-going management in interagency work, the Taskforce's arrangements with other agencies help it approach the task of managing aggressive tax planning across government. The Taskforce's work contributing to the development of policy options on the disclosure of ATO information to other specific agencies (mentioned in Chapter 2), is a positive sign towards potential improvements in interagency work.

## Promoters Taskforce use of the ATPDatabase

**4.70** The ATPDatabase stores and links information on schemes,<sup>204</sup> information about promoters of those schemes and their associates, the taxpayers involved, other issues and the action taken by the ATO.<sup>205</sup> At a broad level, in relation to promoters, the ATPDatabase records the promoter details, PASTO recommendations and risk ratings, the PASTO action log (a running list of activities and interactions with the promoter), and associated documents.

**4.71** The Database is, ideally,<sup>206</sup> the ATO's single repository for the list of promoters. That is, the entire population of promoters known to the ATO,

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<sup>203</sup> ASIC registers investment advisers and securities dealers. ASIC's operations are important in the ATO's aggressive tax planning management because ASIC focuses on a subgroup of the promoter group, that of investment and financial planning advisers and ASIC research has shown links between aspects of some adviser's behaviour and aggressive tax planning. ASIC's report '*Compliance with advice and disclosure obligations: ASIC report on primary production schemes*' February 2003, identified a correlation between advisers' receipt of commissions in excess of market norms and the provision of misleading or inappropriate advice to encourage investment, including investment into aggressive tax planning schemes. The ASIC report '*Survey on the quality of financial planning advice*' February 2003 found that common practices were commission-driven product selling and not providing impartial advice.

<sup>204</sup> e.g. technical issues on a scheme.

<sup>205</sup> e.g. amendments, letters to taxpayers.

<sup>206</sup> The ATO has not set out explicitly its vision or expectations around maintenance and use of the ATPDatabase. See Chapter 2.

whether low risk or high risk, should be recorded on the Database. The ATO advises that, in practice, and at a minimum, the Database should contain all the highest risk cases known to the ATO as well as cases that were high risk and which have been assessed to a lower rating. It advised that not all promoters considered to be low risk, and therefore of lower priority from a compliance management point of view, would be identified on the Database, for reasons of resource cost. That said, as noted in Chapter 2 and in this Chapter, there are also some issues in the operations of the Database in practice which compromise the Database's ability to capture references to what the ATO knows about the aggressive tax planning landscape, in an integrated and comprehensive way.

4.72 We reviewed the promoter case list for the Sydney Taskforce teams on the aggressive tax planning team database<sup>207</sup> as at April 2003. The data there outlines the activities by the Sydney teams (which accounts for all but three teams of the Taskforce nationally). The aggressive tax planning case listing specified 73 cases for the Sydney teams at that time.

4.73 We found that the listing provides useful information supporting integrated management of promoters (e.g. noting referrals to other agencies such as the AFP and support for an integrated taskforce approach across the ATO). On the other hand, we also found in the cases assigned to the Sydney teams, gaps in the Taskforce's management and/ or management of the Database.<sup>208</sup>

4.74 Our review of the promoter case listing for Sydney and advice from the Taskforce about the corporate list in general (mentioned earlier), suggests that the Taskforce, along with other relevant parts of the ATO dealing with aggressive tax planning matters, need to pay increased attention to work processes, task management, and maintaining the accuracy and comprehensiveness of information on the Database.

## Case monitoring and reporting and management information

4.75 One of the ways to facilitate greater attention to case/ task management is to track and report on the progress of the case by entering, monitoring and reporting activity against timing points (milestones). Staff are required to enter their case milestones data on the ATPDatabase (e.g. profile commenced, profile

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<sup>207</sup> The Taskforce team database draws data from the ATPDatabase.

<sup>208</sup> We found:

- eight cases with a high promoter risk rating, but no documented action since mid 2002;
- three promoters listed as high risk but there was slow action. (We also found that four promoters listed as low or medium risk were being worked on. While this departs from a strict interpretation of the Taskforce's role of focussing on high risk promoters, it could be reasonable give the need for the Taskforce to match cases with staff skills and to develop capabilities.);
- three cases in which the ATPDatabase fields were not updated to reflect current action; and
- eleven promoters that did not include a risk rating.

completed, access conducted, audit, and review on completion). Other case milestones, that could enhance case monitoring in the future, include the dates when: the promoter was referred or entered on the ATPDatabase; a compliance plan was prepared; the analysis of the information obtained from an access visit was completed; and an audit was commenced.

**4.76** At the level of monitoring an individual case, the ATPDatabase can produce a standard report (the Action Log Milestone Report)<sup>209</sup> to help assess a case's progress against milestones. Some Taskforce team leaders use the ATPDatabase Action log report to assist them manage their cases; whereas other team leaders use other means to monitor their individual cases' timeframes and understand reasons for delay, (some manually, some with a spreadsheet or a more sophisticated project management tool).

**4.77** As to the Taskforce monitoring case activity on a collective basis, for say the collection and reporting of activity information, monitoring of case cycle times or preparation of management information relating to the Promoters Taskforce, there is not a standard report from the Database that produces such information. The Taskforce advised that, because it has 'back end access' to the Database, it could configure such reports, but it has not done so as a matter of course.<sup>210</sup> It says it uses other monitoring processes that do not require the ATPDatabase system support, such as manager reviews and case reviews, to understand and examine case timeframes and monitor Taskforce work. It advised that it has not done analysis of case cycle times on an aggregate basis using those other monitoring processes. In our view, monitoring case timeliness on an aggregate basis will become increasingly important as Taskforce activities and responsibilities mature, and possibly, change. The Taskforce advised that it also recognises the importance of case monitoring, including timeframes, but points to shortcomings of the ATPDatabase in limiting its scope to develop and use management information reports on an ongoing basis.

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<sup>209</sup> The Action Log Milestone Report lists action type, promoter risk ranking, overall risk ranking, start date and end date. The three other standard reports that the ATPDatabase can generate are: the Aggressive Tax Planning Team Database Report (lists promoter information and the staff members allocated to it); New and Unallocated Promoters Report (lists promoters for which a profile has not been commenced); and the Promoter Risk Report (lists promoter risk ranking and overall risk ranking).

<sup>210</sup> The Taskforce gives two main reasons for not using the ATPDatabase to review overall case cycle times (timeliness against key milestones—such as access visits). One reason is that many actions taken for a case before the introduction of the ATPDatabase in July 2002 are recorded, for convenience, with a July 2002 action date. In these circumstances, analysis of cycle times and progress against milestones is inaccurate. The other reason given is that many of the Taskforce's cases have not progressed significantly through the milestones nominated in the E2E process. We agree that these are practical limitations in undertaking meaningful monitoring of case cycle times based on the ATPDatabase data.

In our view, an additional impediment to the Taskforce using the ATPDatabase to monitor the timeliness of action, such as access visits, is the poor quality of the data, as noted in this Chapter and elsewhere.

**4.78** We found that the ATPDatabase cannot be used readily for activity and governance reporting. Taskforce activity, branch management and governance reports are collated manually from records maintained on different reporting spreadsheets, databases or manual lists.<sup>211</sup>

**4.79** The ATO is in the process of designing and implementing enhancements to the Database to facilitate the collection and reporting of management information.<sup>212</sup> This module is still under development, but the Taskforce considers that the module appears to have little direct benefits to it.<sup>213</sup>

**4.80** For its part, the Taskforce advised that, between August 2003 and January 2004, it intends to consider, and possibly be part of a corporate trial of,<sup>214</sup> the use of the Australian Special Information Service (ASIS) as a tool to improve its case management, monitoring and reporting capacity for its investigations. The Taskforce advised that, relative to the current position of using the ATPDatabase and other various separate spreadsheets, ASIS, as a specialised case management system, offers: vastly improved tracking and reporting capacities; greatly improved IT support; capacity to search on ASIS for investigations cases being conducted in other ATO work areas using ASIS; and improved capacity for quality assurance checks on data. As a product to manage cases at the top end of the compliance pyramid, including fraud investigations, the Taskforce considers that ASIS would be suitable for Taskforce investigations.

**4.81** The Taskforce is responding to a perceived need to improve its case management, monitoring and reporting capacity for investigations. While we appreciate this objective, we see that this matter, and any responses to it, deserve more coordinated consideration across the aggressive tax planning segments reporting directly to the FAC Aggressive Tax Planning and perhaps, even more broadly, with the other aggressive tax planning segments as well. It would be unfortunate if, because particular areas, such as the Taskforce, implemented separate case management and reporting systems to address particular and pressing needs, that scope for integration and consistency across aggressive tax planning segments and the ATO as a whole were compromised,<sup>215</sup> with implications for functionality and costs. The ATPDatabase enhancement proposals are discussed in Chapter 2.

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<sup>211</sup> These sources are the Promoters Taskforce reporting spreadsheet, a database on access visits undertaken and lists from managers and team leaders.

<sup>212</sup> See Chapter 2 for discussion on proposed enhancements to the ATPDatabase.

<sup>213</sup> The Taskforce advised in July 2003 that the MIS module proposed appears to focus on improving screen design and the management of schemes (to present actions in table format like that for promoter milestones).

<sup>214</sup> Other parts of the ATO considering ASIS are Serious Non Compliance, Fraud Investigations and the Excise business line.

<sup>215</sup> We are aware that the integration of case management systems is an issue under corporate review in the Change Program. See Chapter 2.

**4.82** As well as the adoption of a case workflow and reporting system, other ways in which ‘project management’ / case monitoring can be better supported include the use of some additional timeliness targets and activity targets. Examples are a benchmark on the time between milestones (such as the access visit and completion of analysis in certain cases, where practical) and having some targets for the number of audits to be completed in the period (rather than just having a target to undertake a particular number of audits).

