

Chapter 12

Through the Eyes of the Advisers: A Fresh Look at High Wealth Individuals

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Framework for the Study

The Problem

Australians have become more sensitive to the issue of high wealth individuals paying their fair share of tax. A June 1998 survey of 1000 Australians commissioned by the Australian Taxation Office (ATO) found that only 32 per cent believe 'tax laws are effective in making sure large companies pay their share of tax' declining to 27 per cent for 'very wealthy people'. Only 20 per cent believed 'the ATO does a good job of stopping tax avoidance by large companies', falling to 15 per cent who believed that 'the ATO does a good job stopping tax avoidance by very wealthy people'. It was this kind of evidence that caused the Keating government to make high wealth taxpayers an election issue in 1995 and that caused the Howard government to set up the High Wealth Individuals Taskforce after its election victory.²

The problem cannot be dismissed as a creation of political imagination: One adviser in this study said he had a wealthy client who had not paid any tax since 1987. Certain sophisticated tax planning strategies appear to have been widespread. These include: (a) redefining income as capital by using multiple trust structures that conceal a common controlling mind; (b) creating artificial losses, for example by acquiring companies or trusts with accumulated losses; (c) disguising distributions to High Wealth Individuals (HWIs) and family members as loans and other non-taxable benefits; (d) using offshore trusts; (e) converting activities undertaken for private pleasure into tax losses (for example pleasure craft, horse breeding and racing); and (f) using charitable trusts to disguise benefits to HWIs and their families.

Method

A useful model for this research was presented with Roman Tomasic and Brendan Pentony's 1990 study, 'Defining Acceptable Tax Conduct: The Role of Professional Advisers in Tax Compliance'. It was decided to undertake a more

focused investigation of advisers of HWIs and to limit the range of policy issues discussed with them. To define the topics, the author, together with Alice Dobes (an ATO evaluator from outside the Taskforce), first conducted interviews with most senior managers of the HWI Taskforce in Canberra, Sydney and Melbourne, mostly meeting them one or two at a time. This led to a decision to pursue fairly unstructured interviews with advisers of HWIs organised loosely around a set of questions prepared in advance. The questions were designed to address three issues: (a) the compliance problems common among HWIs; (b) to seek advisers' criticisms of the taskforce; and (c) to harness their creativity in considering new and better ways of improving compliance and identifying deficiencies in the law.

The objective then was to test their criticisms and ideas against the policy thinking we had secured from the taskforce managers, focus groups that Alice Dobes conducted with taskforce fieldwork staff subsequent to the adviser interviews, and against what we know from the research literature on compliance (not a lot for High Wealth Individuals).

The Sample

The sample was strategic rather than random, with 27 HWI advisers interviewed, mostly alone, for one to two hours in 1999. All interviews were conducted face-to-face with the exception of one which was conducted as a tele-conference.

The strategic sample included: (a) individuals who senior taskforce management regarded as key HWI advisers; (b) advisers whose policy thinking might be sharper because they have a larger number of HWIs and/or many more contacts with the taskforce due to audit and information gathering activities resulting from higher risk ratings of their HWI clients; and (c) HWI advisers who were selected by professional bodies which were interviewed to represent the views of their membership.

This sample ensured we secured interviews with advisers from all the (then) Big Five accounting firms, some non-charter firms, some distinctive boutique firms and certain prominent lawyer-advisers. In addition to the advisers I also conducted interviews at the Taxation Institute of Australia, the Australian Society of Certified Practising Accountants, the Institute of Chartered Accountants in Australia, and the Law Council of Australia. Each of these bodies had informally canvassed their members to elicit specific concerns and suggestions.

To secure interviews, initial contact was made by letter offering prospective participants the opportunity to speak with either myself as the author of this chapter, or to both Alice Dobes from the ATO and myself. Confidentiality was guaranteed and respondents were informed that while what was said would be used, it would not be attributed to them as individuals or to their firm. They were also assured that they were not required to divulge the names or details of their clients.

While one adviser was overseas for the period of the study, no advisers refused to be interviewed, and in only one case did an adviser opt for a complete absence of the ATO during the interview.

The High Wealth Individuals Taskforce

The HWI Taskforce was established in 1996 with an objective to enhance compliance management strategy for HWIs. In the first year of operation, 180 HWIs received a questionnaire about the groups of entities they control or from which they receive income. These were formalised in subsequent years into expanded returns, called Current Year Data Collection (CYDC) returns or expanded returns. In 1997 and 1998, 142 and 143 HWIs respectively completed expanded returns for 2371 and 2599 associated companies, trusts, partnerships, or individuals respectively.

The taskforce has also provided advice to government on options for legislative reform to address minimisation techniques used by some HWIs, as well as evidence to the Ralph Review of business taxation on the exploitation by some HWIs of structural deficiencies in the tax system (Ralph Report, 1999).

Since the taskforce was established, the Australian Government has introduced several legislative measures that may impact on HWIs including: (a) abolition of research and development syndication arrangements; (b) trust losses; (c) private company dividends disguised as loans; (d) misuse of charitable trusts; (e) franking credit trading and dividend streaming; (f) taxation of foreign source income; and (g) denial of artificially created capital losses.

Findings*Cost of Compliance*

All but one adviser we interviewed found the cost of compliance to be high, and higher than they believed it needed to be. The cost estimate for the professional fees associated with completing the expanded tax return required by the program was in most cases in the range \$20 000 to \$40 000 per HWI. At least this was the estimate for the first expanded returns: views varied on how much costs fell with subsequent returns. Adviser fees to assist with HWI audits were also reported to be as high as 'more than \$1 million'. In addition, the program was reported to impose substantial costs on the time of the HWIs themselves and their staff. It was a distraction when 'they want to keep their eye on the main game which is creating wealth for the benefit of Australia'. Other advisers suggested that the high costs of doing expanded returns for the first time were considerably reduced on subsequent returns and could be reduced further by electronic lodgment.

The main suggestions for reducing costs related to reducing the repetitiveness and increasing the selectivity of expanded return targeting. A HWI who controls sixty entities has to complete sixty special returns, which demand a considerable amount of information. Some advisers said that such burdens on HWIs created business for them, but more were of the view that it was a kind of business they did not want – 'drudgery' as one put it. Others said they would prefer to be helping clients build their business rather than putting their energy into compliance administration. Some said that they were not well geared with the kind of staff needed to fill out hundreds of pages of returns by hand.

It's not the business we want to be in. We want to add value. We don't want to be putting numbers in boxes. It's not satisfying. And our clients don't want to pay big dollars for *that*.

Because compliance costs are such a big issue, they are also a lever. Getting off the program is seen by advisers as a major benefit they would love to be able to secure for their HWI. The opportunity is to take them off the program only when certain compliance outcomes have been delivered.

Many HWI staff have a different perspective from the majority analysis of the advisers. One common view was that self-assessment in the 1980s may have gone too far in respect of companies and trusts. It is now impossible to do a risk assessment on these returns without seeking additional information. The HWI expanded returns are seen as a remedy for this error of the 80s. This was also a minority view among advisers:

I admired Trevor Boucher [former Commissioner of Taxation], but one of the worst things Boucher did was simplify the tax return, especially for corporates. You need a complex return for complex taxpayers...The expanded return questions are pretty good questions...Wealthy people should never be off that cycle. Once you've done the first year, the costs are not high.

