WALKING THE LINE: WHEN IS TAX ADVICE A CONSPIRACY TO DEFRAUD THE COMMONWEALTH? AN ANALYSIS OF *PEARCE v THE QUEEN*

By Helen Hodgson*

The Commonwealth has had a recent string of cases where a person has been successfully prosecuted for fraud, or conspiracy to defraud the Commonwealth. R v Pearce *resulted in five people being imprisoned following the collapse of a mass marketed scheme, known as "Servcom". Of the five convicted of conspiracy, three were accountants that had been involved in arranging the tax effective financing that was the basis of the scheme.*

A charge of conspiracy to defraud the Commonwealth requires that the parties have acted dishonestly, and in a way that puts the revenue at risk. In the context of tax planning, tax advisers regularly give advice that is intended to reduce the tax liability of their client. This article examines the Pearce *case to identify why the actions of the tax advisers were seen as dishonest, thereby crossing the line that separates tax advice from a conspiracy to defraud the Commonwealth. It also examines the relationship between a tax scheme that may be invalidated under income tax law and fraud, as understood in the criminal law.*

1. INTRODUCTION

In July 2004, three accountants were sentenced to terms of imprisonment of five years each after being convicted of the crime of conspiracy to defraud the Commonwealth. The case (*R v Pearce*)[1] sent ripples through the tax community. Appeals against the

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[1] *R v Pearce* (Unreported, Supreme Court of Western Australia, McKechnie J, 1 July 2004).

convictions were dismissed by the Court of Criminal Appeal of the Supreme Court of Western Australia in May 2005.[2]

The Australian Taxation Office ("ATO") is currently pursuing cases of fraud with some vigour. In the case of *R v Pearce*, the charge of conspiracy arose in the context of tax advisers providing professional advice to a client. Of the five who were charged with the conspiracy, one was the architect of the financial arrangements, two were businessmen who were the beneficiaries of the scheme (and who pleaded guilty to the charges against them), and the issue in relation to the tax advisers Sean Pearce and Walter Tieleman was whether the two were sufficiently involved in designing the arrangements to be conspirators in the scheme.

Under the *Income Tax Assessment Acts* ("ITAAs") the responsibility for lodging a correct income tax return falls on the taxpayer. If an incorrect claim is made, whether inadvertently or as a result of deliberate tax avoidance, the taxpayer is held responsible for the tax shortfall and penalties are graded according to the level of culpability. Criminal prosecutions have been used in cases where the tax evasion is so blatant that the public interest is seen to be best served by prosecuting the taxpayer.[3]

The Commonwealth has limited recourse under the ITAAs against registered tax advisers. However, it has shown that it is willing to recommend to the Director of Public Prosecutions ("DPP") that the DPP charge third parties with a criminal offence. The *ATO Prosecution Policy* states that:

> When the evidence discloses that a tax agent, BAS service provider or adviser aided or abetted a taxpayer to furnish false returns, Activity Statements, or information, the tax agent, BAS service

[2] *Pearce v The Queen* (2005) 216 ALR 690 ("*Pearce*"). The High Court rejected a special leave application in October 2005.

[3] The principles that will be applied in determining whether prosecution is appropriate are outlined in the *ATO Prosecution Policy*.

> provider or adviser should be charged with the same offence as the taxpayer — refer to section 5 of the *Crimes Act 1914*.[4]

The *ATO Compliance Programme 2005–06* gives an indication of an increasing willingness by the Commissioner of Taxation ("Commissioner") to recommend to the DPP that the DPP undertake criminal prosecution in relation to evasion and serious fraud:

> We are committed to dealing firmly with the very small minority of taxpayers, intermediaries and others who refuse to comply with their tax obligations and engage in evasion and serious fraud. We investigate and refer serious breaches of the law to the Commonwealth Director of Public Prosecutions to consider for criminal prosecution.
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> Together we have been successful in achieving a steadily increasing number of prison sentences for tax fraud. Virtually every recent tax-related prosecution has been successful, with over 60% of convictions resulting in prison sentences. An increasing proportion of sentences exceed three years, and a nine-year prison sentence was recently imposed by the Western Australian District Court over a tax fraud of almost $1.6 million.[5]

The report goes on to quantify the number of cases being actively pursued:

> At the end of June 2005 there were approximately 270 briefs with the Commonwealth Director of Public Prosecutions and the Australian Government Solicitor, awaiting prosecution for tax and excise fraud. This year we anticipate that the courts will finalise around 170 prosecutions for tax and excise fraud, with a similar proportion as last year resulting in prison sentences. We also expect to raise more than $100 million from over 300 audits of cases involving evasion and serious fraud.[6]

In December 2003, the government announced that it was planning to introduce legislation to enable civil penalties to be

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[4] Ibid para 20.2.2.
[5] *ATO Compliance Programme 2005–06* (2005) 89.
[6] Ibid 91.

imposed on the promoters of mass marketed schemes. A draft of this legislation was released in August 2005.[7] This legislation does not appear to preclude criminal charges being laid in relation to serious fraud and evasion.

A further unusual feature of *R v Pearce* is the significant role that the National Crime Authority and the Australian Federal Police ("AFP") played in the prosecution. Although the *ATO Prosecution Policy* does set out the procedures for referral to the DPP, this particular case was an outcome of a joint taskforce, and it appears that the other agencies were instrumental in the matter being tried as a criminal prosecution.

One of the difficulties in examining the *Pearce* case is that as a criminal matter it was heard in the first instance by a jury, which essentially made its decision based on its interpretation of the evidence, which was heard over eight weeks. Without a written decision it is difficult to analyse the factors that influenced the jury when it determined that the defendants were guilty of the charges. The appeal decision, which was handed down in May 2005, went some way toward identifying and analysing the legal issues raised. A case of this nature, however, does depend on the jury's interpretation of the evidence, and while the Court of Criminal Appeal reviewed whether appropriate evidence existed, there are a number of key issues that the judges accepted were open for the jury to determine based on that evidence.

2. BACKGROUND

2.1 The Facts

In 1998, the Perth firm of McKessar Tieleman was engaged to provide advice in relation to setting up a franchise arrangement known as "Servcom". "Servcom" was one of the tax schemes that

[7] This article does not consider the new legislation or how the legislation might be applied to the facts in *Pearce*.

were marketed at the time throughout Western Australia, particularly to investors from mining towns such as Kalgoorlie and Newman.

The "Servcom" franchise was established by Lawrence Aistrope and Tarek Wahby ("the Businessmen") to fund an internet service provider business. The prosecution initially did not accept that there was an initial attempt to set up a business as an internet service provider, but made this concession during the trial. The business employed staff to carry out programming and administrative duties, but the main focus of the activities of the business in the 1998 financial year was to obtain investors.