## Promoter penalties—policy development contribution

**4.83** The SERC recommended the development of a regime of penalties on promoters so that this group could also carry some of the burden of sanctions for aggressive tax planning promoted to clients. The Minister for Revenue and the Assistant Treasurer has also indicated that the matter is a high priority for Government, in terms of managing aggressive tax planning, particularly in light of the role of promoters in MMIS in the 1990s.<sup>216</sup>

**4.84** The Taskforce has, since 2001–02, worked with the Treasury in providing advice on tax administration issues around the development of policy options regarding promoter penalties. On 5 December 2003, the Government announced<sup>217</sup> that it intends to introduce a regime of civil penalties<sup>218</sup> on promoters of tax avoidance and tax evasion schemes.

## Monitoring and performance assessment

**4.85** Staff of the Taskforce review cases using a range of mechanisms.<sup>219</sup> In addition, the Taskforce has two key activity and review mechanisms for more high-level monitoring and performance review of its activities:

- quarterly review of cases by the Taskforce leader or senior officers (looking at cases and processes) and providing feedback to teams on strengths and opportunities for improvement (in terms of process); and

<sup>216</sup> See, for example, the Minister for Revenue and the Assistant Treasurer’s Press release *Crackdown on promoters of aggressive tax schemes*, 14 February 2001, and speech of 21 March 2003 to the National Press Club, entitled *A tax system redesigned: taking stock*.

<sup>217</sup> See Press Release by the Minister for Revenue and Assistant Treasurer *Crackdown on Promoters of Tax Avoidance and Tax Evasion Schemes*, C 117/03, 5 December 2003.

<sup>218</sup> The Government proposes court-imposed penalties on promoters up to the greater of either 5000 penalty units, (currently \$550 000) or twice the total consideration received by the lead promoter directly or indirectly from the scheme. As well as the civil penalties, the Government also announced measures to improve investor protection, with amendments to the tax laws to allow the Commissioner of Taxation to seek injunctive relief to stop the promotion of a tax avoidance or evasion scheme and to enter into voluntary undertakings with promoters.

<sup>219</sup> These are local meetings of Taskforce managers, national management meetings, case reviews and review of the case action log on the ATPDatabase, depending on the accuracy and completeness of that case data.

- the Risk Review Panel performs something of a monitoring role over the Taskforce. This is quite high level monitoring and tends not to focus on monitoring work practices and operational matters.

**4.86** Documentation from these review mechanisms show that the reviews help to share better practice and to promote continuous improvement in the Taskforce. Some comments in those reviews, encouraging somewhat more vigorous operational management and control, reinforce our findings of the benefits in the Taskforce giving greater prominence to project management and operational matters.

**4.87** The Taskforce Business Plan 2002–03 specified only two ‘targets’ in its measures section. These were the number of higher risk promoters to be subject to PASTO investigation and the target to reduce revenue at risk. These are reasonable overall measures of activity and achievement. As recommended above, we consider that there could also be merit in the Taskforce specifying targets for some of the measures listed (such as the number of new schemes identified), and specifying some additional activity measures and targets (e.g. numbers of profiles undertaken, timeliness targets for analysis of information collected on access visits, timeliness targets around referrals to other agencies, numbers of reports synthesising patterns, trends and drivers in relation to promoter activities and users’ assessment of these synthesis reports).

**4.88** The two key performance measures for the Taskforce in 2002–03<sup>220</sup> required it to identify \$400 million revenue at risk<sup>221</sup> and conduct 30 integrated audits that address the players in the aggressive tax planning landscape in an integrated way (Promoters, Associates, Schemes, Taxpayers and Other matters). It ‘achieved’ its revenue at risk<sup>222</sup> target, identifying approximately \$500 million at risk in 2002–03. It also achieved its audit target, undertaking 30 such audits in the period, completing six.

**4.89** As well as this assessment of performance, the Taskforce is also working to conduct macro analysis to compare, over time, the taxable income and tax paid by a sample of promoters who have been the subject of targeted compliance action with a broader promoter population.<sup>223</sup>

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<sup>220</sup> Reflected in the ATO’s Output Pricing Agreement for the period 2002–03 to 2004–05.

<sup>221</sup> The methodology is to identify the revenue at risk identified from access visits and promoter investigations, e.g. value of suspected inappropriate deductions being claimed by the new taxpayers in a new scheme multiplied by 40 per cent. That rate represents the average of the top marginal tax rate for individuals (48.5 per cent) and the corporate rate (30 per cent) and also has regard to the likely impact of penalties and interest.

<sup>222</sup> The Taskforce includes both direct revenue and indirect revenue effects in this measurement.

<sup>223</sup> We understand that in 2003–04, the Taskforce also intends for year-end, to assess the indirect revenue flows associated with aggressive tax planning work. The intent is to measure the excess of improved compliance by promoters, associates, and former scheme investors, over an average increase in taxation revenue.

**4.90** As noted previously, in addition to specifying a specific target outcome to reduce revenue at risk by \$400 million, the Taskforce Business Plan 2003–04 includes some other activity targets, adding to ones listed in the previous Business Plan. The activity targets are: risk profile 50 promoters; undertake 30 integrated PASTO investigations on strategic, high risk cases; and undertake access visits to 60 promoter premises. We consider that activity targets such as these can help to guide the Taskforce and other stakeholders, and spell out the strategies in tangible, quantified ways.

## Reporting

**4.91** The Taskforce prepares a monthly compliance exception report and also contributes to the monthly compliance report prepared as a consolidated aggressive tax planning report. Both of these reports are presented to the Compliance Strategy Meeting. These are useful, ongoing devices to keep senior management responsible for managing aggressive tax planning and other senior ATO management, informed of major issues.

**4.92** The Taskforce also submits a governance report six monthly to the ATPSC and other relevant stakeholders. We examined the mid-2003 governance report from the Taskforce, finding it a helpful, high level snapshot of activities, issues and risks relating to promoters.

**4.93** We consider that the Taskforce's formal reporting arrangements are appropriate.

## 5. Mass Marketed Investment Schemes

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*This Chapter outlines the mass marketed investment schemes issue that was the subject of significant review by the Taxation Ombudsman and a Parliamentary Committee. It sets out the ATO's settlement processes and administrative action on issues raised in the Parliamentary Committee's reports.*

### Introduction and context

**5.1** The ATO's administration of MMIS was a highly contentious issue for many thousands of taxpayers in the 1990s and early 2000s. There is a perception in some parts of the community that MMIS (and the ATO's management of the MMIS issue) are synonymous with aggressive tax planning management. While understandable, given the significant impact the issue had on many taxpayers, MMIS are only a part (albeit a high-profile part), of the topic of aggressive tax planning. The ATO's administration of the MMIS issue led to major investigations and reviews by the Taxation Ombudsman and a Parliamentary Committee, with important consequences for the ATO.

**5.2** MMIS are schemes of a particular nature that are widely available to participants. Their wide availability distinguishes them from more tailor-made/boutique schemes, designed for particular clients. As outlined in Chapter 1, the ATO describes MMIS as schemes usually sold through a prospectus and in some cases, information memoranda, in respect of 1998–99 and earlier years. They include: round-robin schemes, including non-recourse financing, often in agriculture, afforestation and franchises; and certain film schemes with guaranteed returns that are, in effect, a return of part of the invested funds.<sup>224</sup> The ATO does not include employee benefit arrangements or financing products such as linked bonds, within the definition of MMIS.

**5.3** According to the ATO, there was a slow build-up in the market for MMIS in the early 1990s until 1995–97. At that time, there was a surge in market growth and claims for tax deductions, when the nature of the schemes changed, and

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<sup>224</sup> Although primary production investment ventures do not, as such, receive special treatment under the taxation laws, primary production schemes were marketed as tax effective because of the taxation effect of financing arrangements and the ability to deduct a high proportion of set up costs against income. In contrast, film schemes do receive special taxation treatment under Division 10 BA of the *Income Tax Assessment Act*. Although not as common a MMIS as primary production investments, some film investments were mass marketed. See submission by ASIC to the Senate Economics References Committee's inquiry, p.2 for an outline of the distinction between tax effective schemes and mass marketed tax effective schemes.



when there was a move away from activities in schemes, such as afforestation<sup>225</sup> into other activities, such as research into the use of tea tree oil or franchise schemes.<sup>226</sup>

5.4 In considering MMIS,<sup>227</sup> in light of the wide ranging external review processes that have been undertaken on the topic, we expected to see that the ATO had implemented a settlements regime for the parties affected and had introduced administrative mechanisms to address the systemic issues raised in the reviews, to try to prevent similar problems recurring. Our approach does not include examining the legal merits of individual cases or trying to second-guess the opinions of the courts.

## Taxation Ombudsman reports and the Senate Economics References Committee reports

5.5 In the late 1990s and early 2000s, considerable attention was given to the ATO's actions in relation to mass marketed, so-called 'tax-effective' investment schemes, with the matter being examined in inquiries by the Taxation Ombudsman<sup>228</sup> and the SERC.<sup>229</sup> These reports are outlined in this section.

<sup>225</sup> In examining these sorts of investments, the ATO noted that, while the underlying activity (e.g. the plantation or vineyard activities) may be highly commercial, what is often of concern are the financial arrangements associated with some investments, because they seek to provide substantial tax benefits, which in effect mean that the tax system significantly funds the activity without investor risk. See ATO submission to the *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, p.7, p. E4242.

<sup>226</sup> *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*, Interim Report, June 2001, para. 4.10, p.17.

<sup>227</sup> Our goal was not to revisit the past inquiries in detail, but to see what the ATO had done to address the matters raised. Many aspects of MMIS still present problematic issues in tax administration for some taxpayers, e.g. the length of time the ATO took to amend assessments, settlement terms—particularly the remission of the General Interest Charge in some instances but not others, and the ATO's test litigation processes. However, it must be also noted that the ATO has been told that some taxpayers are happy with the settlement arrangements the ATO had used. See *Senate Budget Estimates June 2003*, Economics Legislation Committee, p. E235.

