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Abstract
The distinction between tax avoidance and tax evasion has been well established in the Australian taxation system. However, for some time the Australian Government has ignored the difference between the two concepts when it comes to Australians using tax havens and being investigated as part of 'Project Wickenby'. The Australian Government is deliberately labelling all attempts to minimise income tax through the use of tax havens and offshore financial centres (OFCs) as tax evasion and therefore a criminal act. There have been examples quoted in the press where the Australian Crime Commission, conducting investigations as part of 'Project Wickenby', have gained access to Swiss bank records on the basis that the Australian taxpayer has been involved in suspected tax fraud when this was not the case. Is this one of the main reasons why the Australian Government is ignoring the distinction in order to detect money held in tax havens? This paper will examine the distinction between the two concepts and try to provide an answer for the approach being taken by the government.

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THE DISTINCTION BETWEEN TAX AVOIDANCE AND TAX EVASION HAS BECOME BLURRED IN AUSTRALIA: WHY HAS IT HAPPENED?

JOHN MCLAREN*

The distinction between tax avoidance and tax evasion has been well established in the Australian taxation system. However, for some time the Australian Government has ignored the difference between the two concepts when it comes to Australians using tax havens and being investigated as part of ‘Project Wickenby’. The Australian Government is deliberately labelling all attempts to minimise income tax through the use of tax havens and offshore financial centres (OFCs) as tax evasion and therefore a criminal act. There have been examples quoted in the press where the Australian Crime Commission, conducting investigations as part of ‘Project Wickenby’, have gained access to Swiss bank records on the basis that the Australian taxpayer has been involved in suspected tax fraud when this was not the case. Is this one of the main reasons why the Australian Government is ignoring the distinction in order to detect money held in tax havens? This paper will examine the distinction between the two concepts and try to provide an answer for the approach being taken by the government.

I INTRODUCTION

The Australian statutory law as well as the common law recognises the important distinction between taxpayers engaging in conduct that constitutes tax avoidance and conduct that constitutes tax evasion. However, for some time the Australian Government has ignored the difference between the two concepts when it comes to Australians using tax havens and being investigated as part of ‘Project Wickenby’. For example, the law to deter the promotion of tax schemes, Division 290, of the Taxation Administration Act 1953 (Cth) ignores the distinction between tax avoidance and tax evasion and deals with ‘tax exploitation schemes’ instead. The Anti-Money Laundering and Counter Terrorism Financing Act 2006 (Cth) (AML/CTF Act) is another example of the blurring of the distinction between tax avoidance and tax evasion because it allows government agencies to detect Australian taxpayers using tax havens by requiring their accountants, lawyers and financial advisers to report ‘suspicious transactions’ that involve the transfer of money between tax havens and

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1 ‘Operation or Project Wickenby’ is the name given to a joint operation involving the Australian Crime Commission (ACC), the Australian Taxation Office (ATO) and the Australian Securities and Investment Commission (ASIC) investigating the use of tax havens by Australian taxpayers in what is alleged as criminal activity.
3 ‘Operation or Project Wickenby’ is the name given to a joint operation involving the Australian Crime Commission (ACC), the Australian Taxation Office (ATO) and the Australian Securities and Investment Commission (ASIC) investigating the use of tax havens by Australian taxpayers in what is alleged as criminal activity.
Australia. These two examples of statutory law are clear examples of the Australian Government deliberately labelling all attempts to minimise income tax through the use of tax havens and offshore financial centres (OFCs) as tax evasion and therefore a criminal act. There have been examples quoted in the press where the Australian Crime Commission, conducting investigations as part of ‘Project Wickenby’, have gained access to Swiss bank records on the basis that the Australian taxpayer has been involved in suspected tax fraud when this was not the case.4 If tax minimisation can be held to constitute a criminal act then tax havens and OFCs can be encouraged to disclose bank account details of Australian taxpayers in that country. Is this one of the main reasons why the Australian Government is ignoring the distinction between tax avoidance and tax evasion in order to detect money held in tax havens? This paper will examine the distinction between the two concepts and try to provide an answer for the approach being taken by the government.

In 2004 Justin Dabner contended that the OECD’s campaign against ‘harmful tax competition’ was trying to ‘criminalise tax avoidance’ by attempting to group tax evasion and tax fraud with legitimate tax avoidance in order to achieve their outcome of deterring tax competition between countries, especially tax havens.5 For example, the law to deter the promotion of tax schemes, Division 290, Taxation Administration Act 1953 (Cth) ignores the distinction between tax avoidance and tax evasion and deals instead with ‘tax exploitation schemes’. The Anti-Money Laundering and Counter Terrorism Financing Act 2006 (Cth) (AML/CTF Act) is another example of the blurring of the distinction between tax avoidance and tax evasion and this will be examined in detail later in the paper. It is contended that the Australian Government, the OECD6 and the Financial Action Task Force (FATF)7 are deliberately labelling all attempts to legally minimise income tax through the use of tax havens and offshore financial centres (OFCs) as tax evasion and therefore a criminal act.

If all tax minimisation activity amounts to a criminal act then tax havens and the OFCs can be encouraged to disclose information on foreign investments in their country and justify breaching their own bank secrecy laws. All banks have strict laws that govern their ability to disclose information about their customers.8 However, in the case of criminal activity, information can be provided to foreign government agencies.9 Tax evasion constitutes the crime of fraud which in turn amounts to the act of ‘defrauding of the Commonwealth’. Hence, utilising the services of an OFC or a tax haven may also constitute the crime of money laundering. This would appear to be the reason why the Australian Government needs to blur the distinction between tax avoidance and tax evasion and therefore to be able to obtain banking details from

7 The Financial Action Task Force (FATF) is located within the OECD in Paris but was established to actively prevent money laundering.
8 It is not intended to discuss the law relating to the relationship between a bank and its customer other than to emphasise that both statutory law and common law provides strict codes of conduct in relation to the confidentiality of bank details. An excellent discussion of the importance of bank secrecy and the laws that try to ensure that customer information is kept confidential can be found in the OECD document, ‘Improving Access to Bank Information for Tax Purposes’ (2000) OECD, 19.
other countries on the basis that all tax minimisation activity amounts to criminal conduct, irrespective of whether it is ‘tax avoidance’ or ‘tax evasion’.

The paper commences with a discussion on the distinction between tax avoidance and tax evasion in Australia and then critically examines the current approach of the Australian Government to ignore the difference between the two concepts. It is argued in this paper that there has been a deliberate move by the Australian Government to treat tax avoidance as amounting to tax evasion and to ignore the legal distinction between the two activities.

II THE AUSTRALIAN APPROACH TO ‘TAX AVOIDANCE AND TAX EVASION’

It is generally acknowledged that tax evasion constitutes an act outside the law whereas tax avoidance is considered an act within the law. This basic principle of taxation law is supported by the definitions of tax avoidance and tax evasion contained in ‘The Taxation Review Committee’ Report, Australia 1975, which is commonly referred to as the ‘Asprey Committee Report’. According to I. G. Wallschutzky, the following definitions are based on those used in the ‘Carter Commission’ Report and the definitions contained in the UK ‘Radcliffe Commission’.

The phrase ‘tax evasion’ describes an act in contravention of the law whereby a person who derives a taxable income either pays no tax or pays less tax than he would otherwise be bound to pay. Tax evasion includes the failure to make a return of taxable income or the failure to disclose in a return the true amount of income derived. ‘…tax avoidance’, on the other hand, usually connotes an act within the law whereby income, which would otherwise be taxed at a rate applicable to the taxpayer who but for that act would have derived it is distributed to another person or between a number of other persons who do not provide a bona fide and fully adequate consideration; in the result the total tax payable in respect of that income is less than it would have been had no part of the income had been distributed and the whole been taxed as the income of that taxpayer.