This adviser then went on to suggest, contrary to the majority view that he would put more, rather than fewer, questions on the expanded return.

Conservatively, compliance costs of the HWI Taskforce, on the basis of the estimates provided in our interviews, would seem to be well over \$10 million a year – that is, a more significant economic issue than the funding of the program (which costs less than \$10 million). This conservative estimate is based on multiplying the number of expanded returns by the modal compliance cost estimate for completing expanded returns, and adding just the estimated audit costs in cases we were told about.

We found that some HWIs accepted these compliance costs as reasonable; others interpreted them as persecution. However the ATO resolves the policy issues here, it needs to communicate more clearly the reasons why HWIs do and do not stay on the expanded returns. Otherwise 'the client gets a feeling of persecution for being who they are'. Failure to communicate reasons for seeking expanded returns risks the reaction of one HWI described by his adviser as someone who had rejected perfectly conservative kinds of tax planning advice on grounds that he wanted to pay his fair share of tax. His reaction to being kept on expanded returns for another year was: 'If the ATO thinks I'm ripping the system off, maybe I should start doing it'.

A policy option here is that after a risk assessment has been undertaken on each expanded return, HWIs be advised that the assessment has been completed and given a general reason if they will be required to complete an expanded return in the following year. If they are not advised, our interviews suggest that HWIs and advisers assume that the ATO is not doing its job and has simply not got around to completing the risk assessment. While expanded returns should be maintained as a routine requirement for HWIs assessed as having a high or medium risk profile, there is a case for continuous improvement in simplifying the process. Continuous reduction in compliance costs might be considered each year by

examining four paths to lower costs: (a) reducing the amount of information requested in expanded returns; (b) reducing repetition of information from year to year and form to form (for example allowing an 'unchanged since last year' response); (c) greater discernment (possibly based on something like a Tax Strategy Review) in assessing which individuals should complete expanded returns in the first place and greater clarity in signalling a path for exit from the expanded return program; and (d) further work to facilitate electronic returns.

Overall Effectiveness

We can divide interviewed advisers into three groups: (a) a group of more than a dozen advisers who accepted the HWI Taskforce, while feeling it was conceived in such a political way that its targeting was ineffective; (b) a group of six who aggressively rejected the very idea of the taskforce; and (c) another group of six who felt strongly that the taskforce was a sound initiative: 'There should have been a program targeting high wealth individuals long ago'.

Only a few advisers thought the activities of the taskforce had made any difference to their clients. However, a minority did say that they felt the existence of the taskforce was making HWIs generally more cautious because they are 'under the microscope':

It's the constant surveillance of being on the program that causes compliance...Part IVA is of indeterminate width. It might be applied more aggressively in future. So I advise clients to be careful.

Asking the question and getting them to focus their mind on where everything is had an impact.

In some cases this impact was bringing into the system business that was offshore, sometimes openly in a way that would be brought to the attention of the ATO, sometimes indirectly, in a way intended to make it difficult for the ATO to notice. Several advisers mentioned instances of voluntary disclosure of large amounts of income prompted not by audit, but simply by the fact of having to fill out the expanded returns.

One adviser was of the view that this aspect of effectiveness would be severely compromised if the expanded return was not universal for wealthy people with complex affairs:

Corporate Australia would say you really should go at it hell for leather as soon as they are dropped off. That's what happened with the Large Case Program. The Large Case Program should never have been stopped. Corporate Australia learned the lessons from it; the ATO walked away from those lessons.

For this adviser, an even more important point was:

The more information he's [the Commissioner's] got, the less aggressive they will be in their tax planning.

What this adviser was saying here was that notifying X in 1998 reduces the taxpayer's degrees of freedom to reconfigure his 1999 affairs in such a way that not-X appears to be the case in 1998. 'Changes each year will be noticed.' So HWIs must keep their affairs consistent with the underlying truths of earlier declarations.

Most advisers thought it would return more revenue for the ATO to shift its resources to the cash economy; some favoured targeting corporations in high risk industries rather than targeting individuals simply because they were wealthy. One argued very forcefully that the best returns would be achieved with low HWIs or sub-HWIs rather than high HWIs.

Forget Kerry Packer and Rupert Murdoch. They are far too big. Their advice is too good. Go after some middle HWIs or lower. Their accountants are small fry, many of them.

A widely held view of the HWI advisers was that a life course of HWIs could be defined. HWIs were most aggressive when they were making their first million, before they became HWIs. They continued to be aggressive while they were building their empires. Then they often wanted to avoid trouble and to pay their fair share once they had made it. Unfortunately, the HWI program is seen as targeting a lot of people who are in this latter quiescent stage, while the real returns are among the younger wealth-builders. One adviser classified HWIs as 'the meek, the bold and the normal'. The meek, on this analysis, would be found disproportionately among older HWIs, the bold among wealth-builders and the normal among mid-career HWIs.

Another view was that the very wealthy, and very aggressive, are hard targets. The more realistic policy objective than working from the very wealthy down is over time to push up the level of wealth where tax planning can succeed in eliminating the need to pay tax – that is, moving from the wealthy up toward the very wealthy.

The strongest and most widely held basis for doubt about the effectiveness of the taskforce was the belief that it collected a lot of information and then did little or nothing with it. Doubts were widespread that anyone had even looked at the information in the returns they had put in, let alone subjected it to a rigorous risk assessment and followed up with audit where appropriate: 'It's a fishing expedition. They don't know what they're looking for'.

Risk Assessment

Another virtually universal reaction in the interviews was that the politicised beginning of the taskforce was a source of resentment. Former Treasurer, Ralph Willis, claimed that HWIs were avoiding \$800 million a year in unpaid taxes during the 1995 election campaign. This was a frequently cited focus of resentment. In some cases, the Commissioner of Taxation was seen as a co-conspirator with the government in whipping up a 'witch-hunt' against HWIs. This then led to an attack on the way the initial targets were selected. Business Review Weekly's list of the wealthiest 200 Australians was widely seen as the basis of the

initial targeting, and as a markedly inaccurate source. Some HWI advisers claimed they had other clients who were wealthier than the clients who were targeted.

Beyond the complaint about the initial basis for risk assessment, there was little complaint about the way subsequent risk assessment was tackled. In many cases, HWI advisers seemed to have very little knowledge of how risk assessment was done. But if risk assessment were a black box to them, it was not a source of complaint. Many advisers were of the view that the shift away from full audits to risk assessment followed by a suite of audit products was a sound move by the ATO. Others were cynical, believing that compliance was falling because the risk of audit had fallen and that this fact was widely recognised in the marketplace. There was general agreement, however, that the ATO was doing a more competent job of risk assessment:

The general view in the accounting profession is that the ATO is better geared than it ever was to detect where the leakage is. Therefore it should be possible for the ATO to keep a clamp on the most aggressive activity. But it audits less, making that more difficult.