The Businessmen were referred to the firm of McKessar Tieleman in February 1998 to try to obtain tax effective financing, as the usual commercial sources of financing were not available to them. The method of investment that was used was to sell "franchises", under which an investor entered into an agreement to pay a management fee to the Businessmen. The advice was provided by Walter Tieleman, a partner, and Sean Pearce, who at the time was a manager in the firm (collectively, "the Tax Advisers"). Stephen Wharton was subsequently approached to assist in providing finance for the venture.

Evidence later given to a Senate Committee and to the Supreme Court of Western Australia indicates that the marketing of the franchise was aggressive. Sales representatives acting for the Businessmen were given clear instructions to focus their attentions on people earning more than $40,000 per annum, and the taxation advantages of the arrangement were emphasised. About 1160 franchises were sold, allegedly putting the revenue at risk to the extent of about $20 million. Of this, about $14 million would flow to the promoters, of which $6 million would be available to the Businessmen.[8]

[8] This summary of the financial impact of the arrangements is taken from *Wahby v The Queen* [2004] WASCA 308 (Unreported, Malcolm CJ, Templeman and Simmonds JJ, 5 November 2004) ("*Wahby*"). Note that in that case the court

The arrangements were reported to the ATO by a disgruntled salesman, with the result that the ATO commenced audit activity in late 1998. This salesman, who had a financial interest in the arrangements, was listed as a witness in the case, but was not called to give evidence. Most deductions were disallowed before assessment, although some refunds (about $1.5 million) were paid. The Australian Crime Commission, DPP and ATO set up a joint investigation which resulted in charges of conspiracy being laid against the five people who were involved in the arrangements: Aistrope, Wahby, Pearce, Tieleman and Wharton. Aistrope and Wahby, who had left Australia during the investigation, returned and cooperated with the prosecution, and received reduced sentences.[9]

The financing arrangements reflected several elements that the Commissioner identified in 1998 as being hallmarks of tax avoidance schemes that would attract the attention of the ATO.[10] In particular, the financing involved a variation on limited recourse loan arrangements, and the marketing strategies aggressively targeted high income earners.

The key to attracting investors in the business was the tax driven financing that was being offered as part of the arrangement. The financing was by way of a loan agreement, arranged through Allied Securities Pty Ltd ("Allied"), a company associated with Wharton, although the company was established to appear to be at arm's length from Wharton. The investors were encouraged to enter into a contract before 30 June 1998, making an initial outlay of $675. An income tax deduction was claimed in relation to the investment in that financial year, resulting in an income tax deduction of $39 500,

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referred to "rebates". However, the relevant claims were for deductions and not for rebates as understood in the ITAA.

[9] The sentences on Wahby and Aistrope were further reduced on appeal. See *Wahby* [2004] WASCA 308 (Unreported, Malcolm CJ, Templeman and Simmonds JJ, 5 November 2004).

[10] Michael Carmody, "'Taxing Times' or 'Beware the Magic Pudding'" (Paper presented at the Australian Society of Certified Practising Accountants Accounting at the TOP 98 Conference, Darwin, 12 June 1998).

of which $29 500 was subject to the financing arrangement. The resulting refund was then used by the investor to fund a further payment of $10 000 in relation to the franchise, which was forwarded directly to Servcom, not to Allied. A further annual payment of $150 was payable by the investor to limit the liability for repayment of the loan.

Apart from the payment by investors to limit liability to repay the loan, there were two other key features of the arrangement that the prosecution regarded as non-commercial and indicators that the arrangement was never intended to be acted upon. The loan was effected by a "round robin" of funds, which were never truly available to Servcom, and this was to be managed through a draw down facility referred to by the Tax Advisers as a "securitised loan". Although the funds that were subject to the loan agreement with each investor were theoretically allocated to Servcom, they were only to be released to Servcom as each investor paid the instalment of $10 000 that was due on receipt of their income tax refund. It was anticipated that Servcom would raise some $40–50 million in this way.

According to the prospectus for the scheme, the source of funds to repay the loans to investors was to be from the expected profitable operation of the scheme, in which a portion of the income derived by each franchisee was to be applied in reduction of the loan owed to the company associated with Wharton. The evidence was that Wharton and the promoters intended to share this repayment as well, because there had been no funds originally provided by Wharton. In fact, none of the round robin payments ever went to Servcom or passed to its control: the Servcom Clearing Account (the account into which the payments were made) was an account owned and operated by Wharton.

2.2 Relevant Legislation

The charges were laid under ss 29D and 86(1) of the *Crimes Act 1914* (Cth), as they stood at the time. Although the legislation has

been amended since the offence with which the Tax Advisers were charged in this case, the former legislation continues to apply to offences committed before 24 May 2001, and there is no time limit on the institution of a prosecution.

2.3 The Issues

In his Honour's summation to the jury in *R v Pearce*, McKechnie J identified the following elements of law that need to be considered in determining whether a charge of conspiracy is proved:

- the conspirator must have entered into an agreement with other persons with the intention of committing an offence;
- an overt act must have been undertaken in accordance with that agreement;
- the conspirator and the other persons must have a common intention to defraud;
- a conspiracy to defraud arises where two or more persons agree to intentionally use dishonest means to prejudice another person's economic right or interest; and
- dishonesty is involved at two levels: firstly there must be an agreement to use dishonest means, and secondly the action is dishonest by ordinary standards.

The jury was instructed that they must first consider whether a conspiracy existed, and secondly whether each accused was a party to the conspiracy.

3. ELEMENTS OF CONSPIRACY TO DEFRAUD

3.1 *Peters v The Queen*

The case of *Peters v The Queen*[11] provides a convenient starting point. It is one of the leading cases in relation to conspiracy to defraud, and again involved a lawyer being charged with fraud

[11] *Peters v The Queen* (1998) 192 CLR 493 ("*Peters*").

against the revenue as a result of tax evasion by a client. In that case, the matter did not involve marketing a scheme, but once again it revolved around fictitious loan arrangements.

In *Peters*, the defendant was instructed to undertake some conveyancing work for a client. The client had obtained funds through drug trafficking, and needed to disguise the source of the funds. While unaware of the source of the funds, the defendant was aware of the need to keep the source secret and constructed a series of financial transactions, including fictitious mortgages, to disguise the source of the funds. Therefore, real funds were involved in the transaction; it was the source of the funds that was fictitious.

A number of the issues raised in *Peters* are relevant to the *Pearce* case.

3.2 Was There a Fraud?

The first issue to be determined in *Pearce* was whether there was a fraud. Because the question of the deductibility of the franchise fees under the ITAA was never formally decided by a court, the court in *Pearce* needed to determine the question of whether the arrangements in fact amounted to a fraud for the purposes of the *Crimes Act 1914* (Cth), and whether there is any relationship between the ITAA and the *Crimes Act* in this context.

