NEW TAX LAWS TO DETER PROMOTERS OF TAX EXPLOITATION SCHEMES

RACHEL TOOMA*

The recently enacted Australian promoter penalty provisions aim to reform old taxes in order to address new world economic and social developments. Such developments include empirical evidence linking investment by taxpayers in tax exploitation schemes to the activities of promoters. In order to assess the effectiveness of the promoter penalty provisions as a means of reforming old law, this paper will critically examine the promoter penalty provisions. It then compares the approach of the promoter penalty provisions to the approach of other jurisdictions to promoters of tax exploitation schemes, including New Zealand, Canada, the United States and the United Kingdom.

I INTRODUCTION

Legislation aimed at deterring the promotion of tax exploitation schemes was recently enacted into Division 290 of sch 1 of the Taxation Administration Act 1953 (Cth) (‘TAA’).1 This article examines the promoter penalties as an example of legislation reforming old tax laws for a new world.

In the new world, promoters entice taxpayers to invest in schemes which taxpayers may otherwise be unaware of. Investment by some taxpayers in such schemes incites investment by a broader group of taxpayers who are concerned to keep up with the initial investors. It therefore appears that the supply of tax schemes is a driver of tax avoidance and tax evasion. The promoter penalty provisions presume that the old law, including criminal sanctions and consumer protection legislation, is limited in its ability to deter promoters from supplying schemes, and addresses these limitations by proposing a new civil penalty regime.

The article will critically examine the civil penalty regime in order to determine whether it may be expected to overcome the problems with the old law. Technical problems with the promoter penalty provisions are examined. It is also necessary to examine the new laws to deter promoters that have been enacted in other jurisdictions. The paper compares the merits of Australia’s civil penalty regime to the tax shelter disclosure requirements which exist in the United States (‘US’), Canada and the United Kingdom (‘UK’). It also examines the lessons for the regime from the experiences of other jurisdictions, in particular, New Zealand, which has a similar civil penalty regime to the new Australian regime.

II PROBLEMS WITH THE OLD LAW

A Addressing the Supply Side of Aggressive Tax Arrangements

Tax avoidance and tax evasion are not new developments; both have existed throughout the history of taxation. However, the scale of tax avoidance has significantly increased in recent times. The supply of tax schemes is a key driver of tax avoidance. The promoter penalty provisions aim to reform old laws in order to address this problem.

* BA, LLB (Hons) (Macquarie), LLM (UNSW); Lecturer, Atax, University of New South Wales.

1 Tax Laws Amendment (2006 Measures No 1) Act 2006 (Cth), amending Taxation Administration Act 1953 (Cth) (‘TAA’).
decades, perhaps for varied reasons. Braithwaite has recently concluded that the waves of aggressive tax schemes in Australia were initially supply-driven. Promoters employed by financial institutions and ‘Big Four’ accounting firms have created schemes for ‘big end of town’ taxpayers. This has, in turn, created a demand for aggressive tax planning opportunities from a larger group of taxpayers who do not want to miss out on the schemes used by the ‘big end of town’.

Recent research has confirmed that many taxpayers rely on tax advisors for tax avoidance schemes of which they would otherwise be unaware. A survey of taxpayers reviewed by the Australian Taxation Office (‘ATO’) concerning the involvement in tax avoidance schemes found that most investors got the idea to invest in tax schemes from financial advisors and tax professionals.

Recent studies have therefore recommended that some responsibility for tax exploitation schemes be placed on promoters of the schemes. Braithwaite identifies some key strategies to address tax avoidance, which include the imposition of promoter penalties, and instituting tax shelter disclosure rules. A Senate Report recommended that that the ATO be provided with the necessary powers to enable it to apply to the courts for injunctive relief to prevent sales of mass-marketed schemes. A need to address the supply side of aggressive tax arrangements was also identified by the First Assistant Commissioner in a paper presented at the Centre for Tax System Integrity Third International Research Conference in July 2003.

In December 2003, the federal Treasury first announced its intention to introduce measures to deter the promotion of tax exploitation schemes. The Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No 1) Bill 2006 (the ‘Explanatory Memorandum’) clearly indicated that the aim of the regime was to impose a direct financial risk upon promoters and implementers — in addition to providing injunctive measures enabling the Commissioner to stop the promotion of a scheme — so as to limit the widespread promotion of tax exploitation schemes.

B Limitations of Existing Means of Deterrence

Under the old law, the means of deterring promoters of tax exploitation schemes was limited to criminal prosecutions; consumer protection legislation; civil suits brought by the taxpayer against the promoter; legislation applying to tax agents; and professional standards. These are briefly discussed in this section.

1 Criminal Prosecutions

Promoters of tax exploitation schemes may be guilty of an offence of aiding and abetting under the Crimes (Taxation Offences) Act 1980 (Cth) or the Criminal Code. The difficulty with using
these provisions as a deterrent for promoters of tax exploitation schemes is that a criminal burden of proof must be satisfied. This may mean that the ATO will only seek prosecutions in the most serious cases. If promoters are aware of this practice, they may persist with promoting tax exploitation schemes in the belief that the ATO will not prosecute offences.

2 Consumer Protection Legislation

Section 52 of the Trade Practices Act 1975 (Cth) prohibits a corporation from engaging in conduct that is misleading or deceptive. A promoter may mislead a taxpayer into believing that a scheme is compliant with the taxation legislation when in fact it is not. In order to establish a breach of s 52, the Australian Competition and Consumer Commission (‘ACCC’) must demonstrate that the person affected (the taxpayer) was induced to act by the corporation’s (the promoter’s) conduct. The ACCC may have difficulties in establishing a breach of s 52 as the promoter must be a corporation and the taxpayer must have been induced to avoid tax by the promoter.11

3 Tax Agents

Section 251M of the Income Tax Assessment Act 1936 (Cth) (‘ITAA36’) imposes a statutory duty of care on registered tax agents.12 The effect of s 251M is to make the registered tax agent liable to pay to the taxpayer any fine or other penalty to which the taxpayer is liable on account of the registered tax agent’s negligence. The limitation of this provision as a means of deterring the promotion of tax exploitation schemes is that it will only apply where the promoter is a registered tax agent.

4 Professional Standards

The Institute of Chartered Accountants in Australia (‘ICAA’) and Certified Practising Accountants Australia (‘CPA’) have issued the Statement of Taxation Standards (APS 6) containing compulsory rules for members of those organisations. Relevantly, paragraphs 23–28 are concerned with ‘Tax Arrangements’. Paragraph 26 prohibits a member from promoting or assisting in the promotion of any schemes or arrangements which have no commercial justification other than the avoidance of tax through exploitation of the revenue laws. The APS 6 Statement does note, however, that the prohibition is particularly directed at the marketing of artificial and contrived schemes to the general public and does not preclude a member from advising clients on schemes and arrangements.13 The ICAA and CPA also prohibit members from having any financial interest in any business organisation which promotes tax schemes or arrangements.14 However, like s 251M, professional standards are limited by the fact that they apply only to members governed by the standards.

