The ATO and Main Camp

Report of the investigation into the Australian Taxation Office's handling of claims for tax deductions by investors in a mass marketed tax effective scheme known as Main Camp

Report under section 35A of the *Ombudsman Act 1976*

January 2001

1. OVERVIEW

The Commissioner's actions in relation to mass-marketed tax-effective schemes have been the subject of wide public debate and comment. The Ombudsman investigated the ATO's actions in relation an arrangement known as Main Camp following complaints from over 120 investors. As there are many other affected investors, tax advisers and financial planners who may benefit by being aware of the Ombudsman's views, the Ombudsman has decided that his report into this investigation should be released to the public under section 35A of the *Ombudsman Act 1976.*

As the Senate Economics References Committee is also undertaking an Inquiry into Mass-Marketed Tax-Effective Schemes and Investor Protection, the Ombudsman intends to provide this report to that Committee.

The complaint

Main Camp is a producer and exporter of tea tree oil. Prospectuses seeking public investment in these activities were released over a period of four years, 1992 to 1995. Main Camp was the subject of an ATO audit during the period 1997-99. This resulted in the ATO issuing position papers to the promoter and the investors proposing to disallow the investors' self assessed claims for deductions in relation to Main Camp Project Nos 3 and 4 for the 1994 and 1995 years, respectively. The ATO estimated that around 1000 taxpayers had made claims for deductions of up to $70m for this period. The Commissioner applied the anti-avoidance provisions (Part IVA) of the *Income Tax Assessment Act 1936* (the Act) to raise the amended assessments for these years.

The common themes running through these complaints are:

- the Commissioner has changed his interpretation of the law as it applies to the Main Camp arrangement;
- the time it has taken the ATO to audit the projects and to raise amended assessments (6 years) is against the law, unfair and unreasonable;
- the Commissioner is acting inconsistently with a Government policy of encouraging investment in Australian products;
- by applying Part IVA of the *Income Tax Assessment Act 1936* to the arrangements the Commissioner is labelling honest investors as tax cheats;
- the application of culpability penalties is inappropriate when investors had acted on the advice of tax and other professionals;
- the application of interest charges is unjust when the interest is a result of the ATO's delay;
- the raising of the amended assessments and commencing recovery action without waiting for a test case is unreasonable; and
- the investors, in many cases, would be facing severe financial hardship if forced to pay the tax debts raised by the ATO's actions.

The Investigation

In 1998-99, the Ombudsman investigated another mass marketed scheme arrangement known as Budplan. A report on this investigation was released publicly in June 1999. As a result of the views expressed by the Ombudsman in the Budplan report, and the more recent improvements in the ATO in addressing mass-marketed schemes, including the development of specific guidelines for settlement of schemes, the Ombudsman's office had been declining to investigate the

majority of complaints about the ATO's actions in relation to schemes. The Ombudsman's staff have been referring the complainants to the ATO in an attempt to allow matters to be resolved directly with the ATO in the first instance.

Complaints about the ATO's actions in relation to Main Camp Projects Nos 3 and 4 were first received in June 2000. Given the number of complaints and the nature of complaints, in particular the fact that the projects had been promoted by the Budplan promoter and pre-dated the Budplan arrangement, the Ombudsman decided an investigation was appropriate.

The Ombudsman and his Special Tax Adviser met with the Commissioner and other senior tax officers in July 2000 to discuss the proposed investigation and the particular areas of concern. Since that time there have been numerous other discussions between the Special Tax Adviser and ATO officers, culminating in the ATO agreeing to consider settlement offers and further penalty and interest remissions.

A draft report, including 20 recommendations, was provided to the Commissioner on 4 December 2000. The Ombudsman acknowledges the cooperation of the Commissioner in providing a preliminary but detailed response on the draft report four days later. While the Commissioner accepted the majority of recommendations, a further meeting was held with him in January 2001 to discuss the outstanding recommendations. At this meeting agreement was reached on all remaining recommendations, the details of which have now been reflected in this report.

Conclusions and Recommendations

In relation to the Main Camp complainants, this report concludes that the Commissioner was legally entitled to take the action he did to amend their returns up to six years after they had first made claims for deductions. The ATO agreed, however, to consider settlement offers in accordance with the Addendum to the Code of Settlement. As a result of discussions with the Ombudsman's office, the ATO agreed to consider settlements which allowed for a tax deduction to the extent of actual cash contributed by the investor in the arrangement. The ATO also agreed to further remissions of penalty tax to a maximum of 5%, recognising of course, that there would always be a need to have regard for individual circumstances in settlement offers.

The Ombudsman is satisfied that this proposal provides a constructive approach to resolving individual investors' tax liabilities in this matter for those who do not wish to dispute the Commissioner's view.

The Ombudsman also recommended that further remissions in relation to interest be considered given the delays by the ATO in addressing the arrangement. This reflects the Ombudsman's view that, while within the legal timeframes, the delays in participants being made aware of the ATO position on the arrangement has created an extra financial burden on the participants. The Commissioner has agreed to this recommendation, which applies to all Main Camp investors, not just those choosing to settle.

This agreement is in relation to Main Camp only. It does not provide a precedent for other mass marketed

schemes cases, as each needs to be considered on its own merits.

Notwithstanding the Commissioner's legal right to take the actions he has, and his willingness to consider settlement offers, this report does raise a number of administrative deficiencies that are the subject of recommendations for future improvements to schemes' administration within the ATO.

The Ombudsman also draws attention to concerns about how the actions and advice of others in the tax system, such as tax agents, tax advisers, financial planners, and scheme promoters, can influence taxpayers' decisions. The Ombudsman considers there needs to be more attention given to the accountability mechanisms which support proper compliance with the community's tax system. As a consequence, a number of the recommendations go beyond the administrative responsibilities of the Commissioner and are matters which the Government, Parliament and the community need to consider.

The complete list of recommendations, together with the Commissioner's responses, are presented here in three parts:

- Part A - Self Assessment,
- Part B - Main Camp Action, and
- Part C - Schemes Management by the ATO.

The Ombudsman will monitor the ATO's progress towards implementation of those recommendations agreed to.

Part A - Recommendations to strengthen self-assessment

Recommendation 1: The ATO analyse the extent to which taxpayers generally are aware of and understand the implications of the self-assessment system, and develop an information and education program aimed at addressing areas of misunderstanding or ignorance which is directed at the taxpaying (as opposed to the tax professional) community.

> ***ATO response:*** *Agreed in principle.*

Recommendation 2: The ATO provide, with Notices of Assessment, an explanation of the way the self-assessment system applies to that assessment.

> ***ATO response:*** *ATO has agreed to look at the feasibility of adopting this recommendation.*

Recommendation 6: The Government confirms the timetable for the introduction of a legislative framework for tax agent services.

> ***Ombudsman Note:*** *This is a matter to be raised with the Government.*

Recommendation 7: The ATO consider any possibilities for expansion of the legislative framework to take into account tax related advice provided by other professionals.

> ***ATO response:*** *Agreed*

Part B Recommendations for action in relation to Main Camp

Recommendation 3: The Commissioner remit tax shortfall penalties to 5% for Main Camp investors in the context of a settlement.

> ***ATO response:*** *Agreed.*

Recommendation 4: The Commissioner remit all interest charges for all Main Camp investors, whether or not they choose to settle, for the period prior to 1 January 1998.

> ***ATO response:*** *Agreed.*

Recommendation 8: The ATO explore the possibility of funding independent legal advice for participants considering a negligence claim against professional advisers.

> ***ATO response:*** *The ATO supports measures, which will enhance the protection of investors from negligent or fraudulent advice and activities relating to the tax aspects of investment schemes and will be raising this with appropriate Senate Committees.*
>
> *The question of legal funding generally is a matter within the responsibility of the Attorney-General and any decision to pursue the general objective underlying the recommendation would require consultation with him and the agreement of Government.*
>
> *The recommendation, if linked to the ATO using revenue collected from penalties would require legislation to implement it. The ATO would require legal advice whether it could lawfully implement the recommendation out of ATO running costs. To do so would be outside the scope of current litigation funding programs.*

Recommendation 14: The ATO write to all Main Camp participants and advise them that it is prepared to consider settlement options and the terms upon which it is prepared to settle.

