

TA 2008/8 - Australian resident entities creating false deductions and/or concealing income through arrangements with promoters based in Vanuatu.

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 This document has changed over time. This version was published on 7 May 2008



Taxpayer Alert

TA 2008/8

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Tax Office has under risk assessment.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the Tax Office considers give rise to taxation issues. These issues will generally require more detailed analysis to provide the Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a Private Ruling. (It should be noted that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: Australian resident entities creating false deductions and/or concealing income through arrangements with promoters based in Vanuatu.

This Taxpayer Alert describes arrangements through which Australian resident entities, with the help of a promoter in Vanuatu, seek deductions for artificially created expenses and/or establish structures that enable the concealment of income to attempt to avoid or evade Australian tax.

DESCRIPTION

The Tax Office is investigating arrangements covered by this alert as part of the whole of government Project Wickenby. These arrangements may involve some or all of the following steps:

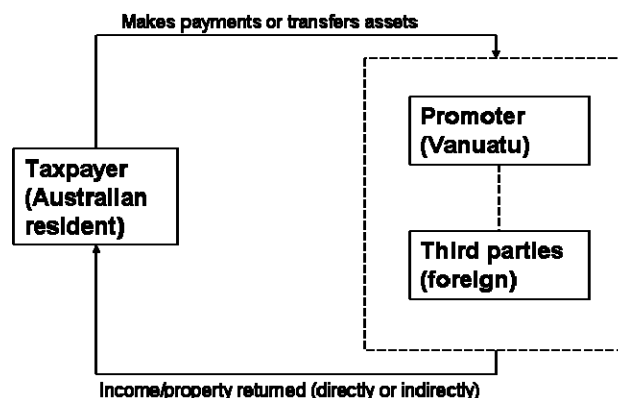
1. An Australian resident taxpayer (the taxpayer) enters into an arrangement with a promoter located overseas which may involve a claim for deductions in relation to services purportedly provided or otherwise justify a flow of funds to entities located overseas.
2. The promoter or its associates then transfers the funds back to the taxpayer through the use of purported loan arrangements, or through the use of debit or credit cards;

3. The taxpayer may seek further deductions in respect of interest on the purported loan used to effectively repatriate the funds;
4. Alternatively, the foreign company may transfer the funds to a separate asset-holding structure (the structure) established in Vanuatu and controlled by the taxpayer or its associates. These funds are used to acquire assets to generate passive income, which is retained by the structure. The taxpayer and/or their associates ultimately reap the economic benefits for the structure, often in a disguised form;
5. The structure may also be used as a standalone arrangement to enable the taxpayer to hold assets offshore and conceal the income that is generated.

The above transactions may not take place as claimed or documentation supporting them may be absent, inconsistent, incomplete or contain false information.

In addition, although claimed to take place in Vanuatu, some steps in the chain of transactions may occur in other countries to further conceal the true nature of the transactions.

DIAGRAM OF ARRANGEMENTS



FEATURES THAT CONCERN US

Australian residents have tax obligations in respect of their worldwide income. This covers income from both Australian and foreign sources and includes income held in offshore structures.

In particular, the Tax Office considers that an arrangement of this type gives rise to taxation issues that include whether:

- a. Such an arrangement or certain steps within it may be a sham;
- b. Any deduction for the expenses purportedly incurred under this arrangement is allowable under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- c. Any funds received as purported loans constitute deemed dividends for the purposes of Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- d. Any steps within the arrangement may give rise to capital gains assessable to the taxpayer under Part 3-1 of the ITAA 1997;
- e. Any of the transactions may be subject to Division 13 of the ITAA 1936;
- f. Any entity within the structure may be a resident of Australia under subsection 6(1) of the ITAA 1936;
- g. Any entity within any established structures, the promoter or other persons involved with the operation, management or administration of any such structures may be acting as trustees (whether under an express, constructive, implied or resulting trust) for the Australian entity as beneficiary in relation to the activities of the structure;

- h. Income from the structure may be assessable to the taxpayer and their associates under the trust income provisions in Division 6 of the ITAA 1936;
- i. Any of the transactions may be subject to the General Value Shifting Regime in Part 3-95 of the ITAA 1997;
- j. The income of the structure may be attributable to the taxpayer under Australia's anti-deferral regimes within Part X, Part XI or Division 6AAA of Part III of the ITAA 1936;
- k. The income of the structure may be assessable to the taxpayer under another provision of the tax law;
- l. The general anti-avoidance provisions in Part IVA of the ITAA 1936 may have application as:
 - a. The arrangement seems artificial and lacks an ordinary business purpose in its design and execution; and
 - b. It appears that the dominant purpose of entering into the arrangement is to obtain one or more tax benefits;
- m. Any entity involved in the arrangement is a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953*.
- n. any criminal offences have been committed in relation to the arrangement.

Falsifying information in an attempt to inflate deductions or to disguise asset holding or offshore income, including through arrangements based in Vanuatu, in an attempt to avoid or evade these tax obligations may attract serious penalties including criminal sanctions or confiscation of criminal assets.

The Tax Office has reviewed this arrangement and has determined that it is not effective because of some or all of the features set out above.

Note 1: Up to 50% penalties can apply to underpaid tax where Part IVA is applied. Base penalties for intentional disregard for the tax law start at 75% of the tax unpaid. Reductions in base penalty may be available if the taxpayer makes a voluntary disclosure to the Tax Office. Voluntary disclosures before a review is commenced can be made under the Offshore Voluntary Disclosure Initiative and may receive a reduced shortfall penalty. Phone us on 1300 132 346 or complete the Offshore voluntary disclosure statement (NAT 71149). For more information, visit www.ato.gov.au.

Note 2: In appropriate cases possible sanctions under criminal law may also apply. Where taxpayers make a voluntary disclosure and that disclosure indicates possible criminal offences, the Commonwealth Director of Public Prosecutions has indicated that favourable consideration will be given to granting an indemnity from criminal prosecution in relation to the taxpayer's involvement in the scheme where:

- *the case does not exhibit a significant degree of criminality*
- *the taxpayer provides information about how the arrangements worked, including the role and identity of the promoter, and*
- *the taxpayer co-operates with the investigation and consequential proceedings*

Note 3: Where appropriate, section 167 of the ITAA 1936 may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PSLA 2007/7 and PSLA 2007/24.

Note 4: Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia

for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.

Note 5: The Commissioner may amend an assessment at any time where he is of the opinion there has been fraud or evasion.

Subject References:

Tax havens

Legislative References:

Income Tax Assessment Act 1936

Subsection 6(1)

Division 6

Division 6AAA

Division 7A

Division 13 of Part III

Part X

Part XI

Part IVA

Section 167

Income Tax Assessment Act 1997

Section 8-1

Part 3-1

Part 3-95

Taxation Administration Act 1953

Division 290

Related Publications

Tax Havens and Tax Administration, NAT 10567

Related Law Administration Practice Statements

PS LA 2007/7: The use of the Commissioner's power to make default assessments of taxable income in respect of attributable income

PS LA 2007/24: Making default assessments: section 167 of the Income Tax Assessment Act 1936 and other similar provisions

Related Taxpayer Alerts:

TA 2005/5

TA 2005/6

TA 2005/7

TA 2005/8

TA 2008/2

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