

**Tax Havens and the Australian
Taxation System**

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Are We “Match Fit”?

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Abstract

In a competitive and international economic environment, tax competition and the use of tax havens is, and will continue to be, an important issue in relation to the Australian taxation system. In February 2004, the Australian Tax Office (ATO) published the report titled ‘Tax Havens and Tax Administration’ outlining the compliance strategies being undertaken to address the use of tax havens by Australian taxpayers. The Commissioner of Taxation outlined that in 2002-03 approximately \$3.8 billion flowed from Australia to tax havens. This paper will identify that perhaps one of the reasons the ATO perceives tax havens as a risk to revenue collection is that the \$3.8 billion represents amounts that have been declared or that could be traced. The amount of undeclared or untraceable funds may be significantly larger. This paper will explore whether the use of tax havens by Australian taxpayers poses a genuine risk to revenue collection by analysing the extent to which tax havens are being utilised by Australian taxpayers in terms of data available from the ATO and other agencies. Additionally, this paper will discuss the concept of tax competition and whether or not the use of tax havens contravenes the objectives outlined in the Ralph Report (optimising economic growth, promoting equity and promoting simplification and certainty) or indeed international economic theory. This paper will finally analyse whether the Australian taxation system is “match fit” in terms of either legislative frameworks or administrative measures aimed at minimising the risk to revenue that the use of tax havens by Australian taxpayers poses.

Tax Havens and the Australian Taxation System – Are We “Match Fit”?

Introduction

“Tax havens undermine the revenue base, tax havens are not fair. And ordinary law-abiding taxpayers are rightfully outraged by the use of off-shore tax havens to avoid paying Australian tax. This is why action against tax havens has been one of my top international priorities for many years.”¹

In February 2004, the Australian Tax Office (ATO) published the report titled ‘Tax Havens and Tax Administration’ (the Australian Tax Haven Report) outlining the compliance strategies being undertaken to address the use of tax havens by Australian taxpayers.² The Commissioner of Taxation (the Commissioner) outlined that in 2002-03 approximately \$3.8 billion flowed from Australia to tax havens.³ This compares to \$185 billion (2%) of total revenue collected by the ATO in 2002-03.⁴ The publication of a specific report on the issue of tax havens indicates that the ATO perceives the use of tax havens as a significant risk to revenue collection. Although the flow of funds from Australia to tax havens represents a small percentage of total revenue collection, perhaps one of the reasons that the ATO perceives tax havens as a risk to revenue collection is that the \$3.8 billion represents amounts that have been declared or that could be traced. The amount of undeclared or untraceable funds may be significantly larger. The ATO recognises that tax havens may be a tool to conceal assets and income that should be subject to tax in Australia, and this is an important issue from an Australian perspective and internationally.⁵

The ATO perceives the use of tax havens as a risk to revenue collection and is directing valuable resources toward minimising this risk through a number of

¹ Costello, P (2004). Excerpt from an address given by the Australian Treasurer the Hon Peter Costello at the Insurance Council of Australia Conference, Parliament House, Canberra, 12 August 2004.

² Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p4.

³ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p4.

⁴ Australia. (2005). *Taxation Statistics 2002-03*, Canberra: Commonwealth of Australia, p9. Table 2.4 outlines total revenue collection for the 2002-03 financial year from all sources as \$185,044m.

⁵ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, (ii).

strategies including the above-mentioned report, compliance strategies and a taskforce. It is imperative to determine whether this risk to revenue collection because of the use of tax havens is genuine and if so, to what extent.

Since its release in 1999, there has been a great deal of comment relating to many of the specific proposals of the Ralph Report.⁶ However, the author is not aware of academic comment specifically in relation to how these proposals relate to the issue of tax havens from an Australian perspective. The Australian Tax Haven Report is the first Government document relating specifically to the use of tax havens since the Ralph Report some six years ago. It is therefore imperative that the proposals outlined in the Australian Tax Haven Report be explored in both the context of the Ralph Report, and also global economic trends. This analysis will help determine whether the use of tax havens poses a risk to revenue collection in Australia and therefore justifies the level of resources being directed to this issue by the ATO.

This paper will initially explore the definition of a tax haven from both historical and contemporary perspectives and outline some of the common reasons taxpayers utilise them. The paper will then explore tax havens in the context of good tax design. This will involve identifying whether the use of tax havens impacts upon the elements of good tax design and also whether there is support for the argument that tax havens create unfair tax competition. The Australian Tax Haven Report will then be analysed with the aim of identifying whether the use of tax havens by Australian taxpayers presents a significant risk to revenue or indeed weakens the elements of good tax design that were outlined earlier. A number of recent Australian court cases will be discussed with the aim of highlighting the reasons taxpayers utilise tax havens and the effect on the elements of the taxation system. This paper will then identify and analyse the legislative and administrative strategies in Australia that are aimed at minimising the risks to revenue that the use of tax havens poses. Finally this paper will conclude by outlining major findings and identifying further research opportunities that were presented.

⁶ For Example: Gome, A. (1999). “The Ralph report: relief at last for the small-business sector” *Business Review Weekly*, 21(37): 38.

Moshinsky, A. (1999). “The Ralph Report: the last nail in the coffin for trusts?” *Taxation in Australia*, 34(5):254-256.

Richards, R. (1999). “What the Ralph Report means” *Law Society Journal*, 37(10): 42.

What is a Tax Haven? – Historical and Contemporary Perspectives

Worldwide, there is a plethora of legislation aimed at preventing taxpayers from avoiding the payment of tax. It has been argued that the introduction of tax avoidance legislation as well as the tightening of rules in relation to allowable deductions has led to a significant increase in the tax avoidance profession and the occurrences of tax avoidance.⁷ Tax concessions which are available within the taxpayer’s own jurisdiction can be referred to as “on-shore havens”. These “on-shore havens” such as film industry concessions, superannuation funds, trusts and companies, have in the past meant that only the extremely wealthy ever needed to consider the use of off-shore havens.⁸ It is thought that in the United Kingdom, this tradition seemed to disappear when marginal tax rates and interest in overseas investment, led to off-shore tax havens being useful to both the middle and upper classes.⁹

Jurisdictions that are commonly referred to as tax havens are often economically poor, small in population and physical size with few available natural resources.¹⁰ These jurisdictions are commonly previous colonies of Organisation for Economic Cooperation and Development (OECD) nations. It is thought that these ex-colonies were left without experienced administrators and that this is one of the reasons for their unsophisticated taxation systems.¹¹ These jurisdictions often use their unsophisticated tax systems to attract capital and therefore revenue to their country. This is especially the case, and often necessary where natural resources are not sufficient to support the economy.

⁷ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, p5.

⁸ Dwyer, TM. (2000). Harmful Tax Competition and the Future of Offshore Financial Centres. *Pacific Economic Bulletin*, 15 (1): 48-69.

⁹ Dwyer, TM. (2000). Harmful Tax Competition and the Future of Offshore Financial Centres. *Pacific Economic Bulletin*, 15 (1): 48-69.

¹⁰ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p28.

¹¹ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p28.

The term “haven” is defined as meaning any place of shelter or safety.¹² A tax haven could therefore be defined as a place where tax is sheltered. That is, investments are placed in a jurisdiction with little or no taxes and tax is avoided or minimised in the “home” jurisdiction. Thus, that investment is sheltered from tax. However, the practices of tax havens are much more elaborate than tax avoidance. Tax havens are a place not only for tax avoidance but also for tax minimisation, postponement and confidentiality of information.¹³ Many of the most popular tax havens promote both tax benefits and other benefits such as confidentiality of personal information.

Ginsberg (1991) categorises tax havens into three groups each with their own inherent benefits. The first, are countries where there are little or nil relevant taxes, for example, the Cayman Islands, the Bahamas and Bermuda.¹⁴ Secondly, countries where there are no or little taxes on foreign sourced income like Hong Kong and Panama.¹⁵ Finally, countries where there are special tax privileges granted to certain types of companies or operations. Examples of this type of activity can be found in the Channel Islands, Liechtenstein and Monaco.¹⁶

It has been argued that in order for the use of a tax haven to be beneficial to the company or individual it should be politically stable, have a stable currency with little or no exchange controls, banking secrecy and confidentiality with little or no regulation, good infrastructure and good facilities.¹⁷ For example, the taxation system of Afghanistan may offer some advantages for taxpayers of other jurisdictions; however its current political uncertainty would make it unattractive to most foreign investors.¹⁸ The particular type of tax haven that is sought by a taxpayer will depend on the types of activities the taxpayer is involved in and the tax laws of their “home” jurisdiction.

¹² The Concise Macquarie Dictionary. “haven” noun meaning (1) a harbour or port (2) an inlet of a sea or river mouth where ships can obtain good anchorage (3) any place of shelter and safety.

¹³ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

¹⁴ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

¹⁵ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

¹⁶ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

¹⁷ The Report of Offshore Financial Centres and Services, *The OFC Report 1993* (1993), Campden Publishing, Hong Kong, Page 120 – 124.

¹⁸ Afghanistan relies heavily (70%) on goods and services taxation rather than direct taxation. The Ministry of Finance of Afghanistan concedes that compliance with taxation laws is very low and there is very little voluntary compliance. www.mof.gov.af

The OECD released a report in 1998 outlining strategies aimed at eliminating Harmful Tax Practices (the OECD 1998 Report). The report outlined a number of criteria, which would be used to classify a jurisdiction as a tax haven. These criteria were that the jurisdiction had no or nominal taxes, there was a lack of effective exchange of information and lack of transparency and that the jurisdiction had no other substantial business activities.¹⁹ The criteria used in this definition are consistent with the reasons that taxpayers seek to utilise tax havens that were discussed previously.