Fairness and Professionalism

While there were many concerns about the fairness of the program, views about the fairness and professionalism of the ATO staff with whom advisers had dealt were overwhelmingly positive. A number of advisers complained that they had little or no contact, but for those who did, only seven were critical of the experience. The strongest criticism was lack of technical competence. Only a handful of incidents were described where ATO staff was seen as less than fair or professional. One repeated complaint was the recording of a 'jaundiced view of taxpayers', their honesty or their lifestyle, in internal memoranda obtained under Freedom of Information and even in position papers. Given the frequency with which this kind of taxpayer will use Freedom of Information to gain more insight into the ATO analysis of their case, especially in the context of settlement negotiations, more consideration may be needed in expressing opinions about taxpayers.

Some of the assessments were very positive: 'He was very good, commercial, understood the realities of going offshore...Compared to other audits I've experienced, it's been very professional'. In response to the question, 'Can you think of any instances where the ATO has not honoured the Taxpayers' Charter in its dealings with your HWI clients?', there was only one specific complaint. In 26 out of 27 cases, the answer was no, though in some cases this was qualified by the concern that the general lack of communication in the program or aggressive assessments to bring the taxpayer to the negotiating table may be Charter issues. Generally, the Charter did not seem to mean a lot to these advisers. One was brutal about it: 'The Taxpayers' Charter is a motherhood document that is really bullshit in the marketplace'.

The generally positive results on fairness and professionalism are important because the literature of the social psychology of procedural justice shows that when people believe they are treated fairly, they are more likely to comply with the law (Tyler, 1990, 1998; Tyler and Dawes, 1993; Makkai and Braithwaite, 1996; Lind and Tyler, 1998). The fact that HWIs often have a sense of fairness that

contributes to compliance, and therefore must be sustained, is illustrated by the following kind of request that advisers said they commonly received:

I want a tax plan that will get my tax down to X per cent, say twenty. I want to pay my fair share. But not that much. Then others will say I want a total tax wipe-out and even pay a ridiculous amount of money to get it.

Some advisers were critical of a failure of taskforce staff to work with other sections of the ATO (for example Transfer Pricing, Small Business, an industry segment of Large Business and International) to avoid turning over the same issues with different sets of ATO people.

On the technical questions, one suggestion was that audit staff be more willing to call in more senior technical people when the issues got thorny, and in such cases, for the ATO technical expert to have sign-off on position papers. There are already three levels of sign-off on HWI risk assessments (analyst, team leader, manager/director), which are often applied to position papers.

On the other hand, sign-off rules may be too formal an approach to something that is fundamentally a cultural challenge for the taskforce. On all aspects of audit, communication is needed to improve quality. Getting position papers technically correct is just a small part of this. The taskforce must be careful in its quality control not to end up with such a focus on avoiding errors in its written communications that it neglects quality assurance of bigger strategic issues that would remove the need for a written communication in the first place. One HWI manager, for example, said that one of the most valuable pieces of advice he regularly gives auditors is: 'I've seen this stuff before and I can tell you following it is not productive'. His view was that the essence of professionalism was not getting bogged down in pointless pursuits.

Training is important here as well. But perhaps formal training is the more important path to keeping technical skills up to date (training the mind), while informal discussion between masters and apprentices is the more important path to improving the wisdom of strategic audit judgment (training the nose). One HWI adviser argued that it takes 20 years for auditors in complex cases to acquire a nose for the right lead. In light of this, he was critical of ATO early retirement packages that were disproportionately taken up by precisely such experienced people. Balance, an ability to extrapolate, the gift of getting an inkling on what a transaction means, and where it might lead, without the full information, are virtues that might be nurtured more by a retention program than by early retirement packages for the people with these rare gifts. The learning process perhaps can also be facilitated by the old and the wise conducting best practice workshops for the young who do not yet know how to read the commercial signs.

When position papers involve difficult technical issues, there seems to be a need for the level of authority for sign off to be increased. The taskforce also needs to set expectations for hours of formal technical training that are realistic in relation to workloads, but well in excess of what is expected of fieldworkers in less complex areas. An ongoing identity that fosters a storytelling culture about how to find fertile leads and how to avoid infertile ones is an issue more systematically addressed in an earlier chapter (Braithwaite, Chapter 9, this volume). Such a culture is one where apprentices are constantly asking masters to relate stories of their experience on strategic decisions they are making. It is also a culture where

masters do not tell apprentices what to do so much as volunteer stories from their experience when they see their apprentices about to repeat mistakes they have made in the past. Best practice workshops are needed nationally to assist with the development of such a storytelling culture that nurtures strategic wisdom.

Communication

A bit of frank discussion goes a long way.

Auditors need to understand that it is natural for me to talk to their head. That is a cultural change needed.

Why can't we have a relationship of trust, a process, which starts with me saying 'here's my analysis of how things have changed since last year'.

What about the Asian and English model of tax inspectors building relationships. Almost a personal thing in paying your tax. A more personal approach that seems to work. Then it's hard to avoid a big issue that arises on either side (professional association interview).

Since most encounters with HWI staff were seen in a positive light by HWI advisers, it is not surprising that most of them wanted more communication. They particularly wanted communication about where their client was up to in the program: 'Had he received a clean bill of health?'; 'When would she get off the program?'. Many HWIs were reported by the advisers as philosophical, that it was reasonable that people of their wealth might be targeted in this way. But there was also a widely reported view that their clients felt victimised by the program. In the view of the advisers, here was where more communication from the ATO would help. Some older HWIs worried about their tax affairs and were concerned to do what was necessary to get a clean bill of health quickly: 'They say it's only money and it's better to sleep at night'. There is an opportunity lost for both the ATO and the taxpayers to reach accommodation quickly when this is the situation. Many advisers wanted agreed timelines for expanded returns to be assessed, decisions made whether to take the case further or to drop their client off the program. And they wanted communication on how this was progressing.

A majority of the advisers specifically requested that there be a taskforce representative assigned to their case and that they meet them in advance of the expanded return being requested. What was most commonly favoured was a preliminary risk assessment by an analyst based on information provided by the HWI at an initial interview. This information would include how the structure of the entities controlled by the HWI had changed since the last assessment, financials, extraordinary transactions, a mud-map of the group structures and the tax reconciliation (from accounting to taxable income). Advisers repeatedly argued that in many cases advisers were in a position to convince an analyst why their client paid little tax even though they were very wealthy.

One adviser suggested that meetings of ATO staff with HWI advisers would assist the professional development of both. It would improve the understanding and clear up misunderstandings about how the ATO works, and discussions on technical issues would expose ATO people to the technical insights of advisers and

vice versa. An adviser gave an example. There had been enormous conflict over a disagreement in interpretation of the law. This disagreement was fuelled by the belief on the part of the adviser that the ATO auditor was technically incompetent. In the wash-up, the adviser admitted that it had been his technical analysis that had been less sophisticated. The ATO's Tax Counsel Network (TCN) had been giving sophisticated advice to the auditor:

They were ahead of us and we didn't know. We just assumed this was another case of this auditor getting settled law wrong. Probably, we should have been communicating directly with the Tax Counsel Network. Certainly if there had been some communication, even from the auditor, on where he was coming from, unnecessary confrontation would have been avoided.