<sup>228</sup> These are as follows:

- *The ATO and Budplan Report of the Investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a tax-effective financing scheme known as Budplan* Report under section 35A of the *Ombudsman Act 1976*, June 1999;
- *The ATO and Main Camp Report of the investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a mass marketed tax effective scheme known as Main Camp* Report under section 35A of the *Ombudsman Act 1976*, January 2001; and
- *Report on investigation of a complaint by a promoter of a series of films about ATO decisions* Report under section 35A of the *Ombudsman Act 1976*, February 2001.

<sup>229</sup> Senate Economics References Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection*. There were three reports: Interim Report (June 2001); *A Recommended Resolution and Settlement* Second Report (September 2001); and Final Report (February 2002).

## Taxation Ombudsman reports

5.6 In 1998–99, the Taxation Ombudsman investigated the ATO’s handling of claims for tax deductions by investors in the Budplan arrangement<sup>230</sup> in response to some 1 600 complaints from investors. The Taxation Ombudsman noted that the ultimate decision as to the legality of the Budplan deductions would probably be decided in the courts,<sup>231</sup> but found that the ATO had acted correctly in disallowing participants’ tax deductions. He also found that there were some minor administrative shortcomings in the ATO’s processes such as inconsistencies in some administrative practices and delays in processing a private ruling request (which had been acted on by the Commissioner during the investigation).<sup>232</sup>

5.7 In 2000–01, the Taxation Ombudsman investigated the ATO’s actions in relation to an earlier mass marketed arrangement known as Main Camp,<sup>233</sup> following complaints from over 120 investors, when their claimed deductions had been rejected and amended assessments raised, along with charges for penalties and interest. The Taxation Ombudsman concluded that the Commissioner was legally entitled to take the action he did to amend returns up to six years after they had first claimed their deductions. However, he made 20 recommendations for the consideration of the ATO, the Government and the Parliament, relating to the terms of a settlement for Main Camp investors, measures to enhance participants’ awareness of their responsibilities under the self-assessment system, and measures to enhance the ATO’s management of schemes.<sup>234</sup>

5.8 In 2000–01, the Taxation Ombudsman also investigated a complaint from a promoter of film schemes. The complaint followed the ATO’s decision in 1998 to issue amended assessments to participants who had invested in relevant film undertakings for the four years 1993–94 to 1996–97. The Taxation Ombudsman concluded that matters of interpretation of the law are open for the Tax

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<sup>230</sup> The activities of the Budplan arrangement were of the nature of research and development relating to the application of various agricultural products such as tea tree oil and celery seed for pharmaceutical use.

<sup>231</sup> In the case *Howland Rose & Ors* (known as Budplan), the Federal Court upheld the ATO view that the MMIS was not tax effective. It held that amounts paid to participate in the Budplan Personal syndicate were not deductible under the general deduction provisions of the income tax law. The Court also held that the general anti avoidance provisions in Part IVA of the income tax law operated to deny deductions for the amounts subscribed because the investment made no commercial sense without the tax benefits.

<sup>232</sup> A greater degree of coordination and centralisation of some of the activities involved and developing the product ruling system provided greater certainty as to the tax consequences of investments.

<sup>233</sup> Main Camp was a producer and exporter of tea tree oil. The Ombudsman said he chose to investigate the ATO’s actions in respect of Main Camp because of the number of participants affected and because Main Camp’s projects were managed by the Budplan promoter and had been put in place prior to Budplan but were not investigated by the ATO until after Budplan.

<sup>234</sup> e.g. possible promoter sanctions, information to taxpayers on the ATO’s reasons for decisions, processes with respect to Part IVA and progressing representative cases to the courts.

Commissioner and the promoter and participants to test in the Administrative Appeals Tribunal or the Federal Court and so did not comment on issues to be put before those bodies. However, he was critical of some elements of the ATO's actions in connection with relevant audits (especially the time taken to complete the audits, communication of views on issues and record keeping) and recommended remedial measures. The ATO agreed with the thrust of these recommendations.

## The Senate Economics References Committee

**5.9** Concurrent with the Taxation Ombudsman's investigation of Main Camp, the SERC was investigating related matters in a broader inquiry into mass marketed tax effective investment schemes and investor protection. The SERC conducted its inquiry between June 2000 and February 2002.<sup>235</sup> The Committee tabled three reports, focussing on the development of MMIS, a settlement proposal for the parties affected and recommendations for systemic improvement, respectively.

**5.10** The Committee's First Report criticised the length of time the ATO took to make clear its position in respect of the deductions claimed by participants in the MMIS and the lack of clarity and apparent force in the ATO's messages to the market. Although the Committee considered that the ATO was not solely to blame for the position many scheme participants were in, the ATO contributed to the problem. It said that a significant share of the blame also fell on promoters and advisers, including elements of the tax, legal and financial planning professions, and at least some taxpayers, who sought to exploit loopholes in the taxation law in a way never intended by Parliament.<sup>236</sup>

**5.11** The Committee's Second Report proposed the terms of a settlement for investors in schemes it considered eligible for settlement concessions. It saw a need to recognise in some concessional settlement, the particular and unprecedented circumstances that applied in the MMIS situation, while maintaining the integrity and fairness of the tax system by requiring repayment of primary tax and not allowing investors to retain a tax benefit to which they

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<sup>235</sup> On 29 June 2000, the Senate referred to the SERC the matter of mass marketed tax effective schemes and investor protection for inquiry and report, with particular attention to:

- the adequacy of measures to promote investor understanding of the financial and taxation implications of tax effective schemes;
- the conduct of, and adequacy of measures for controlling, tax effective scheme designers promoters and financial advisers; and
- the ATO's approach towards, and role in relation to, mass marketed tax effective schemes.

<sup>236</sup> Interim Report, para. 1.8.

are not entitled.<sup>237</sup> The Committee's Second Report also canvassed ways to deter and penalise promoters of aggressive tax planning arrangements.<sup>238</sup>

**5.12** The Committee's Final Report discussed, and made recommendations on, a number of systemic matters bearing on the ATO's handling of MMIS.<sup>239</sup> These were:

- compliance management issues (e.g. regarding promoters, communication measures and risk and intelligence management);
- the role of tax professionals in the tax system and the notion of a responsibility to the broader community regarding the integrity of the tax system;<sup>240</sup> and
- the extent to which taxpayers understand the implications of the self-assessment tax system, including their responsibilities and the powers of the ATO in that regard.

## ATO settlement processes

### The early MMIS settlement framework

**5.13** As part of it trying to resolve the emerging issues relating to MMIS in the late 1990s and early 2000s, the ATO developed a settlement code for mass marketed aggressive tax planning schemes.<sup>241</sup>

**5.14** The settlement guidelines outlined the ATO's general approach in trying to strike a balance between the need to apply the tax law and sensible administration. The ATO's stated intention was to provide a way for the ATO and taxpayers to deal with the past and move forward, with settlements providing fairness and consistency between taxpayers and proportionate with the 'tax mischief' in each case.

### SERC settlement framework

**5.15** The SERC's Second Report recommended penalty and interest charges imposed by the ATO on tax deductions claimed by eligible investors in MMIS be reduced to nil, and a deduction be allowed for cash outlays on MMIS. The

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<sup>237</sup> Second Report, September 2001, pp.8–9.

<sup>238</sup> The Committee's Second Report advocated promoter penalties involving sanctions and attention to enhanced resourcing, capability and legislative/policy issues. Report para. 1.53–1.79, pp.9–14.

<sup>239</sup> The Committee's Final Report (Chapter 4) also dealt with issues related to investor protection. This aspect of its inquiry is not relevant in this audit.

<sup>240</sup> This matter is discussed in Chapter 2.

<sup>241</sup> The ATO released a draft addendum to its Code of Settlement Practice to provide guidelines for the settlement of mass marketed aggressive tax planning schemes and after reviewing feedback on the draft, finalised the addendum in July 2000.

Commissioner responded to the SERC report and agreed, in principle, to most<sup>242</sup> of the recommendations regarding settlement. The settlement offer for eligible investors in eligible schemes,<sup>243</sup> outlined by the Commissioner on 14 February 2002, provided for:

- no penalty or interest on the tax owed by most investors;<sup>244</sup>
- all investors to be allowed their actual cash outlays as a tax deduction;<sup>245</sup>
- two year interest free period for debt repayment, subject to an acceptable payment arrangement being made; and
- the deadline for taking up the offer was two months after the judgement of the Federal Court in the Budplan scheme test case.<sup>246</sup>

**5.16** In making this settlement offer, the Commissioner indicated that the addendum to the ATO Code of Settlement Practice on mass marketed aggressive tax planning schemes ceased to have effect and any other offers in respect of schemes would only be within the ATO Code of Settlement.

## Basis of the ATO settlement

**5.17** The terms of the ATO's settlement offer reflected, after consideration of options, the acceptance of most of the SERC's recommendations.

**5.18** The ATO distinguished between certain schemes<sup>247</sup> and certain types of scheme participant in making its settlement offer. The ATO's approach saw that special circumstances applied to the investors in MMIS, given the nature of the

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<sup>242</sup> The Commissioner did not agree with the SERC recommendation that the ATO should allow deductions claimed in commercially viable schemes, with an independent group of experts assessing the commercial viability of schemes because it was felt that this recommendation would not bring the settlement process to finality in a timely way.

<sup>243</sup> Generally, scheme promoters or anyone who profited from schemes would not get the remission of penalties, unless there were special circumstances to justify a remission (considered on a case by case basis). If the taxpayer were in a small or medium-sized tax agent practice or professional firm and were not a promoter or financial planner and did not receive fees or commissions, a partial remission of interest to 4.72 per cent was allowable. (The partial remission of interest to 4.72 per cent was later made available to all agents and accountants regardless of the size of their practice, unless they received a fee relating to another investor's participation in a scheme.) Eligible schemes for the ATO's settlement offer are agricultural, entertainment, franchise and film schemes that were widely marketed and entered into in 1998–99 and earlier years. It does not cover employee benefit and other schemes.

<sup>244</sup> See previous footnote concerning the position for scheme promoters, tax agents and financial planners and members of professional firms.

