

HAS THE DISTINCTION BETWEEN TAX AVOIDANCE AND TAX EVASION BECOME BLURRED: IS THIS SIMPLIFICATION OR IS THERE ANOTHER AGENDA?

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The Australian common law recognises the important distinction between tax avoidance and tax evasion but the current trend in Australia is for the Australian Government to ignore the difference between the two concepts. It is highly questionable that the difference is being distorted because of a desire to simplify this area of the law. It will be contended in this article that there is a deliberate attempt by the Government to treat tax avoidance as constituting tax evasion and to ignore the legal distinction between the two. For example, the new law to deter the promotion of tax schemes, Division 290, Taxation Administration Act 1953 (Cth) ignores the distinction between tax avoidance and tax evasion and deals with 'tax exploitation schemes' instead. The Anti-Money Laundering and Counter Terrorist Financing Bill (AML/CTF Bill) is another example of the blurring of the distinction between tax avoidance and tax evasion because it allows government agencies to detect Australian taxpayers using tax havens by requiring their accountants, lawyers and financial advisers to report 'suspicious transactions' that involve the transfer of money between tax havens and Australia. It is argued that the Australian Government and the OECD are deliberately labelling all attempts to minimise income tax through the use of tax havens and offshore financial centres (OFC'S) as tax evasion and therefore a criminal act. If tax minimisation amounts to a criminal act then sovereign tax havens can be encouraged to disclose information on foreign investments in their country and breach their own bank secrecy laws. Is this what the Government is trying to achieve by blurring the distinction?

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I INTRODUCTION

The paper commences with an historical discussion on the distinction between tax avoidance and tax evasion in Australia and then critically examines the current trend by the Australian Government to ignore the difference between the two concepts. It is highly questionable that the difference is being distorted because of a desire to simplify this area of the law. It will be contended in this paper that there is a deliberate attempt by the Government to treat tax avoidance as amounting to tax evasion and to ignore the legal distinction between the two activities. For example, the new law to deter the promotion of tax schemes, Division 290, *Taxation Administration Act 1953* (Cth) ignores the distinction between tax avoidance and tax evasion and deals instead with 'tax exploitation schemes'. The Anti-Money Laundering and Counter Terrorist Financing Bill (AML/CTF Bill) is another example of the blurring of the distinction between tax avoidance and tax evasion because it allows government agencies to detect Australian taxpayers using tax havens by requiring their accountants, lawyers and financial advisers to report 'suspect transactions' that involve the transfer of money between tax havens and Australia. It is contended that the Australian Government, the OECD¹ and the Financial Action Task Force (FATF)² are deliberately labelling all attempts to minimise income tax through the use of tax havens and offshore financial centres (OFC's) as tax evasion and therefore a criminal act. If tax minimisation amounts to a criminal act then sovereign tax havens and their OFC's can be encouraged to disclose information on foreign investments in their country and justify ignoring their own bank secrecy laws. Tax evasion is fraud and fraud is a crime which constitutes the 'defrauding of the Commonwealth'. Utilising the services on an OFC in a tax haven may constitute the crime of money laundering. Simplification of the tax law relating to tax avoidance and tax evasion may not be the current objective of the Government when it is actively pursuing taxpayers that have used tax havens as part of operation 'Wickenby'³ and it is being alleged that the taxpayers' have engaged in criminal activity. Given the above, a conclusion will be drawn as to the reason why the Australian Government wishes to blur the distinction between tax avoidance and tax evasion.

II THE AUSTRALIAN APPROACH TO 'TAX AVOIDANCE AND TAX EVASION'

The statutory law does not provide a definition of what constitutes 'tax evasion' or 'tax avoidance'. In the context of the Commissioner of Taxation being empowered to amend a taxpayers' assessment of taxation, s 170(1), ITAA 36, provides that in the case of avoidance of tax due to fraud or evasion, there is no limit on the time in which

¹ OECD, *Harmful Tax Competition: An Emerging Global Issue*, (1998) OECD

² The Financial Action Task Force (FATF) is located within the OECD in Paris but was established to actively prevent money laundering.

³ Operation 'Wickenby' is the name given to a joint operation involving the Australian Crime Commission (ACC), the Australian Taxation Office (ATO) and the Australian Securities and Investment Commission (ASIC) investigating the use of tax havens by Australian taxpayers in what is alleged as criminal activity.

the assessment can be amended, Item 5. In the case of tax avoidance, the time limit is now four years from the date of the original assessment for the Commissioner to amend the assessment, s 170(2), Item 4. The section does not attempt to provide any type of definition of tax avoidance or tax evasion. In fact, Part IVA, ITAA 97 does not provide a definition of what constitutes tax avoidance. In order to obtain an explanation of the type of activity that constitutes tax evasion or tax avoidance it is necessary to look to the common law.