There was little discussion of the taxation legislation by the trial judge in his Honour's summing up. The jury was instructed that they did not need to decide whether the claims would be allowable as a tax deduction, or whether a scheme existed

> but whether there was a real risk that the economic interests of the Commonwealth were prejudiced by false statements designed to obscure aspects under section 177 or section 8-1.[12]

[12] Transcript of summing up to the jury in *R v Pearce* (Unreported, Supreme Court of Western Australia, McKechnie J, 1 July 2004).

It would seem, therefore, that one of the key issues that needed to be determined was whether the revenue was put at risk as a result of the arrangements in question. This issue was not explored in detail in the summing up by the trial judge. The lack of reference to the taxation issues involved was included as one of the grounds of appeal against the original decision, on the basis that the jury needed this information to be able to understand whether a fraud had in fact occurred. The Court of Appeal, however, found that an understanding of the underlying tax legislation was not necessary to determine whether a fraud had occurred.

Following the trial decision, the ATO and some media commentators have taken the view that the Servcom arrangement was clearly a tax scheme:

> Whether a scheme is legitimate, and at what point a scheme crosses the invisible line from avoidance to evasion, depends on the facts and circumstances of each case. The Servcom case, the one that Pearce, Tieleman and Wharton were involved in peddling, appears to have crossed that line convincingly, and 787 investors are worse off as a result.[13]

The arrangement certainly seems to carry the hallmarks of a scheme. Although there was a legitimate business, and the contracts that the investors entered into appeared to have legal effect as between the company and the investors,[14] the use of the payment to limit liability and the lack of real funds to back the increased capital suggest that there was no expectation that the investors would contribute the full amount of the contracted payments. The purpose of the extensive operation by the combined efforts of the DPP, AFP and ATO, which included raids on the premises of the parties, was

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[13] A Fabro, "Advisors Jailed As Warning", *The Australian Financial Review* (Sydney), 16 July 2004. See also R Gottliebsen, "Non-Recourse Tax Dodges Finally Run Out of Rope", *The Australian* (Sydney), 17 July 2004.

[14] Note that in the hearings of the Senate Economics References Committee there were suggestions that Servcom engaged debt collectors to collect the amounts due by investors.

clearly to obtain evidence as to how the transactions worked, and whether they did have economic substance.

The Commissioner is clearly of the opinion that such schemes are ineffective for tax purposes. Apart from the "Magic Pudding" speech,[15] various "Taxpayer Alerts" and tax determinations have been issued to address arrangements where tax effective financing arrangements have been entered into. For example, *Taxation Determination* TD 2002/23 was issued on 18 September 2002, four years after the claims were made, and was entitled: "Income Tax: Is a Taxpayer Entitled To an Income Tax Deduction For Any Part of the Marketing Fee Paid In Respect of the Internet Marketing Expenses Scheme Described In Taxpayer Alert 2002/1?". The taxpayer alert that is mentioned in TD 2002/23 appears to substantially address the Servcom type of arrangement.[16] In TD 2002/23, the ATO indicates that it believes that no deduction is available to investors on the following grounds:

- the arrangement is a sham, with the absence of an intention to create a legal relationship;
- no deduction is allowable under the general deduction provisions of the ITAA because the taxpayer is not carrying on a business, and there is no likelihood of earning income from the investment; and
- the general anti-avoidance provisions of Pt IVA of the ITAA would apply, as the scheme was entered into for the purpose of obtaining a tax benefit.

Clearly the final determination of whether a scheme is tax effective or not is the responsibility of the courts, and cannot be

[15] Carmody, above n 10.

[16] There are differences between the arrangement described in the alert and the Servcom structure, particularly the use of an offshore haven and a guaranteed return on the investment. The investors in the scheme addressed in the determination took out insurance against the risk of having to repay the loan, an arrangement that was comparable to the Servcom loan agreement.

made without full details of the arrangement that has been entered into.

However, it is worth noting that, in spite of the views stated in the determination:

- the existence of an arrangement that amounts to a sham is notoriously difficult to prove in Australian courts, and in fact was not relied upon in *R v Pearce*;
- the transaction was clearly set up as a franchise to gain the tax treatment available for deductions claimable under the second limb of s 8-1, rather than under the requirement of the first limb to be earning assessable income; and
- Part IVA cases are particularly difficult to predict, to the extent that when giving advice on tax structuring arrangements, advisers may qualify their opinion in relation to Pt IVA, noting that the Commissioner or the courts may take a different view.

The defendants in *R v Pearce* obtained an opinion from a Queen's Counsel, and this opinion was incorporated in the material distributed to franchisees. When summing up, McKechnie J indicated that the prosecution contended that the conspiracy to defraud included fraudulently obtaining an opinion from a Queen's Counsel (who was not charged as a conspirator) by withholding relevant information when seeking the opinion. However, this then raises the question as to whether all of the conspirators had access to the information as to how the financing was secured. While the trial judge indicated that it had not been proven beyond a reasonable doubt that Pearce and Tieleman knew that the funds did not exist,[17] the jury apparently believed that Pearce and Tieleman did have a sufficient understanding of the arrangements between the investors, the lender and Servcom.

[17] Transcript of summing up to the jury in *R v Pearce* (Unreported, Supreme Court of Western Australia, McKechnie J, 1 July 2004).

The Court of Criminal Appeal reviewed the question of whether the arrangements needed to be determined to be a scheme within the meaning of the taxation law in order to constitute a fraud. Chief Justice Malcolm found that this question did not need to be resolved in order for a fraud to exist:

> In my opinion, the Crown case was not dependent upon proof that the ATO would necessarily have disallowed the claims by application of s 8-1 or Pt IVA of the Act. What was required was proof that the conspirators agreed to present the public face of the scheme while concealing the private face of the scheme so that neither the franchisees, nor the ATO, would have knowledge of the facts which the appellants knew would be relevant to a proper and fully informed consideration of s 8-1 and/or Pt IVA and that there was a real risk that the ATO, representing the Commonwealth, would have been deprived of a proper opportunity to protect the national revenue by acting promptly to stop payment of refunds, to disallow the claims and to take timely recovery action in respect of refunds previously paid.[18]

Justice Steytler also addressed this issue, saying:

> the Crown case was not that s 177D, read together with s 177F(1), would have seen the claimed deductions disallowed. Rather, it was merely that the conspirators had intended to obtain an advantage for themselves by putting the Commonwealth's property at risk or by depriving it of the opportunity to protect its property. In those circumstances, it was unnecessary for the trial judge to do more than to refer, in general terms, to those provisions of Pt IVA which were of potential application. That is what he did.[19]

This then raises the question: if the claim may in fact be allowable at law, and this has not been conclusively determined by the court, can the actions of the Tax Advisers be considered to be "dishonest"?