Jurisdictions with nil rates of tax or nominal rates of tax on certain income or certain entities are said to meet this first criteria. This means that a jurisdiction may have a nil corporate tax rate, nil payroll tax or nil individual tax rates or impose nominal tax rates in place of the nil rates. As this criterion is a gateway criterion, jurisdictions that are thought to have nil or nominal rates of tax on certain income will only be classified as a tax haven if any or all of the other criteria are apparent. Table 1 at the end of this paper contains a list of example jurisdictions that met the OECD’s criteria for a tax haven in 2000 and also highlights those who have yet to commit to the elimination of these practices.

Lack of effective exchange of information refers to the exchange of information between governments where cross border transactions are involved. Governments can’t always rely on domestic sources of information to ensure that their own tax laws are being complied with. The exchange of information between tax authorities is seen as an effective means of deterring and discovering any non-compliance where cross border transactions are concerned. In a jurisdiction where there are laws to prevent the exchange of financial information, the ability of the other country to determine non-compliance and criminal activity is seriously eroded. An example of this is an Australian case involving a taxpayer claiming deductions from an investment in Vanuatu. During the hearing of the case, the Government solicitor expressed the impossibility of obtaining information about the Vanuatu resident company.²⁰

¹⁹ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p23.

²⁰ *FCofT v Spotless Services Limited and Anor* (1996) ATC 5201.

In jurisdictions where there is a lack of transparency, the taxation laws are not applied on an open and consistent basis among similar taxpayers and there often lacks information to determine a taxpayer’s situation. Lack of transparency of information can be indicated by “secret” tax rulings, negotiated tax rates for special taxpayers and inadequate or no regulatory and government supervision.²¹ Any lack of transparency again makes it difficult for other countries to obtain information about a taxpayer and therefore apply their own tax laws effectively.

Often tax haven jurisdictions require that a taxpayer not conduct business activities within the jurisdiction. In this scenario or where on the whole, the jurisdiction lacks any substantial business activities by its taxpayers, there is said to be no substantial activities.²² The lack of such activities often indicates that a jurisdiction may be attempting to attract investments and transactions that are purely tax driven. It also indicates that the jurisdiction may not be able to provide a viable commercial environment for business activities.

One of the major arguments for the elimination of the practices of tax haven jurisdictions has been the perceived criminal element that they attract. Governments, society and the media have tended to link tax haven jurisdictions to criminal and money laundering activities. Perhaps the reason for this is the confidentiality laws present in these jurisdictions. Why would a taxpayer seek to ensure their personal and income information is kept secret unless they had something to hide? In reality almost every jurisdiction has financial privacy laws which protect people from the unauthorised release of personal information.²³

In the United States, the government, the Internal Revenue Service (IRS) and the Central Intelligence Agency (CIA) each independently assess the extent to which jurisdictions have the potential to attract transactions linked to criminal activities. In relation to assessments undertaken in 2001, there appears to be no link between criminal financial activity and tax status. The United States government list shows fifty-two jurisdictions as areas of primary concern, however, just fourteen of these

²¹ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p23.

²² Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p23.

²³ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122:10-15.

are classified by the OECD as tax havens. It should be noted that Australia is listed as a primary jurisdiction for money laundering vulnerability on this list.²⁴ Further research is required in order to determine why this is the case. The IRS grants “qualified intermediary” status to jurisdictions that have adequate laws for obtaining personal information of account holders. Of the OECD list of thirty-five tax havens, nineteen have received this “qualified intermediary” status including such major financial centres as the Cayman Islands, the Bahamas and the Channel Islands.²⁵ The CIA has published similar studies. Only four of the thirty-five OECD tax havens appear on the CIA’s list of suspected money laundering centres.²⁶ These independent assessments show that there may not be evidence to support the assertion that tax haven jurisdictions attract a larger share of transactions linked to criminal activities. It has been argued that a country’s taxation system has no concrete link to criminal activities, money laundering or terrorist activities.²⁷ One of the reasons for this is that criminals tend to be reluctant to travel “offshore” (which would eventually be required to physically set up and obtain funds) because of the added risks airports and customs officers create.²⁸

This part analysed some of the characteristics of tax haven jurisdictions in terms of how specific practices relate to the criteria that were used to identify tax havens. The analysis highlighted the fact that many tax haven jurisdictions have enacted legislation with the purpose of attracting income and capital which would otherwise be difficult to obtain. This part also analysed the perception that tax havens are a place for criminal activity and found that there may not be evidence to support this.

²⁴ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122, at p12.

²⁵ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122, at p11.

²⁶ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122, at p11.

²⁷ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122, at p15.

²⁸ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122, at p11.

Tax Havens and Good Tax Design

Adam Smith first set the foundation of what constitutes a good tax system by putting forward his four canons of taxation: ‘equality’, ‘certainty’, ‘convenience of payment’, and ‘economy in collection’.²⁹ Adam Smith’s ideals have over time evolved into modern taxation theory, which consists of four main criteria that are used to evaluate tax systems: equity, simplicity, certainty and neutrality.

A recent example of the notions of good tax design being applied in an Australian context can be seen in the Ralph Report. In outlining its purpose, the Ralph Report states that Australia should have a taxation system, which equips it for the coming decades of unparalleled change.³⁰ In addressing this, the Ralph Report outlined the notion of national taxation objectives upon which all decisions relating to changes in taxation law or administration should be measured against. These objectives are optimising economic growth, promoting equity and promoting simplification and certainty.³¹

In any jurisdiction, the sole authority to collect taxes rests with the governing power. This is often referred to as sovereignty and is often one of reasons why problems arise in international taxation. This concept of sovereignty means that jurisdictions should only be concerned with levying taxes within their own jurisdiction and should not have the “sovereign right” to levy taxes within another jurisdiction. Why should the governing powers of Vanuatu use their limited financial resources to assist the Australian government to levy taxes in a jurisdiction they do not have any sovereignty over? From Australia’s perspective, it could be argued that we are not asking for any sovereignty, rather only information that is required to correctly calculate tax payable within our own jurisdiction.³² So, in recognising sovereignty, it is argued that a jurisdiction should be free to have policies of low or no direct taxes if

²⁹ Adam Smith (1976) *An Inquiry into the Nature and Causes of the Wealth of Nations*, 5th edn 1789, Norman S Berg Publisher, pp 777-778.

³⁰ Australia. (1999). *Review of Business Taxation: A Tax System Redesigned*. Canberra: Commonwealth of Australia, p1.

³¹ Australia. (1999). *Review of Business Taxation: A Tax System Redesigned*. Canberra: Commonwealth of Australia, p104.

³² Gaffney, M. (1998). International Tax Competition: harmful or beneficial?. *Offshore Investment*, 90: 40-44, at p41.

it chooses. Conversely, it has also been argued that scrutinising the intent of legislators when evaluating the laws of a country breaches both common law principles and the rule of law.³³

Principles of good tax design and sovereignty are therefore all important factors to consider when analysing any aspect of taxation. There are arguments that tax havens serve a beneficial role in the global economy in that it has been said that tax havens provide a type of sanctuary from jurisdictions which themselves contravene taxation objectives by taxing too much and being overregulated.³⁴ The question is then which dealings (if any) with tax havens impair the integrity of the tax system?

Many of the activities undertaken through tax havens are legitimate dealings. For example, setting up a company in a tax haven jurisdiction does not itself constitute tax avoidance. It may be the case that the jurisdiction is proximate to the home jurisdiction or has an attractive banking sector. If the benefits of using a tax haven are the reduction, postponement and confidentiality of tax matters, then there could be a variety of motivations for using them. The individual or company may come from a jurisdiction where tax rates are relatively high and the use of a tax haven is merely a form of “bargain hunting”.³⁵ For example, the taxation treatment of inheritance income, trust income, estate income and capital gains varies substantially throughout the world. In Australia, gifts of money or property are generally not taxable under income tax provisions where the gift is genuine. However, in New Zealand if a taxpayer makes gifts valuing more than \$27 000 in a 12 month period, they are liable to pay gift duty at marginal rates up to 25%.³⁶ The benefit of confidentiality of information might be sought for both legal and criminal reasons. The protection of assets from creditors and family members is one reason a taxpayer might require confidentiality of their information. Also, a taxpayer might require secrecy due to the types of activities they are involved in. Political considerations also need to be considered, as it may be the case that an individual or corporation is unable to hold wealth in their country of residence or are unable to

³³ Gaffney, M. (1998). International Tax Competition: harmful or beneficial?. *Offshore Investment*, 90: 40-44, at p42.

³⁴ Adams, C. (2002). *An Historian Looks at Tax Havens*, [cited 24 June 2004]. Available from <http://www.fff.org/freedom/fd0305g.asp>.

³⁵ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

³⁶ New Zealand, *Estate and Gift Duties Act* (1968).

trade with a particular country.³⁷ The use of tax havens within close proximity to large economies also makes the possibility of international expansion easier and less costly.³⁸ Finally, if taxation costs are taken to form part of the overall costs to the individual or corporation, then reduction of these costs would result in a more competitively priced product in the home country.³⁹

Previous studies by the OECD and the Australian Government have explored the possible risks associated with the use of tax havens.⁴⁰ One of the major areas of concern identified by both was that the use of tax havens affects the criterion of neutrality. The neutrality of economic decision making between taxpayers is seriously distorted by the fact that some taxpayers can use tax havens to avoid or reduce tax, while others do not or cannot.⁴¹

Australian markets need foreign capital and the opportunities to create products in markets where the costs of resources such as capital and labour are more competitive.⁴² Therefore it follows that taxation should be a factor that needs to be considered when Australian market participants are making decisions regarding investment. This illustrates that although neutrality as a criterion of good taxation system design can potentially be weakened through the use of tax havens, it is also a factor which has the potential to increase the competitiveness of Australia's capital market.

It is argued that the criterion of equity is also affected by the use of tax havens in the same manner as outlined above. A taxation system which allows taxpayers to reduce tax payable through the use of tax havens is highly inequitable. For example, if taxpayer derives income wholly within Australia, they will be liable for Australian tax on this income. Inequities would occur where a taxation system allows for

³⁷ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

³⁸ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

³⁹ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p3.