The common law in Australia is regarded as being settled on the distinction between 'tax avoidance and tax evasion'. In the case of *R v Mears*,⁴ the NSW Court of Criminal Appeal, when considering an appeal against the severity of a sentence for an action pursuant to s 86A, Crimes Act (Cth), conspiracy to defraud the Commonwealth, Chief Justice Gleeson made the following statement on the distinction between tax avoidance and tax evasion:

Although on occasion it suits people for argumentative purposes to blur the difference, or pretend that there is no difference, between tax avoidance and tax evasion, the difference between the two is simple and clear. Tax avoidance involves using or attempting to use lawful means to reduce tax obligations. Tax evasion involves using unlawful means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful. Although some people may feel entitled to disregard the difference, no lawyer can treat it as unimportant or irrelevant. It is sometimes said that the difference is difficult to recognise in practice. I would suggest that in most cases there is a simple test that can be applied. If the parties to a scheme believe that its possibility of success is entirely dependent upon the authorities never finding out the true facts, it is likely to be a scheme of tax evasion, not tax avoidance.⁵

In the case of *Denver Chemical Manufacturing Co v DCT (NSW)*, the Judgment of His Honour, Mr Justice Dixon provides an excellent description of the conduct required to constitute tax evasion by a taxpayer.

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

In the present case the Board concluded that the appellant intentionally omitted the income from the return and that there was no credible explanation before them why he did so. They thought that the conduct of the taxpayer answered the description of an avoidance of tax by evasion.⁶

⁴ (1997) 37 ATR 321.

⁵ *Ibid*, 323.

⁶ (1949) 79 CLR 296, per Dixon J at page 313.

In the recent case of *Kajewski v Federal Commissioner of Taxation*,⁷ the Commissioner of Taxation alleged tax avoidance through fraud and evasion, even though the Commissioner was out of time to bring an action under tax avoidance, Part IVA. The taxpayer argued that the alleged fraud and evasion resulted from actions taken by their tax agent and that they were not aware of the situation that gave rise to the allegation. Section 170(2)(a), ITAA 36 [now s 170(1)] provides the Commissioner with the power to issue an amended assessment at any time if the avoidance of tax is due to fraud or evasion. The taxpayer also contend that 'even if their original assessments were affected by fraud or evasion within s 170(2)(a), it was not fraud or evasion in which they personally engaged and that s 170(2)(a) did not therefore empower the Commissioner to issue the amended assessments in October 1999'.⁸ His Honour, Mr. Justice Drummond made the following comment on the distinction between tax avoidance and tax evasion:

There will be "an avoidance of tax" within this provision where, without any active or passive fault on the part of the taxpayer, less tax has been paid than ought to have been paid. See, eg, *Australasian Jam Company Proprietary Limited v FCT* (1953) 88 CLR 23 at 34; 10 ATD 217 at 222. Fraud within s 170(2)(a) involves something in the nature of fraud at common law, i.e., the making of a statement to the Commissioner relevant to the taxpayer's liability to tax which the maker believes to be false or is recklessly careless whether it be true or false.⁹

Mr. Justice Drummond also quoted from the Judgment by Dixon J in *Denver Chemical Manufacturing Company v Commissioner of Taxation (New South Wales)*, and confirmed that His Honours' analysis was the most appropriate in determining the type of conduct that amounted to fraud or evasion on the part of a taxpayer.

III THE AUSTRALIAN APPROACH: THE LAW TO 'DETER THE PROMOTION OF TAX SCHEMES' AND THE ANTI-MONEY LAUNDERING AND COUNTER TERRORIST FINANCING BILL (AML/CTF BILL)

Recently the Australian Government has introduced two new sets of statutory law to try to eliminate the use of OFC's and tax havens by Australian resident taxpayers. The first, is the law to deter the promotion of tax schemes, and the second, the Anti-Money Laundering and Counter Terrorism Financing Bill. Both sets of law have the potential to deter the use of OFC's in tax havens but both have deliberately ignored the distinction between tax evasion, a criminal offence, and tax avoidance or tax planning, not a criminal offence, by labelling all activities as being of a criminal nature. Before discussing the reason why the Government is blurring the distinction, it is necessary to examine both sets of new law in some detail.

A The law used to deter the promotion of tax schemes

The Australian Government introduced the Tax Laws Amendment (2005 Measures No 6) Bill 2005 in August 2005 to provide a new set of statutory law to deter the

⁷ (2003) 52 ATR 455.

⁸ Ibid, 483.

⁹ Ibid, 484.

promotion of tax avoidance and tax evasion schemes. The law is now contained in 'Schedule 3' of the *Taxation Administration Act 1953* (Cth) (TAA 53) and some minor amendments to the *Income Tax Assessment Act 1997* (Cth) (ITAA 97). In the Explanatory Memorandum to the Bill, the Government advises that the measures are designed to deter the promotion of tax avoidance and evasion schemes collectively referred to as 'tax exploitation schemes' and to deter the implementation of schemes that have been promoted on the basis of a product ruling being provided by the Australian Taxation Office (ATO) but the actual scheme is materially different from what was disclosed in the ruling. The new statutory law came into effect from the date of Royal Assent, namely 6 April 2006 and 'applies to conduct engaged in on or after that date'.¹⁰

In the Explanatory Memorandum, the Government justifies the new law from an economic and social perspective on the basis that by making the promoter of tax schemes at risk of financial loss in the same way that the investor is at risk, then this will deter the marketing of schemes and provide investors with protection from bad investments and therefore encourage more legitimate and productive investments.¹¹ The amount of civil penalty that can be imposed by the Federal Court on promoters is a maximum of \$550,000 for individuals or \$2.75 million for a body corporate, and twice the consideration received as payment for selling the scheme.