The definitions of ‘tax evasion’ and ‘tax avoidance’, as quoted above, are no different from the definitions used in both Canada and the UK. According to I.G. Wallschutzky, the [two types] of tax avoidance are within the law and are therefore different from instances of evasion which are outside the law. Not all commentators believe that the distinction is always clear. Professor Logue contends that the distinction is ‘notoriously fuzzy’, but reinforces the fact that tax evasion usually

12 The Royal Commission on Taxation, Canada 1966, commonly referred to as the ‘Carter Commission’.
13 The Royal Commission on Taxation of Profits and Income, 1955, commonly referred to as the ‘Radcliffe Commission’.
15 Wallschutzky, I. G. n 9, 55. The reference to the two types of avoidance contained in the Asprey Committee’s Report are referring to types of tax avoidance intended to be covered by the legislature and those types of avoidance which are not covered by the legislature.
involves an ‘element of intentionality on the part of the taxpayer’.\textsuperscript{16} An example of this is provided by Professor Logue with a wealthy individual hiding income in a foreign bank account in a manner that is clearly not allowed by U.S. tax law. In that case the taxpayer is clearly a tax evader.\textsuperscript{17} Logue then suggests that tax avoidance could be simply defined as ‘arranging your affairs to minimise your taxes in a manner that is consistent with the law’.\textsuperscript{18}

If the law relating to the distinction between tax evasion and tax avoidance was that simple, and it is contended in this paper that it should be that simple, then the government has no basis for treating tax minimisation and tax avoidance as constituting tax evasion, and thus a criminal activity. The next step in the examination of this area of taxation law is to review the current statutory law in Australia.

\textbf{A Statutory Law Approach}

In Australia the anti-avoidance measures are contained in a number of ‘General Anti-avoidance Rules’, GAARs. According to Professor Evans, these GAARs are found in Part IVA of the \textit{Income Tax Assessment Act 1936} (Cth) (ITAA 36), Section 67 of the \textit{Fringe Benefits Tax Assessment Act 1986} (Cth) and Division 165 of the \textit{New Tax System (Goods and Services Tax) Act 1999} (Cth).\textsuperscript{19} Professor Evans discusses the ‘shotgun and sniper’ approach to the specific statutory anti-avoidance provisions, SAARs, aimed at tax avoidance such as section 26-54 of the ITAA 97 relating to tax deductions incurred in criminal activities and section 86-10 of the ITAA 97 relating to preventing the alienation of personal services income through companies, partnerships or trusts.\textsuperscript{20} Evans contends that in Australia there is a ‘reliance on GAARs, SAARs and the promoter penalty regime, all bounded together in a carefully crafted risk management strategy’.\textsuperscript{21} The tax scheme promoter penalty regime will be critically examined later in this paper as an example of the blurring of the distinction between tax evasion and tax avoidance. However, it is important to note that the promoter penalty regime is seen as a major weapon being used by the government to combat tax avoidance in Australia. Similarly, the concept of a ‘risk based’ approach to managing tax avoidance will be discussed later in the paper under the heading of ‘other approaches to tax avoidance’, as many countries are using this system to try to overcome tax minimisation through abusive tax avoidance and tax mitigation schemes.

The statutory law does not provide a definition of what constitutes ‘tax evasion’ or ‘tax avoidance’. A definition of tax avoidance is found in s 82KH(1) of the ITAA 36, but as Ian Wallschutzky states, it is only relevant for the sub-division in which it appears.\textsuperscript{22} In fact, the GAAR provisions contained in Part IVA, of the ITAA 36, do not provide a definition of what constitutes tax avoidance. At best, the provisions exhaustively define what is a ‘tax benefit’ pursuant to s 177C(1). There is no mention of what might be considered to be acceptable tax avoidance or what is regarded as

\textsuperscript{17}Ibid, 354.
\textsuperscript{18}Ibid, 355.
\textsuperscript{20}Ibid, 42.
\textsuperscript{21}Ibid, 46.
\textsuperscript{22}Wallschutzky, I, n 9, 49.
abusive tax avoidance. The GAAR provisions do not make any distinction at all. In the context of the Commissioner of Taxation being empowered to amend a taxpayers’ assessment of taxation, s 170(1) of the ITAA 36 provides that in the case of avoidance of tax due to fraud or evasion, there is no limit on the time in which the assessment can be amended. In the case of tax avoidance, the time limit is now four years from the date of the original assessment for the Commissioner to amend the assessment.23 The section does not attempt to provide any type of definition of tax avoidance or tax evasion. In order to obtain an explanation of the type of activity that constitutes tax evasion or tax avoidance it is necessary to look to the common law in order to see how the courts in Australia have interpreted this area of the statutory law.

B The Common Law Approach

The common law in Australia is regarded as being settled on the distinction between ‘tax avoidance and tax evasion’. In the case of R v Mears,24 the NSW Court of Criminal Appeal, when considering an appeal against the severity of a sentence for an action pursuant to s 86A, Crimes Act 1914 (Cth), conspiracy to defraud the Commonwealth, Gleeson CJ made the following statement on the distinction between tax avoidance and tax evasion:

Although on occasion it suits people for argumentative purposes to blur the difference, or pretend that there is no difference, between tax avoidance and tax evasion, the difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligations. Tax evasion involves using unlawful means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful. Although some people may feel entitled to disregard the difference, no lawyer can treat it as unimportant or irrelevant. It is sometimes said that the difference is difficult to recognise in practice. I would suggest that in most cases there is a simple test that can be applied. If the parties to a scheme believe that its possibility of success is entirely dependent upon the authorities never finding out the true facts, it is likely to be a scheme of tax evasion, not tax avoidance.25

If the former Chief Justice of the High Court, Gleason CJ believes that the distinction is so important for lawyers and the courts, then why has the government been prepared to overlook this important distinction? A further example of the court considering the distinction between tax avoidance and tax evasion is found in Denver Chemical Manufacturing Co v DCT (NSW). The judgment of Dixon J provides an excellent description of the conduct required to constitute tax evasion by a taxpayer.

I think it is unwise to attempt to define the word ‘evasion’. The context of s 210(2) [now s 170(1), ITAA 36] shows that it means more than avoid and also more than a mere withholding of information or the furnishing of misleading information. It is probably safe to say that some blameworthy act or omission on the part of the taxpayer or those for whom he is responsible is contemplated. An intention to withhold information lest the Commissioner should consider the taxpayer liable to a greater extent than the taxpayer is prepared to concede, is conduct which if the result is to avoid tax would justify finding evasion.

In the present case the Board concluded that the appellant intentionally omitted the income from the return and that there was no credible explanation before them why he did so. They thought that the conduct of the taxpayer answered the description of an avoidance of tax by evasion.26

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23 Section 170(1) Item 5 for tax evasion and Item 4 for tax avoidance.
25 Ibid, 323.
26 (1949) 79 CLR 296, per Dixon J, 313.
Dixon J agreed with the earlier finding of the NSW Court of Appeal in that the actions of the Appellant amounted to tax evasion. However, it should also be noted that the actions which might be regarded as constituting tax evasion and tax avoidance can arise in more situations than those involving the withholding of information or the provision of misleading information. Dealing in cash, as part of the ‘black economy’, to avoid paying tax on income is more than withholding information but still constitutes tax evasion.