⁴⁰ Organisation for Economic Co-operation and Development. (1987) *International Tax Avoidance and Tax Evasion: Four Related Studies*, Paris: Public Affairs Division).and also Australia. (1985). *Reform of the Australian Taxation System: Draft White Paper*, Canberra: Commonwealth of Australia, at pp77-78.

⁴¹ Fraser, P. (1989). Australian Tax Haven Measures. *Australian Tax Forum*, 6 (1): 101

⁴² Fraser, P. (1989). Australian Tax Haven Measures. *Australian Tax Forum*, 6 (1): at p102.

taxpayers to utilise the tax status and confidentiality laws of tax havens in order to reduce or avoid the amount of Australian tax that would have been payable.

One possible solution to the problems of neutrality and inequity that are created by the use of tax havens is for all jurisdictions to remove direct taxes thereby removing the incentive to utilise a tax haven for tax purposes. However, in relation to this point, it is submitted that historic ideologies and large public expenditure commitments mean that most jurisdictions which rely on direct taxes could not consider removing income taxes even if they wanted to.⁴³ Further, it is submitted that if a jurisdiction took the approach of increasing neutrality and reducing inequities by removing income taxes, then by their own definition, they would be classified as a tax haven.

The element of certainty is also affected where tax havens are utilised by taxpayers. From the earlier analysis of the characteristics of tax havens it was clear that anonymity, secrecy and non-detection were often driving factors in terms of the use of tax havens. It is therefore submitted that where any or all of these factors are present, the certainty of revenue collection is weakened. The ATO cannot be certain that income tax revenue will be collected if it is unable to obtain taxpayer or income details from these jurisdictions. This idea will be explored later as it relates to Australia's administrative measures.

If the use of tax havens can affect the elements of equity and neutrality at such a fundamental level, why then, for so many years have taxpayers continued to use them? It is submitted that the use of tax havens creates wealth. It has been said that in the case of the United States, foreign investors are able to purchase and invest in United States corporations, real estate and bonds with the wealth they have created from the use of low-tax bases.⁴⁴ This stimulates the economy to a great extent and their own capital market might be affected should the use of tax havens be prohibited. Another reason is that products produced by many multinational corporations would be selling for a much higher price if it weren't for the use of tax

⁴³ Gaffney, M. (1998). International Tax Competition: harmful or beneficial?. *Offshore Investment*, 90: 40-44, at p41.

⁴⁴ Ginsberg, A.S. (1991). *Tax Havens*. New York: New York Institute of Finance, at p11.

havens. Therefore the final cost of prohibiting tax havens might eventually fall on the consumer regardless of the government’s efforts to avoid it.

The OECD holds the belief that low taxing regimes create unfair tax competition and that tax competition is harmful.⁴⁵ The basis for this argument follows from the problems of neutrality and equity that were outlined earlier. However, the concept of national sovereignty means that the OECD cannot directly force other jurisdictions to change their laws. The OECD has taken the view that using financial threats, inducements, or restrictions on trade is a valid way of eliminating tax competition without breaching national sovereignty.⁴⁶

It was asserted earlier that tax haven jurisdictions are within their sovereign right to impose taxes (or not) as they see fit. Most OECD jurisdictions are able to demonstrate that having a system that allows for the sharing information as well as having systems that protect the privacy of its taxpayers is an entirely achievable task.⁴⁷ However, is pressuring a jurisdiction to enter into exchange of information agreements (treaties) really what some commentators would call “economic bullying”?⁴⁸ Many tax haven jurisdictions are simply places that have no direct taxes and rely heavily on consumption type taxes. For this reason they have no need to enter into exchange of information agreements. Because most OECD countries rely heavily on direct taxes and tax both domestic and overseas income of their taxpayers, the need for exchange of information and international co-operation is created.⁴⁹ Who is benefiting from “forcing” these jurisdictions from entering into these agreements?

If one takes the view (as many economists do) that low taxing jurisdictions are another form of economic competition, then are the tax advantages of these

⁴⁵ Dwyer, TM. (2000). Harmful Tax Competition and the Future of Offshore Financial Centres. *Pacific Economic Bulletin*, 15 (1):51.

⁴⁶ Dwyer, TM. (2000). Harmful Tax Competition and the Future of Offshore Financial Centres. *Pacific Economic Bulletin*, 15 (1):51.

⁴⁷ Australia is an example of an OECD country, which has substantial privacy laws regarding the release of financial and personal information, yet also is able to enter into agreements for the sharing of information with other countries.

⁴⁸ Lambert, I. (2000). Tax Information Exchange- Offshore jurisdictions looking for a place to stand. *Offshore Investment*, at p14 “most off-shore jurisdictions see no benefit in these treaties because other governments increasingly want to tax assets and activities outside their own country”.

⁴⁹ Gaffney, M. (1998). International Tax Competition: harmful or beneficial?. *Offshore Investment*, 90: 40-44, at p41.

jurisdictions any different than any other resource advantage another jurisdiction might have.⁵⁰ Australia might have a resource advantage in the form of wool which allows us to be internationally competitive in this market. How is a tax advantage in another jurisdiction any different to this?

If a new supplier comes into the market and takes some of your market share, any losses that you suffer because you projected based on the current situation may appear real, but this view is unrealistic because you do not have any legal right to market share that is simply projected.⁵¹ The same can be said for tax competition in that countries cannot expect to be protected against projected revenue lost through a new competitor entering the market.

An argument which supports the view that tax havens do have a place in the global economy is that the practices of these tax haven jurisdictions are really a form of economic competition and that in terms of taxation this competition is a natural process, which can eventually stop inefficient taxes of other jurisdictions.⁵² It makes economic sense for governments of these tax haven jurisdictions to take advantage of inefficiencies in other jurisdictions taxation systems.

This section has argued that the use of tax havens by taxpayers threatens a good tax system by weakening equity, neutrality and certainty as elements of good tax design. A tax system which influences companies and individuals to elaborately structure their affairs so as to include tax havens and reduce or minimise tax is not neutral or equitable. Further, it is not politically responsible or fair to allow the burden of tax to fall on its resident payers or to allow any of criminal or avoidance activity to continue unpunished. It is also argued that the use of tax havens will also eventually make the tax system more administratively complex and inflexible as the government attempts to reduce their use. The argument that tax havens create unfair tax competition was also highlighted. However, it is apparent that there are a number of flaws with the argument of tax competition being unfair. There are certainly valid arguments that tax competition is not unlike any other form of

⁵⁰ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p29.

⁵¹ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p43.

⁵² Dwyer, TM. (2000). Harmful Tax Competition and the Future of Offshore Financial Centres. *Pacific Economic Bulletin*, 15 (1): 48-69, at p52.

economic competition. It is submitted that the use of tax havens by Australian taxpayers does in fact weaken the Australian taxation system in terms the Ralph Report goals of being economically efficient (certain), equitable and neutral. However, it is also submitted that this fact alone forming the basis for the elimination of tax competition is flawed.

The Australian Tax Haven Report

This paper began by stating that the ATO had recently published the Australian Tax Haven Report and that in order to justify resources being directed to this area of taxation, it was imperative that tax havens be explored from an Australian perspective. So, why does the ATO see tax havens as a risk to revenue collection and how does this compare to the general perceptions of tax havens that have already been identified in this paper?

Firstly, in terms of the definition of a tax haven, the ATO outlines that their definition of a tax haven is based on the criteria used by the OECD.⁵³ These criteria were outlined earlier as a jurisdiction with; no or only nominal taxes, lack of effective exchange of information and lack of transparency. The ATO further states that they are “concerned about schemes and arrangements where taxpayers exploit the secrecy laws of tax havens in an attempt to conceal assets and income that are subject to tax in Australia.”⁵⁴ From this it is argued that the ATO sees tax havens as a risk to revenue collection because they pose a threat to both certainty of revenue collection and equity of taxation distribution. Certainty and equity were both outlined earlier as essential elements to good taxation design.

Is this concern by the ATO justified? Statistics presented in the Australian Tax Haven Report show that in 2002-03, \$3.8 billion flowed from Australia to tax havens.⁵⁵ This compares to \$909.2 billion flowing from Australia to other non tax haven jurisdictions.⁵⁶ Is it acceptable that the ATO directs considerable funding and

⁵³ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p2.

⁵⁴ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, pii.

⁵⁵ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p4.

⁵⁶ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p4.

indeed creates a dedicated taskforce toward tax havens when they represent only 0.4% of total funds flowing from Australia? Further, the ATO concedes that of this percentage of funds flowing to tax havens, only a small percentage are thought to be illegitimate transactions aimed at avoiding paying Australian tax.⁵⁷

These statistics have been prepared using Australian Transaction Reports and Analysis Centre (AUSTRAC) data and this data is the ATO’s primary source of data (along with information from other organisations and independent research) relating to taxpayers who may be utilising tax havens in an effort to avoid paying tax in Australia.⁵⁸ AUSTRAC is an Australian federal government organisation whose primary goal is as an anti-money laundering regulator and providing financial transaction information to law enforcement and revenue agencies.⁵⁹ The fact that ATO data has been supplied by AUSTRAC is important to note because as will be discussed later in this paper, transactions are only required to be reported to AUSTRAC by cash dealers (for example banks), where the transaction falls into one of three categories;

- significant cash transactions - a transaction of \$10,000 or more in Australian currency, or the equivalent of \$10,000 or more in foreign currency,
- international funds transfer instructions - an instruction for a transfer of funds that is transmitted into or out of Australia electronically or by telegraph,
- suspicious transactions - any transaction which the cash dealer has reasonable grounds to suspect is relevant to criminal activity.⁶⁰

So, in theory, all international funds transactions are reported to AUSTRAC. This should therefore mean that the statistics reported by the ATO in relation to the flow of funds from Australia are reliable. However, the author submits that because these reports are from a third party relying on a combination of adequate computer systems and human employees, these statistics automatically become unreliable. It is therefore argued that due to the nature of dealings with tax havens in relation to secrecy and the purpose of avoiding taxation, many dealings with tax havens would

⁵⁷ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p4. For example, of all the funds flowing out of Australia to Guernsey in 2001-02, 44% of these represented legitimate taxpayer dealings.