The objective of providing investor protection is a very positive move on the part of the Government but is it also designed to support Part IVA, the tax avoidance measures, because of a perceived weakness in the current provisions? This question was discussed by McCormack and Anderson in an article on the new law and their contention will be considered later in this paper.¹²

B Outline of the statutory provisions

The new statutory law is found as Schedule 3, starting with Division 290, of TAA 53. The statutory provisions consist of three main parts, first the imposition of 'civil penalties' on 'promoters' of 'tax exploitation schemes', second; 'injunctions granted by the Federal Court' to restrain an entity from engaging in promoting schemes, and third; 'voluntary undertakings' given by an entity not to continue promoting schemes.

Sections 290-5 states that: the objects of this Division are:

- (a) to deter the promotion of tax avoidance schemes and tax evasion schemes; and
- (b) to deter the implementation of schemes that have been promoted on the basis of conformity with a product ruling in a way that is materially different from that described in the product ruling.

C Civil penalties, Promoter and Tax Exploitation Schemes

This area of the law gives rise to most of the perceived problems that may confront accountants, tax lawyers and financial advisers providing taxation advice to their

¹⁰ Explanatory Memorandum, Tax Laws Amendment (2005 Measures No 6) Bill 2005, 4.

¹¹ *ibid* 59.

¹² McCormack J and Anderson D, Tax Schemes: "Unscrupulous promoters stand warned" (2004) 38 *Taxation in Australia*, 27.

clients. For example, what is meant by being a ‘promoter’ and what is a ‘tax exploitation scheme’. The concept of imposing a ‘civil penalty’ is similar to the range of remedies available to ASIC in situations where it may be difficult to obtain sufficient evidence that may satisfy a burden of proof of ‘beyond reasonable doubt’ as is the case in criminal proceedings, but it may be possible to satisfy a burden of proof of ‘balance of probabilities’, under civil proceedings. While it may be good law to impose civil penalties on those involved in insider trading or breach of director’s duties, it may not be the case with taxation law where there is a reasonable argument that the conduct is within the law and does not amount to tax avoidance. This area of taxation law is still very grey and penalties may be imposed before a court has had an opportunity to rule on the legitimacy of the tax scheme.

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

- (1) An entity is a *promoter* of a tax exploitation scheme if:
 - (a) the entity markets the scheme or otherwise encourages the growth of the scheme or interest in it; and
 - (b) the entity or an associate of the entity receives (directly or indirectly) consideration in respect of that marketing or encouragement; and
 - (c) having regard to all relevant matters, it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.
- (2) However, an entity is not a *promoter* of a tax exploitation scheme merely because the entity provides advice about the scheme.
- (3) An employee is not to be taken to have had a substantial role in respect of that marketing or encouragement merely because the employee distributes information or material prepared by another entity.

What would be the situation for accountants, tax lawyers and financial advisers in a situation where their clients wish to utilise the services of an OFC in say, Vanuatu, in order to invest their savings more effectively. If the adviser provided advice or received a payment from the offshore finance centre does this make them a promoter? Clearly it can be seen that merely giving advice does not make that person or entity a promoter, but if they received a commission from the finance centre or encouraged their clients to enter into the arrangement then they would be caught by the section and possibly face civil penalties. Diversifying investments and using an OFC while being tax effective, most accountants and taxation advisers would still believe that such an arrangement was legal and did not amount to tax avoidance.

One major criticism of the new statutory provisions is that the Explanatory Memorandum does try to clarify what is a promoter but section 290-60, TAA 53 does not attempt to incorporate any clarification whatsoever. For example, in the Explanatory Memorandum, the promoter needs to have a ‘substantial role’ in the promotion of the tax exploitation scheme and not merely provide advice. The concept of what is a ‘substantial role’ is to some extent discussed in the Explanatory Memorandum, but only mentioned once in s 290-60(1)(c).¹³ What happens if in the

¹³ Explanatory Memorandum, above n 1, 49.

first case dealing with the new law the Court refuses to take into account extrinsic materials such as the Explanatory Memorandum in interpreting the statutory provisions?

The adviser may not be liable to the civil penalties if it can be shown that the arrangement was not a 'tax exploitation scheme', Section 290-65.

Section 290-65 provides the following meaning of *tax exploitation scheme*:

(1) A scheme is a *tax exploitation scheme* if, at the time of the conduct mentioned in subsection 290-50(1):

(a) one of these conditions is satisfied:

(i) if the scheme has been implemented—it is reasonable to conclude that an entity that (alone or with others) entered into or carried out the scheme did so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme;

(ii) if the scheme has not been implemented—it is reasonable to conclude that, if an entity (alone or with others) had entered into or carried out the scheme, it would have done so with the sole or dominant purpose of that entity or another entity getting a scheme benefit from the scheme; and

(b) one of these conditions is satisfied:

(i) if the scheme has been implemented—it is not reasonably arguable that the scheme benefit is available at law;

(ii) if the scheme has not been implemented—it is not reasonably arguable that the scheme benefit would be available at law if the scheme were implemented.