> ***ATO Response:*** *The ATO's ability to do this is limited following the decision in Young's case.*

Recommendation 16: The ATO adopts a conciliatory approach to repayment arrangements for Main Camp investors.

Recommendation 17: The Commissioner not seek to make a person bankrupt, or to require them to sell their principal place of residence to repay a debt, unless an unacceptable risk factor has been identified.

> ***ATO response***: *Recommendations 16-17 Agreed in principle within the framework of the ATO's Debt Collection Policy.*

Part C - Recommendations for improvements to schemes management by the ATO:

Recommendation 5: The Commissioner explore whether there is any lawful and reasonable mechanism for placing some onus on promoters to alert participants to any investigations being undertaken by the ATO, or any concerns the ATO has expressed about the way the tax laws may apply to the arrangement where that differs from that

presented in a prospectus or product ruling.

ATO response: *Agreed in principle.*

The ATO is raising this with the Senate Inquiry into Mass Marketed Schemes.

Recommendation 9: The ATO provide taxpayers with more detail on the reasons for the decisions it has made including a précis of case law and rulings relied upon.

Recommendation 10: The ATO provide taxpayers with more indication of what individual circumstances would warrant consideration in terms of any change to the Commissioner's view about the application of Part IVA.

Recommendation 11: Where taxpayers have provided information that they believe warrants consideration in so far as Part IVA applying to their individual circumstances, that the ATO considers that information and responds.

ATO response: *Recommendations 9-11 Agreed in principle.*

Implementation of these recommendations will need to have regard to administrative law considerations to ensure that any statements the ATO makes do not expose its decisions (eg Part IVA determinations) to challenge (eg because of what the ATO says in public statements and guidelines).

Recommendation 12: The Commissioner continue to refrain from determining objections in relation to Budplan participants, other than those participating in the test case program, pending finalisation of the Ombudsman's investigation into that program.

Recommendation 13: ATO to work with taxpayers to get representative cases to court.

ATO response: *Recommendations 12 and 13 - Agreed subject to the Commissioner's comments in his speech, "The Tax Reform Wave – Challenges &Opportunities", on 20 July 2000. (See pp6-7)*

The Commissioner argues that representative cases are not getting to the courts as early as he would like; that there is a real danger that selected representative cases may pull out of the process at the last moment; and that the continuing delays put off the "hard edge of reality of participating in aggressive schemes". He has decided, therefore to generally issue amended assessments and determine objections unless the ATO is considering matters put to it by the taxpayers or their representatives, such as offers of settlement.

Nevertheless, given previous commitments to the Ombudsman and the Budplan participants, he has agreed to hold off on determining Budplan objections for the time being.

The ATO will continue to work with the promoters and taxpayers to get representative cases heard by the courts as quickly as possible.

Recommendation 15: Where the ATO determines that there is scope to consider a settlement, it should advise

participants in the first instance, and then enter discussions for amended assessments to be made on the basis of the settlement offer.

ATO Response: *The ATO's ability to do this is limited following the decision in Young's case.*

Recommendation 18: The Commissioner to consider providing taxpayers with information about ATO debt recovery policy, the existence and role of the Tax Relief Board, and relevant contact points, including access to the Ombudsman, when they are advised that a debt is to be raised.

ATO response: *Agreed in principle*

Recommendation 19: The ATO look at ways of providing the community with information about the ways the tax system does support investment in particular areas. The ATO needs to be able to explain how the tax laws are applied to these investments and, where necessary, the difference between the use of the general deduction provisions vis a vis specific tax concessions or other industry and investment incentives.

ATO response: *Agreed in principle*

Recommendation 20: The ATO take a more holistic approach to the resolution of the inevitable disputes arising from its actions in relation to mass marketed schemes, including:

a) giving greater attention to 'knowing the client' – promoter and participant profile analysis so that the ATO can identify and respond proactively to issues affecting them;
b) providing more information to participants about the reasons for the decisions, including more detailed explanation of the law, the relevant case law and the applications of any rulings etc;
c) testing, prior to release, the level of taxpayers' understanding with the information proposed to be provided to participants;
d) identifying, and advising participants of the circumstances in which a settlement may be considered, and being prepared to act on it from the outset.

ATO response*: Agreed in principle, with d) subject to the legal constraints outlined in response to recommendations 14 and 15.*

2. BACKGROUND

According to the Commissioner of Taxation's 1999-2000 Annual Report[1], as at 30 June 2000, the ATO had finalised its position in relation to 212 mass-marketed schemes and had another 70 under examination. 17,980 taxpayers have received amended assessments; many covering several years, and this number grows as more schemes are addressed. In his Annual Report, the Commissioner estimated the deductions claimed in such schemes in 1998-1999 to be $1bn.

The Commissioner reports that most of the schemes are based in agriculture and afforestation activities, franchises, films and employee benefit arrangements. The Ombudsman has received complaints covering all of these fields. From the information provided by the ATO in position papers and strategy papers viewed by the Ombudsman's office, most are financed by non-recourse or limited recourse loans, established through round robin arrangements where the finance company is closely associated with the promoter company.

Briefly, the common practice in these arrangements is for an investor to borrow money from a finance company, which is then invested with a promoter company. The promoter company uses some of the funds for product development, the balance being held by the finance company. The investor pays an upfront management fee and interest on the loan. The loan is usually only paid off from the profits of the business, which may be some years later. In some circumstances, the timing for the payment of the management fee and interest coincides with the investor's tax refund; a refund based on the premise of the tax deduction for the investment. Alternatively, investors seek a tax saving by way of a tax instalment deduction variation (s221D of the Act), which enables a reduction in PAYE taxes and an increase in net weekly income.

While these mass-marketed tax-effective schemes appear to have been around for many years, it was only when the ATO started to identify an increased use of tax instalment deduction variations in 1997, and a resultant risk to revenue that a coordinated strategy was put in place to investigate the schemes and to determine their legitimacy for tax purposes.

Budplan

The Budplan tea tree oil research and development series of schemes was one of the first to be investigated by the ATO as part of this coordinated strategy. The ATO issued a position statement to the representatives of the promoter of Budplan in April 1998 advising that the deductions claimed by the investors were not allowable and that their returns would be amended and penalties applied accordingly.

The promoter's representative and some 1600 investors complained to the Ombudsman about the Commissioner's proposed actions. We investigated the allegations and issued a public report in June 1999.[2] The Ombudsman reached the conclusion that the Commissioner's interpretation of the law was open to him but noted that ultimately it was a matter for the courts to decide. The taxpayers were not entitled to rely on certain public rulings as the arrangement was not on all fours with those public rulings, and only one of over 10,000 investors had sought the

[1] Commissioner of Taxation Annual Report 1999-2000 p70

[2] 'The ATO and Budplan', Report under section 35A of the *Ombudsman Act 1976*, June 1999

ATO's advice by way of a private ruling request. In view of this, the Ombudsman was of the opinion that the Commissioner was acting lawfully and reasonably by taking the action he did to amend the assessments dating back to 1996 and 1997. It was also appropriate for the Commissioner to consider the application of the anti-avoidance provisions of the Act and to advise the participants accordingly.

The Ombudsman formed the view that there had been defective administration in not responding to the one private ruling request in a timely way, but that that was a matter between the applicant and the ATO, and could have no bearing on the decisions made by the other thousands of investors. The Ombudsman thought the ATO had acted inconsistently in the way it processed tax instalment variations but again concluded that this was not a determining factor in the investment decisions of the participants. The Ombudsman also expressed a concern that the principles of self-assessment did not appear to be well understood by the participants, and that the ATO needed to put more effort into ensuring information about self-assessment was generally available. The Ombudsman also wrote to the participants suggesting that if they thought they might have been poorly advised by their financial planners or tax advisers they may want to consider their options for addressing that with the relevant bodies.

Budplan Test Case Program

The Ombudsman noted the Commissioner's willingness to resolve the matter in a fair and conciliatory manner in proposing to remit tax shortfall penalties from 50% to 5%, and following the intervention of his office, by agreeing to refrain from raising the majority of amended assessments and from recovering the tax in dispute pending the establishment of a test case program relatively quickly.

