

Tax Brief

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The ATO's Approach to Administering the Promoter Penalty Regime

Background

It is now 5 years since the promoter penalty regime was first mooted by the former government and 2 years since it commenced operation. The regime was enacted in large part as a response to the embarrassment caused to the government and the Australian Taxation Office (“ATO”) by the proliferation of “mass-marketed tax schemes” in the late 1990s and the public revelations in the ensuing Senate inquiry.

As with many such measures, the legislation that was enacted cast a much wider net than the problem which prompted it. Some of the difficulties of the legislation are discussed in our earlier Tax Brief on the promoter penalty regime [http://www.gf.com.au/477_466.htm]. The ATO was sufficiently concerned about the reaction to the regime that in 2006 it convened a special subcommittee of the National Tax Liaison Group – the Promoter Penalty Co-design Sub-committee – to consult about the administration of the regime, and in March 2007 the ATO announced that significant decisions involving the regime would (ordinarily) be referred to a Promoter Penalty Review Panel for its advice before action was taken.

Last week, the ATO issued the final version of two Practice Statements on the two types of conduct prohibited by the promoter penalty regime:

- being the promoter of a tax exploitation scheme; or
- implementing a scheme that was marketed on the basis of a product ruling in a way that differs materially from the ruling.

Drafts of the two Statements had been released for comment in March 2007 and triggered a large number of detailed responses. The final documents are best understood as directions to ATO staff about how to administer the promoter penalty regime. This Tax Brief examines what the two Practice Statements tell us about:

- what conduct and circumstances the ATO regards as being within the scope of the regime;
- the factors that will influence the ATO's decision about the kind and size of sanction to seek;
- how the ATO proposes to administer the regime; and
- the circumstances the ATO regards as amounting to “tax exploitation schemes.”

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The Statements convey the general impression that the ATO is proposing to act with a degree of caution in handling promoter penalty matters. The ATO is obviously alive to the sensitivities in the business community about these measures.

Picking out the nuggets

Much of the text of the two Statements is not new – it repeats the legislation or gives examples which beg the question to be answered. But occasionally, there are a few useful indicators scattered within the 80 or so pages of text. They appear often to be directed to allaying some of the concerns raised in the submissions on the Draft versions.

With regard to the scope of the promoter penalty regime, the Statements elaborate the legislation by setting out some of the people and kinds of behaviour that the ATO regards as being within or outside its scope. Some key points to emerge include:

- it is generally expected that enforcement action will be taken against individuals, rather than entities such as companies;
- while a promoter will usually be involved in visible marketing of the scheme to a wide audience, marketing can be as simple as persuading a single client to participate in a scheme;
- being paid wages or a standard professional fee will usually not amount to receiving consideration for marketing the scheme;
- Australian residents may be exposed to penalty if they have significant involvement in marketing schemes devised offshore, representing the offshore entity or facilitating access to the scheme;
- in-house advisers such as lawyers and tax managers will rarely be exposed to penalty where they are advising their employer about its own tax affairs. They may be exposed, however, if their employer promotes schemes to third parties; and
- Authorised Representatives of licensed financial services licensees will usually be considered to have taken reasonable precautions and acted with due diligence in advising clients about the licensee's products (which is a defence to these measures).

With regard to sanctions, the Statements itemise the factors that ATO officers should consider in determining the level of sanction to seek. (These matters are already listed in the legislation.) These factors all revolve around the perceived seriousness of the behaviour in terms of:

- the amount of revenue put at risk;
- the extent of involvement in marketing the scheme;
- the length of time that the scheme was being promoted;
- the person's awareness of the significance of their actions, including any steps to conceal their involvement;
- prior involvement in the promotion of other schemes; and
- the extent of their co-operation in the ATO's inquiry.

