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Promoter Penalties

Gordon S. Cooper, AM*

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

INTRODUCTION

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

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

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

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

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

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

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

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

The Promoter Penalty Provisions

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

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

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

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

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

Parts of the EM may be likened to William Congreve's words that "*Music has charms to sooth a savage breast*".[2]

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

Definition

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

> **290-65 Meaning of tax exploitation scheme**
>
> (1) A *scheme is a **tax exploitation scheme** if, at the time of the conduct mentioned in subsection 290-50(1):
>
> (a) one of the conditions is satisfied:
>
> (i) if the scheme has been implemented – it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a *scheme benefit from the scheme;
>
> (ii) if the scheme has not been implemented – it is reasonable to conclude that, if any entity (alone or with others) had entered into or carried out the scheme, it would have done so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme; and
>
> (b) one of these conditions is satisfied:
>
> (i) if the scheme has been implemented – it is not *reasonably arguable that the scheme benefit is available at law;
>
> (ii) if the scheme has not been implemented – it is not reasonably arguable that the scheme benefit would be available at law if the scheme were implemented
>
> Note: The condition in paragraph (b) would not be satisfied if the implementation of the scheme for all participants were in accordance with binding advice given by or on behalf of the Commissioner of Taxation (for example, if that implementation were in accordance with a public ruling under this Act, or all participants had private rulings under this Act and that implementation were in accordance with those rulings).
>
> (2) In deciding whether it is *reasonably arguable that a *scheme benefit would be available at law, take into account any thing that the Commissioner can do under a *taxation law.

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

Presumably the "*sole or dominant purpose*" requirement is the same as that in Part IVA. That is purpose will be a matter of objective determination rather than the subjective motives of the promoter. However

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

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

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

and then held at 4758 that:

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

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

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

As with Part IVA, under the Promoter Penalty Provisions it may be less clear that the "*sole or dominant purpose*" was to obtain the "*s*cheme benefit*". However even if that can be demonstrated there is a further cond

(d) A *public ruling.

A cynical view of the ATO interpretation of what constitutes "**reasonably arguable*" might be summed up as "*you would not be facing promoter penalties if what you had done was reasonably arguable*

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

(d) the reasonably arguable test only applies to tax shortfalls caused by a taxpayer treating an income tax law as applying in a particular way. A

> been met and to have the Commissioner's decision on the objection reviewed by the AAT or the Federal Court;
>
> (i) a taxpayer will only be liable for penalty for not having a reasonably arguable position where the shortfall caused by the position taken is greater than the higher of $10,000 or 1% of the tax that would have been payable on the basis of the taxpayer's return;

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

Nugatory legislation?

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

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

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

On reflection that is the daily currency of Counsel.

Potential application of Part IVA

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

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

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

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

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

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

Indeed determining what is "*

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

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

> **Example 3.1: When are tax advisers at risk of being promoters?**
>
> A partner (Graeme) in a major accounting firm approaches a high wealth client (Matthew) to advise him on an arrangement to minimise his tax liability by moving taxable income to an offshore tax haven.
>
> The tax haven arrangement was initially developed by another partner (Brett) for another of the firm's clients a73.1(5h.(y)-775her)9.81(i)5.7(t)5.713.2(xher)9.8(.1(nt)(thes(.1(nr(".)-5.3()5.

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

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

Where does that leave the diligent proactive tax partner? Clearly he has a potential

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

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

Onus of proof

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

Section 290-50(3) provides that:

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

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

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

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

- there is a "**tax exploitation scheme*" including the fact that the position taken was not "**reasonably arguable*";

(4) The Commissioner must not make an application under section 290-50 in relation to an entity's involvement in a *tax exploitation scheme more than 4 years after the entity last engaged in conduct that resulted in the entity or another entity being a *promoter of the tax exploitation scheme.

(5) The Commissioner must not make an application under section 290-50 in relation to an entity's involvement in a *scheme that has been promoted on the basis of conformity with a *product ruling more than 4 years after the entity last engaged in conduct in relation to implementation of the scheme.

(6) However, the limitation in subsection (4) or (5) does not apply to a *scheme involving tax evasion.