Communication, advisers argued, would help working relationships in other ways as well:

If an auditor reviews something and gives it a tick, it is good to communicate that back. We learn from that. It also stops us from wondering: Did they miss the issue or did they mull over it? If they did give it a tick, they missed the opportunity to tell us they have noticed this and decided to let it through, the opportunity to have us say: These guys have been pretty fair. Rather than saying they have not been on the ball as they missed it.

Given the propensity in this game for the players to be uncharitable toward their adversary, it is likely that in the absence of communication, the assumption that the ATO is incompetent is exactly what the adviser will take away from the encounter.

Similarly, how ever the ATO resolves the big policy question of whether it should be normal or exceptional for HWIs to stay on expanded returns year in year out, there is virtue in taking seriously the following suggestion of an adviser:

Why not a letter of commendation on clearance. Thanks for your cooperation. You've got a clear bill of tax health.

Even if the HWI is to stay on expanded returns, presumably such a letter might say: 'Thank you for your cooperation. A risk assessment on your return this year has resulted in a decision not to include you in our current round of audits. However, you will be required to complete an expanded return again next year as our risk assessment also showed that you are likely to continue to have a high-risk tax profile. If you have any questions about this, feel free to get in touch with your case contact person, Mary Smith'.

Another adviser implied that competent ATO staff picked up useful risk assessment signals from communication with advisers. This was an adviser who said he dropped HWIs when they lied to him. He felt that through this kind of act, the ethical adviser gives a signal that the competent ATO staff member knows how to read.

Communication between advisers and ATO staff can help keep the ATO up to speed with the latest arrangements in a world where 'the better an idea, the shorter its shelf life'. Several advisers confessed to us that they had dobbed in tax

planning arrangements used by their competitors, combined with their opinion on what its technical weaknesses were. Others explained this was widespread because there is 'a lot of jealousy' or 'a degree of bitchiness out there'. In one example, firm A developed a product with some bugs in it. Clients of firm B were approached about buying into the scheme. Firm B then reverse-engineered the scheme into an improved version and 'made noises to our contacts in the ATO' about the bugs in firm A's version.

Some advisers and some HWI staff did not see the need for the ATO to initiate communication. These advisers said their experience was that they could telephone the taskforce and discuss any question that was concerning them. A number of other advisers had not had this experience, however. They found great difficulty in securing the communication they felt they needed, and in some cases, any communication at all.

Another option for improving communication is suggested by the Canadian Audit Protocols (Revenue Canada, 1996). The Canadian Audit Protocols are not just about a move to real time audits; they are also about rewarding cooperative relationships between the tax authority and its clients with negotiated audit protocols that reduce compliance costs for business and increase compliance effectiveness for the tax authority. For example, scheduling visits by different areas of the tax authority so that disruption to business is minimised, conducting concurrent audits, and informing business in advance of the form in which financial records might be kept to avoid their double handling. The idea is that Revenue Canada and participating corporations jointly produce a written framework that establishes guidelines for the relationship and the audit process. When a HWI is targeted for an audit, it seems quite possible and sensible to give their adviser an audit plan, with the proviso that they might be advised at any stage that the plan has been modified. Indeed, we were told this is generally done with HWIs, though not always in a timely fashion.

Complexity

Half the advice I see people give is wrong...McKinsey and Co showed some years back that the ATO's advice on the basic matters dealt with at the enquiry counter was right only thirty per cent of the time; thirty per cent of the time it was wrong; and forty per cent of the time it was useless and beside the point.

I know twenty per cent of it by working twelve hours a day, six days a week for twenty years.

The Commissioner would have to take two weeks off to get up to speed in what he is talking about in that trust stuff. And he should not have to. The Act should not be so complex that only those below him have the understanding of the law to run and control agendas.

There was consensus among advisers that the complexity of the law was keeping compliance costs high for HWIs and making effective enforcement difficult for the ATO. There was general support for the idea of discerning general principles in the law and disciplining specific elements of the law to be consistent with these general principles. The idea is that all components of business tax law should be

derived from, and consistent with, a smallish set of general principles. There was also general cynicism that the wash-up to the Ralph Inquiry (Ralph Report, 1999) that was developing such principle-based reforms would be any more simplifying than the results from two decades of pronouncements about such efforts. Three years on from the interviews this cynicism has been vindicated, as there has been little of the principle-based reform advocated by the Ralph process.

Offshore Investment

Advisers said that clients came to them requesting that they help set-up offshore investments, accounts and credit cards. But only two said they got into assisting HWIs with this. Two others said this was a reason why clients went elsewhere. A number of advisers felt that few HWIs avoided taxes by using offshore strategies such as tax havens. However three advisers felt offshore tax avoidance was the main risk to the revenue by HWIs and some others saw it as a significant risk. One of these made the point that a higher proportion of Australia's most wealthy people are immigrants compared with most other countries, making offshore trusts a bigger issue for us.

Three advisers also felt that a strategy of the aggressive HWI was to have conservative domestic tax planning arrangements managed by a reputable adviser from a Big Five or second-tier firm, and then to have another set of investments offshore which are not disclosed to their conservative adviser. This strategy implies securing a favourable risk assessment by the ATO on the basis of the conservative side of their dual strategy, thereby protecting the offshore side of the strategy from scrutiny.

Even those who thought offshore tax avoidance was a major problem emphasised that not all HWIs could exploit it. Offshore strategies would be foolish for a HWI who was a resident of Australia and who ran no actual businesses offshore. In these circumstances, it is difficult to conceal the movement of funds as they leave the country. For HWIs who are non-residents or who have non-resident family members, funds can be passed to them and then shifted offshore to a destination unknown. The ATO only has direct access to the domestic tax affairs of non-residents. An Australian resident who is wealthy enough to actually run a business overseas also has a formidable capability for 'bleeding some funds out' into personal accounts protected by a tax haven.

No adviser recommended targeting offshore investments as a sensible shift in enforcement strategy for the taskforce. For some, this was because they did not believe HWIs were using offshore accounts to avoid tax on any large scale. For others who believed HWIs were doing so in a massive way, the belief was that these arrangements would be impregnable or very hard to find: 'You'd end up chasing a British Virgin Islands company where you can't find out who their directors are under their law'.

However, three advisers recommended an amnesty on bringing home or paying tax on offshore investments. One felt that, particularly with older HWIs who wanted peace of mind and a capacity to pass wealth on to their children without undue complication, an amnesty based on agreement to pay back tax and interest (but no penalty) would bring a lot of offshore income into the system. A second adviser felt this would not generate enough incentive to bring in the huge offshore

investments which he said he knew were out there. His policy suggestion was that as long as offshore funds were actually brought back for investment in Australia and future taxing on-shore, all back taxes and penalties should be waived. Only the removal of the threat of back taxes, he believed, would see the repatriation of worthwhile amounts of tax and capital:

Half a dozen merchant bankers who were my clients would have been happy to bring money back into Australia if they did not have to pay back taxes...If you didn't ask any questions, a huge amount of money would come.