5 Civil Suits Brought by Clients of Promoters

Where a taxpayer is found to have evaded or avoided tax, clients of promoters may bring an action against the promoter in either tort or contract.15 An action in contract may be brought on the basis that the promoter breached an implied contractual obligation to exercise reasonable

---

12 Ibid, 146.
13 ICAA and CPA, Statement of Taxation Standards (APS 6) [27] (‘APS 6 Statement’).
14 Ibid, [28].
15 Ibid.
skill and care. An action in tort may require the taxpayer to establish that the promoter was negligent. The main limitation of civil suits brought by clients of promoters is that the time and cost to a taxpayer, particularly a taxpayer which is required to pay taxes with penalties and interest, may be prohibitive.

Tax avoidance cannot be said to be caused entirely by the supply by promoters of tax exploitation schemes; there must also be a demand by taxpayers for the schemes.\(^{16}\) However, the link between promoters and investment by taxpayers in tax exploitation schemes, and the limitations with the existing means of deterring the promotion of tax exploitation schemes, suggest that the old law may fail to adequately address the supply of tax exploitation schemes. It appears that there is a need for a new regime for deterring tax scheme promoters. The issue then, is one of assessing whether the recently enacted civil penalty regime is the appropriate new world response to the promotion of tax exploitation schemes.

### III New Law

The Tax Laws Amendment (2006 Measures No 1) Act 2006 (Cth) introduced new Division 290 into schedule 1 of the TAA. Section 290–50 prescribes the conduct to which the civil penalty regime would apply. Section 290–50(1) provides that an entity must not engage in conduct that results in that or another entity being a promoter of a tax exploitation scheme. There are three methods of deterring the promotion of tax exploitation schemes under the new civil penalty regime: civil penalties, statutory injunctions and voluntary undertakings.

#### A Civil Penalties

The maximum civil penalty applying to individuals who breach s 290–50(1) is the greater of 5000 penalty units (currently $550,000) or twice the consideration received for the tax exploitation scheme.\(^{17}\) The maximum civil penalty applying to bodies corporate is the greater of 25,000 penalty units (currently $2.75 million) or twice the consideration received for the tax exploitation scheme.\(^{18}\)

Section 290–50(5) prescribes the principles to which the Federal Court of Australia must have regard when deciding the appropriate penalty for a breach of s 290–50(1).\(^{19}\) A civil penalty payable to the Commonwealth\(^{20}\) must be ordered by the Federal Court following an application by the Commissioner that an entity has contravened s 290–50(1),\(^{21}\) subject to a number of exceptions listed in s 290–55.\(^{22}\)

While the policy arguments for linking the value of the civil penalty to the financial gain to the promoter of the scheme are clear,\(^{23}\) it is unclear how the Commissioner will calculate ‘the consideration received or receivable (directly or indirectly) by the entity and associates of the

---

\(^{16}\) Evans, above n 2.

\(^{17}\) TAA s 290–50(4).

\(^{18}\) TAA s 290–50(4).

\(^{19}\) These include: the amount of the consideration received or receivable (directly or indirectly) by the entity and associates of the entity in respect of the scheme; the deterrent effect that any penalty may have; the amount of loss or damage incurred by scheme participants; the nature and extent of the contravention; the circumstances in which the contravention took place, including the deliberateness of the entity’s conduct and whether there was an honest and reasonable mistake of law; the period over which the conduct extended; whether the entity took any steps to avoid the contravention; whether the entity has previously been found by the Court to have engaged in the same or similar conduct; and the degree of the entity’s cooperation with the Commissioner.

\(^{20}\) TAA s 290–50(6).

\(^{21}\) TAA s 290–50(3).

\(^{22}\) Exceptions are divided into five categories: reasonable mistake or reasonable precautions; reliance on advice from the Commissioner; time limitation; exception where entity does not know result of conduct; and employees.

\(^{23}\) See, eg, Braithwaite, above n 3, 200, where he concludes that ‘[i]t is inconceivable that promoter penalties could ever be heavy enough to deter the rewards of contingency fees’.  

161
entity in respect of the scheme’. 24 Such a calculation may be possible in jurisdictions requiring
tax shelter disclosure. However, where there are no disclosure requirements, it is difficult to
anticipate how the Commissioner will, in practice, assess the consideration that a promoter
receives in respect of a scheme, for the purpose of imposing a financial penalty on the promoter.

It would perhaps have been preferable to apply a flat rate penalty to promoters, for example,
5000 penalty units for individuals and 25 000 penalty units for bodies corporate. In order to
address a situation where the civil penalty is insubstantial compared to the financial gains to the
promoter from the tax exploitation scheme, the Federal Court could perhaps also have been
granted discretion to order the promoter to meet with a delegate of the Commissioner at certain
periods. A promoter and Commissioner meeting should be required as a matter of course where
the Federal Court has imposed a civil penalty upon the promoter on more than one occasion. The
meeting may result in the delegate of the Commissioner referring schemes of concern to the
relevant ATO task-forces, or may involve the delegate requiring the promoter to implement an
education program for its clients on the consequences of tax avoidance and tax evasion.

B Statutory Injunctions

Under Subdivision 290–C, the Commissioner may seek an injunction from the Federal Court
where an entity has engaged, is engaging, or is proposing to engage in conduct that would trigger
the civil penalty provisions. The Explanatory Memorandum describes statutory injunctions as
having a ‘real time’ impact in that they can stop the promotion of schemes before investors
participate. It further notes that statutory injunctions can be used in addition to civil penalty
proceedings where both injunctive relief and a civil penalty award are considered to be
warranted. 25 The powers conferred on the Federal Court under Subdivision 290–C are
supplementary to the Court’s other powers. 26 Injunctions may be for the purpose of restraining an
entity from engaging in particular conduct, 27 or for the purpose of requiring an entity to do
something. 28 The Federal Court may also grant interim injunctions before considering an
application for an injunction. 29

There are at least two interesting aspects to Subdivision C. First, under the draft promoter
penalties legislation released for public comment in August 2005, the Commonwealth was not
required to give the Federal Court an undertaking as to damages when seeking an interim
injunction. 30 This provision was removed from the promoter penalty provisions as enacted under

Prior to the release of the legislation as enacted, one commentator described the provision
excusing the government from the requirement of providing an undertaking as to damages as ‘a
highly objectionable interference with common law principles’. 31 The commentator argued that if
the Commissioner is convinced that there is a case for an interim injunction, then the
Commissioner should bear the risk of costs if later proven to be incorrect. 32 The explanatory
memorandum to the exposure draft bill stated that the undertaking as to damages should not have

24 TAA sch 1 s 290–50(4)(b).
25 Explanatory Memorandum, para [3.79].
26 TAA sch 1 s 290–150.
27 TAA sch 1 s 290–145(1).
28 TAA sch 1 s 290–145(2).
29 TAA sch 1 s 290–130.
30 Exposure Draft Tax Laws Amendment (2005 Measures No 6) Bill 2005 (Cth) cl 72 and cl 73.
Bulletin, para 1892.
32 Ibid.
been required because the Commissioner would be acting in the public interest; that is, the Commissioner’s intent in applying the civil penalty regime is to protect the interests of taxpayers, the public revenue, and the integrity of the tax system.