In the recent case of Kajewski v Federal Commissioner of Taxation, the Commissioner of Taxation alleged tax avoidance through fraud and evasion. The taxpayer argued that the alleged fraud and evasion resulted from actions taken by their tax agent and that they were not aware of the situation that gave rise to the allegation. Section 170(2)(a), ITAA 36 [now s 170(1)] provides the Commissioner with the power to issue an amended assessment at any time if the avoidance of tax is due to fraud or evasion. The taxpayer also contended that ‘even if their original assessments were affected by fraud or evasion within s 170(2)(a), it was not fraud or evasion in which they personally engaged and that s 170(2)(a) did not therefore empower the Commissioner to issue the amended assessments in October 1999’. Drummond J made the following comment on the distinction between tax avoidance and tax evasion:

There will be "an avoidance of tax" within this provision where, without any active or passive fault on the part of the taxpayer, less tax has been paid than ought to have been paid. See, eg, Australasian Jam Company Proprietary Limited v FCT (1953) 88 CLR 23 at 34; 10 ATD 217 at 222. Fraud within s 170(2)(a) involves something in the nature of fraud at common law, i.e., the making of a statement to the Commissioner relevant to the taxpayer's liability to tax which the maker believes to be false or is recklessly careless whether it be true or false.

Drummond J also quoted from the judgment by Dixon J in Denver Chemical Manufacturing Company v Commissioner of Taxation (New South Wales), and confirmed that His Honour’s analysis was the most appropriate in determining the type of conduct that amounted to fraud or evasion on the part of a taxpayer. From the above limited examination of the common law, it can be seen that tax evasion can be clearly distinguished from tax avoidance and that tax evasion involves the taxpayer being engaged in conduct outside the law with an intention to not pay the required amount of tax by fraud or reckless behaviour. If the courts in Australia have no difficulty in distinguishing between tax evasion and tax avoidance, what then is the approach of other countries to this issue?

C Other approaches to tax avoidance

One of the main criticisms of having a GAAR is that the legislature has a particular view of the type of conduct that may constitute tax avoidance on the part of the taxpayer. However, the judiciary does not always interpret and apply the law in the same way as was intended by Parliament. Tim Edgar explores this dilemma in his paper and strongly contends that it ‘is hopeless to leave it to the judiciary to articulate

27 The term ‘black economy’ is commonly used in Australia to denote business conducted in cash in order to avoid any evidence of the receipt of income so as to avoid the payment of income tax or the Goods and Services Tax (GST) constitutes tax evasion.
28 (2003) 52 ATR 455.
29 Ibid, 483.
30 Ibid, 484.
a behavioural prohibition that is neither under-inclusive nor over-inclusive in its identification of prohibited transactions’. He advocates the design of a GAAR by reference to a ‘business-purpose test’ with emphasis on the different concepts of the economic substance associated with the categories of tax avoidance behaviour, such as tax evasion, acceptable tax avoidance and abusive tax avoidance. By way of illustration, Edgar states that the Canadian GAAR has at its core, a distinction between ‘acceptable’ and ‘abusive’ tax avoidance and this is seen by some commentators as providing an ‘overly-broad category of acceptable tax avoidance and … an under-inclusive category of abusive tax avoidance’. Acceptable tax avoidance is sometimes referred to in the literature as ‘tax mitigation’ or ‘tax minimisation’ whereas abusive tax avoidance is seen as involving schemes that are ‘contrived’ or ‘artificial’. The Australian GAAR does not provide that level of distinction and it is then left to the judiciary to determine those differences.

It could be argued that with the deliberate blurring of the distinction between tax evasion and tax avoidance in Australia that the Canadian approach may be seen as a desirable way of maintaining a distinction between acceptable tax avoidance and abusive tax avoidance. Acceptable tax avoidance is clearly seen to be within the law, whereas abusive tax avoidance, which may be outside the law, is properly treated as being similar to tax evasion.

Furthermore, the OECD in its ‘Study into the Role of Tax Intermediaries’, has introduced the ‘notion of aggressive tax planning into the international tax lexicon’ and draws a distinction between acceptable tax avoidance such as tax mitigation and minimisation and aggressive tax planning involving sham transactions. The OECD study looks at the supply side of aggressive tax planning solutions, being provided by tax intermediaries such as accounting and law firms, and the taxpayers representing the demand side of the tax minimisation products. Aggressive tax planning is defined as: ‘planning involving a tax position that is tenable but has unintended and unexpected tax revenue consequences, and taking a tax position that is favourable to the taxpayer without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law’. It is contended that ‘the test of whether tax planning is “acceptable” should be what the legislation says as interpreted by the courts, and not what the tax authorities suppose it was intended to say’. This issue is highlighted in Part V under the heading of ‘Implications for the Rule of Law’. The approach taken by the OECD in their study into ‘tax intermediaries’ adds further weight to the argument that the current approach to tax mitigation and tax evasion in Australia, and internationally, is threatening the fundamental principle of the importance of the ‘rule of law’ in all legal systems throughout the world.

It is obvious that tax intermediaries have always created a problem for organisations such as the OECD and many countries with the promotion of tax havens and OFCs as a means of reducing the effect of taxation on multi-national corporations and high net worth individuals. As discussed below in this paper, the OECD has been deliberately

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32 Ibid, 837.
33 Ibid, 837.
34 Ibid, 878, 879 and footnote 100.
38 Ibid, 10.
39 Freeman, Judith et al, n 32, 3.
blurring tax evasion and tax avoidance, but this current study by the OECD would appear to put all activities used to mitigate tax within the category of ‘abusive tax avoidance’ and unlawful conduct, and therefore amounting to criminal tax activity. The OECD approach can be seen as another attempt to criminalise tax avoidance by creating an artificial distinction between tax mitigation, on the one hand, and aggressive tax planning, on the other hand, while all the time ignoring the clear cut distinction between tax evasion and tax avoidance that has existed in the law of many of the OECD member countries based on the Anglo-US legal system.

One of the features of the OECD study into tax intermediaries is the discussion of the need for effective risk management by the tax authorities, and the OECD sees that as an important method to prevent tax avoidance by intermediaries. In fact, Australia and the UK\textsuperscript{40} have already adopted a risk-based approach to try to combat tax avoidance. As Anita Paddock and Chris Oates state, ‘[o]ne of the main drivers in the ATOs risk-profiling process is the perceived willingness of the corporate to use marketed tax mitigation in its tax planning programme’.\textsuperscript{41} If tax authorities engaged in cooperative discussions with corporations and high net worth individuals as part of a risk management program to encourage disclosure of tax mitigation arrangements, then there may not be a need to rely on the legislature, and the courts, to prevent tax avoidance after the event. In turn, this may alleviate the need to engage in the tactic of declaring all forms of tax minimisation as constituting criminal activity.

III THE INTERNATIONAL APPROACH TO THE DISTINCTION BETWEEN ‘TAX AVOIDANCE AND TAX EVASION’

International bodies such as the OECD, the Financial Action Task Force, (FATF) and the Economic Union, (EU) have been actively involved in trying to limit harmful tax competition by tax havens and OFCs. By grouping tax avoidance and tax evasion as constituting one and the same activity, the international bodies such as the OECD, the Financial Action Task Force, FATF and the EU are able to make the presumption that any financial activity using an OFC or a tax haven must be tax evasion and therefore of a criminal nature. Branson QC\textsuperscript{42} makes the observation that the OECD in its crusade against ‘harmful tax competition’ has ‘not sought to draw any clear or marked difference between evasion and avoidance and in every relevant respect they have been treated as one homogenous subject’.

The OECD report on harmful tax competition, paragraphs 53 and 54\textsuperscript{43} do not attempt to clearly distinguish between tax avoidance and tax evasion when discussing the need for tax havens to become more transparent and to exchange information. In paragraph 53, the OECD makes the following comment:

\[
\text{Because non-transparent administrative practices as well as an inability or unwillingness to provide information not only allow investors to avoid their taxes but also facilitate illegal activities, such as tax evasion and money laundering, these factors are particularly troublesome.}\textsuperscript{44}
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\textsuperscript{40} The ‘Varney Review’ in the UK had advocated a risk-based approach to managing the tax risk associated with tax avoidance and large corporations. See the paper by Freeman, Judith et al, n 32 for a discussion on this issue.


\textsuperscript{43} OECD, n 4, 23 and 24.

