PROJECT WICKENBY: WHITE HATS AT WORK, OR WITCH HUNT?

The administration of Australia's tax laws is an area where a lot has to be taken on trust. Even people who work in the area struggle to understand the roughly 14,000 pages of federal tax legislation, and tax misfeasance is not something the public intuitively understands. Most laypeople might understand narcotics, embezzlement and other forms of organised crime; but when it comes to tax evasion one doubts that a lay-person could describe what the villains are up to: unless it is the simple case of a person who has 'never filed a tax return', or is blatantly understating their income.

There are also some strange floating assumptions. A seeming article of faith is that with a smart tax advisor a person can legally pay no tax (as Kerry Packer is assumed to have done). Another is that a business with any kind of connection to the Cayman Islands, the Bahamas, or one of the other celebrated jurisdictions cannot possibly be above board. And the public attitude to prosecutions of white-collar offenders was probably best expressed by the journalist Paul Barry when he said:

> Even if they gather the documentary evidence they will be lucky to find a jury that can understand it and will convict. That is true almost anywhere in the world—corporate structures, clever lawyers and sheer complexity both protect and sanitise unacceptable conduct.[1]

An environment which provides obvious support for a clamp-down on tax evasion saw the creation of Project Wickenby in 2006.

Project Wickenby is a government taskforce dedicated to attacking tax evasion. Aside from the Australian Tax Office (ATO), its members are drawn from seven other government agencies, including the Australian Crime Commission and the Australian Federal Police, on the rationale that detection and prosecution can be streamlined by concentrating all the statutory powers of government in the hands of a single team. The Wickenby effort is also highly publicised. It has a permanent place as one of four 'News and Updates' items on the front page of the ATO's website, and its results (in terms of extra tax collected, persons successfully convicted, and similar matters) and activities receive a lot of coverage in the financial pages of most newspapers. The point of the publicity, of course, is to create a deterrent effect and shake up perceptions about the likelihood that tax misfeasance will be detected and prosecuted. The unspoken message of the Wickenby press releases is that a new era has arrived.

Unfortunately, the enduring symbol of the new era is probably Paul Hogan on *A Current Affair*, and there is good reason for this. The ATO spent seven years investigating this well-loved public figure, with plenty of publicity

John Hyde Page is a barrister who specialises in taxation. He represented taxpayers in some of the court cases mentioned in this article.

Endnotes for this essay can be found at www.policymagazine.com.

at every stage of the process (in complete disregard of privacy laws); then during a visit to Australia for his mother's funeral he was issued with a departure prohibition notice by the ATO, which effectively imprisoned him in the country while they finished investigations which it was said might take years. Hogan then took his case to *A Current Affair*, at considerable personal risk because even by acknowledging that he had been interviewed by the Australian Crime Commission he was committing a criminal offence with a potential gaol term. Within a few weeks, the ATO admitted that its suspicions were groundless; Hogan was permitted to leave; and subsequent media reports were that he has a legal claim against the ATO worth millions for the years of harassment and harm to his professional reputation.

A key difference between the Paul Hogan episode and other Wickenby anecdotes is that Hogan's story can be easily understood and is not susceptible to multiple interpretations. Clearly a severe imposition was made on his liberty with little justification; and, just as clearly, the same sort of abuses could be perpetrated against other citizens in circumstances that are less easy to understand and less likely to be publicised by a sympathetic media.

The case illustrates things that have been widely known within the community of tax professionals for years: which is just how extensive the coercive and investigatory powers of the ATO have become; and also that much of the unacceptable conduct obscured by the complexity of our tax laws is engaged in by the ATO, and the ATO can generally get away with it.

Putting the 'new era' in context

After World War II, Australian tax administration was characterised, first, by a steady expansion in tax minimisation, culminating in the 1970s; followed by long decades in which the loopholes were progressively closed off, and many of the protections that had previously been available to taxpayers were watered down. There is a risk of oversimplification in saying this, of course. The trend was never uniform, and in the 1980s financial deregulation created vast new opportunities for companies to shift their profits offshore to low tax jurisdictions. But if the period is looked at in aggregate, the pendulum can be seen to have swung decisively away from taxpayers.