Injunctive powers of government authorities in the area of occupational health and safety appear to support the policy position of the exposure draft bill. For example, s 93 of the Occupational Health and Safety Act 2000 (NSW) allows an inspector to issue a prohibition notice in relation to a place of work where there is occurring or about to occur, any activity which involves or will involve an immediate risk to the health or safety of any person. The notice prohibits the carrying on of the activity until the matters which give, or will give rise to the risk, are remedied. Section 94 further provides that a person who, without reasonable excuse, fails to comply with a requirement imposed by a prohibition notice is guilty of an offence. The statute provides a process for a review of the inspector’s decision to issue a prohibition notice: an application for a review may be made to WorkCover; and an appeal may be made from the WorkCover decision to a Local Court constituted by an Industrial Magistrate sitting alone.

The prohibition notice is very similar to an injunction, in that it prevents an entity from continuing the conduct of its business. The inspector does not need to seek court approval prior to issuing a prohibition notice, and the review and appeals process available to recipients of prohibition notices may be costly and time consuming. The broad powers of inspectors under the NSW occupational health and safety legislation demonstrate that the provision which existed under the exposure draft Bill, that the Commissioner need not give an undertaking as to damages, is not an unprecedented interference with common law principles. Rather, where the Commissioner would seek an injunction against an entity considered to be a promoter, the promoter would have been given an opportunity to appear before the Federal Court. On the other hand, the entity that is issued a prohibition notice under occupation health and safety legislation must comply with the notice, or otherwise seek a review by WorkCover, and possibly also appeal to the Industrial Magistrate.

It is submitted that the public interest in deterring the promotion of tax exploitation schemes was perhaps significant enough to warrant a provision exempting the Commissioner from providing an undertaking as to damages. Arguably, the abandonment of the exception to the damages undertaking in the promoter penalty provisions that were recently enacted is harmful to the success of the new provisions as a means of addressing the old world problem of the promotion of tax exploitation schemes.

The second interesting point about the statutory injunction provisions is the limitation imposed on the Commissioner in seeking an injunction where a product ruling request is pending. Section 290–135 provides that if an entity has made a written application for a product ruling in relation to a scheme and the Commissioner has neither made the ruling nor told the entity in writing that the Commissioner has declined to make the ruling, then the Commissioner cannot make an application for an injunction under s 290–125 until the Commissioner either makes a ruling or advises in writing that he declines to do so. The rationale for this provision is set out in the Explanatory Memorandum, which asserts that the promoter is not at risk of penalty merely as a result of delays in the ATO processing a request for a product ruling.

---

33 Exposure Draft Tax Laws Amendment (2005 Measures No 6) Bill 2005 (Cth), cl 73.
34 Occupational Health and Safety Act 2000 (NSW) s 96.
36 TAA sch 1 s 290–135.
37 Explanatory Memorandum, para [3.84].
The problem with s 290–135 is that it appears to be at odds with the stated policy aim of the promoter penalty provisions: to achieve symmetry in penalty regimes for promoters and taxpayers.38 Under s 290–135, an injunction cannot be sought against the promoter to prevent the promotion or implementation of a scheme prior to the Commissioner deciding a product ruling, whereas a taxpayer investing in the scheme during this period may be subject to any relevant penalties applying to the taxpayer. It is curious, given the aim of s 290–135, that the promoter penalty provisions do not instead prevent the Commissioner from seeking civil penalties while a ruling is pending.

C Voluntary Undertakings

Subdivision 290–D of sch 1 of the TAA allows the Commissioner to accept a written undertaking given by an entity for the purposes of furthering the objectives of the Division.39 The Commissioner cannot compel an individual to give an undertaking, and the Commissioner cannot be compelled to accept an undertaking.40 However, if an undertaking is given, and the Commissioner considers that the entity that gave the undertaking has breached any of its terms, the Commissioner may apply to the Federal Court for an order directing the entity to comply with that term of the undertaking, and/or any other order that the Court considers appropriate.41

The Explanatory Memorandum states that the benefits of voluntary undertakings arise from their flexibility. Voluntary undertakings allow the Commissioner to tailor enforcement responses to individual circumstances and may provide a more timely and cost-effective response than Court orders.42 The explanatory memorandum to the exposure draft bill provided two examples of where the Commissioner may accept a voluntary undertaking, which were not included in the Explanatory Memorandum to the Bill which introduced Division 290.43 The first example related to financing arrangements of a scheme, where an undertaking may require a promoter or scheme implementer to change incorrect statements or include statements such as ‘the Tax Office has advised that it does not endorse this view’. In the second example, it is suggested that voluntary undertakings be used as a preliminary step to prevent an individual from implementing an arrangement in a way that is materially different to the terms of its product, or other binding ruling.

Interestingly, the Explanatory Memorandum does not anticipate voluntary undertakings requiring public advertisements, for example, the publication of advertisements in newspapers advising the public of a breach of Division 290 by the entity promoting a tax exploitation scheme. This may be because it is unlikely that the promoter would agree to such an undertaking. However, the promoter penalty provisions and Explanatory Memorandum are both silent on the issue of whether the Commissioner will require the publication of voluntary undertakings. The Explanatory Memorandum does note that a voluntary undertaking can be made without either party admitting any liability.44

It may be, then, that deterrence through publicity orders was not the policy intent of the legislation. However, it is submitted that publicity orders may serve to deter the promotion of tax

38 Ibid, para [3.136].
39 TAA sch 1 s 290–200(1).
40 Explanatory Memorandum, para [3.93].
41 TAA sch 1 s 290–200(3) and (4).
42 Explanatory Memorandum, para [3.91].
43 Explanatory memorandum to Exposure Draft Tax Laws Amendment (2005 Measures No 6) Bill 2005 (Cth), para [87].
44 Explanatory memorandum to Exposure Draft Tax Laws Amendment (2005 Measures No 6) Bill 2005 (Cth), para [3.94].
exploitation schemes — and as promoters may be reluctant to enter into such undertakings — a fourth category of civil penalty, publicity orders, may have been beneficial.

D What role will the General Anti-Avoidance Rule (‘GAAR’) Panel play?

It has been noted that an aim of the promoter penalty provisions was to create a penalty regime that mirrors the penalties faced by taxpayers. It is submitted then, that promoters ought to be afforded similar rights and protections, with respect to Division 290 of sch 1 of the TAA, to those that are available to taxpayers who have invested in tax exploitation schemes.

Practice Statement PS LA 2005/24, entitled ‘Application of General Anti-Avoidance Rules’, explains that the Commissioner has established a GAAR Panel to advise on the application of GAARs (eg, Part IVA of the Income Tax Assessment Act 1936 (Cth) (‘ITAA36’) and Division 165 of the A New Tax System (GST) Act (Cth)) to particular arrangements. The stated primary purpose of the Panel is to assist the Tax Office in its administration of the GAARs by helping to ensure that the rules are applied objectively, and that a consistent approach is taken to issues regarding their application.

To assist the Panel in providing advice to the Commissioner, a taxpayer is usually invited to attend a Panel meeting and address the Panel. Practice Statement PS LA 2005/24 specifically notes that where an arrangement involves numerous taxpayers in similar circumstances, promoters or facilitators of the arrangement may be invited to address the Panel. Promoters and facilitators should also be afforded the right to make submissions to any Panel established by the Commissioner for the purposes of determining whether the Commissioner should seek to apply Division 290.