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[18] *Pearce* (2005) 216 ALR 690, 726.
[19] Ibid 758.

3.3 Assessing Dishonesty

The question of whether a person needs to be acting dishonestly to be guilty of fraud, and how dishonesty is determined, was discussed extensively in *Peters*. Prior to *Peters*, the test was that set out in *R v Ghosh*,[20] namely, whether the acts in question were dishonest according to current standards of ordinary decent people and, if so, whether the accused must have realised that they were dishonest by those standards.[21]

In *Peters*, Toohey and Gaudron JJ discussed the criteria for dishonesty:

> As in other contexts, the question whether the agreed means are dishonest is, at least in the first instance, a question of knowledge, belief or intent and, clearly, that is a question of fact for the jury. On the other hand, the question whether, given some particular knowledge, belief or intent, those means are dishonest is simply a question of characterisation. And as in other contexts, the question whether an act done with some particular knowledge, belief or intent is properly characterised as dishonest is usually not in issue. Thus, putting to one side the exceptional case where it is in issue, it is sufficient for a trial judge simply to instruct the jury that they must be satisfied beyond reasonable doubt as to the knowledge, belief or intent alleged by the prosecution before they can convict. Alternatively, the trial judge may instruct the jury that, if satisfied as to the knowledge, belief or intent alleged, the means in question are properly characterised as dishonest and they should so find.[22]

Further:

> As already explained, "dishonesty" does not appear in the statute establishing the offence of conspiracy to defraud the Commonwealth. But when properly analysed, the offence of conspiracy to defraud involves dishonesty at two levels. First, it involves an agreement to use dishonest means. Ordinarily, the means

[20] [1982] QB 1053.
[21] Ibid 1064.
[22] *Peters* (1998) 192 CLR 493, 508.

> will be dishonest if they assert as true something which is false and which is known to be false or not believed to be true or if they are means which the conspirators know they have no right to use or do not believe that they have any right to use the means in question. And quite apart from the use of dishonest means, the offence involves an agreement to bring about a situation prejudicing or imperilling existing legal rights or interests of others. That, too, is dishonest by ordinary standards. If those matters are properly explained to a jury, further direction that the accused must have acted dishonestly is superfluous. Conversely, if those matters are not properly explained, a direction that the jury must be satisfied that the conspirators were dishonest is unlikely to cure the defect.[23]

The instruction to the jury in *R v Pearce* was based on the above passage.

The prosecution argued that the Tax Advisers asserted as true something that they knew to be false. The assertion was made to the Queen's Counsel who provided the opinion, to the investors and through them to the ATO, and that this was dishonest. Again, the jury was required to make a decision based on the evidence and clearly determined that the Tax Advisers did know that the assertions were false.

3.4 The Façade

The Court of Criminal Appeal determined that the dishonesty arose from the creation of a façade, under which the apparent validity of the transaction did not reflect the true facts, as known by the appellants.

The appellants argued that the intention of the arrangement was to ensure that it was effective at law, and therefore that there was no intention to deceive the Commissioner by falsely claiming deductions.

The Crown case was built around several assertions:

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[23] Ibid 509–510.

- the brief prepared for senior counsel by the Tax Advisers included a number of false assertions;
- a fax sent to the ATO by the Tax Advisers on 3 September included a number of inaccurate and false statements; and
- the Tax Advisers kept the franchisee taxpayers, who were claiming the tax deductions, ignorant of key facts so that they were not in a position to provide full details to the ATO.

In deciding that there was a deception, the Court of Criminal Appeal focused on the fact that the information that was made available to the franchisees represented, at least by implication, that the funds that were paid in respect of each franchise would be fully expended in relation to the business of the franchise within a 13 month period. However the appellants, who were aware of the financial arrangements underlying the structure, were aware that only $10 393 in respect of each franchise costing $38 000 would be available to the business.[24] As Malcolm CJ observed:

> In the present case, it was clear from the material provided to prospective franchisees that it was intended to represent to them that the $39,500 would be received by the franchisor and that of that amount, $38,000 would be expended in the provision of the services to be provided in the period of 13 months after the expenditure had been incurred. It was also clear that the representations made were both false and intended to cause the franchisees to claim the $38,000 as deductible expenditure against their income in the year ended 30 June 1998. As a matter of fact, to the knowledge of the appellants, while the loan agreements themselves were not shams, there was not to be any genuine transfer of funds, but only a "round-robin" calculated only to provide an artificial basis for the participants to claim a deduction in the amount of $38,000. This was intended by the appellants to enable each franchisee to fund the amount invested from the taxation refund which was obtained from the ATO.
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> It was the intention of the appellants that, if the claimed deductions were not allowed by the ATO, the franchisees would innocently use

[24] See *Pearce* (2005) 216 ALR 690, 713–714.

> the false information provided to them by the appellants to contest the disallowance of the deductions claimed.
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> In this context, the element of dishonesty relied upon by the Crown was that the information provided to the prospective investors was calculated, not only to deceive them into making the investment, but also to cause them to mislead the ATO. In my opinion, this was entirely consistent with the particulars provided by the Crown to the effect that the conspirators, including each of the appellants, agreed that the prospective franchisees were to be given false or misleading information about the scheme. This false or misleading information was calculated to defraud the Commonwealth of taxation revenue to which it was otherwise entitled. The particulars also made it clear that the Crown also alleged that the conspirators agreed to provide the franchisees with false or misleading information both:
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> > to sell the scheme (by convincing them and their advisors that the scheme was lawful and effective); and
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> > to equip and induce the … franchisees to maintain the deception in the face of scrutiny from the ATO.[25]

The Court found that there was a public face to the scheme, designed to convey the appearance that the deductions were allowable when in fact the appellants were aware that this was a façade designed to hide the private face of the scheme. As long as the prosecution was able to show that the appellants conspired to present the public face, while concealing the private face, then there had been a deception.