Note: The condition in paragraph (b) would not be satisfied if the implementation of the scheme for all participants were in accordance with binding advice given by or on behalf of the Commissioner of Taxation (for example, if that implementation were in accordance with a public ruling under this Act, or all participants had private rulings under this Act and that implementation were in accordance with those rulings).

(2) In deciding whether it is reasonably arguable that a scheme benefit would be available at law, take into account any thing that the Commissioner can do under a taxation law. Example: The Commissioner may cancel a tax benefit obtained by a taxpayer in connection with a scheme under section 177F of the *Income Tax Assessment Act 1936*. [Namely Part IVA, ITAA 36]

This then leads to the question, what is meant by the term 'reasonably arguable'? The statutory provision covering this area of law is found in s 284-15, TAA 53, and it was considered judicially in the Federal Court in *Prebble v Federal Commissioner of Taxation*.¹⁴

D When is a matter 'reasonably arguable', Section 284-15

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

¹⁴ (2003) 53 ATR 513.

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

Does the above statutory meaning provide comfort for advisers engaged in encouraging clients to enter into an investment in Vanuatu? Can it be concluded that if the Full Bench of the Federal Court holds that an arrangement does not contravene Part IVA, but the High Court later holds that the arrangement does amount to tax avoidance mean that the arrangement was 'reasonably arguable' and as such was not a 'tax exploitation scheme' pursuant to s 290-65, TAA 53? This was the situation in the case of *Federal Commissioner of Taxation v Hart*.¹⁵ It would be comforting for advisers to think that the Federal Court would find that they have not contravened Division 290, TAA 53, but with all litigation it is not possible to predict the outcome.

E Injunctions and Voluntary undertakings

In the Explanatory Memorandum the Government indicated that an injunction may be obtained from the Federal Court to stop or prevent a promoter from marketing a scheme. The Government also indicates that an injunction can be used as an alternative to civil penalty proceedings or in addition to them if the Federal Court considers the circumstances warrant both forms of relief. However, the statutory provisions do not reflect the fact that an injunction can be used instead of a civil penalty.¹⁶ The Federal Court may not take into account the alternative remedy that is considered in the Explanatory Memorandum when imposing a civil penalty on a promoter.

F No distinction between Tax Evasion and Tax Avoidance

It is very disappointing that the new law does not distinguish between tax evasion and tax avoidance. The new law simply lumps the two distinct activities into one, namely a 'tax exploitation scheme' and ignores the fact that tax evasion is illegal activity and prosecuted under the criminal law whereas tax avoidance is legal but may be struck down by the courts under Part IVA. The penalty for tax avoidance is an additional amount of income tax. The two activities are clearly distinct and it is a shame that this matter has not been dealt with properly. In the USA and Canada the distinction has been considered and given appropriate weight and the penalties imposed on promoters of tax shelter schemes are significantly less than those being considered in Australia. Tax evasion is dealt with under the criminal law and should not be regarded as being similar to tax avoidance.¹⁷

¹⁵ (2004) 55 ATR 712.

¹⁶ Explanatory Memorandum, above n 1, 54.

¹⁷ McCormack J and Anderson D, above n 3.

G Overseas experience with laws to deter tax schemes

According to McCormack and Anderson,¹⁸ Australia is not the first country to introduce a civil penalty regime to deter promoters of tax exploitation schemes. McCormack and Anderson discuss the situation in three countries, Canada, New Zealand, and the USA and the measures that have been introduced to deter the promotion of tax schemes. In New Zealand, the Government introduced measures designed to encourage the use of Rulings so that the Government can be alerted to new arrangements in case the law has to be changed to prevent a loss of revenue. In New Zealand, the law requires the tax arrangement to be offered, sold or promoted to at least 10 or more people in NZ before it is considered a scheme that is caught under the statutory provisions. The new measures were made law on 26 March 2003 and are contained in the *Tax Administration Act 1994* (NZ).¹⁹ The penalty that can be imposed is the amount of income tax shortfall from all participants in the arrangement. In Canada, the law to deter tax schemes was introduced on 29 June 2000 and was designed to catch schemes that ‘do not work and result in unwarranted claims for deductions’.²⁰ According to McCormack and Anderson, the Canadian approach has been to take a narrow interpretation of the law so that the principles of ‘self-assessment’ are not undermined in that all taxpayers are entitled to prepare their tax returns on the basis that they are correct in assessing their income and deductions and that their position has merit in the absence of any misleading or criminal conduct.²¹ The penalties in Canada are significantly less than those in Australia, namely the greater of \$1,000 and 100 per cent of the gross revenue gained from selling the tax shelter arrangement.