E Technical Problems with the New Law

During the consultation period, numerous industry submissions were made cautioning that the promoter penalty provisions have the potential to interfere with ordinary commercial transactions. Such cautioning often focused upon the legislative definitions of ‘promoter’ and ‘tax exploitation scheme’. While some amendments were made to address the concerns expressed, many would still argue that there are technical problems with the recently enacted definitions.

1 Definition of ‘Promoter’

Section 290–60 of sch 1 of the TAA provides a definition of ‘promoter’:

(1) An entity is a promoter of a tax exploitation scheme if:
   (a) the entity markets the scheme or otherwise encourages the growth of the scheme or interest in it; and
   (b) the entity or an associate of the entity receives (directly or indirectly) consideration in respect of that marketing or encouragement; and
   (c) having regard to all relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.

(2) However, an entity is not a promoter of a tax exploitation scheme merely because the entity provides advice about the scheme.

---

45 Explanatory Memorandum, [3.136].
46 PS LA 2005/24, [23].
47 Ibid [31].
48 Ibid [34].
(3) An employee is not taken to have had a substantial role in respect of that marketing or encouragement merely because the employee distributes information or material prepared by another entity.

The exposure draft bill referred to a promoter as including an individual ‘implementing’ a tax exploitation scheme. The use of an undefined term, ‘implementing’, was widely criticised as giving rise to uncertainty for tax advisers.\(^49\) While the explanatory memorandum to the exposure draft bill indicated that a civil penalty would not apply to practitioners who merely provide tax advice, the draft bill itself was less precise.\(^50\) It appears that concern relating to the use of the term ‘implements’ has been addressed by the recently enacted legislation, where a ‘promoter’ is not defined by reference to a person implementing a tax exploitation scheme.

A further criticism of the exposure draft bill related to a note attached to the definition of promoter, which appears to have been directed at excluding advisers from the definition.\(^51\) It was argued that, without the note, it may have been clear that an individual advising was not a ‘promoter’. However, the exception may have captured an adviser if the adviser is considered to have been ‘encouraging or helping entities to enter into the scheme’ (to use the language of the note): for example, by concluding that the scheme is effective.\(^52\) As may be observed from the above definition, the note was removed in the recently enacted legislation.

Despite these changes to the exposure draft bill aimed at preventing tax advisers from being treated as promoters, concern has been expressed that the recently enacted provisions may still unintentionally apply to advisers.\(^53\) Section 290–50(1) provides that ‘[a]n entity must not engage in conduct that results in that or another entity being a promoter of a tax exploitation scheme’. Accordingly, a lawyer who merely advises a financial planner that a product is tax effective, may not be within the definition of ‘promoter’. However, if the financial planner, after receiving the lawyer’s advice, then contacts clients for the purpose of selling the product to them, the lawyer may have contravened s 290–50(1) by encouraging the financial planner to be a promoter of a tax exploitation scheme.\(^54\)

It remains to be seen whether the definition of ‘promoter’ sufficiently excludes tax advisers, as the Explanatory Memorandum indicates was the intention.\(^55\) However, it would appear that there are steps that advisers may take in order to fall outside of the scope of the civil penalty provisions. For example, advisers may require clients to provide a statutory declaration as a condition of engagement, stating that the advice provided will not be circulated for the purpose

---


\(^{50}\) Explanatory memorandum to *Exposure Draft Tax Laws Amendment (2005 Measures No 6) Bill 2005* (Cth), [21]–[35].

\(^{51}\) The definition of ‘promoter’ under the exposure draft bill provided as follows:

An individual is a promoter of a tax exploitation scheme if:

(a) the individual promotes the scheme by implementing it, advancing it or encouraging growth or interest in it; and

(b) the individual or an associate of the individual receives (directly or indirectly) consideration in respect of the scheme; and

(c) having regard to all relevant matters, including the extent of the individual’s participation in the management of the scheme, it is reasonable to conclude that the individual has had a substantial role in promoting the scheme.

Note: However, an individual is not a promoter of a tax exploitation scheme merely because the individual provides advice about the consequences of entering into a scheme (as opposed to encouraging or helping entities to enter into the scheme).


\(^{53}\) Unintentionally because the Explanatory Memorandum has been drafted on the basis that civil penalties only apply to a promoter; see D Williams, ‘Promoter Penalties’ (Paper presented at the Tax Institute of Australia seminar on promoter penalties, Sydney, 21 March 2006, paras [13.4]–[13.5].

\(^{54}\) Ibid.

\(^{55}\) Explanatory Memorandum, *Tax Laws Amendment (2006 Measures No 1) Bill 2006* (Cth), [3.49]–[3.50]. Paragraph 3.50 provides: ‘Advisers who advise on tax planning arrangements, even those who advise favourably on a scheme later found to be a tax exploitation scheme, are not at risk of civil penalty to the extent that they have merely provided independent, objective advice to clients’. 

166
of promoting the particular scheme. More obviously, advisers may need to be more scrupulous in deciding whether to accept a client.

2 Definition of ‘Tax Exploitation Scheme’

As with the definition of ‘promoter’, the definition of ‘tax exploitation scheme’ differs from that contained in the exposure draft bill. The definition in the exposure draft bill provided that a scheme was a tax exploitation scheme if the entity entered into the scheme for the sole or dominant purpose of getting a scheme benefit, where the scheme benefit was not available at law. A note to the definition provided that a scheme was not a tax exploitation scheme where implementation of the scheme was in accordance with binding advice from the ATO.56

Section 290–65 of sch 1 of the TAA has two alternative definitions of ‘tax exploitation scheme’, depending upon whether or not the scheme has yet been implemented. If the scheme has been implemented, it will be a tax exploitation scheme where 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 a scheme, and it is not reasonably arguable that the scheme benefit is available at law.57 A note to the provision provides that it would be reasonably arguable that the scheme benefit is available at law where the implementation of the scheme for all participants was in accordance with binding advice given by or on behalf of the Commissioner (the note states, if the implementation were in accordance with a public ruling or if all participants had private rulings under the TAA). Section 290–65(2) further provides that, in deciding whether it is reasonably arguable that a scheme benefit would be available at law, anything that the Commissioner can do under a taxation law may be taken into account; for example, cancelling a tax benefit obtained by a taxpayer in connection with a scheme under Part IVA of the ITAA36.

The use of the ‘reasonably arguable’ language and example in the recently enacted civil penalty provisions perhaps indicates that Division 290 of the TAA 53 will be exercised where the taxpayer has been found to have acted contrary to Part IVA of the ITAA 36.58 It has been argued, in relation to Part IVA of the ITAA 36 and the administrative penalties in Division 284 of sch 1 of the TAA, that if a dominant purpose is concluded under Part IVA of the ITAA36, the dominant purpose under Division 284 should be met. This is in spite of the fact that a technical reading of Division 284 of the TAA suggests that it may produce a different conclusion to Part IVA of the ITAA36.59 However, the Explanatory Memorandum does not indicate that the intention of the civil penalty regime is merely to apply penalties following from a finding that Part IVA of the