This has potentially serious ramifications for the way in which tax effective advice is prepared and presented to clients. The extent of the involvement of the accountants in the scheme was measured, to some extent, by the advice that was given. The accountants argued as a defence that they were not part of a conspiracy, as they were giving advice to ensure that the arrangements did give rise to a legal

[25] Ibid 722.

entitlement to a tax deduction. However, this was seen as part of the establishment of the façade:

> Amongst the many documents tendered at the trial were a number of documents authored by one or other of Pearce and Tieleman which made plain their knowledge of the "private face" of the scheme. One example of these is a facsimile transmission sent by Pearce to Aistrope and Wahby on 6 April 1998. In that document Pearce said the following:
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> > We should consider the gearing ratio in terms of the level of services to be provided and the available cash paid to the manager, ie if 500 [franchises are] sold services of $17.35 million will be provided in the first 13 months (@ $34,700 each) but only $5 million in cash will be received. Will this be enough cash to perform this level of services?[26]

The advice that was provided, to the extent that it considered how the transaction could be structured to appear to be on a commercial basis, was seen as evidence that the true nature of the transaction was, in fact, non-commercial:

> It is consequently plain that each of Wharton, Pearce and Tieleman was concerned that, if the private face of the scheme was to become known to the Tax Office, there was, at the very least, a realistic prospect of challenge to the claimed deductions. Notwithstanding this, none of them made known to the franchisees the true facts concerning the unavailability of the loan funds to the franchisor for the purpose of meeting its obligations under the franchise agreements.[27]

One of the factors that is relevant when considering whether Pt IVA applies is the extent to which an arrangement can be explained as a commercial arrangement. Often this has been a key point that advisers have addressed when ensuring that an arrangement is tax effective. It has been a generally accepted principle that if there are two methods of constructing an

[26] Ibid 743–744 (per Steytler J).
[27] Ibid 745 (per Steytler J).

arrangement, with different tax consequences, then the taxpayer is entitled to choose the form that the transaction should take. The adviser may well be asked by the client to recommend which alternative is appropriate. However it appears from an analysis of *Pearce* that there is a distinction between advising which alternative is appropriate, and reconstructing an arrangement to fall into what appears to be an acceptable arrangement.

The *ATO Compliance Report 2005–06* indicates that the ATO does not regard commerciality as conclusive in determining whether a scheme exists:

> Some arrangements that do have an ultimate commercial or economic objective are still classified as aggressive tax planning schemes if they are structured or carried out in such a way as to undermine the policy intent of the law. This will usually be evident if there are contrived steps in the scheme that can be explained only on the basis of the tax benefits people expect from them.[28]

While this is clearly the case as Pt IVA is currently understood following the High Court decision in *FC of T v Hart*,[29] the advice that led to this prosecution was given in 1998. The interpretation of Pt IVA has evolved significantly since the advice was given. The construction of a commercial reason for the arrangement may not have been seen in the same light six years ago.

3.5 Does the Fraud Have To Be Successful?

Conspiracy involves an intention to defraud, or to economically prejudice a third party. In taxation matters the ATO will frequently have recovered the revenue that was the subject of the tax evasion, through exercising the powers of amendment under the ITAA. In fact, the imposition of penalties could result in an economic gain to the Commonwealth. Therefore, the question must be asked: does the revenue have to be defrauded for the offence to be committed?

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[28] *ATO Compliance Report 2005–06* (2005) 83.
[29] (2004) 217 CLR 216.

The answer to this question is clearly no. In *Peters*, as in *Pearce*, there was no revenue lost as the Commissioner had issued an amended assessment on discovering the tax evasion. Although taxation revenue was imperilled or put at risk the ATO managed to avoid actual loss as the scheme was discovered early enough to deny deductions at the point of assessment, or to amend assessments that had issued allowing the deduction with a consequent recovery of the revenue that would have otherwise been lost, plus penalties and interest. The leading judgement in *Peters* is that of Toohey and Gaudron JJ, who said:

> The first matter which should be mentioned is that, contrary to what was said by Lord Diplock in *R v Scott*, the offence of conspiracy to defraud is not limited to an agreement involving an intention to cause economic loss, even where the intended victim is a private person. It has always been sufficient that the accused be aware that there is a risk of economic loss.[30] And even where the victim is a private person, there may be cases of fraud which do not involve an intention to put another person's economic interests at risk in any ordinary sense of that term.[31]

It is worth noting at this point that the conspiracy provisions of the *Crimes Act 1914* (Cth) were substantially amended in 1995. *Peters* was heard under the provisions as they stood before the amendments, while the law that applied in *Pearce* was the law following the 1995 amendments. The 1995 amendments clearly contemplate that actual loss may not result from the fraud as s 86(4)(a) provides that a person may be found guilty of a conspiracy to commit an offence even if committing the offence proves to be impossible, as long as the other elements of conspiracy are proven.

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[30] See *Archbold Criminal Pleading, Evidence and Practice* (1996) vol 2, para 17-92. See also *Welham v Director of Public Prosecutions* (1960) 44 Cr App R 124, 131; *R v Théroux* (1993) 79 CCC (3d) 449, 459–461 (per McLachlin J); *Zlatic v The Queen* (1993) 79 CCC (3d) 466, 476 (per McLachlin J).

[31] *Peters* (1998) 192 CLR 493, 507.

In *Pearce*, the action of the ATO to disallow the majority of claims before assessment limited the Commonwealth's exposure to the fraud. The claims that had been allowed before assessment (which totalled approximately $1.5 million) were promptly identified, and the relevant assessments were amended to disallow the claims.

The Court of Criminal Appeal clearly stated that the fact that the arrangement was unsuccessful did not mean that a conspiracy to defraud had not occurred, and this was the reason that it was not considered to be material that the case had not been formally considered by a court and determined to be a scheme for the avoidance of taxation. This is a slightly different issue as to whether a non-existent economic right or interest can be prejudiced. A fraud may be unsuccessful as there has been no loss of revenue. However, in this case there was a fundamental issue as to whether the deductions were properly allowable.

The Court held that as it was sufficient to show that there was the prospect of financial loss, the ATO merely needed to show that the conspirators withheld information the knowledge of which was necessary in order to determine whether Pt IVA could apply. It would, therefore, be a defence to show that there was no basis (including the potential application of Pt IVA) to disallow the deduction, and that there was therefore no prospect of loss.

As stated by Malcolm CJ:

> There was a real question whether the franchisee investors would be in fact or law carrying on a business for the purpose of producing assessable income within the meaning of s 8-1 of the Act and whether the appellants and the other alleged conspirators who were involved in the scheme, and the franchisees who participated in it, did so for the dominant purpose of enabling them to obtain tax benefits from the implementation of the scheme. If this was the case, it was likely that the ATO would invoke ss 177D and 177E of the Act, particularly in the context in which deductions were also intended to be claimed in respect of agents' commissions and the fees and commissions payable to the appellants were also to be

deducted from the limited funds in fact available. In this context, it was sufficient to make out the Crown case that the claims for the relevant deductions might have been allowed: see *Wills v Petroulias*, above, per Spigelman CJ (with whom Handley and Santow JJA agreed). In my opinion, it would be enough to prove that the conspirators were aware that they were exposing the Commonwealth to a risk of economic loss: *Peters v R*, above, at [25]–[26] per Toohey and Gaudron JJ; and at [84] per McHugh J; and *Spies v R*, above, at [77]–[81] per Gaudron, McHugh, Gummow and Hayne JJ.

I have set out earlier in these reasons the various authorities relied upon by the appellants for their contentions regarding the deductibility of the relevant sums claimed by the taxpayers. The fact remains, however, that the claims made by the franchisees might have been disallowed, or if initially allowed, the deductions subsequently disallowed or cancelled by the ATO under the provisions of Pt IVA of the Act, given the reality that only very limited funds would be available to the franchisor for the purpose of meeting its contractual obligations to the franchisees pursuant to the various franchise agreements.