<sup>245</sup> Even if not eligible for the full settlement opportunity, investors in eligible schemes could still settle on a cash outlays basis.

<sup>246</sup> The deadline was originally 29 May 2002, but this was extended to 21 June 2002.

<sup>247</sup> For example, the settlement offer did not cover employee benefit arrangements, which although they might have been mass marketed arrangements, were not defined to be MMIS and appropriate for the settlement offer.

participants.<sup>248</sup> Although the ATO has not set out its rationale for making such distinctions in specific detail, its basis for judgement in relation to participants is suggested in sufficiently clear terms in the press release announcing the settlement and the Commissioner's letter of 15 February 2002 to scheme investors.<sup>249</sup> In respect of the types of schemes, the rationale for limiting the settlement offer to only MMIS (as considered by the SERC) is not explicitly enunciated other than to allude to 'unique circumstances' in which the MMIS were sold.

**5.19** We are aware, from discussions with stakeholders and representatives of some of the tax professional bodies, that some investors have questioned the exclusion from the settlement process of certain 'mass marketed schemes' in which they were involved. The ATO has a process to consider applications for schemes not included in the Commissioner's settlement offer (see next section). Schemes that are considered ineligible for the settlement offer may still be settled under the ATO Code of Settlement Practice.<sup>250</sup> Their exclusion from the February 2002 settlement offer means, however, that any settlement arrangements are typically framed in less generous terms.

## **ATO processes for considering eligibility for the settlement offer—taxpayers and schemes**

**5.20** Under the terms of the settlement offer, categories of taxpayers who did not comply with the terms of the settlement offer could seek to have their claims for concessional treatment under the terms of the settlement, considered on a case-by-case basis. The ATO has a framework<sup>251</sup> by which to make this case-by-case assessment of *taxpayer* eligibility, involving an application/decision-making

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<sup>248</sup> Described in SERC material as typically unsophisticated taxpayers, lacking a comprehensive knowledge of the tax system who had been taken advantage of by unscrupulous scheme promoters.

<sup>249</sup> Media Release Nat 02/07 *Tax Office Announces Settlement Offer for Mass Marketed Scheme Investors*, 14 February 2002 on the ATO website, <<http://www.ato.gov.au>>

<sup>250</sup> The ATO has advised that a number of taxpayers have lodged applications to settle under the Code, and that these applications have been dealt with on a case by case basis in accordance with normal processes under the Code.

<sup>251</sup> The Ombudsman reviewed this process and the relevant Minister, the Minister for Revenue and Assistant Treasurer, was briefed on the process.

process<sup>252</sup> and a review process.<sup>253</sup> ATO statistics on the review of taxpayers initially determined ineligible show that the review process is an active one (with the initial determination being changed in many instances).<sup>254</sup> The ATO also has a framework by which to make the case-by-case reassessment of *schemes* eligibility,<sup>255</sup> involving an application/decision-making process<sup>256</sup> and a review process.<sup>257</sup>

## ATO processing of settlements

**5.21** The processing of settlements occurred via the processing of relevant settlement deeds for each taxpayer, taking account of all their scheme investments. As part of the initial offer of settlement, all taxpayers identified as having invested in an eligible MMIS were sent a settlement deed, accompanied by a letter explaining the settlement offer. Information on the settlement offer

<sup>252</sup> In terms of the consideration/decision-making process around eligibility of people for the settlement offer, people who were not eligible taxpayers at first instance in the settlement offer (scheme promoters, tax advisers, financial planners, tax agents and advisers and members of a professional firm with a tax practice) could apply to be considered an eligible taxpayer (addressing in their application, points that go to their knowledge of the tax system, compliance history and involvement in the scheme). The decision-making process around eligibility involved a decision maker, a quality assurance review of all cases and a decision by a panel of two Senior Executive staff members.

<sup>253</sup> The applicant could be considered eligible for the full terms of the settlement offer, eligible for remission of the General Interest Charge (GIC) to 4.72 per cent or eligible to claim a deduction for the cash outlay only. If a person is not satisfied with the primary decision concerning their eligibility for the settlement terms, they can apply for an independent internal review of the process leading to that decision (asking, e.g. whether the original decision was legal, took account of all relevant factors and individual circumstances and was based on reasonable evidence). Following that review, a person can approach the Ombudsman if they consider that the ATO has not treated them fairly.

<sup>254</sup> In relation to the number of 'ineligible taxpayer' cases considered up to 30 June 2003, the ATO advised that, of the 635 'ineligibles' cases finalised (i.e. through the ATO determination process):

- the number of taxpayers considered eligible in full was 139;
- the number considered ineligible was 150;
- the number of tax agents and others considered ineligible and offered the settlement terms of the cash outlay and the concessional GIC of 4.72 per cent was 346; and
- over 80 independent reviews of the determination process had been sought.

<sup>255</sup> In terms of the eligibility of schemes, people who invested in a scheme in 1998–99 or before, and which was not on the list of 159 eligible schemes in the settlement offer, could apply to have their scheme taken to be an eligible scheme (addressing in their application the details of the scheme, how it was marketed, and reasons why the scheme should be considered to be an eligible scheme). The ATO excluded employee benefit arrangements (EBA) and financing products schemes, saying these types of schemes were specifically excluded from the Committee's recommendations and the Commissioner's settlement proposal. It also excluded from this applications process, old schemes on which a judicial decision had been handed down.

<sup>256</sup> The decision process involved the original auditor of the relevant scheme (where possible) considering the application, review by two other more senior officers in the area and then decision by the responsible Senior Executive officer, Assistant Commissioner ATP (Audit). Factors taken into account in determining whether a scheme was mass marketed include whether it was tailored to individual participants' needs, no set participation amount, sold to limited or select groups, e.g. through tax agents who may have had a direct or indirect relationship with a promoter of the scheme.

<sup>257</sup> The decision about scheme eligibility by the responsible Senior Executive officer was subject to peer review by another Senior Executive officer, Assistant Commissioner ATP (Implementation).

was also provided direct to registered tax agents and to the Financial Planners Association. When the taxpayer sent in the full settlement deed and or a submission outlining why they should be considered eligible for the settlement offer, the ATO processed that document (involving steps to consider the extent to which the taxpayer was entitled to the various concessional terms, a decision step and a quality assurance review step).

**5.22** If the result of the ATO decision or review steps were to determine that the taxpayer was considered *eligible* for the full settlement, the full settlement deed already lodged was processed on a priority basis as per the ATO's normal procedures.<sup>258</sup> If the result of the decision were to determine that the taxpayer was *ineligible* (and if the taxpayer requested a review, the decision about ineligibility was upheld) the taxpayer was given the reasons for that decision and a new settlement deed (excluding clauses relating to nil penalty or nil interest on settlement) to use if they wished to settle.

**5.23** The process beyond that point, reflecting standard ATO process, is that if the investor does not settle, their objection to their tax assessment, if outstanding, will be determined, or collection action will begin. The investor can then decide whether to litigate the matter.

## **The scale of the schemes settlement administrative task**

**5.24** The size of the MMIS settlement administrative task is immense. The complexity of the processing task adds to the burden placed on the ATO.<sup>259</sup> Indicative of the size of the task, the ATO made settlement offers to 41 700 taxpayers, represented by approximately 59 000 deeds. In response, the ATO received over 48 000 settlement deeds from over 36 300 taxpayers.<sup>260</sup>

**5.25** The SB business line, specifically the area called SB Schemes, is responsible for implementing the decisions reached regarding these schemes and translating these into appropriate adjustments to schemes claims made in investors' returns. These adjustments can be in the form of amendment, re-amendment, settlement amendment or interest remissions. The processes required for the ATO to process these settlements, and make the appropriate amendments, are highly involved<sup>261</sup> and require attention to the particular circumstances of the various categories

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<sup>258</sup> Involving consideration of the assessment, receivables management and penalties matters.

<sup>259</sup> Some taxpayers have complained about errors in their revised assessments from the ATO, believing them to result from settlements being handled in several different areas of the ATO. The complexity and scale of the ATO's settlement operations increase the chances of administrative problems.

<sup>260</sup> That represented an acceptance rate of 87 per cent by investors (36 360 eligible responses from 41 700 investors offered settlements).

<sup>261</sup> The ATO's processes have to consider, for example, whether an amendment has been issued to the taxpayer in respect of the scheme involvement, penalties and interest, the size of the debt, appeal status, the number of schemes and/or the number of years.



of taxpayers.<sup>262</sup> The processes involve several areas of the ATO, e.g. from the starting point of receipt of the settlement deed, through the execution of the deeds when the information from the taxpayer is complete, through the areas handling debt management issues, to processing the amendments ultimately sent to the taxpayer. The processes may also involve the Administrative Appeals Tribunal, and possibly the courts, in cases in which appeals have been lodged, as the appeals need to be discontinued for the settlement process to be given effect.

**5.26** The timeliness of scheme settlement processing has been a contentious matter for the ATO. We were told by some representatives of tax practitioners that a frequent complaint from their members is that the processing of settlements takes too long. It has been a major work demand for the ATO since mid 2002 and the settlement operational process has not been as timely as the ATO had planned, for a number of reasons,<sup>263</sup> although the ATO assigned extra staff to the schemes settlement processing activities.<sup>264</sup>

**5.27** In looking at the ATO's planning and operational approaches at this time, we saw evidence of processes slipping and work pressures meaning that other planned tasks could not be undertaken as intended.<sup>265</sup> We also noted, however, good practice by the ATO in trying to manage this immense administrative task—with SB Schemes' plans explicitly outlining priorities, considering risks and working to streamline its approaches (e.g. making certain offices specialise on certain matters and tailoring tasks to fit staff skills and experience).

## Settlement activity status

**5.28** As noted previously, the processing of settlement cases is a demanding and on-going administrative exercise for the ATO. The ATO advised that, as at 30 June 2003, it had finalised approximately 31 000 individuals' cases (representing 85 per cent of the individuals who responded), and finalised over 49 000 deeds (representing 83 per cent of deeds returned).