Representative test cases are now not scheduled to be heard in the Federal Court until June 2001. In the meantime, the Commissioner has found it necessary, because of statutory time limitations, and later year refund cases, to start raising the amended assessments and, where necessary, to apply refunds against the Budplan related tax in dispute. However, following discussions between the Commissioner and the Ombudsman, the Commissioner did agree to continue to refrain from determining objections in these cases. The Ombudsman is now investigating the reasons for the delays in getting representative cases to court. This will be the subject of a separate report by the Ombudsman.

Decision to Investigate Main Camp

Following our investigation into Budplan, and the development of an Addendum to the Code of Settlement Practice to address mass-marketed scheme settlements,[3] the Ombudsman was satisfied that the processes the Commissioner had established to manage the mass marketed schemes program were open, accountable and were intended to treat participants fairly and individually. We have continued to investigate some complaints about the ATO's actions in individual cases. For example our investigation into a film scheme is also nearing finalisation. In the majority of cases, however, we have been exercising a discretion not to investigate, preferring instead to encourage complainants to try to sort the issues out with the ATO in the first instance. The Ombudsman decided to

[3] The Addendum to the Code of Settlement Practice provides guidelines for the settlement of Mass Marketed Schemes. Issued by the ATO in July 2000.

investigate the Main Camp actions because of:

- the number of participants affected;
- the fact that these projects were managed by the same promoter as Budplan and had been put in place prior to Budplan but not investigated until after Budplan; and
- the nature of the allegations raised.

The Main Camp Tea Tree Oil Projects

The Arrangements

There were four Main Camp Tea Tree Oil projects. Only Main Camp Tea Tree Oil Project No. 3 and No. 4 have been subject to amendment action by the ATO and therefore investigated by the Ombudsman. The prospectuses for No. 3 and No. 4 were dated April 1994 and 1995 respectively. Each was lodged with the Australian Securities and Investment Commission. The prospectuses described the decision to subscribe in the investment as a decision to engage in the business of growing and harvesting tea trees, in order to process the harvest and sell quality oil at a profit.

The participant acquired a prescribed interest in the project upon execution of a principal agreement and acceptance of the completed application form. At the same time, the participant became a party to and was bound by the Farm Agreement, the Management Agreement and the Loan Agreement.

The participant was required to pay management fees of $23,450, farm fees of $50 and a seed fee of $200. The second year management fee was $2725, farm fee $50, and no seed fee. All farm fees and management fees after the second year were only payable from the participant's gross farm income arising from the sale of tea tree. There is no further recourse to the participant. If no income is derived, no payment of farm fees or management fees is made after year two.

The Loan Agreement enabled the participants to borrow 100% of the funds to pay the management fees and farm fees for years 1 and 2.

The taxation and cash flow aspects of years 1 and 2, represented in the prospectuses, highlighted the tax benefits which could be obtained. A participant on the highest marginal tax rate, would make an actual cash outlay of $14,475 ($200 for seeds and $14,275 on prepaid interest and repayments of principal). The participant would claim a tax deduction for management fees, farm fees and interest payments of $32,050, which represented a tax saving of $15,512.

The prospectuses included an opinion from a chartered accounting firm in relation to the tax implications. The opinion was heavily qualified and made a number of assumptions as to whether the investor was carrying on a business, or the likelihood of the Commissioner applying Part IVA to the arrangement. Prospective investors were encouraged to seek the advice of professional advisers on these matters.

Application of the tax law according to the ATO

Position papers outlining the ATO's views as to the legality of the tax deductibility of investments by participants in Projects Nos 3 &4 were provided to the representative of the promoter in December 1999. These detailed the ATO's arguments as to why the expenditure did not satisfy the

requirements of the general deductions of the tax laws (Sub-section 51(1) of the Act), why sections 82KL and 82KM may apply, and why it considered that the general anti-avoidance provisions (Part IVA) applied. [4]

Included in the position paper was the ATO view that the finance company and the management company were not at arm's length. The funds borrowed by the participants to pay the management fees and farm fees were involved in a round robin arrangement. No actual funds were available to the manager as a result of this arrangement, as all management fees and farm fees were deposited with the finance company. However, there is evidence of an underlying tea tree farming business being carried on. Funds for this appear to have come only from the interest and principal repayments made by the participants.

Summary versions of these position papers were provided to participants in June 2000. The participants were advised that the Commissioner believed that the dominant purpose of entering into the scheme was to obtain a tax benefit in the form of an up-front tax deduction, and that he intended to apply Part IVA to amend the participant's assessment. The document also presented the Commissioner's views, "that the participant lacked sufficient commercial purpose as evidenced by:

- the high initial management fees relative to later years:
- little or no practical control over the management;
- limited exposure to risk;
- the round robin arrangement associated with the initial management fees;
- the limited recourse nature of the loan with no requirement to pay the interest or repay the principal out of own moneys beyond Year 2; and
- the relatively low interest rate on monies borrowed after Year 2". [5]

The ATO's proposed actions

In addition to the summary version of the position paper advising the participants the ATO proposed to disallow their deductions in relation to the Main Camp projects, the ATO outlined the process for amending their assessments and the penalties involved.

Participants were provided with a schedule to complete with details of the relevant deductions claimed. Voluntary disclosure of these details, together with a 'request' for the Commissioner to amend their assessments would result in a remission of tax shortfall penalties from 50% to 10 %. The ATO advised that interest would be charged on the tax shortfall from the due date of the original assessment to the date the schedule was received by the ATO.

The participants had until 12 July 2000 to undertake this voluntary disclosure.

The letter confirmed that the participants' objections and review rights would not be affected by completion of the schedule.

Participants were invited to include information about their individual circumstances which might assist in the resolution of the matter in a fair way.

[4] ATO Position Paper: Main Camp Tea Tree Oil Project No.3 and the Deductibility to Participants of Management Fees, Farm Fees and Interest Payments, 1 December 1999

[5] ATO Position Papers re Main Camp Tea Tree Oil Project No.3 and Project No.4 issued to participants on 14 June 2000.

They were also advised that the amended assessments would be due for payment 30 days after the issue of the notice of amended assessment. If the investor lodged an objection, the ATO would not take any legal action to recover the tax until the objection was determined, unless there were other tax debts outstanding or there were reasonable grounds to believe that the collection of the tax debt was at risk. The investors were advised, however, that the general interest charge would be accruing on the outstanding taxes. In line with its general recovery policy, the ATO offered that if 50% of the tax in dispute was paid by the due date, the general interest charge would apply at half the rate on the remaining amount.

The Issues

"The Commissioner accepted the schemes – how can he change his mind now and impose penalties and interest charges on me?"

The promoter and the overwhelming majority of complainants argue that the Commissioner had given these projects the all clear and has now changed his mind and is seeking to amend assessments retrospectively, including imposing penalties and interest charges that are unjust.

There are two primary factors which appear to have influenced the participants' view that the ATO had ratified the arrangements:

- Self assessed returns for the 1994 and 1995 years had not been queried or rejected by the ATO, and refunds reflecting the tax deductions claimed in relation to the projects issued; and
- The ATO had provided at least four private binding rulings in relation to Main Camp Projects 1 and 2 approving similar arrangements. On the information provided by the complainants, these rulings appear to have been used by some financial planners and tax advisers, to promote the investment as being approved by the ATO.

Self assessment

A self assessment system has applied in Australia since 1987 and yet, based on the nature of complaints to the Ombudsman, it appears that there continues to be a lack of understanding as to the way the system works and the added responsibility the system has placed on taxpayers.

The basic premise of the self assessment system is that taxpayers' returns are not generally subjected to technical scrutiny by the ATO prior to an assessment being issued. The issuing of an assessment with a refund provides no guarantee that the Commissioner has considered and accepted the income and expenses claimed by the taxpayer. The onus is on the taxpayer to ensure they have interpreted and complied with the tax laws correctly.

This system is supported by the binding public and private rulings system, a penalty system for understatement of liabilities and a wide ranging audit program. The Commissioner has extensive powers to amend assessments. Generally there is a four year limit on amending assessments. This is increased to six years where the Commissioner determines the general anti-avoidance provisions apply, and at any time, where the Commissioner is of the opinion that there has been tax avoidance due to fraud or evasion.