In my opinion, on the evidence before the court at the trial, there were real and substantial questions whether the franchisor and the investors in the scheme were in fact engaged in carrying on a business for the purpose of gaining assessable income, or whether the reality was whether the conspirators, including the appellants, developed and implemented the scheme and/or the taxpayers who participated in it did so for the dominant purpose of enabling the taxpayer franchisees to alter the incidents of income tax or obtain tax benefits by the implementation of the scheme or participation in it.

Further, in my opinion, the Crown case and the evidence was such that the only inference which could properly be drawn in the light of all the evidence was that each of the elements of the charge of conspiracy had been proved beyond reasonable doubt. It follows from this conclusion that, had the true facts been known to the ATO or the Commissioner of Taxation, the deductibility of the claimed deductions would have been questioned or challenged by the

> Commissioner with the result that the deductibility of the relevant expenditure would also have been challenged.[32]

This raises a problem for tax advisers who wish to construct a tax effective arrangement. Is the Court saying that if there is the potential for Pt IVA to be applied, and the advisers are aware of this, then this requirement for conspiracy has been met?

The answer to this question would appear to lie in the other factors that must be present in order for a conspiracy to exist:

- there must also be a "deception"; and
- there must be an overt act by at least one of the parties.

The question therefore becomes whether the Tax Advisers engaged in deceptive conduct in the course of advising on the arrangement. Where the adviser's role is limited to advising on an arrangement, and the adviser is dealing only with the client, the adviser would not be a party to a deception. In *R v Pearce*, the jury found that the construction of the façade, which included preparation of the brief to senior counsel, and the responses to enquiries from the ATO, amounted to deception.

Given the role that tax professionals play in the preparation of documentation surrounding tax effective structures, there seems to be a fine line between advising on the arrangement, and deceptively constructing a façade. It appears that the core issue is the extent to which tax advisers also become entrepreneurs, with a vested interest in the outcome of the arrangements. If the advisers play an active role in constructing arrangements to meet a client's stated goals of tax minimisation, as opposed to advising on options that the client brings to the advisers, then the advisers will clearly be at risk. However, in practice, clients usually bring broad proposals to their advisers for assistance in constructing the detail. It would be helpful to have further guidance on this issue.

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[32] *Pearce* (2005) 216 ALR 690, 723.

3.6 The Defendant Must Be a Party To the Offence

Whether the defendant is a party to the conspiracy is a question that will be answered on the basis of the facts of each situation. In *Peters*, McHugh J quoted the following extract from *R v Gemmell*:[33]

> It is of the essence of a conspiratorial agreement that there must be not only an intention to agree but also a common design to commit some offence, that is, to put the design into effect. The need for the existence of these two elements, the mens rea and actus reus, as they are sometimes called, may be more difficult to distinguish in conspiracy than in other crimes.[34]

This raises a question where a person is providing advice to a client in a professional capacity: to what extent is the adviser liable if the client has requested advice on how to limit exposure to tax on a transaction?

Conventionally tax evasion, which involves fraud or sham transactions, is distinguished from tax minimisation which uses legal means to pay less tax. However, these lines can become blurred. The Commissioner's "Magic Pudding Speech" indicates clearly how the tax schemes that were being promoted in the 1990s were structured around genuine businesses, with a need for money to achieve a commercial goal.[35] However when raising capital, tax effective financial products were developed to encourage investment.

In *Peters*, the transactions were clearly sham transactions: ie the transactions were never intended to have legal effect. Transactions were entered into under false names, and a "mortgage" was set up with no money advanced under the mortgage. Peters was aware that the source of the funds needed to be kept secret from the Commissioner, and was apparently the architect of the arrangements

[33] (1985) 1 CRNZ 496.
[34] Ibid 500, cited in *Peters* (1998) 192 CLR 493, 518.
[35] Carmody, above n 10.

to rotate the funds through a related company to hide the source of the funds.[36]

Peters argued that although he was aware of the mechanics of the arrangements to minimise tax he was not a party to any agreement to conceal income as he was acting in his capacity as a solicitor, and acted as any other solicitor would have done in the circumstances. Kirby J notes:

> However, inherent in the conviction on the first count is the jury's conclusion that the Crown had proved that the appellant did know that the client and his accomplices were conspiring to defraud the Commissioner of Taxation and that that was the purpose of their sham transactions. There was an abundance of evidence to sustain that conclusion as a matter of fact, as was properly conceded for the appellant.[37]

Therefore, acting in a professional capacity does not provide a defence if the jury believes that the evidence shows that the adviser is aware that transactions are being undertaken for tax avoidance purposes.

In *R v Pearce*, the defendants again argued that they were acting in a purely professional capacity. The Tax Advisers were clearly involved in providing advice on the visible aspects of the scheme, and would have been aware that the liability of investors in relation to the loan was limited. However, the Tax Advisers claim that they were not aware that the transactions that were entered into were not intended to have legal effect. In particular, in relation to Tieleman, it was argued that his whole focus was to ensure that the structure was tax effective, which was inconsistent with an intention to deceive.[38] Based on the summary of the evidence included in the judge's summing up to the jury, it is clear that the round robin aspects of the

[36] *Peters* (1998) 192 CLR 493, 512.
[37] Ibid 537–538.
[38] *Pearce* (2005) 216 ALR 690, 708.

financing arrangements in Servcom were devised by Wharton, and that the Tax Advisers were not party to this aspect of the scheme.

Wharton, who was described by McKechnie J at sentencing as "a financial rogue", became a party to the arrangements to provide the financing arrangements. Pearce argued that the firm of McKessar Tieleman referred Aistrope and Wahby to Wharton merely as a professional referral.[39] Although there was correspondence between all of the parties, the financier was engaged by the clients and not by the Tax Advisers. It is clear that the Tax Advisers were involved in ensuring that the loans were structured in a manner to maximise tax deductions, but did they enquire into the source of the funds? Further, did they have a duty to enquire? Pearce argued that he understood that Wharton had the capacity to provide the finance required. In his Honour's summing up to the jury, McKechnie J said that Pearce and Tieleman must have been aware that Wharton's "provenance was shaky".[40] However, the Court of Criminal Appeal found that this was not substantiated by the evidence that showed no more than that "Pearce and Tieleman did little to satisfy themselves of Mr Wharton's true financial situation".[41]

Clearly the jury believed that the Tax Advisers must have been sufficiently aware of the details of the arrangement to be a party to the fraud. The grounds for the appeal against the convictions in *R v Pearce* included the question of whether the jury had enough evidence to conclude that the defendants were a party to any conspiracy.