In the USA, tax shelter promoters are required to register their scheme with the Inland Revenue Service. The penalties are the greater of \$1,000 and 20 per cent of the gross income derived from the arrangement. However, the IRS Internal Revenue Manual, Part 20, states that ‘a tax adviser would not be subject to the penalty for suggesting an aggressive but supportable filing position to a client even though that position was later rejected by the courts and even though the client was subjected to the substantial understatement penalty’.²²

H Conclusion

There is genuine concern that all taxation advisers may be caught by the new law even when only providing advice to their clients on tax planning issues. There is a fine line between tax planning and tax avoidance but in both cases there is no criminal conduct on the part of the adviser or taxpayer. The need for additional laws is not clear, given that there are sufficient criminal and civil remedies contained in the existing law that would offer investor protection and safeguards for the revenue. It does not appear that the Government took into account the experience in Canada and the USA particularly the penalty provisions, before enacting the new law.

¹⁸ J McCormack and D Anderson, ‘Tax Schemes: “Unscrupulous” promoters stand warned,’ (2004) 38 *Taxation in Australia*, 423.

¹⁹ *Ibid*, 425.

²⁰ *Ibid*, 425.

²¹ *Ibid*, 426.

²² *Ibid*, 426.

One of the main concerns with the new law is that many innovative lending and financial arrangements may not see the light of day simply because the originators of the plans are hesitant to release the products for fear of being subject to very onerous civil penalties. All financial markets need innovation and an entrepreneurial approach to new financial products in order to maintain a competitive global environment. Also of major concern is that the self-assessment system may be severely undermined as a result of taxation advisers being too frightened to be seen as 'promoter of tax exploitation schemes' when preparing their clients' tax return and offering taxation advice. The Government may well have taken a sledge hammer approach to a perceived problem, dressed it up as investor protection, but in reality may have caused many taxpayers and their advisers to be too frightened to take a position that may be considered to be well within the law but may subsequently be regarded as tax avoidance and then be branded as unscrupulous tax scheme 'promoters'.

What is the situation where a tax adviser gives advice to a client on establishing an investment fund with an offshore bank in Vanuatu and that was the extent of the advice given to the client? If that client fails to return the foreign income in their Australian tax return each year, is the adviser guilty of a criminal offence? It would be hoped that they were not and that legal professional privilege attached to that advice. Is this the case today in light of the initiatives being generated by the OECD and the Australian Governments' new AML/CTF law?

IV OUTLINE OF THE AML/CTF BILL

A *What is 'money laundering'?*

Much is made of the conduct known as 'money laundering' but very little attention is paid to defining exactly what are the essential ingredients in the act of engaging in 'money laundering'.

In the 'Issues Paper 1, Financial Services Sector' released as part of the Commonwealth Attorney-General's Department paper on the Anti-Money Laundering Reform, an attempt was made to describe 'What is money laundering?'²³ 'The goal of most criminals is to generate a profit. To enjoy their ill-gotten gains, criminals commonly seek to disguise the illegal source of those profits. Money laundering is the processing of criminal profits to disguise their illegal origin.'

In the Australian Law Reform Commission Report 87²⁴ on the Proceeds of Crime and in particular Part 7, Laundering of Property and Money, the report attempts to define money laundering as follows:

The definitions of money laundering most frequently used in domestic legislative provisions is derived from that used in the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances²⁵ which provides that money laundering is:

- the conversion or transfer of property, knowing that such property is derived from any indictable offence or offences, for the purpose of

²³ Issues Paper 1, Financial Services Sector, 1.

²⁴ ALRC Report 87: Proceeds of crime, <www.alrc.gov.au> 2 January 2007.

²⁵ Although that was restricted to narcotics related offences.

concealing or disguising the illicit origin of the property or of assisting any person, who is involved in the commission of such an offence or offences to evade the legal consequences of his or her actions or

- the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an indictable offence or offences or from an act of participation in such an offence or offences.²⁶

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

- a. the conversion or transfer of property, knowing that such property is proceeds, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of the predicate offence to evade the legal consequences of his actions;
- b. the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is proceeds.²⁷

This means that tax evasion, which constitutes the criminal offence of ‘defrauding the Commonwealth’ and is now found under the Commonwealth Criminal Code,²⁸ could amount to money laundering if an OFC in a tax haven was used to disguise or conceal the investments. The Offences relating to fraudulent conduct against the Commonwealth are contained in Part 7.3 of the Criminal Code, s 133 to s 135. The offence of money laundering is contained in Part 10.2, Division 400 of the Criminal Code.

Section 400.2 Meaning of *dealing with money or other property*

- (1) For the purposes of this Division, a person *deals with money or other property* if:
 - (a) the person does any of the following:
 - (i) receives, possesses, conceals or disposes of money or other property;
 - (ii) imports money or other property into, or exports money or other property from, Australia;
 - (iii) engages in a banking transaction relating to money or other property;and
 - (b) the money or other property is proceeds of crime, or could become an instrument of crime, in relation to an offence that is a Commonwealth indictable offence or a foreign indictable offence.

Section 400.3 - Dealing in proceeds of crime etc.--money or property worth \$1,000,000²⁹ or more

- (1) A person is guilty of an offence if:
 - (a) the person deals with money or other property; and
 - (b) either:
 - (i) the money or property is, and the person believes it to be, proceeds of crime; or

²⁶ *Australian Treaty Series 1993 No 4 UNTS art 3(1)(b).*

²⁷ ETS No 141 art 6.

²⁸ The offence of defrauding the Commonwealth was until 2005 contained in the Crimes Act 1914 (Cth), s 29D.