The Ombudsman recognises that the ATO has developed a considerable amount of material to explain taxpayers' rights and obligations under self-

assessment but considers that much of this has been directed at the tax profession. Taxpayers, whether or not they put their affairs in the hands of an adviser, remain responsible for the claims made in their returns. The nature of complaints to the Ombudsman suggests a significant level of misunderstanding or indeed ignorance as to the way self-assessment works. There needs to be a better communication of a taxpayer's obligations and responsibilities, and the Commissioner's powers under self assessment. Despite the ATO's efforts, and the fact that self-assessment has been with us for a decade and a half, for there to still be significant misunderstanding by parts of the community about the fundamentals, suggests that a continuous program of reinforcement is essential.

Following the Budplan investigation the Ombudsman had suggested that the ATO include information in Tax Pack and other public information initiatives to reinforce the self-assessment messages. The Ombudsman acknowledges that some basic information has now been included on page 1 of Tax Pack 2000 but suggests this is not sufficient to overcome the apparent deficiencies in the general community's understanding.

Recommendation 1:

- The ATO analyse the extent to which taxpayers generally are aware of and understand the implications of the self-assessment system, and develop an information and education program, aimed at addressing areas of misunderstanding or ignorance, which is directed at the taxpaying (as opposed to the tax professional) community.

Recommendation 2:

- The ATO provide, with Notices of Assessment, an explanation of the way the self-assessment system applies to that assessment.

Private rulings

The Private Binding Ruling System was introduced in 1992 to provide greater certainty to taxpayers on the application of tax laws to their personal affairs, in a self-assessment environment. Their application is conditional: they only apply to the applicant for the period specified in the ruling; on the basis that full facts have been provided to the Commissioner; and the transaction entered into is as described in the ruling. The Commissioner has described the private rulings system as a 'legislative exercise in risk management…[recognising] that mistakes or errors in interpretation of the law can happen, but [ensuring] the risk to the community's revenue is contained.'[6]

There is no record of any private rulings being sought or provided in relation to Main Camp Projects Nos 3 & 4. The Ombudsman has sighted four private rulings issued in favour of participants' interests in Main Camp Projects Nos 1 & 2. Most complainants to the Ombudsman submit their financial planners or tax advisers provided them with copies of these rulings, as evidence that the Commissioner had given these arrangements his approval. (Each ruling carried the facsimile signature of the local deputy commissioner.)

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[6] *Integrity of the Private Binding Rulings System'*, Speech by Michael Carmody, Commissioner of Taxation, to the Taxation Institute of Australia, Melbourne, 15 November 2000 p3

The use of private rulings in this way appears contrary to the intention of the law. It is the Ombudsman's view that participants cannot be protected from penalties because they acted on, what appears to be, misleading or incomplete advice from their advisers. Investors should take any concerns they have up with their financial advisers – not the ATO.

The Ombudsman is concerned, nevertheless, that inconsistent, incorrect, incomplete and unrecorded private rulings can undermine public confidence in the tax system. The private rulings sighted by the Ombudsman were inconsistent and lacking in detail. Several were so heavily qualified, in terms of assumptions, that the Ombudsman has questioned whether they were even likely to provide protection for the intended recipient. In particular, none appeared to consider the financing arrangements or addressed the application of the general anti-avoidance provisions to the arrangements (with two specifically stating that the ATO could not rule on Part IVA) Furthermore, there is nothing to indicate that these rulings were recorded on a central data base, or that the officers responsible for their approval gave any consideration to the likelihood that the arrangement they were ruling on might have broader significance because of the potential number of participants in the arrangement.

The Ombudsman's office brought these matters to the attention of Mr Tom Sherman in the context of his review of the private binding rulings system. The Ombudsman is satisfied that his concerns were given due consideration in the review, and the recommendations made by Mr Sherman, and agreed to by the Commissioner[7], should go some way towards improving the efficiency and credibility of the private binding rulings mechanism.

The imposition of tax shortfall penalties

It is the Ombudsman's opinion that, on the presumption that the Commissioner's view of the law is the correct view of the law, the imposition of a tax shortfall penalty is appropriate. It stands to serve as a reminder to the community at large, that voluntary compliance with the tax laws is expected of all, and that non-compliance comes with risks. Nevertheless, given the totality of the picture, in particular:

- the likelihood there was an inadequate understanding about the way self-assessment works;
- the ATO has, albeit inadvertently, contributed to a perception that the Main Camp arrangements were acceptable by not acting in a more timely way (which may have also impacted on some investors' preparedness to invest in other schemes, too); and
- the majority of investors relied on the advice of promoters, financial planners and tax professionals, (advice which they ought to have been able to rely on);

some relief from the full force of the penalties is considered warranted.

The Ombudsman considers the ATO took this into account when it proposed to reduce penalties from the statutory 50% to 10%. This was on the proviso

[7] See *Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Taxation Office*, Tom Sherman, August 2000, and Commissioner's response in *Integrity of the Private Binding Rulings System,* ibid.

that the participants cooperated with the ATO and voluntarily provided the information necessary to amend their returns to reflect the ATO's view of the law.

It was the Ombudsman's view that this did not go far enough and that the penalty should be reduced to 5%. The Ombudsman's office argued that the Addendum to the Code of Settlement Practice which proposed a minimum of 10% was only relevant to schemes entered into and addressed after the Commissioner's more public crackdown, which commenced in 1997-98. The Ombudsman's office also argued that there was little to distinguish the background to investors' decisions in this arrangement from Budplan, where a 5% penalty had been accepted. Indeed, the fact that it had been promoted by the same promoter, and that the majority of participants were also Budplan participants, and was an arrangement that predated Budplan made it difficult to accept that anything more than 5% would be equitable.

The Ombudsman put this to the Commissioner but the Commissioner was prepared to agree to the reduction to 5% for settlement cases only. The Commissioner argued that the concept of a settlement at its core involves parties compromising to achieve finality in dealing with a dispute between them. As a general principle, therefore, where there is no compromise a party should not get the benefits of settlement eg reduced penalty. To do otherwise would be contrary to good administration because it would undermine general principle. Where investors choose not to settle and appeal the ATO's decision it is entirely appropriate for the position on penalty to be ultimately reviewed and determined by the AAT or the courts.

The Ombudsman agrees that it is in the interests of the parties concerned that there be some resolution to this matter. If investors are dissatisfied with the Commissioner's interpretation they have the option of appealing. The Ombudsman does consider there is benefit in providing investors with an incentive to settle. Offering a cash basis settlement with a reduction in penalties to 5% should provide that incentive. However, the Ombudsman remains concerned that the ATO acknowledge that its actions, or inactions have affected all investors, whether or not they choose to settle, and that this ought to be reflected in a concession to all investors over and above that which the ATO had offered through its voluntary disclosure mechanisms. The Commissioner accepts this proposition and has now agreed to a remission of interest for all investors in lieu of a further concession on the penalties.

Recommendation 3:

- The Commissioner remit tax shortfall penalties to 5% for Main Camp investors in the context of a settlement.

Interest Charges

In the letter to participants dated 14 June 2000, the ATO advised that it did not consider the circumstances warranted remission of interest in whole or in part. However, it is the Ombudsman's view that it is unreasonable for the Commissioner to be entitled to allow an interest tax debt to accrue for a period of up to six years before he seeks to recover it, and to make no allowances for the impact of the ATO's own inaction on the size of the debt.

Following initial discussions with the ATO it was prepared to offer remission of interest for settlement cases from 1

July 1997 in recognition of the delays in making its position known, and its desire to resolve these matters now. Without a sufficient rationale for this date, the Ombudsman recommended an interest remission for all participants to 14 June 2000 on the basis that this was the first they became aware of the Commissioner's views.

The Ombudsman considers that the participants had a legitimate expectation to be informed of any audit action which may ultimately affect their tax liabilities so that they could consider any steps they may wish to take to try to mitigate the potential damage. Accordingly, it was the Ombudsman's view that the ATO's plan to seek to charge interest in respect of a period of time prior to the participants being made aware by the ATO of its decision on the arrangement, was unreasonable given they were not in a position to protect themselves from the mounting interest bills.