<sup>262</sup> The ATO established different amendment categories in undertaking its processing, i.e. standard cases, high debt, SERC Appeals (relating to Administrative Appeals Tribunal appeal cases that had to be withdrawn by the taxpayer before the taxpayer could settle), SERC settlement, SERC promoter settlement and penalty concessions.

<sup>263</sup> Slower than expected progress for the ATO arose because of: delays in starting full processing; higher than expected error rates in the information provided by taxpayers in their settlement deeds, requiring the ATO to go back to taxpayers more often than intended; and some staff skilling issues, meaning that some staff brought from elsewhere in the ATO on loan to meet the big administrative loads, took longer to learn the processes than expected.

<sup>264</sup> The SB Plan for 2002–03 assigned 77 FTEs to MMIS implementation work, along with an additional 42 FTEs staff on loan and an additional 20 FTEs in terms of overtime.

<sup>265</sup> e.g., SB's work on product rulings review; the scoping of risk on schemes work referred to it by SIA and the Promoters Taskforce; and audits of potential aggressive tax planning schemes referred to it by the Risk Review Panel.

**5.29** The ATO is undertaking a process with taxpayers who did not settle to determine objections, list appeals for hearing at the Administrative Appeals Tribunal or Federal Court and collect outstanding debt. In 2003–04, the ATO will be working to determine 2 300 objections and to advance 460 appeal cases.

**5.30** The finalisation of MMIS will continue to be an important, though less resource intensive area of work for SB in 2003–04.<sup>266</sup>

## **ATO administrative action on the Committee's concerns regarding MMIS**

**5.31** We sought to review ATO action on matters in the Committee's wide-ranging reports that were particularly relevant to the ATO's management of aggressive tax planning. In doing so, we are mindful that the Government has not responded to the SERC's reports. However, the Commissioner considered that he had scope to respond administratively to some recommendations of the Committee and has acted in a number of areas. The development and application of the settlement arrangements, discussed earlier, are examples of the Commissioner's administrative responses. Other matters in the SERC reports relevant to this audit of aggressive tax planning management, and ATO action on them, are outlined in this section.<sup>267</sup>

### **Product rulings for risk management<sup>268</sup>**

**5.32** The ATO introduced product rulings in 1998 as a way to give some level of certainty to prospective investors as to the tax consequences of an investment scheme.<sup>269</sup> Product rulings are valuable in the ATO's management of aggressive tax planning in several ways. One is the fact that they have been embraced by potential investors to such an extent, because taxpayers have come to require

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<sup>266</sup> In terms of staffing, the ATO advised that it appears, as at October 2003, that approximately 50 FTEs are planned to be allocated to such MMIS settlement matters in 2003–04, but this figure will vary depending on the speed with which the work progresses. The planned staffing allocation is a significant decline from the 139 FTEs in 2002–03.

<sup>267</sup> The Ombudsman's report into the Main Camp scheme acknowledged the ATO's measures to improve the administration of MMIS, including intelligence gathering, the Part IVA processes and measures to publicise actively the ATO view about scheme arrangements. See *The ATO and Main Camp Report of the investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a mass marketed tax effective scheme known as Main Camp*, January 2001, p.28.

<sup>268</sup> Interim Report, para. 4.42, noted the need for the ATO to use its intelligence sources (e.g. rulings) better for effective identification and management of the risks of aggressive tax planning.

<sup>269</sup> In considering the investment proposal, the ATO considers whether the tax benefits proposed or claimed to be available to investors in investment schemes are benefits the tax laws actually confer. The ATO does not consider whether the scheme is a sound commercial investment. A product ruling only applies if the arrangement is implemented as proposed to the ATO. For more information on the ATO's administration of product rulings, see Auditor-General Audit Report No.3, 2001–02, *The Australian Taxation Office's Administration of Taxation Rulings*, July 2001.

this assurance as to the tax position of their prospective investment, that such investment proposals are unlikely to be supported in the market unless the proposal has a product ruling from the ATO.<sup>270</sup> This means that the ATO has been able to exercise scrutiny and even, indirectly, a broad measure of influence over the schemes being promoted in the market.<sup>271</sup>

**5.33** Another way product rulings are useful, is that applications for product rulings can be a worthwhile source of intelligence for the ATO. The Product Rulings area of SB, which accounts for the vast majority of product rulings, reports new and emerging issues to SIA and compiles an internal monthly product ruling report outlining patterns and trends in product rulings applications and product rulings issued.<sup>272</sup> These processes and reports help to gather, assimilate and share<sup>273</sup> in a timely way, the risks and intelligence that may be apparent from product rulings. Other features of the ATO's processes in managing product rulings also assist it to identify and manage scheme risks in a timely and integrated way. These are:

- the formal risk assessments that SB Product Rulings conducts of a product ruling, rulings on which the ATO has refused to rule (i.e. cases in which the ATO will not issue a product ruling because the proposal has undesirable features, such as non-recourse financing or the proposal is from a high risk promoter),<sup>274</sup> invalid applications and applications for rulings that were withdrawn. These risk assessments (reflecting elements of the ATO's PASTO approach to considering the aggressive tax planning landscape) are

<sup>270</sup> The SERC Final Report, p.9, noted that many witnesses supported product rulings, quoting from one submission '... Product rulings have become a standard reference for inclusion in a prospectus—without a product ruling, it is now much more difficult to attract investors.'

<sup>271</sup> So influential are product rulings in the market, we understand that some taxpayers (investment scheme providers and other professionals) have complained that delays in the ATO issuing a product ruling in any particular instance affects the marketability of products and therefore can distort competition among potential providers.

<sup>272</sup> e.g. the May 2003 Product Rulings report noted that there had been 104 product rulings applications received and 47 issued in the period 1 July 2002 to 31 May 2003. This was a reduction in both applications and numbers issued compared to those in the previous year. The Product Rulings report mentioned that factors influencing the numbers of applications and numbers issued included the 30 per cent decrease in the number of agribusiness applications and increased litigation because promoters were becoming highly aggressive in their approach. The ATO noted that the percentage of applications on which it 'refused to rule' (i.e. would not approve the application for a product ruling) rose from 34 per cent of all applications finalised (July 2001 to 31 May 2002) to 44 per cent of all applications finalised (July 2002 to 31 May 2003). The report also pointed out that the time taken to issue a product ruling had fallen over time (an average of 107 days at 31 May 2002 and an average of 68 days at 31 May 2003). It should be noted when considering the timeliness of product ruling application processing, that the complexity of many of the arrangements and the failure, or delays, in scheme providers in supplying complete information, affects the processing time.

<sup>273</sup> e.g. about the prevalence of particular types of schemes in applications. One recent matter reported by SB Product Rulings to SIA is the accommodation bond type project (which provides finance to elderly people so that they can access the equity in their home to enter a retirement village—raising issues related to rental income and capital gains tax).

<sup>274</sup> These are the highest risk matters in terms of aggressive tax planning management.

used to update the relevant part of the ATPDatabase. The risk assessment is also provided to SIA (for intelligence purposes), the Promoters Taskforce (to maintain current promoter profiles) and SBATP (to inform their choice of product rulings to be reviewed by that area);

- in relation to product rulings issued, site visits by SB Product Rulings to check on the status of activity against commitments made in the product rulings applications (e.g. where undertaking to plant a certain number of trees or to establish infrastructure such as trellising); and
- in relation to completed product rulings work, SBATP audits of all applications on which the ATO 'refused to rule'. SBATP also undertakes audits on a risk-assessed sample of product rulings issued.

5.34 The ATO intends to give particular emphasis in managing aggressive tax planning in the SB area to auditing product rulings. In 2002–03, SBATP reviewed 107 product rulings, although some of the product rulings reviews carried over into the 2003–04 period. In 2003–04, SBATP plans to review 100 product rulings involving all product rulings on which the ATO refused to rule and product rulings that were withdrawn, and 20 per cent of product rulings issued—selected on a risk assessment basis.

5.35 The ANAO acknowledges that the resource demands associated with processing the MMIS settlements have restricted the ATO's ability to allocate SB staff to other aggressive tax planning matters. This initiative with product rulings will better place the ATO to deal more proactively with aggressive tax planning schemes and indeed possibly even prevent the emergence of some schemes.

### **Intelligence—identification of aggressive tax planning risks, real time intelligence gathering and strategic intelligence capability (assessment of patterns and trends)<sup>275</sup>**

5.36 The ATO has made considerable efforts to enhance its capacity to identify aggressive tax planning risks, gather real-time intelligence and enhance its strategic intelligence capability. These include the expanded capability of SIA and the establishment and operation of the Promoters Taskforce. (See Chapters 3 and 4 for an outline of their operations and reference to the intelligence links across the ATO and links with other agencies and the case studies in Chapters 2 and 3.)

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<sup>275</sup> Identification and management of risks—Interim Report, para. 4.42, strategic intelligence—Interim Report, para. 4.83, identification of patterns and trends—Interim Report, para. 4.5 and real time intelligence capability—Final Report, para. 1.72.

## **Communication and information sharing with the public about aggressive tax planning issues and their responsibilities and the ATO's powers under the self-assessment tax system<sup>276</sup>**

5.37 Important tools the ATO has instituted or enhanced since 2002 to communicate with, or provide information to, the public include: Taxpayer Alerts, speeches by the Commissioner of Taxation and other tax officials,<sup>277</sup> the Commissioner of Taxation's annual reports and the ATO website. See Chapters 2 and 3 for these and other tools used.

5.38 The ATO has sought to better inform taxpayers of their responsibilities and the ATO's powers under the self-assessment tax system by highlighting the messages in practical ways. It has done this with references to relevant requirements in the Tax Pack, and references to the concept of self-assessment and its implications in key ATO public documents, such as the ATO Compliance Program. The ATO advised that it has also had discussions with the Taxation Ombudsman and officers of the education and communication sub-group of the ATO's Tax Practitioner Forum<sup>278</sup> regarding ways to educate the community on the self-assessment system. The ATO also advised that the area with central responsibility for communication in the context of aggressive tax planning management has developed a communication strategy with ATO Relations to advance this arrangement. ATO Relations is the line in the ATO with main responsibility for relationship management between the ATO and taxpayers.