⁵⁸ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p11.

⁵⁹ The role of AUSTRAC as described on their website at www.austrac.gov.au

⁶⁰ The Australian Transaction Reports and Analysis Centre. (2003). *Annual Report 2002-03*, Canberra: Commonwealth of Australia, and also the *Financial Transaction Reports Act* (1988).

not be conducted through cash dealers for the express purpose of avoiding detection. In fact, the ATO concedes this point, if somewhat obscurely, by stating relatively briefly that they are increasing their focus on detecting taxpayers who are operating completely outside of the taxation system.⁶¹

The Australian Tax Haven Report also outlines the specific arrangements that the ATO is concerned about in relation to tax havens. These arrangements are; investments in foreign life insurance policies, schemes that result in increased deductions, schemes relating to service fees paid to companies in tax havens, offshore loans, shareholder loans, self-managed funds, circular flows of funds, management fees paid to companies in tax havens, captive insurance and excessive purchase price schemes.⁶² Many of these types of arrangements have been previously discussed as posing risks to revenue collection. Interestingly, the Australian Tax Haven Report makes several references to the increased occurrence of taxpayers obtaining cash in Australia through the use of offshore credit or debit cards.⁶³ It could be argued then, that the ATO might in the near future be required to follow in the footsteps of the United States in relation to these credit and debit cards, where due to the secrecy laws of the offshore countries involved, the IRS has begun pursuing personal information of cardholders obtained from MasterCard International (obtained through a court order) relating to 230,000 bank accounts in tax haven jurisdictions.⁶⁴

Within the Australian Tax Haven Report, the ATO outlines the strategies being undertaken to investigate potentially illegitimate dealing with tax havens. These strategies are;

- Focusing on the promoters (wholesales, retailers and advertisers) of tax haven based arrangements of the type previously identified and requiring them to provide additional material relating to their clients' financial information,

⁶¹ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, at p14. The word obscurely is used in this instance because such an important point is made in the report as part of a six line paragraph and is not elaborated upon in any detail.

⁶² Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, pp9-10.

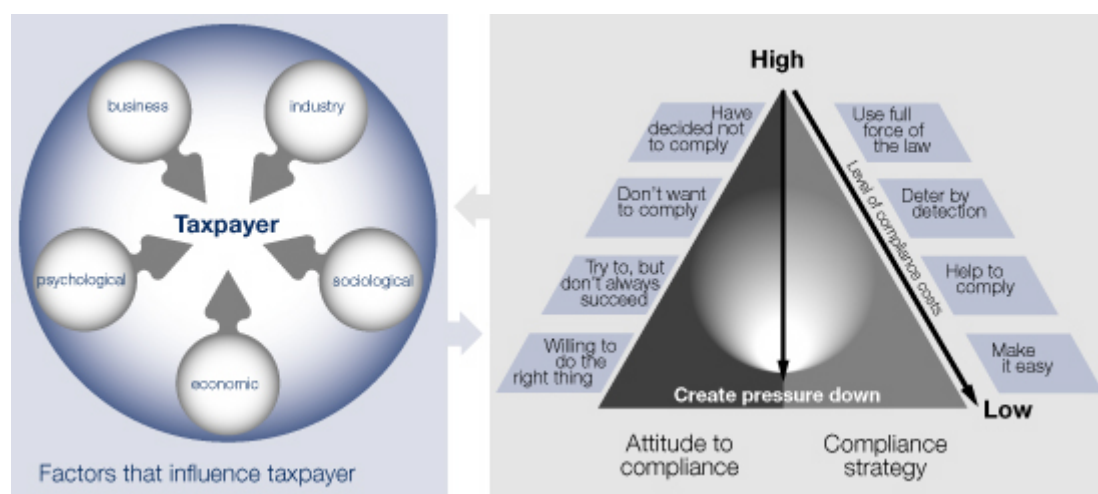
⁶³ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, pp9-11.

⁶⁴ Sharp, WM and Harrison, WT and Harty, SA. (2002). Post-11 September use of offshore Tax havens. *Tax Notes International*, 26(3): 351-360.

- Focusing on participants through utilising AUSTRAC data to identify potential taxpayers involved in tax haven arrangements.
- Issuing offshore information notices requiring a taxpayer to provide information located outside Australia.
- Entering into international information exchange agreements. Currently, Australia has entered into tax treaties with 40 countries; however this measure would indicate that the ATO hopes to increase the number of these treaties.
- Entering into joint investigations with law enforcement agencies such as the Australian Crime Commission, the Australian Federal Police and the Australian Securities and Investment Commission.⁶⁵

As its primary point of determining compliance strategies, the ATO utilises what is referred to as the Compliance Model (see Figure 1 next page). This provides a structured way of determining which type of compliance strategy is appropriate for particular classes of taxpayer. For example, the ATO's philosophy is that the majority of taxpayers are at the bottom of the compliance model (ie. willing to comply) and therefore are worthy of a softer compliance approach. The strategies identified in the Australian Tax Haven Report appear to be those found at the top of the compliance model (ie. using the full force of the law or deterring by detection). These strategies would therefore be consistent with the type of taxpayer corresponding in the model. These taxpayers either don't want to comply or have decided not to comply.

⁶⁵ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, pp15-17.

Figure 1 – ATO Compliance Model⁶⁶

As outlined at the outset, whether or not the Australian taxation system contains legislative frameworks or administrative measures (or both) that are aimed at the use of tax havens is one of the issues being addressed by this paper. Although this question will be discussed later in the paper, it is interesting to note at this point that all of the strategies identified by the ATO in the Australian Tax Haven Report are administrative in nature. This is perhaps an early indication of the ATO's perceived level of importance placed on administrative strategies over legislative strategies.

It has become apparent from this discussion that the ATO sees the use of tax havens as a significant risk to revenue collection and therefore an area which requires a significant compliance focus. What is also apparent is that the ATO's own data in relation to tax havens indicates that dealings with tax havens represent a very small percentage of total international dealings by Australian taxpayers. However, the possible unreliability of the ATO data being reported and the fact that the ATO themselves concede that there are taxpayers acting completely outside the taxation system, means that the actual flow of funds could be significantly higher. The author therefore argues that there is sufficient doubt in relation to the extent of the use of tax havens by Australian taxpayers to warrant further research in this area in order to determine exactly how many transactions go undetected.

⁶⁶ The ATO Compliance Model and information relating to its implementation is publicly available at: <http://www.ato.gov.au/corporate/content.asp?doc=/content/5704.htm>

Recent Australian Tax Cases Involving Tax Havens

Prior to analysing legislative and administrative measures applicable to the use of tax havens, it is important to briefly outline some recent Australian tax cases involving tax havens. This section will show in a practical context how the characteristics of tax havens have been utilised by Australian taxpayers. It will also highlight some of the concerns regarding equity, neutrality and certainty that were discussed earlier. The cases mentioned in this section are based on a search of Australian tax cases involving OECD identified tax havens over the last ten years.⁶⁷ Some cases have been excluded where although a tax haven jurisdiction was involved, it wasn't the central to the case. The analysis of each case will be based on how the types of tax advantages the use of the tax haven presented and how the ATO and courts applied the taxation legislation.

The most commonly referred to Australian tax case involving the use of tax havens is the *Spotless* case.⁶⁸ The facts in this case involved two Australian tax resident companies entering into agreements with banks in Singapore and the Cook Islands. The Cook Islands were identified earlier as meeting the definition of a tax haven due to their low tax rates and confidentiality laws. In this case, surplus funds of some \$40 million were eventually transferred to the bank in the Cook Islands for investment purposes. These funds generated interest income of \$2.96 million. The tax payable in the Cook Islands on this interest income was \$103,230 which was substantially less than what would have been payable had the funds been invested in an Australian financial institution. The Australian resident taxpayers contended that this interest income was not subject to Australian tax because it was sourced outside of Australia and had already been subject to tax in the Cook Islands. This is an example of how the low tax rates of the Cook Islands were utilised by Australian taxpayers to minimise the amount of tax that would have been payable in Australia.

The ATO argued that the interest was sourced in Australia because the income used to generate the interest was initially sourced in Australia. The ATO also argued

⁶⁷ There were a number of cases in the 1970's and 80's relating to tax havens [eg. *Citibank Ltd v FC of T & Ors* (1988) ATC 4714 and *Esquire Nominees Ltd v FC of T* (1973) 4114], however due to changes in Australia's international tax laws since that time, these cases do not add value to the analysis.

⁶⁸ *FCofT v Spotless Services Limited and Anor* (1996) ATC 5201.

that this was a deliberate scheme to avoid paying Australian tax and that the anti-avoidance legislation should apply to make the interest assessable in Australia.⁶⁹ Initially, the judgement in this case supported the taxpayer’s view that the interest was sourced outside of Australia and Part IVA did not apply because the ATO had not properly identified the scheme to which the legislation should apply.⁷⁰ The ATO appealed the Full Federal court decision in 1996, and was successful. The Full High Court found that the Part IVA did indeed apply and that “a reasonable person would conclude that the taxpayers as their most influential purpose, and thus their dominant purpose, the obtaining thereby of a tax benefit.”⁷¹

For the purposes of this paper, this case highlights two important issues. Firstly, that Australian taxpayers of considerable size and wealth are induced by the tax advantages those tax havens such as the Cook Islands offer. Secondly, that in a climate where the Government and the ATO appear to be concerned about the use of tax havens, one case involving a tax haven of physical proximity took nine years of legal debate to decide.⁷² In terms of compliance it is essential that the ATO continue to pursue transactions which it believes fall within the anti-avoidance provisions so that the integrity of the taxation system is upheld.

