

Business Coalition for Tax Reform

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The Hon Mal Brough MP
Minister for Revenue and Assistant Treasurer
Parliament House
Canberra ACT 2600

By email: Mal.Brough.MP@aph.gov.au

Dear Minister

Promoter Penalties – Exposure Draft Legislation Concern by the Business Coalition for Tax Reform

We refer to the exposure draft promoter penalty legislation released on 10 August 2005.

The Business Coalition for Tax Reform ("BCTR") is Australia's peak business tax group comprising a range of industry associations drawn from all sectors of the economy and representing small, medium and large businesses. BCTR members share the common objectives of creating and implementing a better tax system that enhances both international and domestic business competitiveness and fairness and which assists in creating a business climate conducive to investment, growth, job creation and private saving.

BCTR welcomes your action and that of the Government in releasing such a wide ranging document for consultation in order to ensure that the final legislation achieves appropriate outcomes.

BCTR is aware of the need for Government action to curb exploitation of Australia's income tax arrangements by aggressive tax avoidance arrangements promoted to unsophisticated investors in a range of cases which generate widespread social and economic problems. However, it seems that the proposed legislation is also intended to address the promotion of tax arrangements for business taxpayers who are sophisticated. Such a regime would go beyond investor protection and enter the area of business regulation.

Notwithstanding the need for action, BCTR has significant concerns about a number of provisions in the current exposure draft, which we believe will negatively impact business taxpayers. As no doubt your office and the Treasury has received many highly detailed submissions, we will keep our comments brief. Our concerns are:

1. Australia's tax system is complex and BCTR continues to emphasise the need to provide greater certainty for taxpayers. We note that the Inspector General of Taxation, Mr David Vos has recently announced his intention to commence an investigation of ATO decision making processes which cause extended ATO delays in providing guidance to taxpayers. Furthermore, the Commissioner himself, in his speech on 12 October 2005, has accepted that there are difficulties with technical decision making in the ATO highlighted by the Burges report on large business tax audits, released on 13 October 2005.

We believe it is inappropriate to overlay, on a system which already has uncertainties and ATO process delays, new exposures for the business community seeking or receiving advice or issuing products based on supportable tax positions, where they are not involved in aggressively marketed tax exploitation arrangements.

2. There are clear distinctions between different tax advice which might lead to tax minimisation (setting aside product ruling and class ruling situations) which the draft proposal ignores. In particular, the proposal does not differentiate among the following scenarios:

- a) Aggressive marketing of tax exploitation arrangements to unsophisticated investors, which justifies a policy response through targeted consumer protection measures.
- b) Aggressive marketing of tax exploitation arrangements to sophisticated investors. Under best practice policy principles, this is being addressed by the ATO's compliance action and market based solutions (as in other jurisdictions) rather than consumer protection measures. Although New Zealand has introduced promoter penalty legislation, its model is very much focused on schemes which are mass marketed.
- c) Tax saving and tax planning ideas raised with taxpayers. These ideas and plans involve not only external advisors but in-house tax advisers within businesses, managed funds, lenders, companies etc. as well as executives involved in implementing them.
- d) Tax structuring of commercial transactions to achieve best tax outcomes.

The promoter penalty exposure draft applies to all such situations equally if there is "promoter" of a "tax exploitation scheme", the definition of both terms being defined extremely wide. Furthermore, it creates personal exposures not only for in-house tax advisers but also for other employees of business, such as financial officers and other executives where any of them could be seen as somehow being a promoter of a tax exploitation scheme.

BCTR submits that the rules overreach in their application to business employees and legitimate tax advisers involved in tax saving in circumstances where there is no aggressive promotion or sales behaviour surrounding investment. The proposal needs to separate the role of a tax adviser from an aggressive sales driven marketer of tax products.

3. Since the 1990s mass-marketed tax scheme phenomenon, where perceived ATO inaction saw tax avoidance promotion spread from unsophisticated investors to medium and even larger business, Australia has had:

- a) Significant expenditure on enhancing the compliance function within the ATO.
- b) Increased ATO tax audits and ongoing scrutiny by the ATO through its tax risk profiling and associated client risk reviews, audits and other mechanisms. It is worth noting that 89% of the top 100 corporate groups and 83% of the top 200 corporate groups were subject to ATO compliance activity last year. The Federal Treasury noted, in the 2005 Budget papers: *"revenue from taxes on company profits has been growing significantly faster than the corporate income tax base. Possible reasons for this include ...more effective compliance activities of the Australian taxation Office"*
- c) Courts which are willing to send taxpayers and their advisors to gaol for tax avoidance activities and scheme promotion. The much publicised imprisonment of some tax advisers in 2004, under current law, has caused many tax advisers to be more cautious. We also note the ongoing success of the ATO in prosecuting tax avoidance cases, including the imprisonment of a group of Sydney taxpayers for periods of 4-8 years for tax avoidance earlier this month.
- d) Courts are more willing to apply PartIVA for relatively routine transactions (for instance Hart's case). This has caused most tax advisers to be more cautious.
- e) ATO Taxpayer Alerts and much stronger media focus designed to deter taxpayers and their advisers from tax avoidance behaviour (which was developed in response to the mass-marketed experience).
- f) Strong ATO emphasis on educating directors of public and private entities on their responsibilities in tax governance. This is unquestionably affecting directors' perceptions.