The third adviser who recommended an amnesty commended the experience of the ATO overseas controlled trusts amnesty of more than a decade ago. He said most of his clients with overseas controlled trusts came clean about them (on his advice) as a result of this amnesty. In practice, he negotiated on behalf of his clients for more than waiving of penalties – that is, for considerable waiving of back taxes as well: 'My experience is that if the Commissioner will not negotiate, do deals, he will get less tax'. One of them suggested the ATO might also have to bluff HWIs into believing that there would be a major enforcement crackdown on offshore investments after the amnesty and that this was the once in a lifetime opportunity to avoid its fury.

In summary, in this project we have found evidence of some movement of multi-million dollar offshore investments into the system, some known and some unknown to the ATO, simply as a result of the questions that have been asked about them in the HWI expanded tax returns. We suspect this movement has been more than sufficient on its own to pay the costs of the taskforce. We have found little basis for optimism that a crackdown on offshore strategies would generate a lot more revenue. However, an amnesty of say twelve months to encourage both bringing offshore tax into the system and capital back to Australia is a policy option, albeit one with risks and substantial administrative costs. It would need to be combined with a public commitment to enforcement for those who failed to avail themselves of this opportunity, even though the enforcement would not be very effective. In the world of tax motivation described by advisers, where both 'inertia' and 'peace of mind' are important, an amnesty might overcome the inertia of leaving tax-protected offshore investments be, by offering the taxpayer the peace of mind of a clean slate. This motivational account might be particularly appealing to older HWIs who want to leave their affairs in a tidier state for their children. The amnesty need not be a discriminatory benefit made available only to HWIs; it could apply to any taxpayer with offshore funds. There are, for example, academics who receive payments for teaching while they are on study leave which they put in foreign banks.

The Power of Advice to Secure Compliance

If I tell them [HWIs] it's not legal, they don't do it.

The large majority of HWIs, according to their advisers, want to avoid anything illegal, any litigation, anything that will make them a test case for the Commissioner. Consequently, advice by the adviser that a claim is illegal is

enough to stop it, a finding Tomasic and Pentony (1990) also reported. This fact reinforces the need for good communication between the ATO and advisers, who are the agents of much of their voluntary compliance work.

For the same reason, we were repeatedly told of the power of a simple media release by the Commissioner to stop schemes in their tracks: 'The moment taxpayers see a negative statement [by the Commissioner] on a scheme, it doesn't happen. The Commissioner can close them overnight'. A number of advisers pointed out that the ATO should be responsible enough not to issue such releases unless they were accompanied by or followed promptly with a supporting technical paper.

Others were critical of the under use of this effective tool of compliance: 'The ATO sits on things it could kill off'. Sometimes this is because the ATO is slow to complete its technical analysis, sometimes because it does not yet have the resources or political will to attack or test a scheme (and it wants to maintain a reputation for keeping its promises). Sometimes it is slow to detect new schemes, though most advisers felt the ATO had become much more effective in this regard, often pointing to the potency of the strategy of Strategic Intelligence Analysis. Most felt it was possible to keep abreast of the new schemes through a combination of maintaining good lines of communication with their fellow advisers: 'They love to chatter. People have big egos and love to brag. If this fellow doesn't, the next fellow will'. Simply 'knowing what is being said from the rostrum of Taxation Institute conferences, which covers nine schemes out of ten' and following up the advertisements in the *Australian Financial Review* and *Business Review Weekly* can cover much of the field.

Analysis

Changing Lenses: The View from Middle Australia, 1985-1999

This research was undertaken in a different environment from Tomasic and Pentony's (1990) report on the attitudes of advisers. That was a time when tax advising was seen as a much more cautious and responsible business than it had been a decade earlier. The widespread belief, effectively promoted to the public by the Australian Treasurer at the time, Paul Keating, was that the paper schemes of the 70s and early 80s were dead, compliance had improved markedly, capital gains tax had collected more revenue than projected and the rich were paying a fairer share of the tax burden. As Margaret Levi's (1988) research suggests, confidence in the tax system (and compliance itself) did seem to improve substantially after the reforms following the 1985 Tax Summit. 1992 Organisation for Economic Cooperation and Development (OECD) data suggest that at the time, Australia was doing better than most developed economies in getting corporations to pay taxes: Only Japan and Luxembourg were being markedly more successful (Slemrod, 1996).

That confidence has sagged again. And for the reasons Levi (1998) articulated, voluntary compliance of ordinary taxpayers is again at risk as a result. This seems to be a normal phase in an ongoing cycle of reform/honeymoon/decay/repair/collapse-of-confidence/reform.

The aspects of the environment that were causing decay in confidence in the fairness of the tax system at the time of these interviews were the large increases in the income and wealth of HWIs in a decade and a half when Pay As You Earn (PAYE) taxpayer compliance improved, but their income and wealth increased by a lesser amount than that of the rich. There is a belief, which has some foundation (Picotto, 1996), that the globalisation of commerce opens up new opportunities for the rich which are not available to low and middle income earners. There are other changes in the global environment which are beyond the comprehension of the average punter, such as the impact of the growth in derivatives: 'The same minds that figured out how to split a security into a multitude of different cash flows and contingent returns are now engineering products in which the tax benefits are split off from the underlying economics of a deal' (Novack and Saunders, 1998). In a way, the fact that the average person does not understand these things is the problem, and the reason they resort to a simple-minded analysis that the wealthy must be breaking the law and using their power to get away with it.

Moreover, some ordinary citizens are frightened by the implications for their share in the wealth of global competition for the capital of the rich. This particularly focuses on the liberalisation of trade, as evidenced by the populist political movements of the left and the right against globalisation. Many Australians believe their government wants to attract capital to Australia by giving those who own a lot a better tax deal than them. They believe income tax and company tax rates have come down more than their rates. And they believe PAYE makes them more effective payers of those rates than the rich. While few remember 85 per cent income tax rates on high wealth individuals under the Menzies government of the 1950s, they do remember the 60 per cent rates of the early 1980s and the death duties that used to be a significant burden for the rich. In 1985, commentators readily accepted the argument that compliance could be improved by cutting the top income tax rate to align it with the company tax rate. But a year after its introduction, this alignment collapsed as the company tax rate was cut substantially to meet downward competitive pressure on company tax rates led by the Reagan and Thatcher governments and the newly industrialising economies of the Asian region. Middle income earners contrast this reduced burden on corporates and high wealth individuals with the way bracket creep has pushed more of their income into tax rates which were supposed to be the preserve of the rich.

Australia is a society with an egalitarian ethos and for most of its history it has been objectively among the nations with the most egalitarian distributions of income. Unfortunately, one of the things that goes with this ethos is an uncharitable view of the rich. So if a wealthy person is revealed to be paying no income tax, most Australians tend to assume that he or she has cheated, probably broken the law and certainly bent it. The assumption is rarely the charitable one that the high wealth individual has claimed deductions or transferred losses that the law fully intends to be legitimate.

When something like the HWI Taskforce is set up in response to these perceptions in middle Australia, both sides may end up perceiving themselves as victims. While low and middle income earners may perceive themselves as fools to be honest taxpayers, high wealth individuals perceive themselves as victims of a witch-hunt grounded in unfair labelling of them as tax cheats. Both perceptions are unhealthy for tax compliance. The taxi drivers rationalise not paying tax by saying

that Kerry Packer (Australia's wealthiest person) pays none; high wealth individuals rationalise not paying tax by citing the non-compliance of people such as taxi drivers who are paid in cash.