In the case of *Atkinson v FC of T* (2000) a taxpayer was found to have non-disclosed a variety of income over a number of years including interest income from off-shore accounts in Port Vila, Vanuatu and Switzerland.⁷³ The ATO became aware of this during an audit of the taxpayer. During the audit, the ATO inspected Family Court affidavits relating to the taxpayer’s divorce. These affidavits showed that the taxpayer was receiving substantial amounts of income from a variety of sources that had not been declared by the taxpayer. Because of the ATO’s inability to access all the information required to determine the actual amount of income received, (particularly in relation to the off-shore income) the assessed income was based on the taxpayer’s spending during the years in question. The taxpayer appealed this method of calculation in the federal court and was unsuccessful. This case highlights

⁶⁹ Part IV will be analysed in more detail in a further section.

⁷⁰ *FCofT v Spotless Services Limited and Anor* (1993) 93 ATC 4397

⁷¹ *FCofT v Spotless Services Limited and Anor* (1996) ATC 5201 at para 5211.

⁷² The interest was earned in the 1986/87 year of income and the final decision was handed down in December 1996.

⁷³ *Atkinson v FC of T* (2000) ATC 4332.

another administrative measure available (audits) and the difficulty in obtaining information from off-shore jurisdictions.

More recently, in the case of *Hickman v FC of T* (2005), a taxpayer entered into arrangements with two companies resident in Vanuatu.⁷⁴ The arrangement was such that the taxpayer borrowed \$500,000 from one company to purchase an annuity in the other company. Interest was payable on the loan at a rate of 12% and the payments from the annuity would not commence until 2028. The ATO was of the opinion that the whole arrangement was a “sham” and disallowed the interest deduction claimed of \$60,000. The ATO also argued that the arrangement was of the kind relating to the creation of superannuation benefits and therefore because the entity was not a complying Australian superannuation fund, the interest was not deductible. The taxpayer appealed the ATO’s decision to disallow the deduction before the Administrative Appeals Tribunal and was unsuccessful. The fact that the companies were incorporated in Vanuatu was referred to in the court proceedings where it was stated by the government solicitors that ‘it is impossible to make any check on companies registered in that country.’ This case is an example of an Australian resident taxpayer setting out to utilise the confidentiality laws of Vanuatu in reducing Australian tax payable. From the evidence presented in court it appears that the taxpayer was relying on this inability to access information in ensuring that the deduction would be allowed.

A similar arrangement is involved in the case of *JMA Accounting Pty Ltd & Anor v Carmody and Ors* (2004) and relates to the ATO’s ability to gain information about these types of arrangements.⁷⁵ In this case, the ATO suspected an accounting firm located in Brisbane was actively involved in promoting schemes that utilised a tax haven (Labuan Province) in order to avoid the payment of Australian tax. The scheme involved Australian taxpayer clients claiming deductions for the acquisition of goods and services from an entity resident in Labuan Province. The ATO was of the opinion that the monies sent to Labuan Province did not constitute genuine acquisitions and that the monies were simply sent off-shore and then returned to the taxpayers less a small commission. Initial investigations by the ATO revealed that

⁷⁴ *Hickman v FC of T* (2005) ATC 2109.

⁷⁵ *JMA Accounting Pty Ltd & Anor v Carmody and Ors* (2004) ATC 4916.

approximately 70 transactions totalling \$1.35 million were potentially utilising this scheme. The case is an example of taxpayers taking advantage of both the low tax rates and confidentiality laws of the tax haven jurisdiction to create false deductions and therefore minimise tax paid in Australia. The issue to be decided in this case was in relation to whether or not the ATO acted outside its legislative powers of access when it raided the premises of the accountant in search of evidence. The Full Federal Court decision was that the ATO did act outside its access powers and a substantial number of documents were to be returned to the accountant. The decision in this case highlights that where information is unable to be obtained from the off-shore jurisdiction, the ATO still faces some difficulty in gaining access to information that exists on-shore. The effects of this case on the ATO's ability to disallow the deductions claimed is yet to be seen, due to this decision relating only to access powers being handed down in late 2004.

It should be noted here that on 3 June 2005 the media reported that the ATO, the Australian Federal Police and other organisations had commenced proceedings to investigate and arrest persons in respect of a tax avoidance scheme utilising off-shore tax havens.⁷⁶ The unpaid tax is reported to amount to approximately \$300 million. The only information available in relation to this at present is media releases by the ATO, the Federal Police and the Australian Crime Commission. From these releases it appears that these schemes are similar to the case analysed above. The outcome of these investigations is yet to be determined but highlights the importance of all the further research that has been suggested in this paper.

The lack of cases concerning tax havens is surprising given the ATO's apparent concern about the risk to revenue that tax havens pose. An explanation for this might be that many transactions involving tax havens that are detected by the ATO are resolved without the need for judicial intervention. It was highlighted earlier that the ATO sees the use of tax havens as a risk to revenue, yet statistical data did not necessarily support this view. The earlier argument was that statistical data relating to the use of tax havens did not provide a full picture as non-disclosure of income and the inability to effectively trace transactions was really the central issue. This

⁷⁶ See ATO Media Release NAT 2005/35 and also “ATO, police swoop on rich tax evaders”, *The Financial Review*, 11 June 2005.

lack of cases heard in relation to the use of tax havens would appear to support the view that taxpayers are more likely to non-disclose and the ATO is not able to trace information or transactions effectively.

Australian Legislative Frameworks and Administrative Measures

There are a number of measures the government and administrators of Australia could implement to ensure that the risk to revenue posed by tax havens is minimised. These measures are thought to fall into three broad categories; uni-lateral, bi-lateral and multi-lateral.⁷⁷ Multi-lateral measures refer to those involving a number of parties. These measures would include Australia being a member of the OECD and other international organisations such as the FATF. Bi-lateral measures refer to those involving one other party. These would be illustrated by the existence of agreements with another jurisdiction. The third category, uni-lateral measures refers to legislative and administrative measures that the Australian government as a single entity can introduce.

Legislative Framework

An analysis of all Australian taxation legislation and relevant literature identified a number of legislative frameworks that could potentially apply to transactions involving tax haven jurisdictions. These uni-lateral measures have been identified as; source of income and residency rules, transfer-pricing rules, controlled foreign company rules, foreign investment fund rules and the general anti-avoidance provisions. Each of these legislative frameworks will be identified and holistically analysed in this section.

⁷⁷ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p33.

Source of Income and Residency

The most fundamental legislative frameworks are the general source of income and residency rules. The general residency rules operating in Australia are largely based on common law. This means that residency is generally decided on a case-by-case basis. Taxpayers who are Australian tax residents are liable for Australian tax on income and capital earned from both Australian and overseas sources. Non-Australian residents are liable for Australian tax only on income or gains that have an Australian source or are connected with Australia.⁷⁸ In theory, the residence rule promotes capital export neutrality by subjecting Australian taxpayers to worldwide income. In this regard, these rules represent a legislative framework that is aimed at reducing the risk to neutrality and equity that the use of tax havens poses.

So, from this it is argued that residency of a taxpayer and source of income needs to be determined when transaction involving tax havens are apparent. It has been argued that specific statutory source rules should be introduced in Australia in order to increase the efficiency and remove uncertainty.⁷⁹ Taxpayers often try to establish themselves as non-residents for Australian tax purposes in order to ensure that foreign sourced income is not taxable in Australia. In circumstances where this non-resident status cannot be obtained, an Australian tax resident is assessed on all income regardless of its source. Therefore, it is argued that the only option available to avoid paying Australian tax is to invest in foreign jurisdictions where secrecy laws make it difficult for income accumulated to be attributed to them. It has been argued that the fundamental principles of residence and source of income have created a tax-induced incentive for Australian businesses to invest in low tax jurisdictions.⁸⁰ Indeed it is also thought that unless Australia substantially overhauls its residency and source rules, it stands to lose a substantial amount of revenue.⁸¹ Further research is required in order to determine whether the residency and source of

⁷⁸ *Income Tax Assessment Act* (1997) at s6-5.

⁷⁹ Azzi, J. (1996). The Need for further reforms of Australia's International Taxation rules in view of the Spotless case. *Bulletin for Fiscal Documentation*, 50 (4), at p176.

⁸⁰ Azzi, J. (1996). The Need for further reforms of Australia's International Taxation rules in view of the Spotless case. *Bulletin for Fiscal Documentation*, 50 (4), at p173.

⁸¹ Azzi, J. (1996). The Need for further reforms of Australia's International Taxation rules in view of the Spotless case. *Bulletin for Fiscal Documentation*, 50 (4), at p164.

income rules are effective in minimising risks to revenue caused by the use of tax havens.

Transfer Pricing

As identified earlier, the low tax rates of tax haven jurisdictions are often attractive to Australian taxpayers. Transfer pricing involves Australian resident companies incorporating service companies in offshore low-tax jurisdictions. The on-shore Australian resident company then pays an amount of money to the service company. The on-shore Australian resident company is entitled to claim a deduction in Australia for this payment on the basis that it is an amount paid for services provided in the course of business.⁸² Governments and administrators take issue with transfer pricing in situations where payments to service companies are inflated. In this situation, deductions available are often larger than the true value of these transactions. This also means that the service company is assessed on an inflated amount of income. If this service company is located in a tax haven jurisdiction, then being assessed on an inflated amount of income is often of no real concern. As the company is incorporated and controlled outside Australia, it is a non-resident for Australian tax purposes.

The Australian tax legislation contains provisions that effectively ensure amounts paid by Australian resident taxpayers to these off-shore service companies are limited to the real value of these services and not an inflated amount.⁸³ These provisions were introduced shortly after the OECD published a report in 1979 outlining the problems associated with transfer pricing. These provisions are potentially activated where a taxpayer enters into an international agreement for the supply or acquisition of property or services and the consideration for the supply is either nil or less than the arm's length consideration and the consideration for the acquisition is greater than the arm's length consideration.⁸⁴ If the later is found to apply then the Commissioner can exercise discretion so as to limit the amount of

⁸² *Income Tax Assessment Act* (1997) at s8-1.