²⁹ The following sections of the Criminal Code set out a range of penalties from 25 years goal to 5 years goal depending on the amount of money involved in the criminal act. The wording of the sections are similar to the one shown here.

- (ii) the person intends that the money or property will become an instrument of crime; and
- (c) at the time of the dealing, the value of the money and other property is \$1,000,000 or more.

Penalty: Imprisonment for 25 years, or 1500 penalty units, or both.

The Replacement Explanatory Memorandum provides the following estimate of the extent the financial problem faced by the Government in terms of money that is being laundered every year and not being subject to income tax in Australia.

The size of the money laundering problem cannot be accurately quantified but, in a research project funded by AUSTRAC and drawing on a wide range of financial and other data relating to 1994, it was estimated that in that year 'a range of between \$1,000 million and \$4,500 million would appear to be a sensible interpretation of the information provided in these sets of estimates, with perhaps some confidence that the most likely figure is around \$3,500 million, since this figure lies within all three estimate ranges'.³⁰

B Outline of the anti-money laundering law

The AML/CTF law will be implemented in two tranches; the first tranche should be enacted by Parliament by early 2007 and the second tranche at a later time. The law is to be implemented over a 24 months period to allow businesses to meet their obligations. The first tranche will 'cover the financial and gambling sectors, bullion dealers and lawyers/accountants, but only to the extent that they provide financial services in direct competition with the financial sector'.³¹ The Replacement Explanatory Memorandum³² to the AML/CTF Bill states that the 'reforms are a major step in bringing Australia into line with international best practice to deter money laundering and terrorism financing that includes standards set by the Financial Action Task Force (FATF)',³³ and hence the reason for its proposed enactment. At present under the *Financial Transactions Reports Act 1988* (Cth) cash dealers are required to report suspect transactions involving \$10,000 or more or international funds transfers and the opening of bank accounts. The existing law was not considered by the Government to be adequate, especially with the increase in non face to face transactions through electronic transfers. Instead, the AML/CTF Bill adopts a 'risk based approach' to identifying customers that may be engaged in money laundering or terrorism financing and will apply to a very wide range of businesses, not just cash dealers. The use of tax havens and schemes devised by lawyers and accountants is now part of the focus of the new law and will be comprehensively dealt with in the second tranche of law.

³⁰ J Walker *Estimates Of The Extent of Money Laundering In And Through Australia* AUSTRAC September 1995, 39. This report is also referred to in the Replacement Explanatory Memorandum to the AML/CTF Bill at page 12 to justify the introduction of the law.

³¹ Replacement Explanatory Memorandum to the AML/CTF Bill at page 1.

³² The new law was released to the public for comment as an 'exposure draft' and the Anti-Money Laundering and Counter Terrorist Financing Bill was eventually introduced to the Commonwealth Parliament on 1 November 2006 after taking into account submissions by interested parties.

³³ Replacement Explanatory Memorandum, n 30, 1.

C Designated services – Lawyers, accountants and financial advisers

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

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

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

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

For example, lawyers acquiring or disposing of securities on behalf of clients, creating and dealing with promissory notes, bills of exchange, and arranging safe deposit box facilities are providing a designated service. Preparing a will is not a designated service. However, the purchase of real property and the provision of mortgage finance or international transfer of funds is a designated service because the transfer of real property and mortgage arrangements can be used to launder money.³⁴ Similarly, the creation of a trust or company structure to be used to move funds offshore or on shore will be a designated service. The following services are not regarded as being ‘designated services’:

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

³⁴ AML/CTF Bill, Issues Paper 5 – Legal Practitioners – Accountants – Company and Trust Service Providers, 5.

The AML/CTF Bill will require businesses which provide designated financial services to have a process to identify their customers. Professional advisers are referred to as 'gatekeepers' in the Explanatory Memorandum because of those people involved in money laundering using the services of professionals to launder the money. The Government has recognised that criminals use sophisticated structures such as trusts, companies and managed investment schemes to launder money. However, what happens when an existing client seeks advice from their lawyer or accountant about establishing an investment fund in say, Vanuatu, because they want to diversify their investments. Does their accountant or lawyer have to report this activity or be in breach of their obligations under the AML/CTF program, or do they make the judgment that the activity is legal and does not amount to money laundering? What happens if in the future the income earned from those investments is not included in the taxpayer's assessable income? It would appear that the Government would like the client to be reported to and at least initially the activity would be considered to be illegal.

Under the AML/CTF Bill reporting entities have the responsibility of managing their own money laundering and terrorism financing risks. This means that they must establish, maintain and comply with the AML/CTF due diligence program in identifying new customers and reporting suspicious transactions and specified matters to the Australian Transaction Reports and Analysis Centre (AUSTRAC). Service Providers would not have to 'identify' existing customers unless the customer sought additional services or triggered specific reporting obligations. While Service Providers will be able to authorise in writing third parties to carry out an initial customer identification on their behalf, the Service Provider will be responsible for keeping a record of individual customer identification procedures. The AML/CTF program must contain a framework for identifying risks and contain procedures for customer identification. The program must be designed to identify and materially mitigate the risk that the provision of a designated service might involve or facilitate a transaction connected with a money laundering offence or the financing of a terrorism offence.