\textsuperscript{44} Ibid, 23.
In paragraph 54, the OECD then states that progress has been made in accessing information from tax havens through the entering of ‘mutual legal assistance treaties’ in criminal matters such as criminal tax fraud. According to Peter-Szerenyi, the issue of the exchange of information and transparency should only relate to criminal tax matters:

The lack of exchange of information and transparency facilitates only illegal activity, not tax avoidance. Tax avoidance is legal, whether the home country knows about it or not. Thus, the tax authorities of the home country do not need any information for the correct and timely application of its own tax law. The lack of the two criteria (exchange of information and transparency) in connection with tax avoidance is a problem merely because it makes it difficult for the home country to detect and prevent the use of foreign tax regimes – in other words, to enact laws aimed at combating offshore investments (e.g. CFC rules), Paragraphs 70 and 114.45

In the OECD report46 on improving access to bank information it was stated that where ‘some countries rely heavily on a self-assessment system to administer their taxation laws…wilful failure of a taxpayer accurately to report income will generally be considered a criminal action.’47 In terms of requiring other countries to cooperate in providing access to information, the OECD Report goes on to make the following observation:

With respect to assistance provided to other countries in criminal investigations (including criminal tax investigations), some countries generally apply the principle of ‘double incrimination’. That is, before assistance can be provided to a requesting country, it must be established that the conduct being investigated would constitute a crime under the laws of the requested country if it occurred in the requested country. In the tax area, application of this principle will not generally be an impediment to exchange of information for criminal purposes where the definitions of tax crimes are similar. However, where the definitions of tax crimes in the requesting and requested countries are markedly different, it may be impossible in many cases for the requesting country to obtain information that is vital to a criminal investigation.48

In most tax havens tax avoidance is not a crime because as a result of those countries not imposing any form of income tax, there is no tax to avoid. However, the non-payment of income tax by an Australian resident taxpayer on income derived in an offshore bank account can be construed as constituting the act of ‘money laundering’ in Australia, because the proceeds are from a criminal act, namely tax evasion. In the tax havens that have introduced anti-money laundering legislation, tax related criminal activities would constitute a crime under their domestic law, particularly if the requesting country was able to argue that tax avoidance, in any form, was a crime and the subsequent laundering of the money through a tax haven constituting the crime of money laundering. For example, the Cook Islands introduced the Money Laundering Prevention Act in 2000 and amended its Crimes Act in order to introduce law based on the FATF 40 recommendations which are similar to the anti-money laundering law in Australia.49 In that situation, the appropriate banking information about the Australian taxpayer may be supplied by the requested country.

48 Ibid, 15, note 7.
This is one of the main reasons why the new AML/CTF Act has been introduced by
the Australian Government.

The OECD has been successful in convincing Vanuatu, Samoa and Niue to enter
into an agreement to exchange information on foreign investors using their offshore
financial services. The countries entered into the agreements to exchange information
on civil tax matters by 31 December 2005.\(^\text{50}\) Since that time, the OECD has been able
to convince a further 83 OECD and non OECD countries to enter into ‘Double Tax
Conventions’ for the exchange of banking information.\(^\text{51}\) In the same OECD
announcement, it is noted that Belgium has agreed to exchange banking information
with the USA in relation to civil and criminal tax matters. This raises the issue of the
need for countries such as Australia not only to develop relationships with other
countries in order to enter into an agreement for the exchange of banking information,
but also the need to classify tax matters as constituting a civil or criminal offence
under the domestic law. It is not sufficient to merely classify all types of tax
minimisation as constituting abusive tax avoidance and tax evasion on the basis that
the investments are held in a tax haven.

When the then Minister for Foreign Affairs, the Honourable Alexander Downer was
asked about his attitude to Vanuatu being a ‘tax haven’ and Australians using Vanuatu
to avoid income tax, his answer was as follows:

Well, I’m in favour of low tax and countries have got to make themselves as competitive as
they possibly can in a competitive world, but what has worried us in the past has been on the
issue particularly of money laundering. And the Vanuatu Government and Vanuatu Parliament
has now legislated against money laundering and introduced this anti-money laundering
legislation. We see that as a very good step forward but obviously it’s going to be a challenge
to implement the provisions of the legislation and we’re happy to help the Government of
Vanuatu in that respect.\(^\text{52}\)

This comment from the former Australian Minister for Foreign Affairs would
appear to condone Vanuatu as engaging in tax competition but at the same time taking
measures to combat money laundering. It would be assumed that the Vanuatu law is
designed to combat illegal tax evasion and not legitimate tax avoidance or
minimisation. For the OECD or the Australian Government to impose sanctions as a
result of tax avoidance in say Australia, while it is not contrary to the law in Vanuatu,
would in fact be a breach of international law.\(^\text{53}\) To threaten another sovereign nation
with sanctions or to terminate existing treaties just because they will not exchange
banking information that may or may not be of a criminal nature is potentially a
breach of obligations to the World Trade Organisation (WTO) or a breach of Article
54 of the Vienna Convention on the Law of Treaties.\(^\text{54}\) According to Benjamin
Hartman, there is ‘no necessary connection between low taxes and tax evasion …
therefore, no basis to claims that offering low taxes facilitates crimes.’\(^\text{55}\) He makes
this claim on the basis that the tax havens are under no obligation to comply with the

\(^{50}\) Linda Peter-Szerenyi, n 32, 18.
\(^{51}\) OECD, ‘Financial centers become more transparent, but information exchange remains a problem
\(^{52}\) Minister for Foreign Affairs, The Honourable Alexander Downer, MP, Press Conference, Port Vila,
Vanuatu, transcript 19 April 2006, accessed at:
\(^{53}\) Linda Peter-Szerenyi, n 32, 23.
\(^{54}\) Hartman, Benjamin, ‘Coercing Cooperation from Offshore Financial Centers: Identity and
Coincidence of International Obligations Against Money Laundering and Harmful Tax Competition’
\(^{55}\) Ibid, 265.
directives issued by the OECD or FATF and non-compliance is not sufficient grounds to impose sanctions under international law.\textsuperscript{56}

The introduction of the so-called USA Patriot Act\textsuperscript{57} has not dramatically reduced the use of Caribbean tax havens by citizens of the USA.\textsuperscript{58} OECD and EU member countries still compete in trying to attract capital by reducing income tax rates. There is no ‘level playing field’\textsuperscript{59} in the world today and Australia has joined in the tax competition to attract wealthy individuals while ‘ring fencing’\textsuperscript{60} its own residents through the recently introduced tax law that applies to ‘temporary residents’.\textsuperscript{61} It will be interesting to see if the AML/CTF Act introduced into Australia will have a dramatic effect on tax havens. As Eden and Kudrle put it, ‘the jury is still out on whether the OECD’s attempt to name and shame tax havens as renegade states will be successful.’\textsuperscript{62} The same situation can be said of the following legislative attempts being introduced in Australia to prevent tax minimisation through OFCs and tax havens.

\textbf{IV AN EXAMPLE OF BLURRING: THE LAW TO ‘DETER THE PROMOTION OF TAX SCHEMES’}

The Australian Government introduced the law to deter the promotion of tax schemes, with effect from 6 April 2006. The provisions are designed to complement the GAAR.\textsuperscript{63} This law has the potential to deter the promotion of tax schemes such as those that involve the use of tax havens and OFCs, but it appears that it has deliberately ignored the difference between tax evasion, a criminal offence, and tax avoidance or tax mitigation, legal activity.