⁸³ *Income Tax Assessment Act* (1936) at Division 13 and also Taxation Ruling TR 94/14.

⁸⁴ *Income Tax Assessment Act* (1936) at s136AC, s136AD(1), s136AD(2) and s136AD(3).

consideration to what would be the arm’s length value of the transaction.⁸⁵ The Australian provisions limiting available deductions in transfer pricing arrangements are aimed primarily at foreign-based multinational companies shifting profits outside the Australian taxation system.⁸⁶ So, although it is apparent that the legislative framework available in relation to transfer pricing is applicable to the use of tax havens, further research needs to be undertaken in order to determine its effectiveness in this context.

Controlled Foreign Companies

The major legislative framework in relation to the use of tax havens by Australian taxpayers is the ‘controlled foreign company’ (CFC) regime.⁸⁷ The broad objective of this regime is to tax Australian shareholders under an accruals basis on income from foreign companies that has not already been comparatively taxed offshore or which has not been derived from active overseas business activities.⁸⁸ This means that an Australian resident taxpayer can potentially be assessed on income from a foreign company regardless of whether or not that company has actually distributed the income in the form of a dividend.

The CFC rules came into effect from 1 July 1989 as a result of the Government being concerned about the deferral advantages of the previous foreign tax credit system.⁸⁹ It is thought that the CFC rules are capable of alleviating these deferral problems which arise when an Australian resident company accumulates income in a foreign subsidiary so as to avoid being subject to Australian tax.⁹⁰ Taxpayers are able to incorporate a foreign company and effectively control it from Australia by interposing another company (known as a CFC) between the source of income and the beneficial owners.⁹¹ In comparison to transfer pricing, where the focus was on

⁸⁵ Income Tax Assessment Act (1936) at ss136AD(1)–(3).

⁸⁶ Fraser, P. (1989). Australian Tax Haven Measures. *Australian Tax Forum*, 6 (1): at p100.

⁸⁷ Contained in the *Income Tax Assessment Act* (1936) ss316-468.

⁸⁸ CCH Australia Ltd. (2004). *Australian Master Tax Guide*, CCH Australia Ltd, Sydney, at p21-110.

⁸⁹ The Treasurer. (1988). *Taxation of Foreign Source Income: A Consultative Document*, Canberra: Commonwealth of Australia.

⁹⁰ Azzi, J. (1996). The Need for further reforms of Australia’s International Taxation rules in view of the Spotless case. *Bulletin for Fiscal Documentation*, 50 (4), at p165.

⁹¹ Azzi, J. (1996). The Need for further reforms of Australia’s International Taxation rules in view of the Spotless case. *Bulletin for Fiscal Documentation*, 50 (4), at p173.

multi-national companies shifting profits outside Australia, the focus of the CFC provisions is to ensure that Australian based multinational companies do not leave profits outside Australia in order to avoid Australian taxation.⁹²

The application of these rules directly affects the advantages associated with the use of tax havens in that all tax haven jurisdictions are not listed countries. Therefore any passive income derived by an Australian resident taxpayer from a CFC resident in a tax haven could potentially be attributed when it is actually derived.

Although the Australian legislation regarding the taxation of CFC's is said to be successful and one of the toughest regimes in the world, it is also thought to play a significant role in restricting foreign investment and encouraging Australian companies to move their operations completely off-shore.⁹³ This is particularly concerning for Australia in light of earlier arguments about competition. If the Australian Government is genuinely concerned about becoming a competitive player in the global economy then it seems counterproductive to also have a taxation regime, which encourages corporations to move offshore. Additionally, studies have shown that in many jurisdictions, the introduction of similar CFC provisions did not yield the expected large amounts of revenue and that compliance costs to taxpayers were extremely high.⁹⁴ At the time of their introduction, it was thought that the CFC rules constituted a significant improvement over the existing foreign tax credits system. However, it was also thought that in making this improvement, the overall problems of neutrality in terms of international investment would not be completely alleviated.⁹⁵ From this analysis, it is submitted that although the CFC rules can apply to transactions involving tax haven jurisdictions, further research needs to be undertaken in order to determine its effectiveness in this context.

Foreign Investment Funds

From the above discussion, it became apparent that there would be situations where Australian resident taxpayers could derive income from tax haven jurisdictions that

⁹² Fraser, P. (1989). Australian Tax Haven Measures. *Australian Tax Forum*, 6 (1): at p100.

⁹³ Szekely, L. (2001). Tax Competition – An Australian Perspective, at p1. Available from: http://library2.cch.com.au/dynaweb/@CCH__Access/eitc/itc/frames/eitc.htm?cid=1802EF97DCF16EFE0E46E28EB146nal Ltd and also n244 at p3.

⁹⁴ Fraser, P. (1989). Australian Tax Haven Measures. *Australian Tax Forum*, 6 (1): at p103.

⁹⁵ Fraser, P. (1989). Australian Tax Haven Measures. *Australian Tax Forum*, 6 (1): at p100.

would escape the CFC rules because the foreign company would not be controlled by Australian resident taxpayers. The Foreign Investment Fund (FIF) rules were designed to overcome this gap in the legislation.⁹⁶ Therefore, from July 1992, both income and capital gains from investments in FIF's is to be attributed to the Australian resident taxpayer who owns the investment.⁹⁷ This income is taxed similarly to that under the CFC rules in that the accruals method is used. The FIF provisions are designed to work in conjunction with the CFC provisions. The FIF provisions have been described as “clearly mop-up provisions... if they haven't got you under the CFC provisions or the non-resident trust provisions, they will get you on FIF's.”⁹⁸

At the time of their introduction, it was estimated that the increase in tax collected from these measures would be around \$150 million.⁹⁹ Due to the broad nature of the FIF provisions and the fact that they do not specifically distinguish between foreign jurisdictions (i.e. no listed or unlisted countries), there are many exemptions.¹⁰⁰ The main exemptions are for foreign entities already liable to pay tax under existing foreign source income rules, foreign entities to which the CFC provisions already apply and overseas investments of less than \$20 000. This \$20,000 threshold is thought to be a concession for small-scale investors.¹⁰¹ However, it is submitted that this threshold represents a potential weakness in relation to the use of tax havens. Large numbers of small scale investors may still amount to a significant risk to revenue in relation to tax haven jurisdictions. Also exempt under these provisions are investments of less than 10% in companies listed on an approved stock exchange and investments in an “active business”.¹⁰²

Once it is established that an Australian resident taxpayer has an investment in an FIF and that no exemptions apply, the legislation will attribute assessable income to

⁹⁶ The Government was concerned that the CFC rules could be avoided through the promotion of small portfolio interests in companies that were resident in low tax jurisdictions.

⁹⁷ An FIF is any foreign company or trust, see s481 *Income Tax Assessment Act* (1936).

⁹⁸ Lyons, M. (1991). Tax Haven Net to Catch Minnows. *Business Review Weekly*, 6 September 1991, at p90, as stated by Peter Blackwood of Deloitte Ross Tohmatsu and former ATO branch chief.

⁹⁹ Lyons, M. (1991). Tax Haven Net to Catch Minnows. *Business Review Weekly*, 6 September 1991, at p90.

¹⁰⁰ *Income Tax Assessment Act* (1936) at ss503-527.

¹⁰¹ Lyons, M. (1991). Tax Haven Net to Catch Minnows. *Business Review Weekly*, 6 September 1991, at p91 by John Denyer (executive director Investment Funds Association of Australia).

¹⁰² Lyons, M. (1991). Tax Haven Net to Catch Minnows. *Business Review Weekly*, 6 September 1991, at p90 and also *Income Tax Assessment Act* (1936) at ss495-501.

that taxpayer using one of three methods; the market value method, the deemed rate of return method or the calculation method.¹⁰³ The FIF provisions can therefore potentially apply to any income derived from a company or trust that is resident in a tax haven jurisdiction regardless of whether the company is controlled by Australian tax residents or the taxpayer has a greater than 10% ownership interest.

There has been much debate around how equitable the provisions are. It has been argued that these provisions have the potential to levy tax on income that has not actually been earned.¹⁰⁴ One commentator has even suggested that investors would be better off paying tax under the CFC provisions where they are not liable until they realise the gain and that it is “outrageous” to demand tax be paid on income that has not been received.¹⁰⁵ The FIF measures have been described as like using a “sledgehammer to crack a nut”.¹⁰⁶ In terms of this paper’s focus on legislative frameworks designed to minimise the risk posed by the use of tax havens, it is apparent that the FIF measures are applicable to certain transactions involving tax haven jurisdictions but further research is required in order to determine their effectiveness in this context.

General Anti-Avoidance

The final piece of legislative framework that could potentially apply to limit the risk to revenue collection posed by Australian resident taxpayers utilising tax haven jurisdictions is the general anti-avoidance provisions. The provisions are commonly referred to as Part IVA and are contained in the *Income Tax Assessment Act (1936)* at sections ss177A – 177F. The aim of Part IVA is to assess and penalise taxpayers where it is found that;

- the taxpayer has entered into a scheme, and
- the taxpayer has obtained a tax benefit from that scheme, and

¹⁰³ *Income Tax Assessment Act (1936)* at ss535 and 538, ss543 – 557 and ss557A – 583.

¹⁰⁴ Lyons, M. (1991). Tax Haven Net to Catch Minnows. *Business Review Weekly*, 6 September 1991, at p90 where Peter Knox from Ernst and Young says that “the Government and Treasury people do not fully understand what they are doing.”

¹⁰⁵ Lyons, M. (1991). Tax Haven Net to Catch Minnows. *Business Review Weekly*, 6 September 1991, at p90.