It follows that a useful way of framing the compliance challenge before the government might be to ensure all participants in the economy pay a share of the tax burden that most participants would view as fairer than the present distribution, to enable all participants to have a realistic perception of that distribution and why it is that way, and thereby to eliminate inaccurate perceptions that some sectors are cheating more than they really are. Such a shift in perceptions might improve compliance in middle Australia, in the cash economy and among HWIs. If such improvements were strong enough, they might allow a reduction in tax rates for all, thereby further strengthening perceptions of fairness.

It is in the context of this framing of the compliance challenge that we might take seriously the suggestion of one HWI adviser that the HWI Taskforce disclose to Parliament the aggregated accounting income of all entities controlled by HWIs, and then the aggregated adjustments listed for each reason for adjustment that reduces the accounting income to the taxable income. This means a breakdown of the reasons for the tax-gap between accounting and taxable income. His argument is that the top half dozen reasons would account for most of the reduced tax liability of HWIs. They would be reasons such as depreciation on property, research and development, franking credits and write down of stock to market value. Because the big-ticket items on this list would be small in number, they would be easy for Parliament to digest. Parliament and the people would then have a more realistic understanding of why HWIs pay the level of tax they do. It would be clear why law breaking does not need to be invoked as an explanation. The major reasons would be plain to see. Then governments and electors could make their judgments about whether the economic and other benefits of each reason for the draining away of revenue justify the documented loss of tax receipts. Economic policy decision-making would become more transparent. Confidence in the integrity of government and of HWIs might thereby be enhanced. The adviser's claim was that this would not be difficult for the taskforce to do: 'You just list the reasons for adjustment on an Excel spreadsheet and add in the numbers for each taxpayer'. In summary, this policy presumption is that the ATO disclose to Parliament the aggregated accounting income of HWIs, what percentage of this they pay in tax, and the aggregated adjustments responsible for reducing the accounting income to the taxable income, listed in descending order of importance. This would render transparent the share HWIs are or are not paying and why.

The following analysis shows why this suggestion might be taken seriously. It is based on the cycle of principled tax reform, followed by a honeymoon when citizens perceive the system as decent, an inevitable creeping of unprincipled elements into the package as a result of global, technological and legal change, followed by rising taxpayer cynicism that ultimately makes the next cycle of reform necessary. One reason the unprincipled elements corrode the system is that legislators do not get feedback on the costs to the revenue of their legislative mistakes. They only become aware of them when the hole is so catastrophic that no one needs an Excel spreadsheet to notice it. But by then the interests entrenched to defend it, the scale of the investments entered into on the assumption that it would continue, may be so massive as to make repair extremely difficult politically. So the rationale for this prescription is that it might extend the

honeymoon of confidence and trust in the tax system not only because it would be more transparent but because the transparency would put governments under pressure from Parliament and the people to nip in the bud unjustified corrosions of the tax system before they became gaping holes capable of destroying confidence in the system. By keeping middle Australia's lens on the tax system clear, it will be slower to change focus from the confidence after reform to cynicism about a system seen as in decay.

The Limited Relevance of Deterrence to Protecting the Revenue

If you can stand by your interpretation of the law, then the prospect of audit does not deter.

Most people think that compliance with regulatory laws is mainly secured by punishments imposed by the courts if the law is violated. Hence, their crude analysis of the HWI Taskforce would be that HWIs are almost never prosecuted criminally and are infrequently subject to tax penalties, so this is the reason why they pay such a low proportion of their wealth in tax. In most regulatory domains, this view is simple-minded or mistaken, but particularly so with tax compliance by HWIs.

The advisers told us that outright non-compliance is rarely a rational strategy even when detection risks are extremely low. Consider the following highly effective form of blatant evasion available to HWIs. It is loosely based on a real case:

The HWI has a million dollars in profits. He gets a charitable deduction by donating it to a breast cancer research foundation he sets up in Geneva. The foundation then almost immediately lends it back to the HWI at an exorbitantly high interest rate. This interest rate enables the company that pays it to record a loss that the HWI can then write off against profits in another entity he controls. The HWI gets his million dollars back and two tax write-downs: A deduction on the way over to Geneva and a loss he can use to reduce taxes on the way back from Geneva. If he disguises the transactions effectively, it almost certainly won't be detected. If it is, the HWI has reputable people organised to testify that he always fully intended to repay the loan. He can actually do so before the matter goes to trial. The Director of the Breast Cancer Research Foundation will testify that they wanted to use the money well, to wait until a research proposal came along that would really produce a medical breakthrough. But while they were waiting they wanted to put their money to work. They knew that their benefactor, the HWI, knew how to do that better than they. And he was generous enough to pay an above-market interest rate to ensure that all the profits from his investment would be passed back to the Foundation. The ATO decides it does not want a case where a judge might vilify it for persecuting a businessman dedicated to such a cause.

While this kind of case has happened, it is not a kind of scam that in the opinion of HWI staff is widespread, not one of the major risks to the revenue among HWIs with the level of resources needed to exploit it. Why? After all it is highly profitable, simple enough to execute and almost guaranteed never to land the HWI in jail. The perfect crime. The answer according to our interviews is twofold. First,

the HWI has too much to lose to risk even the remote prospect of the perfect crime unravelling. Second, there are other perfectly legal ways she can arrange her affairs to avoid having to pay tax on her million dollars without losing any sleep at night. So she prefers to pay an adviser to help her execute one of these latter strategies. The level of tax benefit in respect of her million dollars will depend on how competent and aggressive her adviser is, both being attributes in an adviser she can pay a premium to get.

All the government should or can do about the HWI who goes to the extraordinarily competent, yet conservative, adviser is to close off the biggest legal opportunities they exploit. For these conservative HWIs who pay little tax, deterrence is utterly irrelevant as a strategy for protecting the revenue. There is no need to deter the Geneva charity scam because this kind of option is unthinkable to them. It would be improper to deter them from exploiting the services of an unusually competent but law-respecting practitioner.

We now consider whether there is a place for a strategy of deterring the use of an unusually aggressive adviser.

Global Competition and the Hustling of Tax Advice

The global tax situation is more of a risk than Australian schemes.

Two letters sent by the Big Five accounting firm, Deloitte and Touche, in late 1998 opened as follows (Novack and Saunders, 1998):

Dear _____

As we discussed, set forth below are the details of our proposal to recommend and implement our tax strategy to eliminate the federal and state income taxes associated with [the company's] income for up to five (5) years ('the Strategy').

They were sent to two medium-sized United States (US) corporations asking for a contingency fee of 30 per cent of the tax savings from taking the tax liability to zero.