\textit{A The law used to deter the promotion of tax schemes}

The statutory provisions\textsuperscript{64} consist of three main parts, first the imposition of ‘civil penalties’ on ‘promoters’ of ‘tax exploitation schemes’, second; ‘injunctions granted

\textsuperscript{56} Ibid, 265.
\textsuperscript{57} The term ‘USA Patriot Act’ is an anachronism for the Act called the ‘Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act’
\textsuperscript{59} The term ‘level playing field’ is taken from the OECD, ‘Tax Co-operation: Towards a level playing field (2006) OECD, 7. The OECD is determined to achieve a ‘level playing field’ in the areas of transparency and effective exchange of information for tax purposes, especially with civil and criminal tax matters.
\textsuperscript{60} ‘Ring Fencing’ is the term used by the OECD, n 4, to denote the existence of tax concessions for foreign investors that are not available to resident taxpayers. For example, temporary residents are not taxed on their foreign sourced income and are taxed as if on a ‘territorial’ basis. In this case the Australian resident taxpayer is ‘fenced in’ and not able to take advantage of the same tax concession.
\textsuperscript{61} The new law takes effect from 1 July 2006 and is now contained in Division 768, ITAA 97. The law started out as the Taxation Laws Amendment (2006 Measures No.1) Bill 2006 (Cth) and was enacted as Act No.32 of 2006. Section 768-900 provides that ‘this Subdivision modifies the general tax rules for people in Australia who are temporary residents, whether Australian residents or foreign residents. The term ‘ring fencing’ is used to denote tax law that favours non-residents over a countries own residents. In this case temporary residents do not pay income tax in Australia on income derived outside Australia.
\textsuperscript{62} Lorraine Eden and Robert Kudrle, n 34, 124.
\textsuperscript{63} Evans, C, n 19, 46.
\textsuperscript{64} The new statutory law is found as Schedule 3, starting with Division 290, of TAA 53.
by the Federal Court’ to restrain an entity from engaging in promoting schemes, and third; ‘voluntary undertakings’ given by an entity not to continue promoting schemes.

Sections 290-5 states 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.

In the Explanatory Memorandum, the Government advises that the measures are designed to deter the promotion of tax avoidance and evasion schemes, collectively referred to as ‘tax exploitation schemes’ and to deter the implementation of schemes that have been promoted on the basis of a product ruling being provided by the ATO but the actual scheme is materially different from what was disclosed in the ruling. The Government justifies the new law from an economic and social perspective on the basis that, by making the promoter of tax schemes at risk of financial loss in the same way that the investor is at risk, then this will deter the marketing of schemes and provide investors with protection from bad investments and therefore encourage more legitimate and productive investments. The promoter would be required to pay to an amount of money equivalent to the amount of tax, interest and penalties that is required to be paid by the taxpayer as a result of having entered into the scheme in the first place, if the scheme is found to have constituted tax avoidance or tax evasion. The money to be paid by the promoter is in the form of a civil penalty that can be imposed by the Federal Court up to a maximum of $550,000 for individuals, or $2.75 million for a body corporate, and twice the consideration received as payment for selling the scheme.

The objective of providing investor protection is a very positive move on the part of the Government but it is also designed to support Part IVA, the tax avoidance measures, because of a perceived weakness in the current provisions. This issue was discussed by McCormack and Anderson on the basis that Part IVA may not extend to promoters of tax schemes in order for them to be penalised under those provisions. It would be usual for a promoter to obtain a fee or profit from the underlying scheme rather than a tax benefit. The only way to penalise the promoter was to introduce the ‘promoter penalty’ regime. The ATO have recently released their practice statement, PS LA 2008/8 to provide guidance to their staff as to the application of the law to situations involving the promotion of tax schemes and in particular the role of the ‘promoter penalty review panel’ that is responsible for administering the law.

B Civil penalties, Promoter and Tax Exploitation Schemes

This area of the law gives rise to most of the perceived problems that may confront accountants, tax lawyers and financial advisers providing taxation advice to their clients. The concept of imposing a ‘civil penalty’ is similar to the range of remedies available to the Australian Securities and Investment Commission in situations where

66 Ibid, 59.
67 McCormack J and Anderson D, Tax Schemes: “Unscrupulous promoters stand warned” (2004) 38 Taxation in Australia, 27. The contention in the paper was that in the case of Vincent v FCT (2002) 51 ATR 18, the Full Bench of the Federal Court was not prepared to hold that the promoter engaged in the scheme in order to generate a tax benefit but rather to make a profit out of the companies associated with him.
it may be difficult to obtain sufficient evidence to satisfy a burden of proof ‘beyond reasonable doubt’ (as is the case in criminal proceedings), but it may be possible to satisfy a burden of proof of ‘balance of probabilities’, under civil proceedings. While it may be good law to impose civil penalties on those involved in insider trading, or breaching directors duties, it may not be the case with taxation law, where there is a reasonable argument that the conduct is within the law and does not amount to tax avoidance. This area of taxation law is still very vague and penalties may be imposed before a court has had an opportunity to rule on the legitimacy of the tax scheme. This situation could arise as it can take many years before a dispute as to whether or not a tax arrangement constitutes tax avoidance or tax evasion is determined by the High Court, but in the meantime the promoter has been required to pay civil penalties.

What is meant by the term ‘promoter’? Section 290-60 provides the meaning of promoter as:

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.

3. An employee is not to be 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.

What would be the situation for accountants, tax lawyers and financial advisers in a situation where their clients would like to utilise the services of an OFC in say, Singapore, in order to invest their savings more effectively? Simply locating investments in an OFC such as Singapore does not amount to tax avoidance or tax evasion and most accountants and taxation advisers would still believe that such an arrangement was legal. If the accountant or tax adviser in Australia provided advice or received a payment from the offshore finance centre does this make them a promoter? Clearly it can be seen that merely giving advice does not make that person or entity a promoter, but what is the situation if they received a commission related to the amount of money invested with the financial institution in Singapore, or encouraged their clients to enter into the arrangement, would they be caught by section 290-60 and possibly face civil penalties?

One major criticism of the promoter penalty provisions contained in Division 290 is that while the Explanatory Memorandum does try to clarify the meaning of ‘promoter’, section 290-60 fails in its attempt to provide any detailed clarification as to the extent of the conduct required to be held to be a ‘promoter’. For example, in the Explanatory Memorandum, the promoter needs to have a ‘substantial role’ in the promotion of the tax exploitation scheme and not merely provide advice. The concept

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68 Singapore is regarded by both Australia and the OECD as an offshore financial centre and has demonstrated a reluctance to cooperate on the disclosure of banking information unless it concerns their own tax law. The OECD media release dated 29 September 2008, titled, ‘Financial Centres become more transparent, but information exchange remains a problem for some’, states that there are ‘significant restrictions on access to bank information for tax purposes … in Singapore.’ For more details see the OECD, ‘Tax Co-operation: Towards a level playing field’ (2006) OECD, 20.
of what is a ‘substantial role’ is to some extent discussed in the Explanatory Memorandum, but only mentioned once in s 290-60(1)(c), as seen above.69 The subsection 290-60(3) merely states that having a ‘substantial role’ requires more than the ‘marketing or encouragement through the distribution of information or material prepared by another entity’. It would have been very helpful if the section had provided greater guidance on this point so that accountants and advisers would be able to gain a greater understanding of their legal position when a client asks them for advice on investing money in, say, Singapore. The Acts Interpretation Act 1901 (Cth), sections 15AA and 15AB, do provide for the judiciary to interpret provisions of the act by taking into account the objectives and the purpose of the government in enacting the ‘promoter penalty regime’, and section 15AB also allows the court to take into account extraneous materials such as the explanatory memorandum.

The adviser may not be liable to the civil penalties if it can be shown that the arrangement was not a ‘tax exploitation scheme’, Section 290-65. In summary, the section provides the following meaning of tax exploitation scheme:

A scheme is a tax exploitation scheme if:

1. the scheme was implemented with the sole or dominant purpose of that entity or another entity obtaining a scheme benefit from the scheme;
2. if the scheme has been implemented and it is not reasonably arguable that the scheme benefit is available at law or would be available at law;

This then leads to the question, what is meant by the term ‘reasonably arguable’? The statutory provision covering this area of law is found in Schedule 1, s 284-15, of the TAA 53, in relation to the imposition of penalties for a shortfall in the payment of tax. The concept of what constitutes a ‘reasonably arguable’ position was considered judicially by the Federal Court in Prebble v Federal Commissioner of Taxation.70

C When is a matter ‘reasonably arguable’, Section 284-15

Section 284-15 (1) states that ‘a matter is ‘reasonably arguable’ if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct than incorrect.’