56 See Exposure Draft Tax Laws Amendment (2005 Measures No 6) Bill 2005 (Cth), s 290–65, which provided that a scheme is a ‘tax exploitation scheme’ if:
(a) it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme, or part of it, did so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme; and
(b) the scheme benefit is not available at law.
A note to draft section 290–65 provided:
The condition in paragraph (b) would not be satisfied if the implementation of the scheme for all participants were in accordance with binding advice from the Australian Taxation Office. For example, if that implementation were in accordance with a public ruling under the Taxation Administration Act 1953, or all participants had private rulings under that Act and the implementation were in accordance with those rulings.
57 Under TAA s 290-65, if the scheme has not yet been implemented, it will be a tax exploitation scheme if it is reasonable to conclude that, if an 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, it is not reasonably arguable that the scheme benefit would be available at law if the scheme were implemented.
58 See further Explanatory Memorandum, [3.58], which states that ‘[i]t is appropriate for the tax system to be protected against participation in tax avoidance or evasion schemes under Subdivision 284C’.
ITAA36 applies to a taxpayer. It states: ‘A promoter’s liability to penalty is independent of any action that may be taken against scheme participants’.60

It may have been preferable for the definition of ‘tax exploitation scheme’ to have instead followed the definition of ‘scheme’ in Part IVA of the ITAA36. If the language of Part IVA were adopted, it could have been established more clearly whether a dominant purpose in relation to the civil penalty provisions requires an objective test, and as with Part IVA, there could have been a list of factors indicative of purpose.61

F Conclusions

The new civil penalty regime may be expected to be a more effective deterrent for promoters of tax exploitation schemes than the existing means of deterrence. However, notably absent from the powers available to the Commissioner under Division 290 of sch 1 of the TAA is the power to seek publicity orders. It is unclear whether promoters will be afforded the same opportunity as taxpayers investing in tax exploitation schemes, to appear before the GAAR Panel prior to the Commissioner seeking civil penalty orders from the Federal Court. Not specific to the new Australian legislation, there is also some uncertainty regarding the definitions of ‘promoter’ and ‘tax exploitation scheme’. At this juncture then, it is necessary to consider the approach of other jurisdictions to deterring the promotion of tax exploitation schemes.

IV Comparative Analysis of New Laws Deterring Promoters of Tax Exploitation Schemes

New Zealand, the US, Canada and the UK have enacted legislation aimed at deterring the promotion of tax exploitation schemes.62 It is interesting to examine the development of these different regimes, and to compare the relevant definitions to those applying under the new civil penalty regime in Australia, in particular the definition of ‘promoter’, and the types of schemes to which the provisions relate.

A New Zealand

New Zealand has recently enacted legislation for the purpose of deterring the promotion of tax exploitation schemes.

60 Explanatory Memorandum, para [3.65], which further provides: ‘The test of whether it is reasonably arguable that a scheme benefit is available at law is applied when the promoter’s conduct takes place, and not with the benefit of hindsight once the review and appeal rights for scheme participants have been exhausted’. Paragraph [3.66] of the Explanatory Memorandum provides: ‘When examining what is reasonably arguable at the time of the promoter’s conduct, the Federal Court may take into account anything that the Commissioner can do under a taxation law, including issuing a determination under Part IV A of the ITAA 36 or exercising a discretion’.

61 D Williams, above n 53, [20.3–20.4].

62 The Victorian duties legislation was also recently amended to introduce a promoter penalty applying with respect to both transfer duty: Duties Act 2000 (Vic) s69D; and land rich duty: Duties Act 2000 (Vic) s 89J. Each provision is entitled ‘misleading information’, and broadly applies to a person who is:

• employed or concerned in the preparation of an instrument that effects or evidences a dutiable transaction, or the provision of any advice regarding the form of the dutiable transaction; and

• omits or fails to include in the instrument or any other material or data presented to the Commissioner any fact or circumstance affecting the liability of any person to duty.

The penalty under the provisions is 10 penalty units, which is currently $1000. The provisions have been widely criticized, particularly as they have the potential to apply to persons with only a remote involvement with a dutiable transaction. Various submissions by professional bodies on the amending legislation argued that a purpose test should have been included in the provisions.
The idea of a promoter penalty was first raised in a review by the Inland Revenue Department in August 2001 ("the Review"). The rationale for the introduction of promoter penalties was not unlike that expressed in Australia. The Review noted that, while a taxpayer investing in a scheme which constitutes tax avoidance is liable to a shortfall penalty, no penalties were imposed on promoters of the scheme. The Review further noted that in some cases, the offer documentation for tax schemes attempts to prevent taxpayers from taking legal action against the promoter. Because the promoter is usually the party with the greater knowledge of the scheme’s tax effect, the Review considered that the promoters of schemes should be accountable for their actions.

The Review posed three alternative options for addressing the promotion of tax schemes: increasing the penalty for investors in the tax scheme; introducing a penalty for promoters of tax avoidance schemes; and a combination of increasing investor penalties and introducing promoter penalties. The conclusion with respect to the first and third alternatives was that an increase in the level of investor penalties would result in investors facing penalties in excess of their offence, and these options were therefore considered not to be feasible.

Discussion of the second option, the introduction of promoter penalties, considered that penalising a scheme’s promoter had the potential to reduce tax avoidance across many taxpayers by reducing the number of schemes promoted and encouraging promoters to take greater care in determining the tax impact of their schemes. Interestingly, the Review noted that one way in which promoters may take greater care in determining the tax impact of their schemes is by making increased use of binding rulings on the tax effects of the scheme. It was considered that requests for binding rulings would enable any problems with the legislation to be brought to the attention of the Inland Revenue Department, and the legislation could then be amended more quickly than it otherwise may have been. To this end, it is important to note that in January 2002 the Policy Division of Inland Revenue issued a paper which recommended that certain tax schemes be required to be registered with Inland Revenue in order to efficiently obtain information on schemes. However, the recommendation as to registration of tax schemes, which faced staunch opposition from tax professionals and industry groups, was never enacted into legislation.

Disadvantages of promoter penalties were also noted in the Review. First, promoter penalties were considered to have the potential to weaken the principle that taxpayers have sole responsibility for their tax return. Secondly, the penalty may not be able to be enforced in situations where a promoter uses a ‘straw-man’ or becomes a non-resident. However, the government concluded that the introduction of a promoter penalty was the best way of ensuring that promoters are held accountable for their actions.

The Review recommended that the promoter penalty would apply if a scheme breached an anti-avoidance provision or resulted in an investor having a shortfall penalty for an abusive tax position. However, the imposition of the penalty would not depend on the successful imposition

---

63 CCH, ‘Promoter Penalty in Review’ (October 2003) CCH New Zealand Online Library No 5.
64 Inland Revenue Department, ‘Taxpayer Compliance, Standards and Penalties: A Review – A Government Discussion Document’ (Inland Revenue Department, August 2001) (‘the Review’).
65 Ibid [9.1].
66 Ibid [9.2]–[9.3].
67 Ibid [9.9].
68 Ibid [9.11].
70 Inland Revenue Department, above n 64, [9.13].
71 Ibid [9.16].
of a penalty on the investor.\textsuperscript{72} It was proposed that the penalty would be imposed at a flat rate of 39 per cent of the shortfall penalty imposed on the investor. It was considered necessary to link the penalty to the shortfall amount to ensure, on the one hand, that the penalty is not so little compared to the returns that the promoter may make from the scheme, to render the penalty as merely an expense in selling the scheme, and on the other hand, that the penalty is not excessive.