The ATO responded with the comment that the correct principle for interest remission in a settlement context is outlined in paragraph 6.3.3 of the Addendum to the Code of Settlement Practice, being principles introduced as a result of the Special Tax Adviser's representations. Those principles do not link interest reduction to the date at which an investor is directly notified. Rather the reduction of interest depends on a wider range of consideration as outlined in paragraph 6.3.3

On fairness grounds the ATO accepted the principles in paragraph 6.3.3 justified a substantial interest period reduction. However, on fairness and a good administration grounds, it could not accept that interest only apply from the date it notified a taxpayer that it takes a different view of the law. This is inconsistent with the legislative schemes and goes beyond any test of reasonable timeframes for the ATO to act. It would also put the schemes investors in a much more favourable position than is the norm for people who face adjustments to their income under ordinary audit programs.

The Ombudsman acknowledges the Addendum to the Code of Settlement Practice was drafted to reflect his view that there are circumstances where it is appropriate to consider a remission of interest. He also accepts the Commissioner's concerns regarding any erosion of the principles as presented but was seeking an administratively practical means for the ATO to acknowledge that it would have to bear some responsibility for the delays which have contributed to large interest bills, and which would reflect the Commissioner's willingness to resolve this matter fairly. Some concession on interest for all investors, not just settlement cases, was warranted in these circumstances.

Following further discussions with the Commissioner, and agreement on confining remissions on penalties to settlement cases, the Commissioner has now agreed to remit interest prior to 1 January 1998 for all investors. This date has been agreed upon as the latest date that the Main Camp promoter, who had power of attorney for all investors, was made aware of the ATO's view of the tax consequences of the arrangement.

Recommendation 4:

- The Commissioner remit all interest charges for all Main Camp participants for the period prior to 1 January 1998.

Recommendation 5:

- The Commissioner explore whether there is any lawful and reasonable mechanism for placing some onus

on promoters to alert participants to any investigations being undertaken by the ATO, or any concerns the ATO has expressed about the way the tax laws may apply to the arrangement where that differs from that presented in a prospectus or product ruling.

The role of advisers

The important role of the tax profession in a self-assessment environment, and the need for this to be supported with appropriate regulation, professional standards and a tax adviser penalty regime were addressed some years ago by a joint ATO and tax professional bodies taskforce. A legislative framework to support this was announced by the Assistant Treasurer in April 1998,[8] and confirmed by the Commissioner in evidence before a Senate Inquiry in March 2000, as likely to be "progressed shortly".[9] It is still to see the light of day. The Ombudsman recommends the Government confirm the timetable for this legislation.

In addition to the tax agent penalties and safe harbour proposals mooted as part of this proposed legislation, the ATO should also consider advice to Government on possible amendments which would recognise the responsibility other professional advisers, including tax advisers, financial planners and scheme promoters, should bear when taxpayers are acting on their advice. This is particularly important where the professional has power of attorney over a taxpayer's tax affairs or is otherwise representing the taxpayer's interests in interactions with the ATO.

Complainants' submissions suggest that the majority sought professional advice about their proposed investments. If that advice did not bring to attention the potential risks of the investment for tax purposes, or improperly or incorrectly relied on the private rulings referred to above, it is the Ombudsman's opinion that the participants ought to consider seeking legal advice about their prospects for recovering, from those advisers, the tax penalties that they have incurred. Section 251M of the Act provides for such action to be taken against tax agents. There is nothing in the tax laws which provides for similar actions against taxation advisers, financial planners or schemes promoters. It is the Ombudsman's view that the ATO should consider what assistance it can provide to participants who believe that their advisers may have been negligent, including funding, perhaps from the revenue collected from penalties incurred, an independent legal adviser to provide the participants with advice on this matter.

Recommendation 6:

- The Government confirm the timetable for the introduction of a legislative framework for tax agent services.

Recommendation 7:

- The ATO consider any possibilities for expansion of the legislative framework to take into account tax related advice provided by other professionals.

Recommendation 8:

- The ATO explore the possibility of funding independent legal advice for participants considering a negligence claim against professional advisers.

[8] 'New Legislative Framework for Tax Agent Services', Senator the Hon. Rod Kemp, Assistant treasurer, Press Release No.14, 6 April 1998

[9] Commissioner of Taxation as quoted in *Inquiry into the operation of the Australian Taxation Office – report of the Senate Economics Committee* March 2000, paragraph 3.42

"How can the Commissioner call me a tax cheat?"

Many of the complainants have expressed, in the strongest possible terms, their anger and frustration at being referred to as tax avoiders. They point to a number of reasons why they believe such a label is unjustified, including that they:

- relied on advice that the case law supported the claims under the general deduction provisions of the Act;
- made a full disclosure of the arrangement in their tax returns;
- invested in the arrangement for the dominant purpose of generating income in future years, not for the dominant purpose of receiving up-front deductions; and
- satisfied themselves that a real commercial business was being conducted.

The law clearly provides for the Commissioner's view to be reviewed by a court or tribunal. The Ombudsman is of the opinion that it is reasonable for the complainants to exercise their rights of review before such a court or tribunal, rather than for him to reach a view on this aspect of the complaint. He has not, therefore, found it necessary to consider the correctness or otherwise of the Commissioner's interpretation of the tax laws applying to the deductions claimed.

The Ombudsman notes the promoter's representative's arguments about the relevance of the principles established in *Lau's case,* and comments in *Fletcher's case* supporting their position. They also suggest that ATO policy as reflected in income tax ruling IT 2195 applied to their position. All of which, they argue, points to a 'reasonably arguable' position.

The ATO counters this by suggesting that while *Lau's case* and IT 2195 may provide a basis for deductions where expenditure relates to funds borrowed through limited or non-recourse loans, paragraph 13 of IT 2195 specifically discusses the possibility of Part IVA applying to round robin financing arrangements. The ATO points out that the application of Part IVA to the Main Camp arrangements had never been ruled out, including in the private rulings provided for Projects Nos 1 and 2. (The ATO's interpretation with regard to particular financing arrangements and the application of Part IVA, is expanded on in Taxation Ruling TR 2000/8 (which was previously issued in 1997 as Draft Taxation Ruling TR 97/D17)).

Given the Ombudsman does not propose to form a view on the correctness or otherwise of the Commissioner's interpretation, it is not relevant to discuss the relative merits of either parties' arguments.

However, the position papers provided to the participants do not discuss in any detail the case law upon which the Commissioner is relying for his interpretation with regard to the general deduction provisions or the anti-avoidance provisions. Nor do the papers seek to respond to the alternative arguments put forward by the promoter's representatives. In the Ombudsman's opinion, it is this lack of detail or response to alternative arguments which has created a perception among the participants that the Commissioner is "making the law". The Ombudsman considers the ATO needs to put more effort into explaining to the participants the reasons for its decisions.

The second point again highlights the apparent lack of understanding about the way self-assessment works, and in

particular the point that tax returns are not generally scrutinised prior to an assessment issuing. The arrangement may have been disclosed in a participant's tax return. That does not alter the fact that the Commissioner may later turn his mind to what has been claimed, and interpret the law on a different basis than that which has been presented in the return. This point and the final two points also reflect a lack of understanding about the way the ATO is interpreting the general anti-avoidance provisions in this matter.

For the same reasons that applied to the general deduction provisions, the Ombudsman will not form a view of the Commissioner's interpretation of the anti-avoidance provisions. And again, it is not relevant to address the relative merits of the parties' arguments here. The Ombudsman notes, however, that the position papers forwarded to the participants on 14 June 2000 contained only a brief description of the Commissioner's view as to why Part IVA applied. The information provided by the ATO to the participants does not, in the Ombudsman's view, sufficiently explain the objective tests which the Commissioner needs to apply in making a Part IVA determination. Quoting one case in the whole position paper to support its position, the High Court's decision in relation to a large Australian company with offshore investments,[10] appears to have only served to confuse many of the participants, who questioned what possible relevance it might have to their situation.

Part IVA requires the Commissioner to make a determination on an individual basis. The participants were invited to provide information about their individual circumstances which would help ensure the ATO resolved their case in a fair way. Many of the participants have advised the Ombudsman that they did take up this offer, only to find that the next they heard from the ATO was the issuing of a Part IVA determination, with an accompanying amended assessment which did not appear to take into account the information they had provided.

The Ombudsman sought further information from the ATO as to what individual circumstances might be taken into consideration. The ATO explained that it formed the view that Part IVA applied by considering the arrangements as a whole, and in particular the method of financing the investments (that is, the limited recourse loan, financed through a round robin arrangement). The ATO was of the view that the essential features of the arrangement, and upon which they were applying Part IVA, were common to all participants, and therefore, only participants who did not use the limited recourse loan facility would have been considered differently.