A customer due diligence program must be included in the AML/CTF Program. The key elements of a customer due diligence program are:

- know your customer (KYC) information;
- risk classification; and
- transaction monitoring.

A financial institution must not enter into a correspondent banking relationship with:

- a shell bank; or
- another financial institution that permits a shell bank to maintain an account with it.

Before a financial institution enters into a correspondent banking relationship, a due diligence assessment must be carried out. If a financial institution has entered into a correspondent banking relationship with another financial institution, regular due diligence assessments must occur.

D International implications of the Law

Designated services are not subject to the new law unless the service is provided in Australia through a 'permanent establishment' of a Foreign Service provider, or the service is provided by an Australian resident or a resident subsidiary company through a permanent establishment in a foreign country. Will this law result in Australian's seeking financial services obtaining that advice from a non-Australian provider in a location outside Australia? Will Australian's be reluctant to obtain financial services in Australia even if not engaged in money laundering but legal tax minimisation or tax planning using an OFC? In particular, what effect will this law have on Australian's using tax havens for legal purposes? Given that Australian Banks, Australian accounting firms and Australian law firms have offices' in tax havens in the Asia-Pacific region; will their services now be in more demand? Under the AML/CTF Bill those entities operating in a tax haven may still find that they must comply with their new obligations, especially those operating through a permanent establishment in that country. These questions will not be answered for a number of years and should provide a fertile area for future research. Indeed, as Eden and Kudrle have noted in their research as to the future of tax havens in light of initiatives by the OECD and now Australia with the proposed anti-money laundering legislation, at this stage no research has been undertaken into the role of the multinational enterprises and international tax and accounting firms located in tax havens.³⁵

V THE INTERNATIONAL APPROACH TO THE DISTINCTION BETWEEN 'TAX AVOIDANCE AND TAX EVASION'

In the international arena the distinction between tax avoidance and tax evasion has been deliberately blurred so that international bodies such as the OECD, FATF and the EU can make the presumption that any financial activity using an OFC in a tax haven must be tax evasion and therefore of a criminal nature. Branson QC³⁶ makes the observation that the OECD in its crusade against 'harmful tax competition' has 'not sought to draw any clear or marked difference between evasion and avoidance and in every relevant respect they have been treated as one homogenous subject'.

The OECD report on harmful tax competition, paragraphs 53 and 54³⁷ do not attempt to clearly distinguish between tax avoidance and tax evasion when discussing the need for tax havens to become more transparent and to exchange information. Paragraph 53 states that 'because non-transparent administrative practices as well as an inability or unwillingness to provide information not only allow investors to avoid their taxes but also facilitate illegal activities, such as tax evasion and money laundering, these factors are particularly troublesome.'

In paragraph 54, the OECD then states that progress has been made in accessing information from tax havens through the entering of 'mutual legal assistance treaties' in criminal matters such as criminal tax fraud. According to Peter-Szerenyi, the issue

³⁵ Lorraine Eden and Robert Kudrle, *Tax Havens: Renegade States in the International Tax Regime*, (2005) *Law and Policy*, 100, 124.

³⁶ CC Branson, *The international exchange of information on tax matters and the rights of taxpayers*, (2004) 33 *Australian Taxation Review* 71, 77.

³⁷ OECD, n1, 23 and 24.

of the exchange of information and transparency should only relate to criminal tax matters:

The lack of exchange of information and transparency facilitates only illegal activity, not tax avoidance. Tax avoidance is legal, whether the home country knows about it or not. Thus, the tax authorities of the home country do not need any information for the correct and timely application of its own tax law. The lack of the two criteria (exchange of information and transparency) in connection with tax avoidance is a problem merely because it makes it difficult for the home country to detect and prevent the use of foreign tax regimes – in other words, to enact laws aimed at combating offshore investments (e.g. CFC rules), Paragraphs 70 and 114.³⁸

Is this the reason why the Australian Government is deliberately blurring the distinction when dealing with international taxation issues? Is the problem facing the Government twofold: first; because of the use of a system of self-assessment in preparing taxation returns by taxpayers, is it difficult for the ATO to detect tax avoidance, and second; in order to counter problems of overcoming bank secrecy laws in tax havens, is it better to treat all forms of tax avoidance as constituting criminal conduct and therefore requiring all countries to exchange information with the Australian authorities on the use of OFC's by Australian residents?