Section 284-15 (2) states that to the extent that a matter involves an assumption about the way in which the Commissioner will exercise a discretion, the matter is only ‘reasonably arguable’ if, had the Commissioner exercised the discretion in the way assumed, a court would be about as likely as not to decide that the exercise of the discretion was in accordance with law.

In Prebble v Federal Commissioner of Taxation, the taxpayer, Dr Prebble was denied a deduction for a contribution made to a non-complying superannuation fund. However, even though the deduction had been denied, Cooper J held that as a result of advance opinions and rulings having being issued by the ATO to other taxpayers in earlier years, it was ‘reasonably arguable’ for him to take that position in preparing his tax return and therefore no understatement penalties should be imposed.71 It would be very difficult to predict whether this case and the existence of s 284-15 will provide comfort for advisers engaged in encouraging clients to implement a marketed tax mitigation arrangement? It would be comforting for advisers to think that the Federal

69 Explanatory Memorandum, n 60, 49.
71 Ibid, 470.
Court would find that they have not contravened Division 290, of the TAA 53, on the basis of a reasonably arguable position. However, with all litigation it is not possible to predict the outcome, and they could be facing civil penalties as a promoter of a tax exploitation scheme.

D No distinction between Tax Evasion and Tax Avoidance: Overseas Experience

It is disappointing that the new law does not differentiate between tax evasion and tax avoidance. The new law simply lumps the two distinct activities into one, namely a ‘tax exploitation scheme’ and ignores the fact that tax evasion is illegal activity and prosecuted under the criminal law, whereas tax avoidance is legal but may be struck down by the courts under Part IVA. The law does not even consider making a distinction between acceptable tax avoidance and abusive tax avoidance, which appears to be the trend in other countries, as discussed above. The two activities, tax avoidance and tax evasion are clearly different and it illustrates the fact that the government is content to blur the distinction. In the USA, New Zealand and Canada, with their equivalent promoter penalty regimes, the distinction has been considered and given appropriate weight and the penalties imposed on promoters of tax shelter schemes are significantly less than those being considered in Australia.

According to McCormack and Anderson,\(^\text{72}\) Australia is not the first country to introduce a civil penalty regime to deter promoters of tax exploitation schemes. McCormack and Anderson discuss the situation in three countries, Canada, New Zealand, and the USA and the measures that have been introduced to deter the promotion of tax schemes. In New Zealand, the Government introduced measures designed to encourage the use of tax rulings issued by the Inland Revenue Department so that the Government can be alerted to new arrangements, in case the law has to be changed to prevent a loss of revenue. The term ‘arrangement’ is very broadly defined to include ‘any contract, agreement, plan or understanding.’\(^\text{73}\) The Australian equivalent, a ‘tax exploitation scheme’, has at its core the requirement that the entity has the ‘sole or dominant purpose of obtaining a scheme benefit’. In New Zealand, the law requires the tax arrangement to be offered, sold or promoted to at least 10 or more people in New Zealand before it is considered a scheme that is caught under the statutory provisions.\(^\text{74}\) The penalty that can be imposed is the amount of income tax shortfall from all participants in the arrangement. The New Zealand experience is similar to the Australian situation in that both governments are keen to see tax rulings obtained before tax planning arrangements are widely marketed to taxpayers. However, trying to obtain a private ruling in Australia requires time and money which runs counter to the whole concept of having a tax system based on self-assessment.

In Canada, the law to deter tax schemes was introduced on 29 June 2000 and was designed to catch schemes that ‘do not work and result in unwarranted claims for deductions’.\(^\text{75}\) According to McCormack and Anderson, the Canadian approach takes a narrow interpretation of the law so that the principles of ‘self-assessment’ are not undermined, in that all taxpayers are entitled to prepare their tax returns on the basis that they are correct in assessing their income and deductions, and that their position

\(^{72}\) Ibid, 423.
\(^{73}\) Ibid, 425.
\(^{74}\) The new measures were made law on 26 March 2003 and are contained in the *Tax Administration Act 1994* (NZ).
\(^{75}\) Ibid, 425.
has merit, in the absence of any misleading or criminal conduct.\textsuperscript{76} The penalties in Canada are significantly less than those in Australia, namely the greater of $1,000 and 100 per cent of the gross revenue gained from selling the tax shelter arrangement.

In the USA, tax shelter promoters are required to register their scheme with the Inland Revenue Service. The penalties are the greater of $1,000 and 20 per cent of the gross income derived from the arrangement. However, the IRS Internal Revenue Manual, Part 20, states that ‘a tax adviser would not be subject to the penalty for suggesting an aggressive but supportable filing position to a client even though that position was later rejected by the courts and even though the client was subjected to the substantial understatement penalty’.\textsuperscript{77}

There is genuine concern that some taxation advisers may be caught by the law even when providing advice to their clients on marketed tax mitigation arrangements. There is a fine line between tax planning and tax avoidance, but in both cases there is no criminal conduct on the part of the adviser or taxpayer. It does not appear that the Government considered the experience in Canada and the USA, and in particular the penalty provisions, before enacting the new law.

One of the main concerns with the law is that many innovative lending and financial arrangements may not be promoted simply because the originators of the plans are hesitant to release the products for fear of being subject to very onerous civil penalties. Also of major concern is that the self-assessment system may be severely undermined as a result of taxation advisers being too frightened to be seen as ‘promoters of tax exploitation schemes’ when preparing their clients’ tax returns and offering taxation advice. The Government may well have taken a ‘sledge hammer’ approach to a perceived problem and dressed it up as investor protection. Consequently it may have caused many taxpayers and accounting and law firms to be too frightened to take a position considered to be well within the law, but may subsequently be regarded as tax avoidance, therefore branding them as unscrupulous tax scheme ‘promoters’. In a situation where an accountant or lawyer is asked by their client to provide advice and to use their professional network to establish an investment fund with an offshore bank in, say, Singapore, what should they do? They will not be held to be engaging in the conduct of being a tax scheme promoter if the structure is not marketed to other clients of the firm or other professional practices. However, if that client fails to include any foreign income in their tax return each year, is the tax adviser then held to be a tax scheme promoter and guilty of a criminal offence? The tax adviser would be very wise to have extensive evidence that their client was made aware of their obligations to declare all foreign income and that criminal sanctions could be imposed, similar to those imposed on Glenn Wheatley,\textsuperscript{78} and potentially other taxpayers targeted by ‘Operation Wickenby’.

\textbf{V A FURTHER EXAMPLE OF BLURRING: THE AML/CTF ACT}

The \textit{Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)} (AML/CTF Act)\textsuperscript{79} was introduced to overcome the inadequacies of the existing law

\begin{itemize}
\item \textsuperscript{76} Ibid, 426.
\item \textsuperscript{77} Ibid, 426.
\item \textsuperscript{78} Glenn Wheatley, a high profile Australian, was sentenced to gaol on 19 July 2007 for tax evasion as a result of using a tax haven to hide his investments. His actions were detected as part of the ‘Project Wickenby’ investigations. ATO, ‘Banking on you, our open door policy’, Speech by the Commissioner of Taxation, Australian Bankers’ Association Tax Workshop, Sydney, 22 August 2008.
\item \textsuperscript{79} The AML/CTF Act 2006 received Royal Assent on 12 December 2006.
\end{itemize}
relating to the reporting of cash transactions and to require professional accounting, legal and financial advisory firms to report suspect transactions. The law has been implemented over a 24 months period to allow businesses to meet their obligations. The first tranche has ‘covered the financial and gambling sectors, bullion dealers and lawyers/accountants, but only to the extent that they provide financial services in direct competition with the financial sector’. The second tranche then applied to real estate agents as well as accountants/lawyers carrying out certain transactions such as setting up a company in a foreign country. This means that accountants and lawyers will, from 12 December 2008, be required to report their clients if engaged in suspicious transactions such as transmitting money to a tax haven or OFC. On the face of it, such conduct would appear to constitute the act of money-laundering because the proceeds of that conduct would constitute the proceeds of a crime, in this case the crime being tax related. Even if the client was engaged in legitimate tax planning activity the transfer of funds to a tax haven would need to be reported to the Australian Transaction Reports and Analysis Centre, (AUSTRAC).