From a political theorist's perspective, troubling features of Australia's tax legislation are the number of provisions that apply either at the ATO's discretion, or based on interpretations of taxpayer motive. The notion that a person's behaviour can be perfectly lawful, while also attracting substantial penalties if its purpose is to reduce tax liability, is difficult to reconcile with libertarian concepts about the rule of law; but it is also the fulcrum on which many of Australia's anti-avoidance provisions operate.[2] Increasingly common, also, is a type of legislative provision that imposes automatic penalties on certain classes of commercial transaction, while granting a purely discretionary power to the ATO on the expectation that it will provide relief in cases where plain vanilla transactions have been penalised.[3] And the operation of all this legislation is conditioned by procedures for judicial review that explicitly place the onus on the taxpayer.[4]

The heightened potential for abuse that this creates is realised upon the creation of a special taskforce such as Wickenby with full access to these powers, an arbitrary target for how much additional tax it is expected to raise, and a credo that emphasises a new era of aggressive tax administration.[5] It is also logical to expect that when a taskforce such as Wickenby is highly celebrated within an organisation, its values will start to percolate down through the bureaucracy.

There are plenty of examples for how this works in practice. For example, the legislation has always given the ATO the right to collect tax while a taxpayer is still engaged in the process of challenging its tax assessment in the courts; and then, if the tax can't be paid, the ATO can enforce the sale of a taxpayer's assets or put a taxpayer into liquidation. Back in the 1980s, the exercise of these powers was acknowledged to be 'unusual,' but in the current climate the entry of a judgment debt against a taxpayer occurs

almost as a matter of course.[6] One of the ATO's other powers is to abjure any real attempt at calculating taxable income and issue a tax assessment that treats all the deposits in a taxpayer's bank account as income, leaving the taxpayer with the task of proving the real figure to a court. The use of this power, which should only be appropriate in the most extreme cases, is becoming more and more common.

Concomitant to the emergence of a newly aggressive ATO, the courts have also changed their attitudes. For much of the twentieth century, a pro-taxpayer bias was formally enshrined in the so-called *Duke of Westminster* doctrine. One could generally assume that tax legislation would be interpreted strictly, and any doubts about its meaning would be resolved in favour of taxpayers. This traditional approach to tax legislation, which lost a great deal of influence after the High Court decision in *Cooper Brookes v Federal Commissioner of Taxation*, has continued to wane and finds its reflection in the resolution of individual tax disputes.[7] Many of the pro-taxpayer decisions brought down by the Barwick High Court in the 1970s would be inconceivable today. A 2006 study found that taxpayers win only 23% of tax disputes.[8]

Interestingly, one of the main drivers of the court's approach to tax legislation seems to be a reaction against the judicial activism of the 1980s and early 1990s. It is now an acknowledged trend in the decision-making of our courts to focus on the text of legislation and minimise other considerations that have no explicit foundation in the words used by the legislature. This can throw up curious results when a statute does not exhaustively state the considerations that bear on how government powers should be exercised. An example is *WR Carpenter v Federal Commissioner of Taxation*, which was a recent transfer pricing case.[9] The purpose of Australia's transfer pricing regime is to combat artificial pricing arrangements that are designed to shift revenue into low tax jurisdictions, but in *WR Carpenter*, the High Court said that a taxpayer's ability to show that a pricing arrangement lacks a tax avoidance purpose is irrelevant to whether the transfer pricing provisions should apply. The court's reasoning was that 'tax avoidance' is not expressly articulated as a consideration in the text of the transfer pricing legislation. One can understand how this approach might have harsh consequences for taxpayers where tax legislation grants substantial powers to the ATO but is silent about the factors that inform the exercise of these powers.

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The downside of aggressive revenue collection

Evaluating the merits of Project Wickenby, as well as the brand of aggressive tax administration for which it stands, is not simply a matter of weighing civil rights concerns against increased revenue collections, because the effect of Wickenby on revenue is not straightforward. In fact, to some extent, aggressive revenue collection practices work against other elements of government policy.

Australia has always relied heavily on foreign investment, but since the so-called 'Review of Australian International Taxation' in May 2003, a major design feature of the tax system has been the attraction of in-bound capital. The most striking of these design features is the exemption from capital gains tax for foreign investors, but recent years have seen the introduction of a host of investor friendly measures—almost invariably accompanied by a press release about Australia's quest to become the 'financial hub' of Asia.

The tension here between economic and fiscal aspirations is obvious. Jurisdictions that succeed in turning themselves into financial centres generally achieve this by offering an environment that combines stability with the bare minimum of government regulation and interference. Tax incentives are part of what is needed to accomplish the goal, but there also needs to be a level of comfort that government officials will not be knocking on the door every five minutes.