In the OECD report³⁹ on improving access to bank information it was stated that where 'some countries rely heavily on a self-assessment system to administer their taxation laws...wilful failure of a taxpayer accurately to report income will generally be considered a criminal action.'⁴⁰ In terms of requiring other countries to cooperate in providing access to information, the OECD Report goes on to make the following observation:

With respect to assistance provided to other countries in criminal investigations (including criminal tax investigations), some countries generally apply the principle of 'double incrimination'. That is, before assistance can be provided to a requesting country, it must be established that the conduct being investigated would constitute a crime under the laws of the requested country if it occurred in the requested country. In the tax area, application of this principle will not generally be an impediment to exchange of information for criminal purposes where the definitions of tax crimes are similar. However, where the definitions of tax crimes in the requesting and requested countries are markedly different, it may be impossible in many cases for the requesting country to obtain information that is vital to a criminal investigation.⁴¹

In most tax havens tax avoidance is not a crime, simply because those countries do not impose income tax. However, in most tax havens money laundering activities would constitute a crime, particularly if the requesting country was able to argue that tax avoidance in any form was a crime and amounted to the crime of defrauding the Commonwealth and the subsequent laundering of the money through a tax haven constituting the crime of money laundering. In that situation, the appropriate information about the Australian taxpayer may be supplied by the requested country, and hence, one of the main reasons why the new AML/CTF laws have been introduced by the Australian Government.

³⁸ Linda Peter-Szerenyi, The OECD's artificial approach to tax havens: Part 2, (2003) Vol 14, Issue 3, *Journal of International Taxation*, 10, 20.

³⁹ OECD, *Improving Access to Bank Information for Tax Purposes*, 2000.

⁴⁰ *Ibid*, 15, note 7.

⁴¹ *Ibid*, 15, note 7.

The OECD has been successful in convincing Vanuatu, Samoa and Niue to enter into an agreement to exchange information on foreign investors using their offshore financial services. The countries entered into the agreements to exchange information on civil tax matters by 31 December 2005.⁴²

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

Well, I'm in favour of low tax and countries have got to make themselves as competitive as they possibly can in a competitive world, but what has worried us in the past has been on the issue particularly of money laundering. And the Vanuatu Government and Vanuatu Parliament has now legislated against money laundering and introduced this anti-money laundering legislation. We see that as a very good step forward but obviously it's going to be a challenge to implement the provisions of the legislation and we're happy to help the Government of Vanuatu in that respect.⁴³

This comment from the Australian Minister for Foreign Affairs would appear to condone Vanuatu as engaging in tax competition but at the same time taking measures to combat money laundering. It would be assumed that the Vanuatu law is designed to combat illegal tax evasion and not legitimate tax avoidance or minimisation. For the OECD or the Australian Government to impose sanctions as a result of tax avoidance in say Australia, while it is not contrary to the law in Vanuatu, would in fact be a breach of international law.⁴⁴

The introduction of the so-called USA Patriot Act⁴⁵ has not dramatically reduced the use of Caribbean tax havens by citizens of the USA.⁴⁶ OECD and EU member countries still compete in trying to attract capital by reducing income tax rates. There is no 'level playing field' in the world today and Australia has joined in the tax competition to attract wealthy individuals while 'ring fencing' its own residents through the recently introduced tax law that applies to 'temporary residents'.⁴⁷ It will be interesting to see if the AML/CTF legislation introduced into Australia will have a dramatic effect on tax havens. As Eden and Kudrle put it, 'the jury is still out on whether the OECD's attempt to name and shame tax havens as renegade states will be successful.'⁴⁸ The same situation can be said of the legislative attempts being introduced in Australia to combat tax minimisation through OFC in tax havens.

⁴² Linda Peter-Szerenyi, n 33, 18.

⁴³ Minister for Foreign Affairs, The Honourable Alexander Downer, MP, Press Conference, Port Vila, Vanuatu, transcript 19 April 2006, accessed at: http://www.foreignminister.gov.au/transcripts/2006/060419_vanuatu.html, on 22 September 2006.

⁴⁴ Linda Peter-Szerenyi, n 33, 23.

⁴⁵ The term 'USA Patriot Act' is an anachronism for the Act called the '*Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act*'

⁴⁶ Lorraine Eden and Robert Kudrle, n 34, 123.

⁴⁷ The new law takes effect from 1 July 2006 and is now contained in Division 768, ITAA 97. The law started out as the *Taxation Laws Amendment (2006 Measures No.1) Bill 2006* (Cth) and was enacted as Act No.32 of 2006. Section 768-900 provides that 'this Subdivision modifies the general tax rules for people in Australia who are temporary residents, whether Australian residents or foreign residents.'

⁴⁸ Lorraine Eden and Robert Kudrle, n 34, 124.

VI CONCLUSION

The distinction between tax avoidance and tax evasion, that has been firmly established in the Australian common law, is still of great importance when dealing with taxation issues domestically. However, it would appear that the Australian Government is determined to make no distinction between tax avoidance, a legal activity and tax evasion, a criminal activity, when it comes to Australian taxpayers engaging in tax planning in a tax haven through the use of an OFC. The Government has recognised that many tax schemes involved the use of tax havens, in particular Vanuatu, and that the law to deter the promotion of tax schemes makes no distinction between tax avoidance and tax evasion. Similarly, in relation to the law to detect and eliminate money laundering, once again the Government appears to blur the distinction and argue that all measures to reduce and minimise income tax through tax havens constitutes criminal activity and allows the tax haven to breach its bank secrecy laws. The fact that the rights of the taxpayer may be adversely affected and the taxpayer wrongly being accused of criminal activity is of no concern for the Government when trying to maximise government revenue through taxation. The blurring of the distinction between tax avoidance and tax evasion does not appear to have any thing to do with a desire by the Government to simplify this aspect of the taxation law.