The Replacement Explanatory Memorandum to the AML/CTF Bill states that the ‘reforms are a major step in bringing Australia into line with international best practice to deter money laundering and terrorism financing that includes standards set by the Financial Action Task Force (FATF)’ and hence the reason for its proposed enactment. Prior to the AML/CTF Act, under the Financial Transactions Reports Act 1988 (Cth) cash dealers were required to report suspect transactions involving $10,000 or more in cash or international funds transfers, and the opening of bank accounts in Australia. The statutory law in existence prior to 2006 was not considered by the Government to be adequate, especially with the increase in non face to face transactions through electronic transfers. Instead, the AML/CTF Act adopts a ‘risk based approach’ to identifying customers that may be engaged in money laundering or terrorism financing and applies to a very wide range of businesses, not just cash dealers. The use of tax havens and schemes devised by lawyers and accountants is now part of the focus of the new law and will be comprehensively dealt with in the second tranche of law.

A What is ‘money laundering’?

Much is made of the conduct known as ‘money laundering’, but very little attention is paid to defining exactly what are the essential ingredients in the act of engaging in ‘money laundering’. In the ‘Issues Paper 1, Financial Services Sector’ released as part of the Commonwealth Attorney-General’s Department paper on the Anti-Money Laundering Reform, an attempt was made to describe ‘What is money laundering?’ ‘The goal of most criminals is to generate a profit. To enjoy their ill-gotten gains, criminals commonly seek to disguise the illegal source of those profits. Money laundering is the processing of criminal profits to disguise their illegal origin.’

80 The obligations under the Act require (1) customer identification and verification within 12 months from 12 December 2006; (2) record keeping – in various stages within the 12 months; (3) establishing and maintaining an AML/CTF program – within 12 months; (4) ongoing customer due diligence and reporting suspicious matters, international funds transfers – 24 months after 12 December 2006.
81 Replacement Explanatory Memorandum to the AML/CTF Bill at page 1.
82 The new law was released to the public for comment as an ‘exposure draft’ and the Anti-Money Laundering and Counter Terrorist Financing Bill was eventually introduced to the Commonwealth Parliament on 1 November 2006 after taking into account submissions by interested parties.
83 Replacement Explanatory Memorandum, n 30, 1.
84 Issues Paper 1, Financial Services Sector, 1.
In the Australian Law Reform Commission Report 87 on the Proceeds of Crime and in particular Part 7, Laundering of Property and Money, the report attempts to define money laundering as follows:

The definitions of money laundering most frequently used in domestic legislative provisions is derived from that used in the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances which provides that money laundering is:

- the conversion or transfer of property, knowing that such property is derived from any indictable offence or offences, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person, who is involved in the commission of such an offence or offences to evade the legal consequences of his or her actions or
- the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an indictable offence or offences or from an act of participation in such an offence or offences.

Similarly, in the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, money laundering is defined as follows:

a. the conversion or transfer of property, knowing that such property is proceeds, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of the predicate offence to evade the legal consequences of his actions;

b. the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is proceeds.

This means that tax evasion, which constitutes the criminal offence of ‘defrauding the Commonwealth’, which is in the Commonwealth Criminal Code, could amount to money laundering if an OFC or a tax haven was used to disguise or conceal income from investments that were not subsequently declared in the Australian taxpayers tax return. The offence of money laundering is contained in Part 10.2, Division 400 of the Criminal Code. The Replacement Explanatory Memorandum to the AML/CTF Bill provides the following estimate of the extent the financial problem faced by the Government in terms of money that is being laundered every year and not being subject to income tax in Australia.

The size of the money laundering problem cannot be accurately quantified but, in a research project funded by AUSTRAC and drawing on a wide range of financial and other data relating to 1994, it was estimated that in that year ‘a range of between $1,000 million and $4,500 million would appear to be a sensible interpretation of the information provided in these sets of estimates, with perhaps some confidence that the most likely figure is around $3,500 million, since this figure lies within all three estimate ranges.

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86 Although that was restricted to narcotics related offences.
87 Australian Treaty Series 1993 No 4 UNTS art 3(1)(b).
88 ETS No 141 art 6.
89 The offence of defrauding the Commonwealth was until 2005 contained in the Crimes Act 1914 (Cth), s 29D.
90 J Walker Estimates Of The Extent of Money Laundering In And Through Australia AUSTRAC September 1995, 39. This report is also referred to in the Replacement Explanatory Memorandum to the AML/CTF Bill at page 12 to justify the introduction of the law.
B Designated services – Lawyers, accountants and financial advisers

The concept of requiring businesses engaged in providing ‘designated services’ to report suspect customers and obtaining proof of identification are the key measures being used by the law to detect suspicious matters. The definition of ‘designated services’ is so broad, that it will cover all businesses which provide trade credit, including all consumer credit transactions. There is also no limit on the money being paid for a designated service, except a $1000 limit for stored value cards.

The Act generally requires a business to ‘identify’ new customers before providing a service. Circumstances in which a customer can be identified after the service has been provided are if the prior identification would disrupt the ordinary course of business, the service is specified in the AML/CFT Rules, and:

– It is not provided face-to-face; or
– It consists of acquiring or disposing of a security or derivative on behalf of a customer; or
– It consists of issuing or undertaking liability as the insurer under a life policy or a sinking fund policy.
– In some circumstances, the provision of certain low-risk services will not require client identification.

The AML/CTF Rules are made by AUSTRAC pursuant to powers provided by s 229 of the AML/CTF Act and to date a number of rules have been made.91

Lawyers, accountants and financial advisers are only under an obligation to report suspicious matters when providing ‘designated services’. Section 6 of the Act contains two tables. The first lists 63 designated services of a financial services nature with specific reference to Australian Financial Services License holders (Items 62 and 63 refer to buying and selling bullion). The second table refers to gambling services. Therefore lawyers, accountants and financial advisers are a reporting entity to the extent that they provide designated services.

For example, lawyers acquiring or disposing of securities on behalf of clients, creating and dealing with promissory notes, bills of exchange, and arranging safe deposit box facilities are providing a designated service. Preparing a will is not a designated service. However, the purchase of real property and the provision of mortgage finance or international transfer of funds is a designated service because the transfer of real property and mortgage arrangements can be used to launder money.92

Similarly, the creation of a trust or company structure to be used to move funds offshore or on shore will be a designated service. The following services are not regarded as being ‘designated services’:

• Preparation of a tax return is not a designated service.
• Providing advice on what are securities and derivatives.
• Establishing a superannuation fund and then advising on the investment of the funds.
• Advising on life insurance or a sinking fund insurance policy.

The main thrust of the AML/CTF Act is to require businesses which provide designated financial services to have a process to identify their customers. Professional advisers are referred to as ‘gatekeepers’ in the Explanatory Memorandum because of those people involved in money laundering using the services of professionals to launder the money. The Government has recognised that criminals use sophisticated structures such as trusts, companies and managed investment schemes to launder money. However, what happens when an existing client seeks advice from their lawyer or accountant about establishing an investment fund in say, Singapore, because they want to diversify their investments. Would their accountant or lawyer have to report this activity or be in breach of their obligations under the AML/CTF compliance requirements, or do they make the judgment that the activity is legal and does not amount to money laundering? The simple answer is that they must report these transactions to AUSTRAC or face serious consequences.