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The Statements also set out factors to examine in deciding what kind of penalty to seek – voluntary undertaking enforceable in the Federal Court, injunction or civil penalty. The Statements say that ATO officers need to consider both punishing past behaviour (for which a civil penalty may be appropriate) and deterring similar conduct in the future (for which a voluntary undertaking or injunction may be appropriate).

The Statements explain the special procedure for the administration of the promoter penalty rules. ATO staff who believe the provisions have been breached must refer the matter to a dedicated unit – the Promoter Intelligence Branch – within the ATO. The members of this unit must seek technical support from the legal services branch and the tax counsel network. Both of these steps suggest that promoter penalty issues will be taken out of the hands of relatively junior or inexperienced ATO staff. That unit will eventually make a recommendation to a more senior ATO officer about the appropriate action to take, if any. Except in “exceptional circumstances,” that officer must also seek advice from the Promoter Penalty Review Panel. The Panel contains both ATO staff and external members.

The Statements also indicate a few additional useful administrative matters:

- even though employees are potentially within the regime, ATO officers should usually pursue the “individuals who are the controlling mind (rather than the agent or employee) behind another entity’s prohibited conduct;” and
- only the special promoter penalty unit can discuss the possible application of the promoter penalty measures, to avoid other ATO staff accidentally disclosing information or proceedings that might damage an entity’s reputation.

The wood and the trees

Most of the text in the two Statements is directed to the “who” question – who will be within the ATO’s sights under these measures? The Statements are far less detailed about the “what” question – what products or advice will be regarded as amounting to tax exploitation?

Many in the finance industry will want to know whether any prohibited conduct – according to these rules – arises in respect of marketing a product, or advising a client about a transaction or structure and what steps they can take to avoid exposure. The answer will often be that there is no “tax exploitation scheme” as defined. No penalty can be imposed if the scheme was effective from a tax point of view, or it was reasonably arguable that the scheme was effective. Unhappily, the Statements do not elaborate this matter in much detail – the discussion occupies only 7 out of about 80 pages. The Statements say simply that:

- Part IVA has to be considered in deciding what is reasonably arguable – that is, a position will not be reasonably arguable if it was reasonable to suspect the arrangement would be struck down by Part IVA;
- whether something will be a “tax exploitation scheme” is to be determined at the time that it is being promoted;

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- a product or advice can be a “tax exploitation scheme” even if it is not acted upon (in which case the ATO officers have to speculate whether the scheme would have been effective or reasonably arguable);
- the customer or client must have entered the scheme for the sole or dominant purpose of securing a tax benefit, but it is not a defence to these measures that no tax benefit was available at law;
- the promoter penalty rules apply to schemes designed to achieve tax benefits under a range of taxes – including income tax, fringe benefits tax and GST; and
- whether a position is reasonably arguable for these measures is the same as the test used in deciding whether a taxpayer is liable to penalty, which means that the ATO’s views and rulings on penalties are relevant here – for example, that a favourable tax opinion will not always amount to a defence.

There is one further passage which tries to address the fundamental conundrum at the heart of these measures – the provisions are intended to control the behaviour of promoters but whether they are triggered or not can depend upon whether a taxpayer succeeded in securing a tax benefit. The problem is that the taxpayer may fail to secure a desired tax benefit for reasons other than the advice of the promoter: schemes may be ineffective because of the client’s circumstances or actions, but the client’s behaviour now puts the promoter in jeopardy. The Statements accept that the provisions are principally directed to the behaviour of promoters and so the promoter should not be regarded as offending these rules if:

- the promoter alerted the client to relevant qualifications for the scheme to be effective;
- the promoter was misled by the client about its circumstances; or
- the promoter drew reasonable assumptions about the client’s position.

One final point to remember is that Practice Statements are not formally binding on the ATO – they simply reflect how the senior levels of the ATO would like ATO staff to behave.

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These notes are in summary form designed to alert clients to tax developments of general interest. They are not comprehensive, they are not offered as advice and should not be used to formulate business or other fiscal decisions.

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