One report prepared by the Policy Advice Division of the Inland Revenue and Treasury in November 2002 responded to the concerns of tax advisors and industry bodies with respect to the draft legislation for the introduction of a promoter penalty.\textsuperscript{73} Many of the concerns raised have similarly been raised in the Australian context, most notably in respect of the definition of ‘promoter’ and the scope of arrangements caught by the promoter penalty provisions; and the need for promoter penalties where criminal sanctions already exist.

Submissions with respect to the meaning of ‘promoter’ argued that, as the definition included any person who ‘is involved in formulating a plan or program from which an arrangement is offered’\textsuperscript{74} it would catch advisers who have not promoted the scheme. The government noted that the definition of ‘promoter’ was intentionally broad, but was concerned not to allow individuals or entities peripherally involved in a scheme to be covered by the definition. The definition was therefore amended to include persons ‘significantly involved’, rather than ‘involved’.

In order for the promoter penalties to apply under the New Zealand draft bill, it was necessary for the scheme to have been marketed to five or more persons. A submission on the draft bill by the New Zealand Law Society argued that if the legislation was genuinely intended to attack mass-marketed schemes, then a threshold of sales to 20 or more persons would be more appropriate.\textsuperscript{75} The New Zealand Law Society considered that ‘offering an arrangement to five people, particularly if they are related to the offeror, or are the offeror’s business associates, would hardly constitute ‘mass-marketing’\textsuperscript{76} The government accepted the rationale of the submission but was concerned that a threshold of 20 or more may allow some promoters to avoid imposition of the penalty. The government therefore recommended 10 or more people as the threshold.

Submissions on the draft bill argued that the promoter penalties were not necessary as the government was already able to pursue promoters of tax schemes. The government rejected such submissions, noting that the existing penalty for aiding and abetting is a criminal penalty requiring a criminal standard of proof to be established. The government considered that the promoter penalties were necessary to prevent the promotion of tax schemes where the criminal standard of proof would be difficult to establish.

2 Overview of New Zealand’s New Promoter Penalties

The promoter penalty provisions are prescribed in ss 141EB and 141EC of the \textit{Taxation Administration Act 1994} (NZ) and apply to arrangements entered into from 26 March 2003. Section 141ED provides that a ‘promoter’ of an arrangement is liable to a promoter penalty\textsuperscript{77} if:

\textsuperscript{72} Ibid [9.17].
\textsuperscript{73} Policy Advice Division, ‘Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill: Officials’ Report to the Finance and Expenditure Committee on Submissions on the Bill’ (Inland Revenue and Treasury, November 2002).
\textsuperscript{74} New Zealand Law Society, ‘Submissions on Taxation (Annual Rates, Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Bill’, <http://www.nz-lawsoc.org.nz/General/submissions/Taxation per cent20(MOTC per cent20(Misc per cent20Prov) per cent20Bill per cent201609.htm>
\textsuperscript{75} Ibid.
\textsuperscript{76} Ibid.
\textsuperscript{77} \textit{Taxation Administration Act 1994} (NZ) s 141EB(1).
• a taxpayer becomes a party to the arrangement and a shortfall penalty for an abusive tax position is imposed on the taxpayer as a result of the arrangement; and
• the arrangement is offered, sold, issued or promoted to 10 or more persons in a tax year.

‘Promoter’ is defined in section 141EC to mean:

• a person who is a party to, or is significantly involved in formulating, a plan or program from which an arrangement is offered; or
• a person who is aware of material and relevant aspects of the arrangement and who sells, issues or promotes the selling or issuing of the arrangement, whether or not for remuneration.

However, s 141EC notes that a ‘promoter’ does not include a person whose involvement with the arrangement is limited to providing legal, accounting, clerical or secretarial services to a promoter. In Standard Practice Statement INV 290 Promoter Penalties, the Commissioner indicates that the question of whether a person is a party to a plan or program is a factual inquiry based on factors such as the flow of money, involvement with the design of the arrangement, the person’s degree of knowledge, and documentation and any advertising or promotional material. Non-individuals may be promoters, and there may be more than one promoter in relation to an arrangement.78

An ‘arrangement’ is broadly defined in s 3 of the Taxation Administration Act 1994 (NZ) to mean a contract, agreement, plan or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect. Section 141EB(2) notes that an arrangement is treated as being offered, sold, issued or promoted to 10 or more persons if 10 or more persons claim tax-related benefits as a result of the arrangement.

The amount of the promoter penalty is the sum of the shortfalls resulting from taking an abusive tax position for which the promoter would have been liable if the promoter had been a party to the arrangement in the place of each party to the arrangement to whom the arrangement was offered, sold, issued or promoted. A shortfall penalty for an abusive tax position occurs where the taxpayer takes an unacceptable tax position with a dominant purpose of avoiding tax, and which results in a shortfall of at least NZ$20,000.79

A promoter has equivalent objection rights to penalties as those of investors in tax schemes. Section 138L of the Taxation Administration Act 1994 (NZ) provides that a taxpayer assessed by the Commissioner to a civil penalty:

• may challenge the penalty in the same way as a taxpayer may challenge the assessment of tax to which the penalty relates; and
• has the same rights and obligations, in relation to proceedings concerning the penalty, as a person has in relating to proceedings concerning the tax.

The term ‘civil penalty’ is defined in s 3 of the Taxation Administration Act 1994 (NZ) to include a promoter penalty. Similarly, ‘taxpayer’ is broadly defined to mean a person who: is liable to perform or comply with a tax obligation, or, may take a tax position whether as principal or as an agent or officer or employee of another person, or otherwise.

While the promoter penalties are new and untested, the Inland Revenue has indicated in informal discussions that they are aware of a trend in New Zealand away from mass-marketed schemes to boutique schemes with less than ten investors, which would avoid the promoter penalties.

78 CCH, above n 63.
79 Ibid.
B Canada

1 Third Party Civil Penalties

Third party civil penalties commenced in Canada from 29 June 2000. The penalties were intended to deter tax shelter or tax shelter-like promotions with faulty or inflated assumptions. The penalties were aimed at two main sources of abuse: tax promoters who devise schemes which result in unwarranted claims for deductions (‘planning penalties’); and tax return preparers who manufacture deductions (‘preparer penalties’).

Broadly, planning penalties may apply to an individual, a corporation or an entity that makes or furnishes, participates in the making, or causes another to make or furnish a statement that the person knows is a false statement, in the course of a planning activity. A ‘planning activity’ is defined to mean:

- organising or creating, or assisting in the organisation or creation of, an arrangement, an entity, a plan or a scheme; and
- participating, directly or indirectly, in the selling of an interest in, or the promotion of, an arrangement, an entity, a plan, a property or a scheme.

The Canadian planning penalties are very different to the New Zealand ‘promoter penalties’. Whereas the New Zealand penalties generally apply as a result of there being a contravention of the GAAR, the Canadian third party civil penalties are not intended to apply to arrangements by reason of a determination that they are subject to the application of the GAAR. The Canadian GAAR applies if an arrangement is technically effective, and the third party civil penalties apply where the arrangement is ineffective and based on false statements.

Like the New Zealand promoter penalties, the Canadian third party civil penalties were intended to overcome the difficult burden of proof of establishing conduct of a criminal nature. The penalty for a breach of s 163.2 of the Canadian Income Tax Act is generally CAN$1000. However if the breach of s 163.2 is the result of a false statement made in the course of a planning or valuation activity, the penalty amount is the greater of CAN$1000 or the total of the person’s gross entitlements for the planning or valuation activity.