## **Cooperative arrangements with professional bodies<sup>279</sup>**

5.39 As noted in Chapter 2, the National Tax Liaison Group (NTLG) continues to be a forum for interaction between the ATO and the professional bodies on a wide range of matters including aggressive tax planning matters. Topics for discussion have included the roles and responsibilities of the parties in the tax system (in 2001), and matters concerning the status of scheme settlement activities and policy development measures.

5.40 The ATO has sought to engage with the professional bodies in other ways regarding aggressive tax planning. It appears that there has been only limited

<sup>276</sup> Final Report, paras. 1.53-1.59 and 3.36.

<sup>277</sup> See K Fitzpatrick, *The Australian Taxation Office's Approaches to Aggressive Tax Planning*, Centre for Tax System Integrity Third International Research Conference Responsive Regulation: International Perspectives on Taxation: Canberra 24 and 25 July 2003.

<sup>278</sup> The Tax Practitioner Forum is the key body in the ATO for coordination of activities with tax agents. Its role is to facilitate the coordination of all ATO activities that may impact on the workload of tax agents and thereby order and harmonise ATO efforts supporting them. For more information on its activities, see Audit Report No.19 2002-03, *The Australian Taxation Office's Management of its Relationship with Tax Practitioners*, 2002.

<sup>279</sup> Final Report, paras. 1.51 and 1.52.

interest by those bodies in sharing information and concerns with the ATO in a formal way (see Chapters 2 and 3).

## **Promoter control and monitoring of promoter activities and promoter sanctions<sup>280</sup>**

5.41 Since the external reviews of the 1990s and early 2000s, the ATO has substantially developed its strategies to control and monitor promoter activities by establishing and then expanding the Promoters Taskforce (see Chapter 4).

5.42 The Taskforce has, since 2001–02, worked with the Department of the Treasury in providing advice on tax administration issues around the development of policy options regarding promoter penalties. On 5 December 2003, the Government announced<sup>281</sup> that it intends to introduce a regime of civil penalties on promoters of tax avoidance and tax evasion schemes (see Chapter 4).

## **ANAO comment**

5.43 The ATO acknowledges that its efforts in managing MMIS in the 1990s were less than ideal. It has had the benefit of considerable external scrutiny in this area since the late 1990s. It has put a range of measures in place since that time (e.g. for better intelligence gathering and analysis, better and more timely information flow and warnings to the public). It has also invested considerable resources settling the MMIS cases.

5.44 It is difficult to assess the effect of these measures. The SERC's Final Report discussed, at some length, the trends in ATO figures on disallowed deductions relating to MMIS<sup>282</sup> and what that might indicate regarding the point at which the ATO could be said to have stemmed the growth in MMIS. Later figures relating to the amounts of revenue raised by the ATO from disallowed MMIS deductions show the effects of the ATO's efforts in curbing MMIS. Whereas revenue raised in 1999–00 was \$914 million, this fell to approximately \$653 million in 2000–01, \$120 million in 2001–02 and \$36 million in 2002–03.

5.45 While the ATO's revenue figures might suggest that participation in MMIS has been contained, in the highly adaptive market of schemes, it is likely that other types of schemes may become widely marketed (such as employee benefit

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<sup>280</sup> Second Report, paras. 1.58–1.79.

<sup>281</sup> See Press Release by the Minister for Revenue and Assistant Treasurer, *Crackdown on Promoters of Tax Avoidance and Tax Evasion Schemes*, C 117/03, 5 December 2003.

<sup>282</sup> Including the findings of the ATO's June 2000 internal review of its work on MMIS and subsequent ATO figures for disallowable deductions in MMIS, see Senate Economics References Committee, *Inquiry into Mass marketed Tax effective Schemes and Investor Protection*, Final Report, February 2002, pp.2–5. The Committee reported (p.4) ATO figures indicating that MMIS non-allowable deductions were estimated to be \$666 million (1996–97), \$1,100 million (1997–98), \$1,500 million (1998–99), \$527 million (1999–00) and \$121 million (2000–01).

arrangements and linked bonds schemes).<sup>283</sup> The ATO has to remain vigilant and flexible in its efforts to manage compliance and in monitoring the effectiveness of its aggressive tax planning management measures. The tax professionals we consulted advised that, in their view, the prevalence of aggressive tax planning, particularly MMIS, seems to have reduced but that the matter is one requiring the ATO's ongoing management and attention. For the ATO's part, the Commissioner has noted that the appetite to find ways to pay less tax and the propensity to profit from devising and promoting schemes to satisfy that appetite—is an ongoing risk to the revenue system.<sup>284</sup> The Commissioner indicated that the Office has seen the warning signs of aggressive tax planning for GST purposes and in the emerging bartering sector.

**5.46** A basic test of the effectiveness of the ATO's aggressive tax planning management measures (such as intelligence gathering and analysis, product rulings, early warnings and other information to the community and tax professionals) is whether they can identify and 'head off' another MMIS-type event. While there is no guarantee that another MMIS-type event will not recur, in our view the ATO has identified some important lessons from its earlier experience and has introduced a wide range of remedial measures that should allow it to better manage aggressive tax planning, in its various forms, in the future.

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Canberra ACT  
29 January 2004



P. J. Barrett  
Auditor-General

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<sup>283</sup> The ATO's aggressive tax planning performance report 2003 highlights the rises and falls in revenue raised in different types of widely marketed schemes. The Commissioner of Taxation said, in June 2003, that the ATO is not seeing the same sort of issues like the mass marketed schemes but that it continues to see a significant number of tailored or more boutique schemes. See Senate Budget Estimates Hearings 2003–04, Economics Legislation Committee, 3 June 2003 p. E 235.

<sup>284</sup> Australian Taxation Office, *Commissioner of Taxation Annual Report 2002–03*, ATO, 2003, p.7.





# Appendices



## Appendix 1: Agency Response

### The Australian Taxation Office's Management of Aggressive Tax Planning—Proposed Audit Report

Thank you for the letter of 19 November 2003, from your Executive Director Mr Peter White, and for the opportunity to provide comments on the proposed audit report on the Australian Taxation Office's Management of Aggressive Tax Planning.

Overall I support the thrust of the recommendations, subject to the following points.

Recommendation No.1  
Paragraph 2.16

The ANAO recommends that, to improve the implementation of strategies and approaches designed to manage aggressive tax planning in an holistic way, the ATO:

- clarify the roles, and its expectations, of staff implementing the strategies and approaches; and
- support staff appropriately in these respects with suitable training and performance management measures, including structured checklists and follow-up review.

**ATO Response:** Agreed.

**Comment:** The ATO's strategies in managing aggressive tax planning have evolved over recent years as we have learned from our experiences in dealing with the mass marketed schemes of the 1990's. These strategies continue to evolve and we will continue to improve the implementation of strategies and approaches.

The skilling aspect of this recommendation will be included in the ATO's Active Compliance Development Program.

Recommendation No.2 Paragraph 2.28

To provide better support for aggressive tax planning management, the ANAO recommends that, as a matter of priority, the ATO:

- develop and implement a strategy for the best use of the ATPDatabase that also specifies clearly the role of the Database in the management of aggressive tax planning;
- clarify expectations and needs of aggressive tax planning staff who are expected to use the ATPDatabase; and
- implement measures to improve the management and reporting of aggressive tax planning data.

**ATO Response:** Agreed.

**Comment:** The ATO is currently redesigning its information management and compliance reporting processes and systems. Through this process the role and position of the ATPDatabase as well as the input and integrity processes for the data will be defined and if necessary changed.

In the interim the ATO will ensure that business practices and rules and quality assurance processes in relation to the ATPDatabase are properly documented.

Recommendation No.3 Paragraph 2.53

To improve aggressive tax planning risk management processes, the ANAO recommends that the ATO:

- incorporate business risks into future business planning around aggressive tax planning;
- conduct all aggressive tax planning risk assessments on a consistent basis; and
- record all aggressive tax planning risks on the Aggressive Tax Planning Risk Register, as intended.

**ATO Response:** Agreed.

**Comment:** Business risks have been taken into account in the ATO's Aggressive Tax Planning risk processes. However, the ATO accepts that these need to be more clearly articulated in the outputs from its aggressive tax planning risk management processes

Our experience has shown that in relation to aggressive tax planning risk assessments different approaches are required for different levels of complexity. While this may give the appearance of inconsistency, all risk assessments are based on the foundations of the ATO Risk Consequence Rating Matrix.

Recommendation  
No.4  
Paragraph 4.19

The ANAO recommends that for enhanced clarity about responsibilities, the ATO specify the role and associated functions of the Promoters Taskforce more explicitly, including relative to other areas of the ATO that also have responsibilities regarding promoters.

**ATO Response:**

Agreed

Comment:

We will communicate more clearly how the Promoters Taskforce works with other areas in the ATO and in particular the respective responsibilities of different areas in managing promoters in the different taxpayer markets.

Recommendation  
No. 5  
Paragraph 4.49

To provide greater accuracy and consistency of the promoter risk assessments on the ATPDatabase as the basis for appropriate work selection, the ANAO recommends that the ATO:

- systematically review its list of promoters and conduct all risk assessments on a comparable basis that reflects the current aggressive tax planning risk management approach; and
- review risk assessments of promoters on the list from time to time so that they remain accurate, given changing circumstances.

ATO Response:

Agreed

Comment:

We will look at how we can improve consistency and comparability having regard to different approaches in different markets. While risk assessment of promoters should be on a comparable basis using the same guiding criteria, processes may vary depending on the nature and extent of a promoter's activities and impact on compliance behaviour.

Based on an ongoing assessment of risk we are focusing on the higher risk promoters. Because of the complexity of this type of work not all cases will be advanced at the same time.

We agree that the ATO will give priority to Recommendations 1, 2, 4 and 5.