The Court of Criminal Appeal held that it was open for the jury to conclude that the appellants were aware of the true facts, which were that the full amount that was to be claimed as a tax deduction

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[39] Ibid 709.
[40] Transcript of summing up to the jury in *R v Pearce* (Unreported, Supreme Court of Western Australia, McKechnie J, 1 July 2004).
[41] *Pearce* (2005) 216 ALR 690, 762 (per Steytler J).

would not be available for use in the Servcom business.[42] The decision of the Court of Appeal drew a distinction between the information that was within the knowledge of the Tax Advisers, and information that was kept from them by their co-conspirator, Wharton. While it was acknowledged by the trial judge, and by the Court of Appeal that Wharton did, to some extent, deceive the Tax Advisers, the core of the deception lay in the fact that the Tax Advisers knew that only a small proportion of the funds borrowed by investors would in fact be available to the venture, with the balance (as understood by the Tax Advisers) being held on a "securitised deposit" that was not available to the venture.

A factor that must be taken into account is that the Tax Advisers were to be remunerated partly on the basis of a proportion of the franchises sold, apparently giving them a financial interest in the successful marketing of the franchise.[43] Although the evidence showed that the Tax Advisers were not involved in the marketing arrangements, including the extent of the marketing and the instructions given to the employees, the remuneration arrangements (which gave the Tax Advisers a financial interest in the success of the arrangement) made possible a finding that the Tax Advisers were doing more than providing professional advice and were in fact entrepreneurs or parties to the arrangements.

Professional standards do in fact bar a tax adviser from being remunerated on the basis of the outcome of a relevant arrangement. The rules of the Institute of Chartered Accountants allow fees to be charged on a success, or commission basis, as long as this fact is made clear to a client.[44] However, this general rule is overridden by the specific provisions of APS 6, which state that:

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[42] Ibid 723 (per Malcolm CJ).
[43] Ibid 706.
[44] *Institute of Chartered Accountants Members' Handbook* (June 2005) G1 Fees (effective from March 1996).

> A member shall be remunerated in respect of his tax practice by way only of professional fees computed in accordance with Section F.6 (Professional Fees) of the Code of Professional Conduct, and, in no event, shall fees be charged on a percentage, contingency or similar basis.[45]

The form of the remuneration in *R v Pearce* suggests that the Tax Advisers had a financial interest in the outcome of the arrangements.

The nature of the fraud as argued by the Crown clearly impacted on the type and level of knowledge that was required by the appellants in assessing the extent of their participation in the conspiracy. The deception that amounted to fraud was determined to be the "façade" that was presented, which made it appear that the full amount of $38 000 per franchise would be available to Servcom when in fact only a fraction of that amount would be made available. The correspondence tabled in evidence that discussed this arrangement made it clear that whether or not Pearce and Tieleman were aware of the source of the funds, they were aware of the details of this arrangement. Therefore, the fact that they did not know that Wharton did not have access to the necessary real funds to provide to the business did not mean that they were outside the conspiracy: even on the understanding that real money existed, they were aware that only a small proportion of the funds would ultimately be available for use in the business.

An interesting aspect of *R v Pearce* is the prosecution of a manager in the relevant firm, as well as that of a partner. Although employment law will frequently provide some measure of protection to an employee who is acting under instructions, a person who is employed in a professional capacity is expected to exercise his or her professional judgement. A person who is charged with an offence such as conspiracy would be seen to be acting in a professional capacity to the extent of that person's involvement in constructing

[45] *Institute of Chartered Accountants Members' Handbook* (June 2005) APS 6: Statement of Taxation Standards, para 29 (effective from June 1982).

the arrangements in question. As such, the liability would be a personal liability. It was argued on behalf of Pearce that any benefit of the arrangement went to the firm, and not to him as he did not at the relevant time receive any proportion of the commissions that the firm would receive from the marketing of the scheme. However, the prosecution made out its case that the employee was so intimately involved in setting up the arrangements that he was a party to the conspiracy, even though no benefit flowed directly to him.

3.7 Sentencing

One reason that *R v Pearce* generated such a feeling of unease within the tax community was the level of the sentences that were imposed on the conspirators, particularly the Tax Advisers:

- Pearce, Tieleman and Wharton were found guilty at trial and were sentenced to five years imprisonment each, with minimum terms of eighteen months.
- Aistrope and Wahby pleaded guilty and were sentenced to four years imprisonment each, with minimum terms of eighteen months. Aistrope's sentence was reduced by a year (to three years) due to personal factors. The minimum term for Aistrope and Wahby was reduced on appeal by four months.[46]

It was accepted by the sentencing judge that the maximum term for the offence of conspiracy was ten years at the relevant time. The perceived severity of the offence can be seen from the level of the sentence imposed.

The sentencing judge clearly accepted that Wharton was the architect of the scheme, describing him as a "financial rogue". The sentence imposed on Wharton was the equivalent of the sentence

[46] *Wahby* [2004] WASCA 308 (Unreported, Malcolm CJ, Templeman and Simmonds JJ, 5 November 2004).

imposed on the Tax Advisers because of the personal factors involved.

On appeal, the sentences were confirmed. In view of the need for a general deterrent effect, and the scale of the fraud, the length of the sentences was seen as appropriate. In particular, Steytler J cited *Director of Public Prosecutions (Cth) v Goldberg*:[47]

> Offences such as this raise considerations of the kind mentioned in *Director of Public Prosecutions (Cth) v Goldberg* (2001) 184 ALR 387; [2001] VSCA 107 at [32]. There Vincent JA (with whom Winneke P and Batt JA were in agreement) referred, with apparent approval, to what had been said by the sentencing judge in that case, as follows:
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> > Tax evasion is not a game, or a victimless crime. It is a form of corruption and is, therefore, insidious. In the face of brazen tax evasion, honest citizens begin to doubt their own values and are tempted to do what they see others do with apparent impunity.[48]

Although the Court acknowledged that Pearce and Tieleman were deceived by Wharton, the similarity of the sentences was a consequence of the sentencing judge taking into account Wharton's different circumstances, and was within the parity principle.[49]

To place the sentences in *R v Pearce* in context, in *Peters* the defendant was sentenced to a term of imprisonment of eighteen months. In *Peters*, the potentially lost revenue was approximately $440 000 and was in relation to a single client. *R v Pearce* involved up to $20 million and several hundred clients. However, the transaction in *Peters* was clearly tax evasion while the arrangements in *R v Pearce* were more sophisticated, and arguably the deductions were allowable.

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[47] (2001) 184 ALR 387.
[48] *Pearce* (2005) 216 ALR 690, 763 (per Steytler J).
[49] Ibid (per Steytler J).