¹⁰⁶ Lyons, M. (1991). Tax Haven Net to Catch Minnows. *Business Review Weekly*, 6 September 1991, at p91. by Robert Goatly (managing director of GT management).

- it could be concluded that the taxpayer entered into the scheme for the purpose of obtaining that tax benefit.

It is submitted that Part IVA is a legislative framework that is available to be applied to transactions involving tax haven jurisdictions. It was argued earlier that taxpayers are often attracted to use tax haven jurisdictions because of the tax benefits they provide. Therefore, prima-facie Part IVA could be effective in minimising the risk to revenue that tax havens pose. The Spotless case was analysed earlier and is an example of where Part IVA was utilised in order to assess in Australia a transaction involving a tax haven jurisdiction. It has been argued that the use of Part IVA in the Spotless case would have been unnecessary had the Australian taxation system contained specific legislative source rules.¹⁰⁷ There would have been no need to establish a motive or purpose behind the transaction had the interest income been found to have an Australian source initially.

Analysis of literature in relation to Part IVA revealed that it has been the subject of extensive academic research.¹⁰⁸ However, it is thought that further research could be conducted in relation to how Part IVA specifically applies to transactions involving tax havens rather than its overall effectiveness.

This part has identified the legislative frameworks within the Australian taxation system that can be implemented to ensure that income derived by Australian resident taxpayers is still assessable in Australia regardless of whether that taxpayer has utilised a tax haven jurisdiction for the purposes of avoiding tax. It is apparent that the identified legislation is wide-ranging and covers the types of tax haven transactions that were earlier identified as potential risks to revenue. Although beyond the scope of this paper, the author recognises that each one of these identified pieces of administrative measures needs to be individually evaluated as to whether or not it is successful in relation to the use of tax havens.

¹⁰⁷ Krever, R.(1995). The Continuing Story of Tax Avoidance and the High Court: Peabody v Federal Commissioner of Taxation. *Just Policy* 44 and also Azzi, J. (1996). The Need for further reforms of Australia's International Taxation rules in view of the Spotless case. *Bulletin for Fiscal Documentation*, 50 (4), at p176

¹⁰⁸ Examples of this academic research include; Boujous, J. (2003). Part IVA...no limit to its operation?, *The Tax Specialist*, Vol 7(1):27-37 and Richards, R. (1993). Part IVA read down yet again, *Australian Accountant*, Vol 6(7):60-61 and Cassidy, J. (1994). Part IVA – a tiger or toothless, *Revenue Law Journal*, Vol 4(1&2):160-181.

It is argued that the risks to revenue might be stemming from the fact that taxpayers must non-disclose in order to make transactions with tax havens beneficial in terms of taxation and is the reason why the following discussion on administrative strategies is important. One support for the argument that taxpayers are non-disclosing rather than being forced to comply with broad and complicated legislation is that the ATO's own figures show a relatively small amount of income flowing to and from tax havens. It is argued that there are simply too many taxpayers and too many transactions for the ATO to monitor all of them and computers have made it easier both for detection but for taxpayers to avoid tax. However, if a taxpayer is willing to non-disclose income generated through tax havens, why wouldn't they save them selves some trouble and just non-disclose income generated in Australia? Perhaps this is because the taxpayers feel that the transactions do not genuinely belong in the Australian tax system, otherwise they would just non-disclose it here.

Administrative Measures

An analysis of Australian government reports, ATO reports and other literature has identified a number of possible administrative measures. The measures identified are; ATO intelligence, information gathered from AUSTRAC, information gathered from Australian Customs Service and criminal measures. These administrative measures will be analysed in the following section in order to identify ways in which they may be utilised in reducing the risks associated with the use of tax havens.

ATO Intelligence

The ATO asserts that its primary method of identifying transactions involving tax havens is through data collected and presented on tax returns and previously gathered taxpayer information.¹⁰⁹ When a taxpayer provides information on a tax return or additional schedule of information, the ATO is often able to determine whether a tax haven jurisdiction has been utilised. Taxpayers are required to

¹⁰⁹ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p1.

separately report income from foreign sources and investment income. The ATO is therefore able to determine whether the legislative provisions that were outlined earlier have been interpreted and applied correctly. The ATO performs risk analysis of all information provided by taxpayers in order to determine whether a taxpayer or transaction requires further investigation in the form of audit activities.¹¹⁰ In its compliance program for 2003/04 the ATO outlines that the following key strategies in relation to tax havens;

- facilitating the exchange of information between administrators of tax havens,
- increasing audit activities,
- providing education and assistance to taxpayers about the risks associated with tax havens and taxpayer responsibilities,
- undertaking risk analysis.

Where intelligence gathered identifies a taxpayer or transaction requiring further investigation, the ATO is able to gather specific information from taxpayers or their associates through its ‘access of information powers’ contained in the *Taxation Administration Act* (1953) at section 264. It has been argued earlier that the very nature of confidentiality laws in tax haven jurisdictions has the potential to limit the effectiveness of ATO intelligence in identifying transactions involving tax havens. For example, in situations where the ATO believes that a taxpayer has been utilising a tax haven in order to avoid Australian tax, information to support this claim would be required to be obtained (under section 264). In many situations this information would be located within the tax haven jurisdiction where access is limited due to the confidentiality laws which make the jurisdiction a tax haven.

A number of further research opportunities present themselves in relation to the effectiveness of ATO intelligence in identifying transactions involving tax haven jurisdictions. Further research is required in relation to the number of taxpayers and transactions identified as relating to tax havens which result in amended tax return assessments being issued. Also, further research could be conducted in relation to the number of taxpayers or transactions which are identified as involving tax havens

¹¹⁰ Australian Taxation Office. (2003) *Compliance Program 2003/04*, Canberra: Australia at p45.

for which no further investigations were conducted. Although it is recognised that this information would be difficult to obtain due to the sensitivity of taxpayer information, it would be necessary in order to determine the exact level of effectiveness of ATO intelligence.

AUSTRAC

As referred to earlier, AUSTRAC is an Australian federal government organisation whose primary goal is as an anti-money laundering regulator and providing financial transaction information to law enforcement and revenue agencies. It was argued earlier that one of the reasons why it may be difficult to ascertain the exact level of risk posed by tax havens is that information gathered by the ATO is often only information that has been or could be traced by AUSTRAC. It is submitted that information supplied by AUSTRAC plays a significant role in identifying those transactions which have fallen outside the ATO's system. It was outlined earlier that information gathered by AUSTRAC from by cash dealers (for example banks), falls into one of three categories; significant cash transactions, international funds transfer instructions or suspicious transactions. An example of a suspicious transaction was when AUSTRAC released a circular to financial institutions outlining circumstances where a transaction may be utilised to finance terrorist activities.¹¹¹

It is submitted that financial and time constraints of both organisations mean that not all transactions that are reported will be further investigated. This was the experience in the United States where law enforcement agencies reported difficulties in tracing up to 700,000 electronic money transfers involving about US \$2 trillion per day.¹¹² It was thought that the majority of these represented legitimate commerce, but administrative agencies lacked the tools to differentiate those which related to criminal or tax evasion matters.¹¹³ Financial institutions in the United States filed approximately 13 million currency transaction reports in 1999 with an administrative

¹¹¹ The Australian Transaction Reports and Analysis Centre. (2003). *Annual Report 2002-03*, Canberra: Commonwealth of Australia, the *Financial Transaction Reports Act* (1988) and see also The Australian Transaction Reports and Analysis Centre. (2003). *Information Circular No.31*, Canberra: Commonwealth of Australia.

¹¹² Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122: 10.

¹¹³ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122:10-15.

cost to the industry of more than US\$100 million. It is thought that less than 1/1000th of 1% of currency reports are ever used in a money laundering conviction.¹¹⁴

It is also submitted that there are inconsistencies in some of the information exchanged between these organisations.¹¹⁵ Questions about the accuracy of this administrative technique of investigation were highlighted previously in relation to the fact that only certain entities are required to report information to AUSTRAC, and even then, only in relation to certain transactions. An example of how this information cannot necessarily be relied upon from the ATO's perspective is that while the ATO reports that \$3.8 billion flowed to tax havens from Australia in 2003-03, media comments around the time of the release of the report stated that AUSTRAC data identified \$9.1 billion leaving Australia for Switzerland alone.¹¹⁶ This identifies a potential weakness in this administrative measure.

Although the previous analysis identifies a number of possible weaknesses in the system of transactions reporting, it should be noted that on the whole, AUSTRAC regarded highly as the international level and is often complimented for the way in which the system is constantly reviewed.¹¹⁷ In relation to transactions with tax haven jurisdictions that have a taxation purpose, it is concluded that AUSTRAC is a primary administrative measure. However, an area of possible further research has been presented in terms of the effectiveness of exchange of information between AUSTRAC and the ATO and also the role that financial constraints play in the ability to investigate transactions involving tax havens.

Australian Customs Service

The primary role of Australian Customs Service is managing the security and integrity of Australia's borders.¹¹⁸ In relation to the use of tax havens, the role played by Customs Officers falls into both the categories of uni-lateral and multi-lateral

¹¹⁴ Mitchell, DJ and Quinlan, AF. (2001). Who are the real money laundering havens? *Offshore Investment*, 122, at p13.

¹¹⁵ Australian Taxation Office. (2004). *Tax Havens and Tax Administration*. Canberra: February 2004, p11.

¹¹⁶ Gilchrist, M. (2004). Tax Haven Crackdown - ATMs used to tap into undeclared offshore cash, *The Australian*, 24 February 2004, at p1.

¹¹⁷ Parker, D. (2000). Havens Forbid. *Australian CPA*, 70 (10): 33.