Should you wish to discuss this matter further please contact Graham Whyte on (03) 9275 2566.

Thank you for your constructive and co-operative approach to this review. I would like to commend to you the work of your auditors, Anne Cronin, Christian Anderson and Dianna Waanders who were very professional in their approach.

Yours sincerely

Jennie Granger  
Second Commissioner of Taxation  
19 December 2003

## Appendix 2: The ATO's Indicators of Aggressive Tax Planning<sup>285</sup>

Aggressive tax planning undermines the integrity of the tax system and erodes community confidence in the fairness and equity of the tax system. The characteristics identified below, whether alone or in combination, are likely to typify an aggressive tax planning arrangement and thus be challenged by the ATO. The following list is not meant to be exhaustive or exclusive:

- arrangements which are contrived and artificial in their method of execution;
- little or no real underlying business activity or purpose;
- the significance of the claimed tax benefit in realising an economic return;
- the complete or substantial removal of any risk to a taxpayer;
- the contrived transfer of a tax benefit;
- limited or non-recourse financing associated with borrowing of funds under a capitalising debt facility;
- mechanisms for winding up or exiting an arrangement before net income is generated for an investor;
- assumptions, including 'blue sky' projections, that can lead to seemingly excessive valuations of assets resulting in inflated deduction claims;
- use of tax-exempt entities, especially charities, to wash income; and
- transactions involving tax havens.

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<sup>285</sup> Reproduced from ATO Practice Statement 'Law Administration' 2001/15, *Taxpayer Alerts*, p.2.

## Appendix 3: ATO Action on High Wealth Individuals Taskforce Audit Report

*This Appendix reviews the ATO's implementation of recommendations from the ANAO audit report on the High Wealth Individuals Taskforce.*

### Introduction

Aggressive tax planning involves not only mass marketed investment schemes, it also includes more tailored schemes or arrangements that undermine the policy intent of the law. Aggressive tax planning arrangements entered into by some high wealth individuals (HWI) may lead to arrangements with similar features being marketed to, and implemented by, other taxpayers. In view of this, the ATO's HWI Taskforce reports to the FAC Aggressive Tax Planning.

We did not audit the HWI Taskforce in the current audit of the ATO's management of aggressive tax planning; the management and operations of the HWI Taskforce were examined in The High Wealth Individuals Taskforce Audit Report No.46, 1999–2000. As part of this audit, we looked at the measures the ATO has taken to implement the three recommendations from the previous audit report, because of the organisational links between HWI Taskforce and the FAC Aggressive Tax Planning.<sup>286</sup>

### ANAO recommendations

The recommendations of the ANAO were directed to improving the public reporting of the outcomes of the HWI Taskforce's work and to the ATO continuing the Taskforce's effective operations within the context of a sound risk management framework. We found that the ATO has fully implemented each of the recommendations, as outlined below.

**Recommendation 1** *The ANAO recommends that the ATO report the HWI Taskforce's revenue outcomes on a consistent and standardised basis so that the Taskforce's level of achievement is more readily discernible from year to year.*

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<sup>286</sup> The Joint Committee of Public Accounts and Audit (JCPAA) reviewed the Auditor-General's High Wealth Individuals Taskforce report on 23 August 2001. The JCPAA agreed with the ANAO's recommendations and recommended that the ATO 'make further efforts to promote greater public awareness of the High Wealth Individuals Taskforce's activities and achievements by disseminating more widely the information contained in the Commissioner's annual report.' JCPAA Report No. 382 *Review of Auditor-General's Reports 1999–00, Fourth Quarter (23 August 2001)*, p. xviii.



### *Direct revenue outcomes*

The ATO has introduced several work practices<sup>287</sup> to improve the quality and consistency of the direct revenue measure. It has reported on several other measures of improvement in revenue from compliance activities, e.g. the impact on revenue collections from tax return lodgement enforcement activity. The Taskforce has also done a significant amount of analysis on patterns and trends in direct revenue collection in relation to the Taskforce's compliance activity.

The ATO has reported on direct and indirect revenue outcomes for the HWI Taskforce in its annual reports since 1996. The 2002–03 Annual Report<sup>288</sup> outlines, in a table, direct revenue outcomes since 1996–97. However, in our follow-up work in this audit, we found that the figures for direct revenue listed in that table have not been reported on, on a consistent basis. This is not disclosed in the table.

We found that for some years (1996–97 to 1998–99, i.e. the earlier years), the figures reported do not include amounts in dispute,<sup>289</sup> whereas the later years' figures in the table (1999–00 to 2002–03) *do* include amounts in dispute.<sup>290</sup> We understand why the ATO would wish to report direct revenue outcomes on the latter basis: that basis means it reports all revenue collections made, even if some of the cases may still be in dispute and resolution of these cases may require the ATO to repay to taxpayers some of the amounts it has already collected. The ATO agrees that it should point out in its series of figures where the basis of the figures for reported revenue has changed.

### *Indirect revenue outcomes*

The HWI audit report recognised that the attribution of an indirect change in individuals' and companies' taxation behaviour, as a result of compliance activities other than on them directly, is difficult to quantify.<sup>291</sup> However, it found

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<sup>287</sup> e.g., the HWI Taskforce Research and Analysis Team sends a quarterly management report to each HWI Taskforce manager, enabling them to verify that all their compliance products are listed on the relevant ATO case management system and the amounts recorded against these products are correct. The Team also reconciles collections recorded on the case management system against clients' accounts in the ATO Integrated System.

<sup>288</sup> Australian Taxation Office, *Commissioner of Taxation, Annual Report 2002–03*, ATO, 2003, p.162

<sup>289</sup> Auditor-General, *The High Wealth Individuals Taskforce Audit Report No.46, 1999–2000*, para. 3.22 (Table 1) and para 3.26.

<sup>290</sup> Australian Taxation Office, *Commissioner of Taxation, Annual Report 2001–02*, ATO, 2002, p.95, Australian Taxation Office, *Commissioner of Taxation, Annual Report 2000–01*, ATO, 2001, p.57 and Australian Taxation Office, *Commissioner of Taxation, Annual Report 1999–00*, ATO, 2000, p.77.

<sup>291</sup> Auditor-General, *The High Wealth Individuals Taskforce Audit Report No.46, 1999–2000*, para. 3.15.

that the ATO's derived indirect figures represent a reasonable estimate of indirect revenue resulting from the activities of the Taskforce.<sup>292</sup>

The ATO indicated that it continues to apply the procedure and methodology that the audit found acceptable. However, due to concerns about the quality of the data in the comparative population, the ATO did not report indirect revenue figures in the Commissioner of Taxation *Annual Report 2001–02*. The ATO also advised that, since the HWI compliance program has matured, the ATO considered that the extra years of data on direct revenue and losses provide a good indication of results achieved. Consequently, there is less need now to estimate indirect revenue resulting from Taskforce activities. However, the ATO advised that the Taskforce continues to explore and evaluate ways of measuring the indirect revenue effect of voluntary compliance.

We accept the ATO's statements and undertakings on the reporting of revenue outcomes. We consider that the ATO has implemented Recommendation 1.

**Recommendation 2** *The ANAO recommends that the ATO report publicly each year on the on-going achievements of the HWI Taskforce in terms of:*

- *the revenue, both direct and indirect, that has been gained through audit and other activities of the Taskforce; and*
- *the initiatives it has taken to address undesirable tax minimisation practices.*

The ATO has reported the Taskforce's achievements in the Commissioner's annual reports, including the amount of revenue collections. Some of the Taskforce's strategies have been publicised through the ATO Compliance Program 2002–03 booklet (published in November 2002). As noted previously, the ATO reported indirect revenue collections in annual reports prior to 2001–02 but did not do so in the Annual Report for that year.

In terms of initiatives to address undesirable tax minimisation practices, the Taskforce has reported on initiatives it has taken to address undesirable tax minimisation briefly through the 2001–02 *Annual Report*,<sup>293</sup> and in the ATO's large business and tax compliance booklet.<sup>294</sup> The Taskforce has also publicised its approach to undesirable tax minimisation practices through various media reports and interviews.

We consider that the ATO has implemented Recommendation 2.

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<sup>292</sup> Auditor-General, *The High Wealth Individuals Taskforce Audit Report No.46, 1999–2000*, para. 3.21.

<sup>293</sup> Australian Taxation Office, *Commissioner of Taxation, Annual Report 2001–02*, ATO, 2002, p.94–96, 2002.

<sup>294</sup> Commissioner of Taxation, *Large business and tax compliance*, 2003, p.6.

**Recommendation 3** *The ANAO recommends that, subject to appropriate risk assessment, the ATO consider retention of the capability for dealing with the complexity of tax matters characteristic of high wealth individuals and their associated entities.*

The HWI Taskforce manages the compliance of all HWI and the entities that they effectively control. The Taskforce uses ATO and LB&I systems to record risks and revenue collections, but also continues to maintain HWI Taskforce-specific systems, that deal with the complexity and uniqueness of the high wealth segment. There are 108 full-time equivalent (FTE) HWI Taskforce staff.

The Taskforce liaises with other areas of the ATO, i.e. the Promoters Taskforce, SIA, LB&I, PTax Aggressive Tax Planning and GST Aggressive Tax Planning, so that these areas appreciate the uniqueness of this segment, and provide a united front to these clients. We saw evidence of this liaison during the current audit of the ATO's management of aggressive tax planning.

We consider that the ATO has implemented Recommendation 3.

## Summary of implementation of report

We consider that the ATO has implemented all the report's recommendations. With regard to Recommendation 1 concerning the consistency of HWI Taskforce revenue outcomes over time, we note that the ATO has advised that it has introduced several work practices to improve the quality and consistency of the direct revenue measure. As well, the ATO will address the matter of the reporting of the direct revenue measures with a note to the table indicating where the basis of calculation has changed. Given the need for accuracy in the calculation of revenue outcomes, we accept the ATO's decision not to report the indirect revenue outcome figure, if it has concerns about the quality of this figure.