In Australia, our interviews suggested that the then Big Five did not touch the marketing of schemes with anything like this kind of aggression and that they did not operate on such a contingency fee basis.³ The more aggressive shelters are marketed by non-charter firms, some by small law firms, others by financial advisers of a rather fly-by-night character ('they get \$10 000 each from 200 people for their scheme and then they don't care what happens'). That may be, but there is a reality of the global market here. The fact is that in the US, the Big Five seem to have been able to increase their profits substantially through shifts toward such tactics. Individual staffers can secure bonuses up to US \$400 000 for landing deals such as those pursued by the Deloitte and Touche letter. Ernst and Young and Deloitte and Touche reported a 29 per cent jump in revenues from tax services in the US in 1997. Since 1993 tax revenues for the Big Five have grown at twice the pace of audit revenues (Novack and Saunders, 1998). American Express is contesting their market in a formidable way. Something is changing in the risk environment here and it is probably global.

If it is about global change in financial engineering, Australia cannot resist it. Novack and Saunders (1998) argue that in the US 'it has taken a while for inhibitions to be shed and the most outlandish gimmicks to propagate'. But the inhibitions have shed under pressure from the aggressive marketisation of proactive as opposed to reactive advice. Today, as one adviser worried 'if you pay enough you can find a lawyer to write an opinion supporting anything'. The advice market, in Australia as well, decreasingly operates through advisers just reacting with specific strategies to cope with the needs of clients as they arise.⁴ If advisers do not proactively market strategies to substantially reduce the tax liabilities of major clients, they can count on it that competitors will. Once the large accounting firms reach the conclusion, as they clearly have in the US, that they will lose business unless they match it with aggressively proactive promoters of shelters, a level of global sophistication in the engineering of proactive tax planning that is within the competence of the big firms comes into play.

Moreover, as the major accounting firms increase their proactiveness, a change can be expected in business culture on tax matters. 'Inertia', as one HWI adviser explained to us, is a major cause of tax compliance. If no one is pushing aggressive tax planning at a client, they do not feel incompetent for failing to do it. In Australia, there is a business ethos, and an ethos of the elite tax advisers, that 'if there is not an underlying business case for an investment, but only a tax case, don't do it'. The gradually growing clout of the general anti-avoidance provision of Part IVA of the *Income Tax Assessment Act 1936* is perhaps one reason for this.

However, it would be naïve to assume that global commercial pressures might not change it. Thanks to the GATS (General Agreement on the Trade in Services) agreement of the GATT (General Agreement of the Tariffs and Trade) – for which American Express (a heavy buyer of tax lawyers and accountants) and PricewaterhouseCoopers were the leading advocates, along with Citibank – the financial services market is now globalising. The consequence will be that if the Australian tax advice culture is seen by aggressive foreign firms as excessively conservative, they may view it as a market they should attack through a sales force that systematically works a distribution network to all HWIs. Globalised investment banks, with all their aggression, networks, expertise and reputational capital,⁵ may be the biggest threats for ushering in this change. So even if it is the case that Australian business culture is more reactive than proactive on tax design, and that the tax departments of large corporations are not typically seen as profit centres in their own right (increasingly the case in American business culture), the capacity for Australian businesses to resist a globally-driven culture change must be in doubt. There is a kind of culture transformation and take-off with these things, as Australia saw with the schemes of the 1970s: 'Once companies get a taste, they become more comfortable and continue to do it' (Novack and Saunders, 1998). A critical litmus test of the culture change is a growing belief in the business community that paying any significant amount of tax is a sign of weakness that might be criticised by shareholders.

So it may be that global financial services market pressures will progressively unsettle the inertia and conservatism that delivers a lot of HWI taxpaying at the moment. Moreover, the profits that the US accounting firms seem to be deriving from contingency arrangements at the top end of the market suggest that there is reason for promoters to move down the market offering proactive hustling of more engineering-intensive tax planning.

This seems a risk to the revenue that would run down from HWIs and large corporates to players of more intermediate levels of wealth. In addition, it would put at risk the culture of tax compliance at lower levels of the economy which has been reasonably strong in Australia by international standards. The worry is that if ordinary Australians become as cynical as Italians about the tax morality of the rich, we will be at risk of Italian levels of voluntary compliance, or even Colombian levels. As difficult as the Commissioner's job is, we should never assume it is incapable of getting a lot more difficult. One step that is a priority in Australia is to persuade tax professional bodies to set self-regulatory standards that prohibit contingency fees on reduced tax liabilities.

For these reasons, it seems necessary to guard against the risks from global competition in tax hustling by deterring aggression in tax advice. How can that be achieved? It is not against the law to give aggressive tax advice and nor should it be. Advice to break the law is sufficient reason to withdraw a licence to offer tax advice. But we have seen that this is not the real problem. Deterrence is largely beside the point at the moment because taxpayers who breach the law on the basis of a reasonably argued position supplied by a licensed adviser will not be subjected to any penalty tax; they simply pay the back taxes plus interest. This means that it can be rational to go to advisers who push their advice to the limits of what could conceivably be accepted as a reasonably argued position.

In the US context, Novack and Saunders (1998) express this rationality as follows: 'The IRS misses nine out of ten shelters. On the tenth, the company pays back taxes and the government agrees to no penalties'. In the Australian context, there appear to be two highly rational strategies if you are a HWI: One is to go to a conservative adviser respected by the ATO who will put you only into tax planning arrangements which have been approved by the Commissioner in a Private Binding or Public Ruling, and who will do that with maximum transparency to the taskforce. The taskforce is therefore likely to assess you as a low risk. But the other rational strategy may be to conceal a highly aggressive tax planning activity so it is most difficult for the ATO to find and then cover it with a (weak) reasonably argued position. If you are unlucky enough to be audited and have it detected, you roll over and pay up quickly so long as there is no penalty in the settlement, or a minimal one. An in-between strategy of a highly visible reasonably argued position, which would have a strong chance of success in the courts (but is rejected by the ATO) is not attractive because you risk the uncertainty, costs and notoriety from fighting the ATO on a test case.

The policy objective we wish to explore is deterring the second strategy so as to encourage the first. This cannot be accomplished through penalties because the probability of a serious penalty is too low when there is some sort of reasonably argued position in relation to a low visibility activity that is unlikely to be scrutinised by an auditor. It can be accomplished, however, by targeting audits and other forms of surveillance on HWIs who use the services of aggressive advisers or promoters. Among other things, these would be advisers and promoters whose clients are frequently found to have activities tucked away, which are defended by a weak reasonably argued position supplied by the adviser. They would have a track record of promoting arrangements that have been disallowed by the Commissioner or struck down by the courts. The idea of this strategy is that clients who wish to avoid the risks and direct costs of an audit, steering their business away from aggressive advisers and promoters, would improve compliance. There are

limitations to the strategy. The best tax planning is specifically designed for a HWI and will not be noticed as a problem.

A credible litigation strategy is an imperative to show HWIs that it is not an option to bankroll the government out of enforcement action and that the ATO keeps its promises, even if this requires high litigation expense. Using test cases to develop a strategic case law around Part IVA seems particularly important.

Raising the Bar and Lowering the Costs

For the critics, the expanded return at the heart of the HWI Taskforce risk assessment strategy amounts to saying: 'Give us the haystack and we'll find the needle'. Some advisers argue that what the taskforce should be doing is 'getting their rifle out, not their shotgun'. Advisers generally do not realise that a systematic risk assessment is completed on the information in the expanded return, and a team leader and manager check this assessment with sign-off.