The AML/CTF Act requires professional practices, whether they are engaged in accounting, legal or financial planning services, to not only formally identify their clients but also to report their activities to AUSTRAC that may be suspicious in terms of money laundering or terrorist financing. As was mentioned above, the government is aware that these types of professional practices provide services to those people engaged in money laundering and they want to identify those involved so that they can be prosecuted. Unfortunately, taxpayers engaged in tax planning activities may be caught by this new law as it makes no distinction between tax evasion, tax avoidance or tax planning. Clearly, the government would like to see all tax minimisation activity categorised as constituting a criminal offence and then the taxpayer can be prosecuted under the Commonwealth Criminal Code for money laundering.

C International implications of the Law

Designated services are not subject to the new law unless the service is provided in Australia through a ‘permanent establishment’ of a Foreign Service provider, or the service is provided by an Australian resident or a resident subsidiary company through a permanent establishment in a foreign country. Will this law result in Australians obtaining financial and taxation advice from a non-Australian provider in a location outside Australia? This may well be the case and the government will be in an even more difficult situation in trying to detect Australian taxpayers engaged in tax planning activities in tax havens and OFCs. Similarly, will Australians be reluctant to obtain tax planning advice in Australia even if not engaged in money laundering, but legal tax mitigation using a tax haven or OFC? In particular, what effect will this law have on Australians using tax havens for legal purposes? Given that Australian Banks, Australian accounting firms and Australian law firms have offices in tax havens in the Asia-Pacific region their services are subject to the AML/CTF Act where they are operating through a permanent establishment in that country. These questions will not be answered for a number of years and should provide a fertile area for future research. Indeed, as Eden and Kudrle noted regarding the future of tax havens in light of initiatives by the OECD and now Australia, with the proposed anti-money laundering legislation, at this stage no research has been undertaken into the role of the multinational enterprises and international tax and accounting firms located in tax havens.\textsuperscript{93}

VI IMPLICATIONS FOR THE ‘RULE OF LAW’

\textsuperscript{93} Lorraine Eden and Robert Kudrle, n 52, 124.
One of the major implications of the government treating all tax minimisation activity, either by tax avoidance or tax evasion, as constituting criminal activity, is that it threatens the ‘rule of law’. By ignoring clear distinctions within the established taxation law of Australia on this point, it provides the ATO with powers that potentially infringe the rights of taxpayers. More importantly, by confusing the issue of what constitutes acceptable tax mitigation activity with unacceptable tax avoidance, the rule of law is put at risk by the inherent complexity of the current law.

The ‘Rule of Law’ is a principle contained in the English legal system and as enunciated by Professor Dicey, holds that all men are equal under the law except the Crown. It can also be expressed as the notion ‘that the people and the government should obey the law and be ruled by it’, but the legal concept of the ‘rule of law’ is not readily definable. What is important in this context is the fact that there is a ‘strong correlation between economic growth and a strong rule of law…’ In other words; a country that ensures that all of its citizens and the government obey the law will have a strong and vibrant economy. If that is the case then the law must be easy to understand and administered fairly, and the doctrine of separation of powers should also operate effectively. Parliament, consisting of elected representatives, makes the law; the Executive administers the law and the Judiciary resolves any disputes arising from interpreting the law. In the context of a deliberate blurring of the distinction between tax avoidance and tax evasion, the rule of law has relevance because of how the existing law is to be made and interpreted by Parliament, the Executive and administrators, and the Judiciary. Professor Walker is of the opinion that the rule of law is being eroded due to the number of wide discretions, especially in relation to tax avoidance, Part IVA, and provides the following statement to that effect:

The ultimate grant of discretionary power is, of course, Part IVA, enacted in 1981 and to which the rest of the Act is subject. Australia has placed more reliance on the GAAR than any other Western democracy, and Part IVA’s supporters argue that it may strengthen the rule of law by increasing compliance with tax legislation. The problem, however, is that it seeks to encourage compliance by means that compromise the rule of law, for example by depending on discretion and opinion.

Professor Walker contends that there is far too much discretion given to both the ATO and the courts in determining what constitutes tax avoidance. He quotes extensively from Professor Jeffrey Waincymer in that ‘this approach offends against the separation of powers doctrine and the requirement that the laws be made by parliament not bureaucrats’. One of the key issues that Professor Walker has identified as being conducive to an erosion of the rule of law is found in the ATO’s ruling system where in ‘perhaps 90 percent of cases these materials are consistent with enacted law, but in the remainder

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96 Ibid, 425. Ross Buckely has taken this quote from Douglas North, the Nobel Prize winner in Economics in 1993 who researched the correlation between the rule of law and economic growth and development.
the ATO is effectively making its own rules’. In 1992, when the ruling system was being introduced into Parliament by the Minister assisting the Treasurer, it was stated that ‘the ruling system was touted as promoting certainty for taxpayers and thereby reduce their risk and opportunity cost’. However, a recent example of where an ATO ruling, TR 1999/5 was in conflict with the case law is found in the Federal Court decision in Essenbourne Pty Ltd v FCT. The ruling was subsequently withdrawn on 27 June 2007 after the Commissioner of Taxation had publicly disagreed with the decision of Kiefel J through an ATO Media release and the Commissioner had brought three more cases before the Federal Court in an attempt to obtain a Federal Court decision in line with its public ruling, TR 1999/5. In the end, all of the Federal Court decisions held that there was no fringe benefit in the situation involving employee benefit trusts and non-complying superannuation funds. The major issue threatening the ‘rule of law’ in this situation was that the Commissioner of Taxation was adopting the position of the Parliament and the Judiciary in making new taxation law in relation to the fringe benefits tax. The stance taken by the ATO went far beyond what is required to administer the taxation law and would have added to the confusion facing tax professionals, business and individual taxpayers.

Professor Walker provides a number of examples of situations where the discretion provided to the Commissioner of Taxation has led to the ATO adopting the role of law maker and as such threatening the rule of law. One example that has serious implications for tax administration is the bonus arrangement that auditors are being paid for every extra dollar of revenue collected. As Professor Walker states, ‘the practice of remunerating tax officers according to the amount of revenue they collect recalls the 18th century tax-farming abuses that helped trigger the French Revolution’.

V CONCLUSION

The distinction between tax avoidance and tax evasion, that has been firmly established in the Australian common law, is still of great importance when dealing with taxation issues domestically. However, it would appear that the Australian Government is determined to ignore the distinction between tax avoidance, a legal activity and tax evasion, a criminal activity, when it comes to Australian taxpayers engaging in tax planning in a tax haven or through the use of an OFC. The Government has recognised that many tax schemes involve the use of tax havens, and appear to have designed a set of laws to deter the promotion of tax schemes that make no distinction between tax avoidance and tax evasion. Similarly, in relation to the law to detect and eliminate money laundering, once again the Government appears to have deliberately blurred the difference between tax avoidance and tax evasion. The AML/CTF Act would appear to designate that all measures to reduce and minimise income tax through the use of tax havens constitutes criminal activity and therefore

99 Ibid, 2.
103 The cases before the Federal Court that held that there was no fringe benefit in terms of the ruling TR 1999/5 were Walstern Pty Ltd v FCT (2003) 138 FCR 1, Caelli Constructions (Vic) Pty Ltd v FCT (2005) 147 FCR 449, and Indooroopilly Children Services (Qld) Pty Ltd v FCT [2007] FCAFC 16.
104 Walker, Geoffrey, n 96, 3-5.
105 Ibid, 5.
justifies the tax haven in breaching its bank secrecy laws. The fact that the rights of the taxpayer may be adversely affected and the taxpayer wrongly being accused of criminal activity is of no concern for the Government when trying to maximise government revenue.