BCTR is concerned that the current proposals have not taken proper account of the above developments. As a result the proposals are far too broad and we request that you review the basis for its far-reaching nature.

4. BCTR considers that the draft legislation amounts to over regulation of the taxpayer community in cases where tax positions are reasonably arguable. In particular:

- a) There are suggestions that any taxpayer or tax adviser who has some uncertainty in relation to a proposal can easily seek a tax ruling.

However, despite moves in recent years to overhaul its ruling process, the ATO is still not geared to deliver tax rulings on a timely basis. The Burgess Report states:

".. All the companies interviewed reported great difficulty in obtaining timely private binding rulings, to the extent in many cases of rendering the private binding ruling concept virtually useless to them. It was also reported to be almost impossible to obtaining meaningful non-binding indications of ATO concerns, which would be most helpful in saving time and expense during the planning stage of major transactions. It was felt that improvement in these two areas would greatly assist in developing the spirit of mutual cooperation."

These experiences arise for all taxpayers and BCTR notes that the ATO:

- Does not have the people to deal with a large increase in ruling requests which is expected if this legislation proceeds in its current form.
 - Is not able (or willing) to provide rulings where it considers the law is uncertain. Many of the technical corrections the government introduces are in response to gaps in the law which the ATO cannot resolve administratively.
 - Is not equipped to deliver all responses in a timely manner even with sufficient people and processes. A new ATO process for critical tax rulings for major companies, which BCTR applauds, requires top level ATO "sponsors" to walk a private binding ruling through the ATO processes, which consumes significant ATO resources".
- b) In its current form, the proposal will congest the process of obtaining tax advice for business transactions. It is not realistic to expect that every single transaction with any tax uncertainty will be put to the ATO for a ruling. Often a tax issue is only a relatively minor aspect of a larger transaction and an effective ruling requirement would impose impractical and unrealistic procedural constraints and new risks in relation to business transactions.
- c) This proposal fundamentally conflicts with the self-assessment system as it creates an environment where taxpayers would be exposed to major civil penalties and reputation risk unless they clear innovative transactions with the ATO before they advise, implement or execute it.
- d) The recent Review of the Self-Assessment regime has led to a number of simplifications for taxpayers, including a reduction in penalties for taxpayers not following a private binding ruling where they can demonstrate that they had a reasonably arguable position (RAP). It also introduced a lower Shortfall Interest Charge. It is quite inconsistent to introduce, at the same time, a radical increase in penalties for tax advisors and product issuers recommending and implementing a RAP. It would be incorrect to think of a RAP as reducing a penalty after an administrative offence has been committed rather there should be no administrative offence or penalty for adopting a RAP.
- e) There is a fundamental problem with an individual being exposed to a penalty of more than \$500,000, whether that individual be a corporate executive, business officer or tax adviser, in a situation where that individual takes a reasonably arguable position on a tax matter. This will be another disincentive to attracting skilled workers to deal with challenges in our tax system.

The proposal would place individual employees in an invidious position where they would have to take responsibility for conduct effectively required of them by their employer. This would be unfair to the individuals because they would personally bear tax risk that should lie with their employer in business or in the professions.

5. The current proposal will frustrate the process of business seeking tax advice on business transactions and will delay business in carrying on its business. By creating so much risk for individual staff, business will be unable to provide a rapid response to any opportunity that presents itself, because internal staff will be unwilling to move on a transaction without obtaining a ruling. This will stifle innovation and risk-taking by business.

The proposal would unacceptably increase the cost of regulation on business at a time when a new Commonwealth Regulatory Taskforce is to consider reduced regulation. The proposal must be refined so that it does not penalise legitimate Australian business and restrict its entrepreneurial vigour because of the previous behaviour of a few miscreants

Please feel free to contact me on (03) 9634 9901 if you would like to discuss these issues further.

Yours sincerely



John V Stanhope
Chair
Business Coalition for Tax Reform

cc: The Hon John Howard MP, the Prime Minister
The Hon Peter Costello MP, the Treasurer