2 Requirement for Promoters to Register Tax Shelters with the Canadian Revenue Authority

Like the US and more recently, the UK, promoters of tax shelters in Canada are required to register with the Canadian revenue authority. This registration requirement has existed in Canada since 1988. Broadly, s 237.1 of the Canadian Income Tax Act requires the ‘promoter’ of a tax shelter to apply for a tax shelter identification number, and prohibits the selling of a tax shelter without an identification number. In addition, s 237.1(7) requires every promoter of a tax shelter who either accepts consideration in respect of the tax shelter, or who acts as principal or agent in

---

80 Bill C–25 became law on 29 June 2000. It added s 163.2 to the Income Tax Act, which contains the new third party civil penalties legislation.
81 Canadian Customs and Revenue Authority, ‘IC 01–1 Third Party Civil Penalties’ (Canadian Customs and Revenue Authority, September 2001).
83 Canadian Customs and Revenue Authority, above n 81, [20].
84 Income Tax Act s 163.2(2).
85 Canadian Customs and Revenue Authority, above n 81, [77].
87 Income Tax Act s 163.2(3).
respect of the tax shelter in a calendar year, to file an annual information return with the revenue authority. The information return includes information about investors in the tax shelter, including the name, address and either the Social Insurance Number or Business Number of each investor. Penalties exist for failure to register a scheme and for failure to lodge the information return.

It is necessary then, to examine the definition of ‘promoter’ under the Canadian legislation. Section 237.1(1) of the Canadian Income Tax Act provides that a promoter in respect of a tax shelter means a person who, in the course of a business:

- sells or issues, or promotes the sale, issuance or acquisition of, the tax shelter; or
- acts as agent or adviser in respect of the sale or issuance, or the promotion of the sale, issuance or acquisition, of the tax shelter; or
- accepts, whether as a principal or agent, consideration in respect of the tax shelter; and
- more than one person may be a tax shelter promoter in respect of the same tax shelter.89

Canadian commentators and tax professionals have noted the breadth of the definition of ‘promoter’. In particular, it has been noted that, under the definition of ‘promoter’, no investment dealer or other intermediary need be involved, but rather, a promoter may be one of two parties to a private transaction.90 It is also clear from the definition of promoter that an adviser to a promoter would be considered a promoter.91

C US

1 Penalties for Promoters

US tax legislation prescribes certain third party civil penalties that may apply to promoters of tax shelters. Section 6700 of the Internal Revenue Code (‘IRC’) applies to persons promoting abusive tax shelters with little or no utility aside from the tax benefits that they generate.92 Broadly, in order for the penalty under § 6700 of the IRC to apply, a person must:

- organise, assist in the organisation, or participate in the sale of a tax shelter (ie. an entity, plan or arrangement), and
- in connection therewith, make or supply a statement regarding the allowability of any deduction or credit, the excludability of any income, or the securing of any other tax benefit by reason of holding an interest in the tax shelter that the person knows or has reason to know:
  (i) is false or fraudulent as to any material matter, or
  (ii) is a gross valuation overstatement (exceeds 200 per cent of fair market value) as to any material matter.93

A promoter may be an individual, a corporation, a partnership, a trust, or an estate, and although § 6700 of the IRC targets those marketing tax shelters; its coverage is much broader.94 It

89 Income Tax Act s 163.2(2).
90 Ibid 1219.
91 Ibid.
93 IRC § 6700 (1986).
appears that the penalty is more like the Canadian penalty than the New Zealand penalty in that there must be a fraudulent element in order for the penalty to apply.\textsuperscript{95}

Unlike Australia, New Zealand and Canada, the IRC does not contain a statutory GAAR. Unsurprisingly then, the penalty is not linked to a shortfall amount, as is the case with the New Zealand promoter penalties. Rather, the penalty under § 6700 is the greater of 100 per cent of the gross income derived from the activity and US$1000.

2 \textit{Injunctions against Promoters}

Section 7408(a) of the IRC allows the Internal Revenue Service (‘IRS’) to commence a civil action in the name of the US to enjoin any person from further engaging in conduct subject to a penalty under § 6700 of the IRC. However, injunctive relief prohibiting a person from acting will only be provided where the person has engaged in conduct subject to a penalty under § 6700; and, injunctive relief is appropriate to prevent recurrence of such conduct.

Accordingly, the IRS may seek an injunction to prevent the further promotion of abusive tax shelters by promoters. This is a different approach to the Australian promoter penalties legislation, where an injunction may also be sought against a promoter prior to a finding that there has been any promotion of a tax exploitation scheme.

3 \textit{Requirement for Promoters to Register Tax Shelters}

Legislation requiring promoters of tax shelters to register with the IRS and to maintain lists of tax shelter investors have existed in some form in the US since 1984. For transactions occurring after 22 October 2004, new provisions of the IRC require ‘material advisors’ to file an information return with the IRS in respect of any ‘reportable transaction’.\textsuperscript{96} Broadly, a ‘material advisor’ is a person providing material aid, assistance or advice with respect to organising, promoting, selling, implementing or carrying out any reportable transaction, and who derives gross income in excess of US$250 000 (US$50 000 for services provided to natural persons) for such advice or assistance. ‘Reportable transactions’ are prescribed in the regulations to the IRC, and include the following: listed transactions; confidential transactions; transactions with contractual protection; loss transactions; transactions with a significant book-tax difference; and transactions involving a brief asset holding period. Failure to disclose a reportable transaction may result in a penalty of US$100 000 (or for listed transactions, the greater of US$200 000 or 50 per cent of the gross income derived by the person required to file the return).\textsuperscript{97}

Penalties of up to US$100 000 may apply to ‘material advisors’ who fail to provide lists of investors in reportable transactions to the IRS within 20 business days of a request by the IRS.\textsuperscript{98} Further, the \textit{American Jobs Creation Act 2004} allows the IRS to seek injunctions against material advisors who fail to furnish investor lists to the IRS where requested, or who fail to file required information returns.\textsuperscript{99}

\begin{itemize}
\item \textsuperscript{95} Note also that § 6701 of the IRC imposes a penalty on those that knowingly and intentionally assist taxpayers in the understatement of their taxes.
\item \textsuperscript{96} CCH, ‘American Jobs Creation Act of 2004’ (11 October 2004) \textit{CCH Tax Briefing – Special Report}.
\item \textsuperscript{97} CCH, ‘American Jobs Creation Act of 2004’ (11 October 2004) \textit{CCH Tax Briefing – Special Report}.
\item \textsuperscript{98} IRC §§ 6112, 6708.
\end{itemize}
As in Australia, US tax professionals are subject to standards of practice applicable to lawyers, certified public accountants and tax practitioners. However, in addition to professional standards, Circular 230 governs the practice of lawyers, accountants, actuaries, enrolled agents and other persons practising before the IRS.

Circular 230 imposes requirements on tax advisers giving ‘covered opinions’. Relevantly, Circular 230 provides that any written opinion will be treated as a ‘covered opinion’ if it has a significant tax avoidance purpose. A covered opinion must meet the requirements prescribed by Circular 230, otherwise the taxpayer cannot rely on the advice to avoid penalties. Further, tax advisers who wilfully, recklessly, or through gross incompetence violate Circular 230 are subject to sanctions.