The Ombudsman acknowledges this view, and considers the ATO should have done more to explain this to the participants in the first instance. The participants should have also been informed as to why the additional information they provided was, by and large, unlikely to change the ATO's views about the objective tests it was applying to the making a Part IVA determinations. It is the Ombudsman's opinion that, irrespective of the numbers of participants involved, the principles of fairness and accountability remain paramount. This includes requiring the ATO to explain fully the basis of its decisions. This lack of explanation to the individual participants, in the Ombudsman's opinion, amounts to a breach of the Taxpayers' Charter.

[10] FC of T v Spotless Services Limited & Anor 96 ATC 5201

Recommendation 9:

- The ATO provide taxpayers with more detail on the reasons for the decisions it has made including a précis of case law and rulings relied upon.

Recommendation 10:

- The ATO provide taxpayers with more indication of what individual circumstances would warrant consideration in terms of any change to the Commissioner's view about the application of Part IVA.

Recommendation 11:

- Where taxpayers have provided information that they believe warrants consideration, in so far as Part IVA applies to their individual circumstances, that the ATO considers that information and responds.

"Why won't the Commissioner hold off amending my assessment until a test case is decided, like he has with other schemes?"

The Budplan Scenario

Following the intervention of the Ombudsman in Budplan, the Commissioner agreed to refrain from raising amended assessments and therefore, from determining any tax liability or recovering the tax in dispute pending the timely establishment of a test case program, and the hearing of suitably representative cases in the Federal Court. The Ombudsman understands the Commissioner made similar arrangements for several other schemes.

The Ombudsman believed this approach demonstrated a willingness by the Commissioner to resolve the matter in a fair and conciliatory manner. The downside to this, of course, was that interest charges would continue to accrue, and despite efforts to ensure participants are aware of this, the Ombudsman is concerned that many may not appreciate the impact of this, if the case ultimately goes against them.

The agreement was based on the premise that the cases would be brought before the courts within about six months. Unfortunately, the Budplan test cases are not now scheduled for hearing until June 2001, which will be almost three years from the date this proposal was first mooted. As mentioned earlier, the reasons for the delays are the subject of a separate investigation by the Ombudsman and a report is expected to be finalised on this matter shortly. Irrespective of the reasons, the lengthy delays have made it necessary for the Commissioner to raise amended assessments for many of the participants where statutory time limits have come into play, or where later year assessments were resulting in refunds which were required by law to be offset against earlier debts. The Ombudsman understands there have been similar delays in relation to other schemes.

While not pre-empting the findings of the other investigation, the Ombudsman does accept that the raising of the amended assessments is the appropriate action for the Commissioner to take in relation to the Budplan cases which are likely to be affected by statutory time limits.

This view primarily stems from the concerns that the longer this matter is deferred the greater the risk to the participants, should the cases ultimately go against them. It is important that the individuals involved understand what their potential liability will be, and what the ongoing effect of accruing interest charges could be, should they not be

successful. Being more fully aware of the risks and potential costs involved may assist individuals to make more informed decisions about the action they should take. Nevertheless, given that the Budplan test case program is still progressing, the Ombudsman has asked the Commissioner to refrain from determining any objections, other than for the representative cases, so that the participants are not forced into the position of having to decide whether or not to appeal the decision and incur additional expenses in this regard only to not proceed if the test cases resolve the matter.

The original agreement not to raise amended assessments or determine objections in all but the representative test cases, pending a court decision, was intended to counter criticism which may have been levelled at the Commissioner for having the power and the resources to take these matters on, at the expense of individuals who, with more limited resources, may be forced into simply accepting the Commissioner's interpretation. Holding off determining any subsequent objections maintains the spirit of this view.

- **Recommendation 12:** The Commissioner continue to refrain from determining objections in relation to Budplan participants, other than those participating in the test case program, pending finalisation of the Ombudsman's investigation into that program.

Action to amend assessments and determine objections for schemes cases generally

In hindsight, it may have been naive to think a court case might be mounted so quickly. Experience suggests this is unlikely to have ever been achievable. In view of this, the Ombudsman is reluctantly of the view that, on balance, a better course of action for all newly determined schemes cases, including Main Camp, is to proceed to amend the assessments and to determine any objections. It is far better that the taxpayers concerned have a complete and accurate picture of their tax liability and can make informed, personal decisions about how to deal with that.

Should taxpayers express an interest in taking the matter to appeal, the ATO should work directly with the taxpayers to identify and fast track representative cases to court. The Ombudsman also put to the ATO that it might explore options which would enable other taxpayers to hold off appealing, pending court decisions on the representative cases.

The ATO advised that extensions of time for lodging appeals depend on the applicable rules of the Federal Court and AAT. There is no power for the Federal Court to extend the time for a taxpayer to appeal beyond the 60 days provided for in the Taxation Administration Act. There is such a power available to the AAT. It is the ATO's view that the taxpayers in general will need to appeal to protect their position and the ATO will not support extensions of time to appeal except in exceptional circumstances. The ATO considers this approach is fairest for the community and the individual, noting that for most individuals they will not have to do more than file an appeal pending a decision in the representative cases. The Commissioner advised that he is meeting with representatives of the federal Court and the AAT to discuss case management in these circumstances.

The Ombudsman accepts this position and agrees that taxpayers should be

required to make a decision about whether they wish to appeal or not, and respond accordingly. It would be inequitable to encourage extensions of time if such extensions were only available in the AAT. The Ombudsman notes, however, that the Commissioner is taking action to identify and progress representative cases as a priority.

Recommendation 13: ATO to work with taxpayers to get representative cases to court.

Main Camp Settlements

In light of the comments above, the Ombudsman accepts that amended assessments should be raised in relation to the Main Camp participants. Statutory time limitations made it necessary for the Commissioner to move quickly to amend assessments once the individual taxpayers had come forward with details of their investments and tax claims.

As suggested earlier, it appears that the first that many of the Main Camp investors knew about the ATO's audit of the Main camp projects and its decision to not accept the deductions claimed up to six years previously, was when they received the position paper from the ATO which issued on 14 June 2000, or at the very earliest, several days prior to that via a newsletter from the promoter. The participants were given to 12 July 2000 to voluntarily provide information to the Commissioner upon which an amended assessment would be raised with penalties remitted from 50% to 10%.

It is the Ombudsman's understanding that the Commissioner commenced to amend assessments immediately the information was received. This is despite the fact the discussions were being held between the ATO and the Ombudsman's office regarding the potential for consideration of a cash basis of settlement and reduced penalties. The swiftness of this action, which left little time for the investors to seek advice on their options, including settlement options has caused considerable distress and not surprisingly, ill feeling by the complainants towards the Commissioner. The Ombudsman notes, however, that the ATO had been in discussions with the promoter, who had power of attorney over the investors' affairs in relation to their interest in Main Camp, since November 1997.

In accordance with the Addendum to the Code of Settlement Practice, the ATO needed to consider the level of 'tax mischief' embedded in the arrangement, before it could negotiate a settlement. The ATO has identified eight characteristics which aggravate the level of tax mischief. These include the extent to which the arrangements:

- may be contrived and artificial;
- are uncommercial from a business or economic perspective;
- involve fraud on the revenue;
- involve round robin financing
- are not implemented as specified in contractual or other legal documentation;
- abuse specific concessional or anti-avoidance provisions;
- provide a permanent advantage as distinct from a timing advantage; and/or
- create a risk to revenue.[11]

Having considered these matters, and identifying only several of these characteristics, the ATO is prepared to consider settlement offers which would give the investor a tax deduction for the

[11] See the Addendum to the Code of Settlement Practice, Chapter Four

cash contributed to the project. This is in recognition that these amounts reflect the funds available to the manager to provide services in respect of which deductions were claimed. Specifically, a deduction would be allowed in the year in which the participant was committed to make those payments, generally the year of income in which the relevant documentation was signed.

The Ombudsman assumes the Commissioner, by applying the Addendum to the Code of Settlement Practice, would have agreed to settle on a cash outlay basis had taxpayers individually approached him to discuss settlement. He considers, however, that his intervention has facilitated an earlier and more coordinated consideration of this. The Ombudsman is satisfied that the proposed basis of settlement, together with the further reduction in penalties is cognisant of the extenuating circumstances and the level of tax mischief involved.