## Appendix 4: Application of Part IVA Anti-avoidance Provisions

### Background

The ATO has two forms of anti-avoidance provisions under the taxation legislation: specific<sup>295</sup> and general.<sup>296</sup> Our focus in the audit is on the general anti-avoidance provisions. The general anti-avoidance provisions, Part IVA of the *Income Tax Assessment Act (ITAA) 1936*, apply when it can be concluded that at least one person has entered into or carried out a scheme for the sole or dominant purpose of obtaining a tax benefit.<sup>297</sup> It can only be used when the specific provisions cannot be applied to a particular matter.

The ATO considers all cases to which Part IVA applies to be aggressive tax planning. However, Part IVA cannot be applied to every case of aggressive tax planning. Part IVA is a provision of 'last resort'. Consequently, it does not apply unless the taxpayer's claim is otherwise allowable.<sup>298</sup> The application of the Part

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<sup>295</sup> The specific anti-avoidance provisions can only apply to the particular matters to which they relate.

<sup>296</sup> If there is a situation that results in conflict between the general provision and a specific provision, the specific provision prevails.

<sup>297</sup> In determining this, the Commissioner must take into account the following matters:

- i. the manner in which the scheme was entered into or carried out;
- ii. the form and substance of the scheme;
- iii. the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- iv. the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
- v. any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
- vi. any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
- vii. any other consequence for the relevant taxpayer, or for any person referred to in subparagraph (vi), of the scheme having been entered into or carried out; and
- viii. the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in subparagraph (vi).

<sup>298</sup> Taxpayers are entitled to claim deductions/expenses in relation to their income under the general and/or specific deduction provisions. However, for a taxpayer who is aggressively tax planning, it is only if their claims would be otherwise allowable under the general or specific deduction provisions that the ATO can use the Part IVA provisions to disallow the claims (if the sole or dominant purpose is considered to be to obtain a tax benefit).

IVA anti-avoidance provisions involves complex matters of legal interpretation, with the interpretation developing through a number of court decisions.<sup>299</sup>

## Role of the Part IVA provisions in securing compliance

The role of the Part IVA provisions is to secure compliance by discouraging taxpayers from entering into tax avoidance arrangements. If Part IVA is held to apply, a range of penalties<sup>300</sup> can be imposed, depending on the culpability of the taxpayer and specific circumstances surrounding the tax avoidance scheme. The provisions are very powerful<sup>301</sup> and can be an effective deterrent to tax avoidance.<sup>302</sup>

For the purpose of providing early warnings and information to secure compliance, the ATO flags its concern that Part IVA may apply, in Taxpayer Alerts<sup>303</sup> and media releases. It communicates its view on the application of Part IVA in Tax Rulings and Tax Determinations. These public statements on the application of Part IVA are designed to inform taxpayers and to promote awareness of the application of Part IVA when a trend or issue has been recognised.<sup>304</sup>

## Processes for determining the ATO position on Part IVA

The initial work, on an issue to which Part IVA may apply, occurs in the business lines. If ATO staff are considering the application of the Part IVA provisions, the

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<sup>299</sup> An example of the technical complexity and evolving interpretation of Part IVA is the High Court's decision in *Spotless (FC of T v Spotless Services Limited & Anor 1996 ATC 5201 at 5210)*. The High Court found that 'A particular course of action may be...both 'tax driven' and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether...[there was a] 'dominant purpose' of enabling the taxpayer to obtain a 'tax benefit'". Australian Master Tax Guide 30-170, p. 1389. 'The High Court overturned the majority decision of the Full Federal Court to find that Part IVA applied.' Thompson, W. (2002). *Part IVA—in perspective*. Queensland Taxation Institute Convention, p. 149.

<sup>300</sup> The base penalty amount is 50 per cent of the scheme shortfall amount (i.e. the difference between actual tax paid and what the ATO assesses the tax to be). In addition, although not a penalty, the General Interest Charge is also payable in some circumstances.

<sup>301</sup> An ATO internal review of the Part IVA provisions found that they had been very effective for certain types of schemes and were supported by Federal Court decisions.

<sup>302</sup> On the matter of the deterrent effect, for example, Robert Richards, a prominent tax advisor, states that '...when considering this arrangement (which was widely marketed), I advised clients against investing in it because I felt the Part IVA risk was too great'. *Australian CPA*, December 2002, pp. 78–79. In contrast, though, see the article *The Utility of Part IVA* by P Donovan and J Georallis in *CCH Tax Week Issue 37 25 September 2003*, which questions the utility of Part IVA given the arguable weaknesses in its operation at law.

<sup>303</sup> See Chapter 3 for further discussion on Taxpayer Alerts.

<sup>304</sup> During 2002, seven Taxpayer Alerts, twenty media releases and eight Taxation Rulings/Determinations were issued making reference to Part IVA.

major reference document they use as guidance is Practice Statement, PS2000/10, *Application of Part IVA*.<sup>305</sup>

In broad terms, after initial consideration in a business line that Part IVA might apply, there are subsequent processes involving several points of expert review. The Part IVA Panel (discussed below) is one source<sup>306</sup> of expert review. If, after the consideration and review stages, the ATO determines that Part IVA applies, the ATO provides a position paper on the taxation component of the arrangement to the promoter (where applicable), the taxpayer and their advisers, for their response. It is only after this process that the ATO issues an amended assessment to the taxpayer.

The Part IVA Panel<sup>307</sup> was established to help ensure that the Commissioner's power to make determinations under Part IVA is exercised appropriately and fairly, by ensuring that each case has been considered objectively on its facts.<sup>308</sup> The Part IVA Panel's budget is included in the 'Rulings Program' cost centre; the Rulings Program totalling \$1.5 million in 2002–03.<sup>309</sup> (The budget for the Panel's consultants is \$150 000 per annum.)

It is difficult to measure the operational performance of the Panel, as it is an internal, advisory body that does not have, or exercise, any power in its own right. That said, one way of determining the Panel's performance is to assess whether the ATO has followed its advice and, where matters have been to court, whether the Panel's views have been upheld in court.<sup>310</sup> A review of all matters that went to the Part IVA Panel in 2000–01<sup>311</sup> showed that the ATO acted

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<sup>305</sup> PS2000/10 is a publicly available document that provides instruction and practical guidance to staff on the application of Part IVA to taxation benefits obtained in connection with a scheme. It is the responsibility of the officer making the determination to take proper account of the individual facts in each case. However, in many cases there is little scope for the individual's circumstances to make a material difference. Whilst the ATO makes every attempt to abide by PS2000/10, it is not required to abide by the Practice Statement by law if the situation arises where it is impractical to do so or if it creates unintended consequences. PS2000/10 is presently under review in order to incorporate changes in the law and the outcomes of recent legal cases.

<sup>306</sup> Other points of expert review include the Tax Counsel Network and the Deputy Chief Tax Counsel.

<sup>307</sup> Comprising the Chair of the ATPSC, Deputy Chief Tax Counsel and three external tax practitioners. The Panel is supported by a secretariat and resourced by the Office of the Chief Tax Counsel.

<sup>308</sup> The strategic goals of the Panel include:

- helping to settle, maintain and develop the ATO position on Part IVA; and
- monitoring consistency and identifying trends involving Part IVA.

<sup>309</sup> This does not include the salary cost of business line staff involved in the particular Part IVA matter, or that of the FAC Aggressive Tax Planning, who chairs the Part IVA Panel.

<sup>310</sup> We recognise that there are many factors that affect the Part IVA Panel's operational performance, why the ATO may take matters to court and the ultimate decision of the courts. While recognising that the various factors prevent any simple assessment, we consider that this analysis can provide some indication of how well the Panel is operating.

<sup>311</sup> The ANAO found the 2000–01 time period appropriate because it provides enough time to allow matters to have gone through all the steps and progressed to a stage illustrative of the outcome of the case.

consistently with the Panel's advice in all cases. It also showed that the court judgments in the two matters in this time period in which the ATO considered that Part IVA applied, both favoured the ATO.<sup>312</sup>

## Stakeholders

Some stakeholders we consulted expressed concerns about aspects of the ATO's process in applying Part IVA. We are also aware that some of the investors in MMIS of the 1990s complained about aspects of the ATO's application of Part IVA (e.g. the consideration of investor's individual circumstances and that a private binding ruling on a matter may not prevent Part IVA being applied<sup>313</sup>). We also understand that the ATO has been told that some taxpayers do not appreciate some of the particular processes the ATO adopts in formulating its view on Part IVA matters nor whether they have an opportunity to provide input into those processes.

Practice Statement PS2000/10 (a publicly available document) broadly sets out the ATO's intended processes, including the consideration of individual circumstances. During the audit, the ATO also prepared a process map to provide more information on the steps the ATO takes in considering the application of the Part IVA provisions. It has provided this map to parties on request. We consider that this is a useful step as it may provide greater clarity about the processes and offer increased information and understanding to the taxpayers concerned.

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<sup>312</sup> More broadly, on the matter of the ATO's success rate before the courts on Part IVA matters, it appears that the ATO has been successful in many of the cases that have gone to court. See Robert Richards' article *Anti avoidance: a year end review*, Australian CPA December 2002. The article showed that between the December 1996 case of Spotless Services Limited and the October 2002 case of MacArthur, the ATO won 11 of the 17 cases the author examined.

<sup>313</sup> The following points outlining the interaction of private rulings and the ATO's application of Part IVA are relevant to the latter concerns.

- the ATO can consider the application of Part IVA when issuing a private ruling even if the taxpayer does not ask for a ruling on those provisions. The ATO can also, in certain circumstances, refuse to answer a taxpayer's request to rule on the application of Part IVA;
- the ATO *cannot* apply Part IVA later, if it has ruled that Part IVA has *no* application, *provided* the arrangement entered into is not materially different from that described in the private ruling; but
- the ATO *can* apply Part IVA after it has issued a private ruling that *does not* rule on Part IVA i.e. a private ruling that does not rule on the application of Part IVA cannot be used as a shield against the Commissioner seeking to apply it.

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