The ATO has been doing a lot more than knock on doors. A strange spectacle of recent times has been ATO bullying of offshore taxpayers who it suspects of wrongfully claiming the foreign investor tax incentives. Almost invariably, these incidents feature an *ex parte* application to a judge by the ATO for orders freezing the investors' assets in Australia on the rationale that they might flee the jurisdiction, after which time the taxpayer will be told the nature of the ATO's concern.

Resource Capital Funds (RCF) was an offshore private equity fund that had more than $37 million of its Australian assets frozen in November last year. A month later, when the court orders had been discharged, the fund's general counsel pointed out that RCF was 'precisely the style and structure of private equity firm the ATO [had] identified as conforming with its rules,' and said RCF would have appreciated the chance to explain this before being sued in the Federal Court, with all the attendant publicity.[10] In a separate incident, the ATO unsuccessfully sought an extension of freezing orders against an offshore company *after* the taxpayer had offered security for its tax debts.[11] At the time of writing, there were at least five other foreign taxpayers with assets in Australia worth tens of millions whose assets have been frozen while the ATO decides whether they owe tax.

All this has been made possible because in recent years, Australian courts have shown a new willingness to issue freezing orders, and otherwise interfere with property rights. Historically, a freezing order was considered an 'extraordinary remedy' to be granted only if a litigant might abscond with assets and frustrate any judgment of the court. There has been no explicit abandonment of these precepts (and the phrase 'extraordinary remedy' is still bandied around), but the trend in judicial decision-making has been to grant such orders in circumstances that are so innocuous that the legal tests have almost no stringency at all. It is now sufficient for the ATO to show that little is known about an offshore taxpayer and that in the ordinary course of its business, the taxpayer is likely to shift assets out of the jurisdiction, rendering the collection of the tax debts less certain. This is a far cry from deliberately frustrating the court's process, but is now enough to secure a court order. The new preparedness to interfere with economic liberty has attracted little public attention. As political consultants well know, civil rights generally get the short-shrift unless compelling footage can be offered to the television networks.

Unlike Paul Hogan, none of the taxpayers mentioned above had the opportunity to make their case on *A Current Affair*. On the other hand, these incidents have received considerable publicity in financial circles and would certainly be in the minds of those considering an investment in Australia.

Just how great the impact is on foreign investment cannot be known, which is a central difficulty confronting any cost benefit analysis of Project Wickenby. It is highly artificial to treat the extra tax collected, or the number of successful prosecutions, as the full extent of Wickenby's success, but there is only anecdotal evidence for whether Wickenby is improving taxpayer compliance across the board. Nor is there an obvious way to measure the chilling effect that aggressive revenue collection has on foreign investment, or its ultimate cost in revenue dollars.

Conclusion

It is a reality of modern commerce that tax laws need flexibility and a considerable discretionary element if they are to adequately protect the national revenue. As much as some of the rules have an inherent potential for abuse, there is no suggestion that they should be repealed. Instead, our solution should be to ensure that the potential for abuse goes unrealised. For much of the twentieth century, the courts could be relied upon to provide an adequate safeguard to the extent that it was needed. The course of recent events suggests this may no longer be enough.

Endnotes

1 Paul Barry, *The Rise and Fall of Alan Bond* (Bantam Books, 1990), 290.

2 Inter alia, Part IVA and section 45B of the *Income Tax Assessment Act 1936*.

3 For example, Division 7A of the *Income Tax Assessment Act 1936* and, in particular, section 109RB.

4 *Taxation Administration Act 1953*, Part IVC.

5 Details of Project Wickenby's terms of reference are available on the ATO website. See, in particular, www.ato.gov.au/corporate/content.asp?doc=/content/00220075.htm&page=8&H8.

6 See, for example, the judgment of Mason J in *Clyne v Deputy Federal Commissioner of Taxation* 82 ATC 4510.

7 *Cooper Brookes (Wollongong) Pty Ltd v The Federal Commissioner of Taxation* (1981) 147 CLR 297.

8 David Voss, 'Review of Tax Office management of Part IVC litigation' (2006), [3.106].

9 [2008] HCA 33.

10 *Weekly Tax Bulletin* 53 (17 December 2010).

11 *Commissioner of Taxation v Grimaldi (No.3)* [2009] FCA 740.