One adviser made the point that the ATO could not do the job of targeting audits for HWIs in a sensible way before the expanded returns were introduced. Audits, as a result, were 'a lottery'. He therefore saw a rationale for continuing the expanded returns on an even wider front than their current coverage:

The average innocent Australian would have less chance of being audited for the wrong reason.

The questions in the HWI returns are pretty compelling. If everyone, other than PAYE returns, had to declare these things, there would be more compliance.

He illustrated the point with being forced to declare offshore income. He said it was one thing to be in a situation where you can defend a failure to declare something as an oversight. It was another to answer 'No' to that expanded return question on overseas trusts from which you might benefit, when it can be shown later that you knew the answer to be 'Yes'.

Theoretically, that's go to jail stuff and people want to sleep at night.

Some other advisers made similar points: 'If you have been doing the wrong thing, some of those questions must be difficult to answer'. On this view, the genius of the expanded return is that it puts HWIs in the position where they have to lie outright rather than 'overlook' something. It forces into black and white what had previously been grey. Both conscience and fear of deterrence work better in the realm of black and white than in the realm of grey. This point applies to both HWIs themselves and to their advisers.

The expanded returns also have preventive value. Completing an expanded return reduces the degrees of freedom for redefining income and deductions for the purposes of a subsequent return or audit. We agree with the adviser who argued that this has preventive value in itself. Because HWIs do see the personal and financial costs of being on the expanded return program as something they want to avoid, there is also an opportunity for risk management by setting the standards the taxpayer has to meet to get off the program. One option would be to follow the

risk assessment on an expanded return with an interview with the adviser. At that interview it could be common for the analyst to say to the adviser: 'On the basis of our risk assessment we are expecting your client to continue on the expanded return program next year unless her circumstances change so that these compliance risks no longer apply'. Each HWI risk assessment could include a judgment of which compliance risks would have to be removed for the risk assessment to be changed to 'low' (and therefore no expanded return). There could then be some strategic conversations with the HWI adviser about these risks that are keeping the HWI on expanded returns. In some cases agreement could be reached on a compliance management plan for getting off expanded returns.

Conclusion

The HWI Taskforce is tolerated as reasonable by many HWIs, resented by many, loved by none. It imposes considerable costs on taxpayers, which can be somewhat reduced. Overwhelmingly, in the view of advisers, it does its work in a way that complies with the Taxpayers' Charter. Its officers are mostly perceived as fair and professional, though lacking in tax technical skills compared to their opposite numbers.

The taskforce has a daunting job, because non-payment of tax occurs on a wide scale among HWIs and the Australian community and their political leaders are sensitive to this fact. A globalisation of tax hustling by aggressive promoters may unsettle a lot of the inertia that delivered voluntary compliance in the past. At the top of the market, their entrepreneurship with new financial products can be technically dazzling.

The fact of life is that if you are rich enough and aggressive enough, it is not necessary to pay much tax. Legal penalties are important and lower than they should be. But even if they were dramatically increased, legal penalties could never on their own make it rational to pay the level of tax that Parliament and the people expect the rich to pay. If revenue is escaping out of four open windows, closing three of them might simply see more flowing out the fourth, or a fifth window being prized open. This is not to say that it is impossible to achieve improved levels of taxpaying through a combination of measures. If the Commissioner works tirelessly at closing every window through which the revenue escapes as soon as he sees it, the returns to tax planning will fall because the high costs of developing shelters will pay returns for shorter periods. Combine this with inertia, the threat of expanded return oversight, audits, penalties, the desire of many for the quiet life free of governmental hassles, the desire of many others to pay their fair share, to eschew a self-image as a cheat, to sleep well at night, and the result can be an improvement of compliance, especially if all these levers are used in a way that is perceived as fair. Indeed, the taskforce does seem to have succeeded in incrementally improving compliance among those subject to its work, as evidenced by the jump in the tax paid by HWI-controlled private companies from substantially below to substantially above that of non-HWI private companies.

There is evidence from many areas of compliance with law of a tipping point phenomenon. Failure to meet the law's obligations becomes so widespread that enforcement authorities effectively give up, and have little choice but to do so, given the enormity of the task. Mark Kleiman (1993) calls it enforcement

swamping, a phenomenon widely observed with drug-selling hot-spots in the US. Where the capacity for the police to enforce the law is fixed, a rise in crime in the neighbourhood reduces the punishment per offence. This lower level of punishment attracts new offenders. Enforcement swamping arises where enforcement capabilities fall too low to prevent this positive feedback cycle. Arguably the ATO had an enforcement swamping crisis with HWIs in the 1970s and early 1980s and is at some risk of descending into that situation today because of global pressures. Equally, there is encouraging evidence of the HWI Taskforce tipping the balance somewhat toward compliance. This perspective means that the nihilism of saying that the closing of three windows will simply see revenue rush out a fourth is quite misguided. The eternal vigilance of pushing windows shut as quickly as possible is critical to fending off enforcement swamping in an environment where this is an emergent risk.

The taskforce seems well designed to meet this formidable challenge. Purists might say enforcement should be targeted on individual and corporate taxpayers. I would say, in contrast, that enforcement should be focused on strategic foci of decision-making. HWIs that control many entities, the tax managers of large corporations, influential advisers and promoters are all examples of priority foci of enforcement effort. In establishing the HWI Taskforce, Australia has sensibly abandoned a simplistic purism in favour of targeting nodes of control over decisions of major import for tax compliance. It would be a policy error to take this pressure off.

Viewing compliance through the eyes of the advisers has enabled us to see that the taskforce is applying the ATO Compliance Model in a sophisticated way. We have seen that the understanding taxpayer behaviour part of the Compliance Model does require more sophisticated micro-macro analysis based on the HWI system. Building community partnerships can be strengthened by various improved communication strategies with advisers. The whole idea of the taskforce is a paragon of flexibility in ATO operations to encourage and support compliance. And finally, we have sought to develop some ideas for more and escalating regulatory options to enforce compliance, though perhaps the most important suggestion here amounts to the de-escalation of getting off the expanded return program in exchange for compliance undertakings.

Notes

- 1 The ATO acknowledges the comments made in this chapter and notes that they relate to past practices employed by the HWI Taskforce. The processes employed by the HWI Taskforce have significantly changed and the taskforce has implemented recommendations outlined in the report.
- 2 My gratitude to the HWI advisers, officers of professional associations and ATO staff who contributed to this research. I must say I was impressed by their professionalism. I especially want to thank Alice Dobes who participated in almost all the interviews conducted for the research and was a constant source of sound advice as were Andrew Stout and Kevin Fitzpatrick.
- 3 The main area of contingency fee usage in the past seems to have been with firms that offer to apply for refunds of sales tax in return for a fee of, say, 20 per cent of the refund.

- 4 In any case, within the Australian market, an adviser 'looking at the ball from different angles, will often come up with an opportunity for one client. Then he applies it to a few more clients. Then the idea might get out and some financial planner or little accountant might market it widely'.
- 5 The 'credibility and respectability' of investment banks with HWIs, as one adviser put it in our interview.

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