It is now a matter for the participants to decide whether to seek to settle their claims on the cash outlay basis offered or to object to the decision as outlined in the position paper and to have the matter dealt with by the courts.

While the Ombudsman is satisfied with the basis proposed for settlement, he is of the opinion that the ATO would benefit by taking a more holistic approach to the resolution of cases at the outset. In particular, when the Commissioner comes to a view of an arrangement, he should also consider at the same time, the extent to which he might be prepared to settle the matter in accordance with the Addendum to the Code of Settlement Practice. Any position paper issued should be able to take this into account. Taxpayers should not be threatened with amendments and large tax bills, only to find out later the Commissioner was always prepared to consider a settlement offer for a significantly lesser amount.

The Commissioner advised that the Federal Court decision in Young v Commissioner of Taxation (February 2000) and legal advice following that decision, leaves the ATO at risk of a challenge to any public offers of settlement where the primary tax is to be settled at a lower figure than that which the ATO would assess if there was no settlement. The ATO is of the view that the more prudent path is to avoid the risk by not making public offers of the type made in Young's case. The ATO will write to taxpayers in terms which draw their attention to the Addendum to the Code of Settlement Practice and seek to encourage them to make an offer to the ATO.

The Ombudsman is of the opinion that it is vitally important that the Commissioner provide the community with a general indication of his views and his preparedness to settle cases. The Ombudsman has asked the Commissioner to review the legal advice and consider the alternatives to ensuring he is able to communicate his position to taxpayers. While this did not occur in the initial communications with Main Camp investors, the Ombudsman acknowledges the ATO is now addressing this matter.

Recommendation 14:

- The ATO write to all Main Camp participants and advise them that it is prepared to consider settlement offers and the terms upon which it is prepared to settle.

Recommendation 15:

- Where the ATO determines that there is scope to consider a settlement, it should advise

participants in the first instance, and then enter discussions for amended assessments to be made on the basis of the settlement offer.

"I'll go broke, or worse, trying to pay for this now."

Many of the complainants have written expressing their concerns about their ability to repay the tax debts arising out of the ATO's actions. The letter to participants of 14 June 2000 provides information about standard recovery procedures while debts remain in dispute. However, it provides no guidance about the possibility of considering longer-term settlement of the debt. It is the Ombudsman's experience that taxpayers remain sceptical about the ATO's willingness to enter into repayment arrangements and are generally not aware that relief may be able to be granted, given that the ATO is not proactive in bringing such matters to attention.

The penalties and interest charges are to be reduced as a result of the negotiations with the Ombudsman's Office. This will affect the amount of tax actually outstanding. If the complainants agree to settle this matter along the lines outlined above, their total tax bill will be significantly reduced. Nevertheless, the Ombudsman recognises that the outstanding amounts of back taxes now payable are likely to impact heavily on some investors.

The ATO has developed a receivables management policy to provide general guidance to staff and taxpayers about the way it will deal with outstanding debts and the factors it will take into account in coming to payment arrangements. The Commissioner is reminded that he should treat each taxpayer as an individual and the factors to be considered in determining an appropriate debt recovery arrangement must be considered on a case-by-case basis and have regard to the principles of good management.

In his recent GST addresses [12], the Commissioner has said that he did not want to see a debt with the ATO to be the cause of bankruptcy for a viable business which made a reasonable attempt to implement the New Tax System. He has suggested that he will 'adopt an empathetic approach to payment arrangements' to ensure that such a debt would not of itself cause a viable business to go under.

Given the length of time it has taken for the Commissioner to address Main Camp, the Ombudsman considers it is appropriate that the Commissioner adopt a similarly 'empathetic' approach to payment arrangements for these taxpayers reflecting his willingness to conciliate the matter. This should be especially so when the taxpayer can point to evidence of seeking professional tax advice on his or her personal tax implications before deciding on the investment.

In the Ombudsman's opinion it should be an extraordinary case for the Commissioner to commence bankruptcy proceedings against a taxpayer with a tax debt from investment in this scheme. He is also of the view that an investor should not be forced to sell his or her principal place of residence to pay off such debts, where that is the only asset, except where it can be shown that there is an unacceptable risk to collection.

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[12] *Accounting for and Accountability for the GST*, Speech by Michael Carmody, Commissioner of Taxation, to the CPA Australia/Australian National University Annual Research Lecture, 15 November 2000

The Ombudsman has asked the Commissioner to consider a public statement on his willingness to be reasonable and to adopt a conciliatory approach to resolving outstanding debts in relation to mass marketed schemes. The Ombudsman has also asked the ATO to ensure staff is provided with guidance from management as to the appropriate use of the policy in respect of payment arrangements for taxpayers settling their schemes liabilities or where these issues are before the courts.

Recommendation 16:

- The ATO adopt a conciliatory approach to repayment arrangements for Main Camp investors.

Recommendation 17:

- The Commissioner not seeks to make a person bankrupt, or to require them to sell their principal place of residence to repay a debt, unless an unacceptable risk factor has been identified.

Recommendation 18:

- The Commissioner to consider providing taxpayers with information about ATO debt recovery policy, the existence and role of the Tax Relief Board, and relevant contact points, including access to the Ombudsman, when they are advised that a debt is to be raised.

"The schemes are commercial and good for the Australian economy – why should the Commissioner be able to knock them down?"

Many of the complainants argue that their decision to invest in the scheme was influenced by a view that Government was encouraging this type of investment. It was seen as an investment in an Australian product; the activity was creating employment in Australia, especially in regional or rural areas; and any export revenue would also be valuable. They claim that the business was, and is commercially viable, offering good income and profit potential. They argue that by disallowing their tax deductions, the Commissioner is stifling Australian business and this is at odds with Government policy.

The Ombudsman has not considered it necessary or appropriate to explore the extent to which the scheme is commercially viable but notes the ATO's position papers which suggest that while the projects do have commercial aspects, only a small percentage of the 'available' funds are actually invested in the product development and distribution. The issue in relation to the tax deductions for the participants was whether or not the participant's interest had sufficient commercial purpose, not whether the scheme itself had sufficient commercial purpose.

It is a matter for Government to decide what, if any, incentives it wishes to provide to investors supporting Australian business, and to what extent the tax system should be used to support this. There is a difference between what incentive is provided by way of general tax deductions, which is at issue with these arrangements, and that which is provided through specific tax concessions such as for some research and development expenditure. In both situations, however, it is a matter for the Commissioner to determine whether any expenditure incurred would be allowable as a deduction in accordance with the provisions of the taxation laws. The Commissioner must apply the law as he interprets it to the facts of the particular arrangements, and his decisions are subject to review.

Recommendation 19: The ATO look at ways of providing the community with information about the ways the tax system does support investment in particular areas. The ATO needs to be able to explain how the tax laws are applied to these investments and, where necessary, the difference between the use of the general deduction provisions vis a vis specific tax concessions or other industry and investment incentives.

3. CONCLUSIONS

The Ombudsman has not considered whether the Commissioner's views of the law as applied to Main Camp Projects are correct or not, including whether or not Part IVA applies. The Ombudsman notes, however, that the Commissioner's interpretation is reasonably open to him, although more effort could have been put into providing the participants with a detailed basis for his views.

The Ombudsman's investigation has, therefore, focussed on the Commissioner's actions once he had made the decision that the claims were not allowable.

Having received the ATO's position paper, the promoter argued that the matters should be allowed to rest because the impact on the participants would be such that there would be 'an avalanche of complaints from the farmers about the inequity of the approach' being taken by the Commissioner, and that 'Part IVA should only be used as a last resort'.

In the Ombudsman's view, the Commissioner, having audited the schemes and come to the conclusion that he did, was obliged to act on his interpretation. It would have been totally inappropriate and unacceptable to the rest of the community had the Commissioner decided, because of the implied threats of complaints, to withdraw from his proposed action. In the Ombudsman's opinion the decision to raise amended assessments dating back to the 1994 and 1995 years, and to apply penalties and interest charges was in accordance with the law. What was left for the Ombudsman to consider was whether these actions were unreasonable, unjust, oppressive or improperly discriminatory, or that the law itself may be unreasonable, unjust, oppressive or improperly discriminatory.[13]

There is no doubt that the individuals affected by the Main Camp decisions regard the ATO's actions as unreasonable. In forming an independent view on this, however, the Ombudsman needs to balance consideration of the Commissioner's responsibilities to administer the taxation laws and manage compliance behaviour generally, with the need to treat individuals fairly.