¹¹⁸ See www.customs.gov.au

defence that were outlined earlier.¹¹⁹ It is submitted that in some cases, taxpayers utilising tax havens to avoid the payment of Australian tax, will physically follow their money either from or to the tax haven jurisdiction. In this regard, Australian Customs Service plays an important role. Persons entering Australia through immigration are required to declare to Customs Officers currency they are carrying which is equal to or in excess of \$10,000 Australian dollars. Reports of these amounts are forwarded to AUSTRAC and dealt with in the same manner transactions reported by other financial institutions. It is submitted that this administrative measure plays a small role in identifying transactions involving tax havens because it is only applicable to one side of a transaction. This is supported by the fact that in 2002/03 Customs Officers reported 190 cases of undeclared currency excesses to AUSTRAC.¹²⁰ In today's electronic society it is also submitted that the number of persons gaining access to their funds in this physical manner would be substantially less than those obtaining access through electronic means such as electronic transfers and ATM cards. This has been the experience in the United States where it was identified that many taxpayers were utilising credit cards to gain access to their monies.¹²¹ However, evaluating the level of risk posed by persons physically bringing money into Australia from tax havens is a possible area of further research.

Criminal Measures

The Australian Federal Police, the National Crimes Authority, the Australian Crimes Commission and the Department of Public Prosecutions also play an administrative role where transactions involving tax havens are concerned. These organisations are called upon in limited circumstances. As at November 2003, only nine cases from the ATO had been referred to these avenues from projects undertaken by the ATO in 2002.¹²² It is submitted that because these organisations become involved after a taxpayer or transaction relating to tax havens is identified, they will not be discussed in detail as part of this project.

¹¹⁹ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p34.

¹²⁰ Australian Customs Service. (2005). Annual Report 2003/04, Canberra: Commonwealth of Australia.

¹²¹ Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p34.

¹²² Fullarton, AR. (2003). *A critical analysis of Tax-Avoidance Schemes in Australia*, at p23.

The aim of this part was to identify and analyse the possible legislative frameworks and administrative measures that can be utilised in minimising the risks associated with the use of tax havens. It is argued that the number of these frameworks and measures that were identified illustrates that the Australian taxation system is equipped to minimise the risk to revenue that tax havens pose. However, the level of effectiveness of each of these frameworks and measures needs to be further investigated.

Conclusions and Future Research Directions

The motivation for this paper was a direct result of the ATO issuing the Australian Tax Haven Report. This report made clear that the ATO was concerned about the risk to revenue that tax havens pose. The aim of this paper was to explore whether there is evidence to suggest that tax havens pose the threat that the ATO perceives and if so, whether the Australian taxation system contains legislative frameworks or administrative measures (or both) which are aimed at minimising this risk to revenue. It was discovered that the tax reasons behind the use of tax haven jurisdictions are often only one reason among many and that the protection of assets and personal information can often be overriding reasons. It was also apparent one of the reasons tax havens need to be considered carefully is that the livelihoods of many jurisdictions rely on the large financial sectors that have been built up over many years.

In terms of good tax design, it was submitted that four criteria are generally used to evaluate a tax system; equity, simplicity, certainty and neutrality. It was concluded that both within Australia and globally, the use of tax havens poses potential risks to a number of these elements, but particularly to equity, neutrality and certainty. As a result of the Ralph Report it is apparent that the Australian government and the ATO see these criteria as paramount in evaluating the current taxation system and any future changes. It was concluded that in situations where taxpayers invest money in off-shore tax haven jurisdictions problems with equity and neutrality arise. It was also concluded that certainty is affected once funds leave Australian shores. It was

argued that these threats to equity, certainty and neutrality are much greater for taxation systems that rely heavily on direct taxes and common law principles of source and residency (such as Australia).

The fundamental concept of sovereignty means that one jurisdiction cannot and should not play any part in determining how another jurisdiction should design its taxation system. From this, it was argued that the idea of tax competition being unfair might be fundamentally flawed. What right does the government of Australia have to demand that Vanuatu change its taxation system to protect its own tax base?

This paper identified that Australia has a number of legislative frameworks which attempt to target dealings with tax havens. If the Australian taxation system contains legislative frameworks, which are aimed at preventing taxpayers from using tax havens to avoid paying tax, and the ATO still sees them as a potential risk area, then it was submitted that importance must be placed on the administration side of this issue. It was argued that if taxpayers want to benefit from the use of tax haven jurisdictions then they are most likely left with no other option but to not declare the transaction or income. This paper analysed the administrative tools available for detecting these types of transactions and ensuring that the legislative frameworks are complied with. It was argued that AUSTRAC has been recognised as having some of the best practices of transactions recording organisations in the world. However, it was also argued that there may be inconsistencies between data collected by AUSTRAC and by the ATO or that there was a lack of communication between the two agencies. It was argued that although AUSTRAC does have the technological capacity to track each and every transaction that occurs in Australia, there are physical and financial constraints in doing so. The ATO administrative powers were also analysed and it became apparent that although the ATO has made clear that it is concerned about the risks associated with tax havens, it is constrained in a number of ways. Firstly it is constrained by what is actually declared by taxpayers initially and ensuring that these amounts are actually in accordance with the legislation. It is also constrained by information which is provided by a third party (AUSTRAC) whose resources need to be apportioned between a number of

interested organisations. Finally, it is also constrained by its inability to obtain information from tax haven jurisdictions once funds have flowed there.

The effectiveness of Australian legislation and administrative tools has been identified as an important opportunity for further research. Each of these legislative frameworks and administrative measures needs to be independently and quantitatively evaluated in order to determine the extent of their effectiveness in relation to minimising the risk to revenue that tax havens pose. However, one conclusion of this paper is that the effectiveness of both the legislative frameworks and administrative measures is limited largely by communication across organisations, the financial cost of tracing all transactions, and the constraints involved in tracking and obtaining information once it has left Australian shores.

One of the questions that this paper has raised as a fundamental further research opportunity is why taxpayers are attracted to using tax haven jurisdictions in the first place? Taxation systems are increasingly becoming a competitive economic commodity. Tax competition is often referred to as a ‘race to the bottom’ where there are no winners in the end.¹²³ However, as argued in this paper, there are valid opposing views about this.

It is therefore argued that there must be something fundamentally unattractive about Australia’s taxation system that makes the use of tax havens a viable option for taxpayers. One of the solutions presented in this paper which requires further investigation is for Australia to embrace the idea of tax competition and become a competitive player in this field. As with any form of natural competition, taking such a view would mean that those countries with the “best” systems would start to be noticed and others would follow in their footsteps. It has been argued that this view would create a “race to the top”, which is far more attractive than a race to the bottom.¹²⁴

¹²³ Dwyer, TM. (2000). Harmful Tax Competition and the Future of Offshore Financial Centres. *Pacific Economic Bulletin*, 15 (1): 48-69, at p52.

¹²⁴ Gaffney, M. (1998). International Tax Competition: harmful or beneficial?. *Offshore Investment*, 90: 40-44, at p44.

If Australia were to abolish all forms of direct taxation and rely solely on consumption taxes then there would be no financial benefit for taxpayers to utilise tax havens. This solution is one that should be further investigated in order to determine its ability to overcome many other inequities in our taxation system.

This idea of removing direct taxation goes hand in hand with the idea of becoming a competitive player in the international tax market. It has been argued that one of the reasons many taxpayers in high-taxing countries find the idea of tax havens attractive is that they do not accept their tax systems as “fair” or equitable, and are therefore merely doing what they can to protect themselves and their families.¹²⁵ If the taxation incentive of using tax havens was taken away through the abolition of direct taxation, it would then become clear that those taxpayers who continue to use tax havens would only be doing so for reasons other than tax. However, would the Australian government be prepared to take this drastic action of abolishing direct taxation? From the discussions in this paper this would, by definition, make Australia a tax haven itself. Also, would it be possible for the current level of social support to be continued to be provided without direct taxation? So, until this solution can be independently evaluated, it is therefore concluded that the Australian government and the ATO must accept that some jurisdictions are more competitive from a tax perspective. Therefore the legislative frameworks and administrative measures that are in place need to be utilised effectively. This will ensure that the risks associated with the use of tax havens will not be allowed to increase whilst there is complete and contemporary qualitative research undertaken to ascertain the reasons why taxpayers find the Australian taxation system so unattractive that they make the decision of utilising tax haven jurisdictions.

¹²⁵ Dwyer, TM. (2000). Harmful Tax Competition and the Future of Offshore Financial Centres. *Pacific Economic Bulletin*, 15 (1): 48-69, at p53.

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Table 1 – Initial Tax Haven Jurisdictions¹²⁶

Andorra #
Anguilla – Overseas Territory of the United Kingdom
Antigua and Barbuda
Aruba – Kingdom of the Netherlands
Commonwealth of the Bahamas
Bahrain
Barbados
Belize
British Virgin Islands – Overseas Territory of the United Kingdom
Cook Islands – New Zealand
The Commonwealth of Dominica
Gibraltar – Overseas Territory of the United Kingdom
Grenada
Guernsey/Sark/Alderney – Dependency of the British Crown
Isle of Man – Dependency of the British Crown
Jersey – Dependency of the British Crown
Liberia #
The Principality of Liechtenstein #
The Republic of the Maldives
The Republic of the Marshall Islands #
The Principality of Monaco #
Montserrat – Overseas Territory of the United Kingdom
The Republic of Nauru
Netherlands Antilles – Kingdom of the Netherlands
Niue – New Zealand
Panama
Samoa
The Republic of the Seychelles
St Lucia
The Federation of St. Christopher & Nevis
St. Vincent and the Grenadines
Tonga
Turks & Caicos – Overseas Territory of the United Kingdom
US Virgin Islands – External Territory of the United States
The Republic of Vanuatu

¹²⁶ Organisation for Economic Co-operation and Development. (2000). Towards Global Tax Cooperation: Progress in Identifying and Eliminating Harmful Tax Practices (the 2000 Report), Paris: Public Affairs Division, at p17. Those marked with # are those who were yet to commit to the OECD project as at 2004. Organisation for Economic Co-operation and Development. (2004). The OECD’s Project on Harmful Tax Practices: The 2004 Progress Report.