US tax advisers have been widely critical of the burdens imposed upon them by Circular 230, considering that the requirements will affect all practices and not just practices promoting tax shelters. This is because Circular 230 requires advisers to evaluate every piece of written tax advice to determine whether it is a ‘covered opinion’, which itself is a subjective process. If it is concluded that the advice is a ‘covered opinion’, there are five possibilities which the adviser must work through for the advice:

- the tax adviser is prohibited from giving the advice;
- the adviser may give the advice without a legend;
- the adviser may give the advice if it ‘prominently displays’ the non-marketing legend;
- the adviser may give the advice if it displays the non-marketing legend; and
- the taxpayer receiving the advice may or may not be able to rely on the advice for penalty protection.

In addition to being considered to impose too restrictive regulations on tax practice, Circular 230 may have detrimental results for tax avoidance. For example, Circular 230 may encourage advisers to provide non-written advice to taxpayers in order to fall outside of the scope of the standards. This may mean that taxpayers enter into tax shelters without the benefit of reflecting upon a written advice which considers the aspects of the transaction in detail.

D UK

Disclosure legislation for direct taxation was introduced in the UK with effect from 30 September 2004. The legislation requires promoters of arrangements to disclose details of arrangements to the UK Inland Revenue. The definition of ‘promoter’ is broad, encompassing all advice and proposals given to clients, rather than being restricted to mass-marketed schemes. Currently, the promoter is required to make a disclosure to the Inland Revenue where one of the main benefits of the arrangement is the obtaining of a tax advantage by the saving or deferring of UK corporation tax, income tax or capital gains tax, in connection with a financial product or an employment product. However, in the 2005 Pre-Budget Report, the Chancellor announced that...
the regime would be extended to cover avoidance risks across all of income tax, corporations tax and capital gains tax, with effect from April 2006. From October 2004 to 30 June 2005 there were 524 direct tax disclosures from 100 promoters. Legislation has already been introduced to counter disclosed schemes, and the 2005 Pre-Budget Report contains further anti-avoidance measures informed by the disclosure regime. Further, the Report also announced a new requirement for businesses to provide to HM Revenue and Customs, within 30 days of implementation, information on direct tax schemes and arrangements devised in-house so to bring requirements in line with those imposed on promoters.

Disclosure provisions also exist in respect of indirect tax, such as Value Added Tax. However, unlike direct tax disclosures, the obligation to disclose indirect tax arrangements is generally an obligation of the taxpayer rather than the promoter.

E Conclusions

The new Australian civil penalty regime applying to promoters of tax exploitation schemes most closely resembles the recently enacted New Zealand regime. The New Zealand experience suggests that legislative definitions are crucial for the overall effectiveness of the legislation. This is particularly so, given that the New Zealand Inland Revenue consider that promoters continued to market schemes following the commencement of the legislation; only now to fewer customers at a time to circumvent the definition of the scheme to which the penalties apply.

The US, Canada and the UK have instead adopted disclosure regimes, requiring tax advisers and taxpayers to make prescribed disclosures to the revenue authorities. Again, the definitions used in the disclosure legislation may be expected to have had consequences for tax adviser and taxpayer behaviour. For example, the breadth of application of the disclosure regime may encourage taxpayers to evade tax rather than to seek planning advice from an adviser, in circumstances where the adviser may be required to make disclosures to the revenue authority.

V Assessment of the New Law as a Means of Overcoming Problems with the Old Law

A comparison of the new civil penalty regime with the approach of other jurisdictions to promoters demonstrates, first, that a disclosure model was an alternative to Division 290 of sch 1 of the TAA, and secondly, that there are lessons from other jurisdictions for Division 290. Further, an examination of the effect of the promoter penalty provisions compared to its purpose finds that there were some improvements which could be made to the provisions, to assist them in reaching the aim of reforming old tax laws for a new world.

First, the US, Canada and the UK have each adopted legislation requiring promoters of tax schemes to register the schemes with the relevant revenue authority before selling the scheme. Such legislation also requires the promoter to maintain lists of investors in the scheme, and in Canada, the promoter is required to file an annual information return including information about investors in the promoter’s scheme. The Explanatory Memorandum to the recently enacted Australian legislation noted that it would be possible to supplement the civil penalty regime with

---

110 Ibid.  
additional record-keeping and reporting requirements.\textsuperscript{112} However, such requirements were considered to involve unduly high compliance costs, and there were also privacy concerns over the information collected and held by promoters.\textsuperscript{113}

While the purpose of the disclosure regimes in the US, Canada and the UK is to provide the revenue authorities with information about tax schemes, the promoters and the investors, the effect of a disclosure regime may be to deter taxpayers from investing in schemes where the investment will need to be reported to the revenue authority.\textsuperscript{114} The Australian tax system is a self-assessment regime supported by administrative audit powers and penalties. Investors may reasonably consider that there is a greater risk of audit by the administration where a promoter is required to disclose the investors’ name and scheme to the revenue authority, than there is of being found to have evaded tax. A disclosure regime in Australia may in fact encourage taxpayers to evade tax as a less risky alternative to investing in a reportable tax scheme.

Secondly, some useful lessons emerge from New Zealand for Division 290. In New Zealand, the promoter has equivalent objection rights to penalties as those of taxpayers investing in tax schemes. However, in Australia, it is unclear whether promoters will have rights to appear before the GAAR Panel similar to those of taxpayers, in circumstances where there appears to be no policy reason for distinguishing between the two. On the other hand, the New Zealand legislation may demonstrate some benefits following from the recently enacted Australian definition of ‘promoter’. While the Australian definition of ‘promoter’ has been criticised as being too broad and failing to exempt tax advisors, the New Zealand definition may be too narrow by merely targeting promoters of mass-marketed schemes (that is, schemes offered, sold, issued or promoted to 10 or more persons in a tax year).

It is also considered that the New Zealand legislation may benefit from the flexibility of the voluntary undertakings adopted in the Australian legislation, particularly if voluntary undertakings are required to be published. However, an examination of the effect of the promoter penalty provisions compared to the purpose leads to the conclusion that the legislation lacks a taxpayer education function. It would have been beneficial for the civil penalty regime to have provided publicity orders as a fourth power available to the Commissioner for deterring the promotion of tax exploitation schemes. It is also suggested that the civil penalties could be improved by allowing the Court a discretion to require a delegate of the Commissioner to meet with the promoter on a periodic basis, for a review of its schemes and its client education policies, to prevent a situation where the monetary penalty is insufficient to deter the promotion of tax exploitation schemes.

\textsuperscript{112} Explanatory Memorandum, [3.124]. The Explanatory Memorandum states that this would include ‘requiring promoters to report certain tax effective schemes to the Commissioner and to keep additional records in relation to financing arrangements and investor details’.

\textsuperscript{113} Ibid. The Explanatory Memorandum further provides, at [3.148]: ‘The civil penalty regime is preferred to the options of administrative penalties and increased reporting/disclosure requirements because it is a more targeted and transparent measure that provides for substantial remedies to be imposed by the Federal Court against illegitimate promoters, while imposing low or no compliance costs on legitimate businesses’.

\textsuperscript{114} Fraser, above n 111, 290.