The self-assessment system puts the onus on taxpayers to ensure that what they show in their returns is correct. It is a system based on voluntary compliance. The ATO must be able to provide taxpayers with the information they need to enable them to comply with the tax laws. The primary source of this information is through Tax Pack, other ATO publications, its on-line facilities, and the public and private rulings systems. The system is supported by an extensive audit program which is designed to gauge areas of non-compliance and act on them in a timely way.

From this and our previous investigation into Budplan, the Ombudsman has formed the view that, in relation to the mass-marketed schemes, the mechanisms required to support self-assessment have not worked as effectively as one would hope. Taxpayers generally have not sought the protection of the private rulings system, and the ATO has not acted in a timely way to identify and act on areas of non-compliance. The impact of this is only now being realised by individual taxpayers, who find themselves with

[13] As per paragraph 15(1)(a) of the *Ombudsman ACT 1976*

large tax debts, years after the event; and by the ATO, which is now facing a significant resourcing burden as it seeks to bring to account many thousands of disputed tax assessments.

It is easy in hindsight to identify what might have been done differently. The Ombudsman's interest is, however, in ensuring that:

- where it is shown that deficiencies in administration have impacted on taxpayers, they are dealt with fairly, and that the most efficient and effective means are implemented to resolve any disputes they have with the ATO as a result; and
- lessons learned result in continuing improvements to support a fair, equitable and open tax administration that ensures community confidence in the tax system is maintained.

To this end, the Ombudsman acknowledges the work the Commissioner has undertaken to provide greater certainty to taxpayers considering investing in mass marketed schemes, including:

- establishing, in 1997, a coordinated and centralised unit focussing on more timely and coordinated responses to tax instalment variation processing and mass marketed schemes auditing activities;
- introducing the Product Rulings system in 1998 to provide greater certainty about the tax consequences of mass marketed products;
- setting in place mechanisms which will enable his staff to focus on intelligence gathering to identify and deal with new and emerging arrangements in 'real time';
- involving senior tax counsel in decision making to improve the quality and consistency of decisions in relation to schemes;
- seeking the advice of expert panels with external professional representation in making decisions about Part IVA determinations or litigation;
- actively publicising in speeches, media releases and on the ATO's website his views about scheme arrangements;
- consulting widely on and issuing an Addendum to the Code of Settlement Practice which provides guidelines for mass marketed schemes settlements; and
- reviewing the private rulings system.

The Ombudsman's office contributed to the development of the Addendum to the Code of Settlement Practice and is satisfied that it provides significant guidance for ATO staff, taxpayers and their advisers about the circumstances and the extent to which settlements may be considered. The Ombudsman's office has also provided input to consideration of matters before the Litigation Panel and put submissions to the Sherman Inquiry into the Private Rulings System.

The ATO has now developed administrative arrangements which should ensure schemes that do not meet the Commissioner's view of the tax laws are brought to participants' attention in a more timely way. Participants should be in a much better, more informed position to decide whether they will enter a proposed arrangement or continue to invest in like arrangements; they should understand the tax risks associated with an investment; and they should be able to be confident in the knowledge there will be consistent and transparent processes in place to clarify or test the Commissioner's interpretation.

With particular regard to the Main Camp complaints, the Ombudsman acknowledges the Commissioner's proposal to consider settlement offers reflecting a cash outlay basis for deductions which recognises the actual cash contributed by the participants. In addition, the reduction in the tax shortfall penalty to 5% represents a conciliatory approach to the ATO's actions. Nevertheless, the Ombudsman considers further remission of interest charges should apply to all participants because the ATO's actions and inactions have been a contributing factor in taxpayers being exposed to increased compliance costs.

In view of the deficiencies identified, the Ombudsman considers that the further substantial remissions in penalties and interest charges for participants outlined above, together with an empathetic approach to debt recovery provide a fair and reasonable approach. Whether or not participants choose to accept the terms of settlement or decide to object to the Commissioner's interpretation is a matter entirely for them to decide. The Ombudsman also recognises that there may be individual circumstances that may warrant treatment other than that recommended here, for example, where a participant might identify a private binding ruling or advance opinion they had personally received from the ATO which provided an interpretation of the law to their situation contrary to that now being put by the ATO.

The Ombudsman makes the point, however, that the recommendations he makes in relation to Main Camp cannot be regarded as providing any precedent for any other mass-marketed tax-effective scheme resolution. The circumstances of any other scheme arrangements, and the ATO's actions in relation to them, must be considered on a case by case basis. The Addendum to the Code of Settlement Practice provides guidance on the approach to be taken.

At a more general level, the Ombudsman recognises the considerable effort being made, and resources devoted, to trying to clear the decks of mass-marketed tax-effective schemes cases dating back many years. He also acknowledges the generally conciliatory approach being adopted by the Commissioner to resolve these cases efficiently, effectively and fairly. He is of the opinion, however, that there is more to be done to achieve this end and in particular, considers that a great deal of angst and frustration could be avoided if the ATO were to take a more holistic approach to the case management of each scheme.

For example, some profiling of the Main Camp participants may have assisted the ATO in determining how they would react to what was being put to them and how best to manage those responses. The very fact that a lot of these people were already in dispute with the ATO over its actions in relation to their investments in Budplan - actions which they had complained to the Ombudsman about - meant that this further round of action was likely to create antagonism and criticism.

In the Ombudsman's view, insufficient detail was provided to the participants for them to really appreciate why the ATO was of the view it was, and why it was only raising it some six years after the event. More consideration needs to be given to the way information is presented; more detail about the reasons for the decisions, greater explanation of the case law or rulings being relied upon and why others have been dismissed, and clarification on what sort of individual circumstances

the ATO might be prepared to consider in resolving the individual's case.

The ATO also needs to be more mindful of the effect a large, unexpected tax bill is likely to have on any taxpayer. It should consider ways of reducing the impact in the first instance by identifying up front, any possibility that a settlement may be considered, by giving taxpayers a reasonable time to get information together and consider their options, and ensuring they are aware of the potential for repayment arrangements.

Recommendation 20: In addition to the tax administration developments acknowledged above, the ATO take a more holistic approach to the resolution of the inevitable disputes arising from its actions in relation to mass marketed schemes, including:

a) giving greater attention to 'knowing the client' – promoter and participant profile analysis so that the ATO can identify and respond proactively to issues affecting them;
b) providing more information to participants about the reasons for the decisions, including more detailed explanation of the law, the relevant case law and the applications of any rulings etc.
c) testing, prior to release, the level of taxpayers' understanding with the information proposed to be provided to participants;
d) identifying, and advising participants of the circumstances in which a settlement may be considered, and being prepared to act on it from the outset.

Finally, the Ombudsman has found the regularity with which complainants have suggested that the projects were marketed to them by financial advisers or tax advisers, on the basis they had the ATO's all clear, as particularly concerning. The Ombudsman has been criticised in some quarters for making public comment about the role of tax advisers and other private industry professionals who have the ability to impact on tax compliance.

The Ombudsman, as Taxation Ombudsman, plays an important role in ensuring that the community has confidence in the tax system. Self-assessment imposes greater obligations on taxpayers to understand the tax law as it applies to their circumstances. This has helped to foster the growth of the tax profession which is an integral part of the tax system. The people working in the tax profession derive certain benefits and protections from the tax system but certain obligations should also be expected.

The Taxation Ombudsman gives a transparency to ATO processes, by focussing on the circumstances of an individual's dealings with the ATO, and at a broader organisational level. While complaint investigation and resolution is an important aspect of this role, also significant is the power to undertake broader investigations of systemic issues, and through those, to identify and support improvements in tax administration more generally. To this end, if the Taxation Ombudsman identifies actions or issues which may be impacting on the interests of taxpayers in obtaining fair and reasonable treatment under the tax system, whether or not they be the actions of the ATO, he has a responsibility to bring these matters to the attention of the Parliament and the community. It is then a matter for the Parliament to determine whether it should act on any opinion he has expressed.