4. COMMUNITY ATTITUDES

It is clear that once again the tide of public opinion has turned against the promotion of mass marketed schemes. To place *R v Pearce* in context, it is useful to refer to the work of the Senate Economics References Committee,[50] the work of the Inspector General of Taxation[51] and various media reports over the past few years.[52] Clearly in the 1990s there was a resurgence in the marketing of mass marketed schemes, often targeted at taxpayers with high disposable incomes who were not particularly sophisticated financially (although frequently the taxpayers said that their advisers had also invested in the schemes). Such taxpayers are likely to accept the opinions provided by the promoters of the schemes.

The public awareness stemmed largely from the impact of self-assessment on the investors. Prior to the introduction of self-assessment, large or questionable claims for deductions were identified on lodgement of tax returns, and claims were disallowed promptly. Under the self-assessment regime, case of investment in questionable tax minimisation arrangements were often not identified until audit programs commenced, which might occur only after a lapse of several years. During this time the investor had received a refund, may have had to make further payments to the promoters and had lodged subsequent claims in relation to the scheme. When the claims were disallowed the taxpayers were required not only to repay the original refund for each year in question, but also the compounded general interest charge. As a consequence of the marketing methods used by the promoters, whole communities were

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[50] Senate Economics References Committee, Parliament of Australia, *Mass Marketed Tax Effective Schemes and Investor Protection* (2002).

[51] For example, *Review of the Remission of the General Interest Charge For Groups of Taxpayers In Dispute with the Tax Office* (2004).

[52] For example, ABC Television, "The Crackdown", *Four Corners*, 18 June 2001 <http://www.abc.net.au/4corners/archives/2001a_Monday18June2001.htm> at 31 May 2006.

affected.[53] The public backlash that resulted from the disallowance of the deductions from such schemes was instrumental in the development of the current system of Product Rulings available from the ATO.

Due to the publicity surrounding cases where taxpayers have been involved in mass marketed schemes, the public has become more aware of the dangers of investing in such schemes. This awareness is likely to have influenced the jury when reaching its verdict.

An awareness of the dangers of investing in mass marketed schemes certainly influenced the sentencing judge. His Honour is reported as having said while sentencing the Tax Advisers:

> conspiracies such as the one upon which you have been convicted are pernicious in many respects. First, they represent a substantial fraud upon the Australian government. Indirectly, they are a fraud on all law-abiding taxpayers as well. Your scheme played on the greed of those who participated as franchisees so that they could claim a substantial refund to which they were not entitled.
>
> The tax industry is a significant industry involving lawyers, accountants and persons like Wharton on the fringes. As has been submitted, many within the industry will have been shocked and surprised at your convictions. They, and indeed you, may have become complacent, regarding taxation strategies as some sort of intellectual game to be played between you and the ATO. No doubt many have thought that the only penalties to be incurred might be financial ones imposed if the Commissioner disallowed a particular scheme.
>
> This has not been a case about tax effective capital raising or about aggressive marketing of tax effective schemes, it is a case of fraud. However, as you have not realised, and this case will serve as a warning to others in the industry, when the honesty of schemes is under consideration, the question will be determined by ordinary

[53] Transcript of sentencing in *R v Pearce* (Unreported, Supreme Court of Western Australia, McKechnie J, 13 July 2004).

> men and women who daily perform their civil duties as members of juries. The questions will not be determined solely by standards which might be acceptable to tax accountants and lawyers.[54]

When discussing the issue of punishment, his Honour observed that:

> There is a need for punishment for the audacity and brazenness of this conspiracy, and there is a need also for general deterrence. Conspiracies are by their very nature hard to detect and investigations tend to be long and complex. I do not therefore accept that this was a stale prosecution, nor do I regard as relevant the fact that other schemes were not prosecuted. A warning must be sent to others in the industry and to promoters that fraud is not tolerated.[55]

It is interesting to compare the conviction by the jury in *R v Pearce* with the inability of the jury to reach a verdict in the latest *Petroulias* case. There has been public speculation about whether a jury is capable of achieving a safe verdict in matters that involve financially complex issues. While the comments of the sentencing judge in *R v Pearce* indicate that the standard of honesty that will be applied in fraud cases is the standard of ordinary men and women, there is some concern that ordinary men and women may be overwhelmed by such cases. It has been reported that:

> Later (in the proceedings), during jury selection, a number of people who feared they could not understand the case were excused including one man who told Justice Scully the tax system was "so convoluted and involved that most of the accountants out there don't know it all and to expect a normal member of the public to understand it is impossible."[56]

5. CONCLUSION: LESSONS FROM *PEARCE*

In identifying the key factors from *Pearce* that seem to be relevant in deciding whether a tax professional is a party to

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[54] Ibid.
[55] Ibid.
[56] F Buffini, "Try, Try Again: Petroulias Jury Discharged", *The Australian Financial Review* (Sydney), 17 August 2005.

promoting a scheme for the avoidance of taxation, and thus potentially a party to conspiracy to defraud the Commonwealth, the following stand out:

- The view of Pt IVA at the time of the facts in *Pearce* led to an adherence to process in designing the scheme. Although in *Pearce* each step in the arrangement could be explained, an analysis of the scheme as a whole showed a fatal lack of commerciality.
- The relevant arrangement does not have to be tested by the courts to ascertain whether it will be struck down under the relevant tax provisions. Conspiracy requires the court to determine that a deceit has occurred, and this deceit may arise from the conduct of the parties as much as from the intended outcome of the arrangement or arrangements in question.
- Arrangements between the manager and the financier in tax driven arrangements are not required to be disclosed in a prospectus or in an information memorandum. Tax advisers should consider the extent to which they should review, and disclose, these arrangements, and whether they carry any responsibility to ensure that real funds are available through the financier.
- The Tax Advisers were seen as being among the architects of the scheme in *Pearce*. The correspondence, and the language used in that correspondence, was used to show that they were not merely advising on arrangements that were being considered, but were assisting in constructing a scheme that would, on the face of it, have the desired outcome.
- The remuneration arrangements were ill-advised, as it gave the Tax Advisers a pecuniary interest in the success of the marketing of the scheme.

Finally, the comments of the trial judge at sentencing should be noted:

> when the honesty of schemes is under consideration, the question will be determined by ordinary men and women who daily perform their civil duties as members of juries. The questions will not be determined solely by standards which might be acceptable to tax accountants and lawyers.[57]

So if a professional crosses the line between tax planning and promoting tax evasion, what are the costs likely to be?

The risk of imprisonment is very real, with the consequent dislocation of family and personal life.

But in addition most professional indemnity policies do not cover tax advisers for claims made against them where Pt IVA has been applied, or where criminal charges are involved. In *Pearce*, both defendants were represented by senior counsel throughout an eight week trial. After including the cost of appeals, bail applications and other proceedings, the total cost would have been substantial.

Where a tax professional has been convicted of fraud, a question is raised as to whether he or she will ever be able to practice in the tax field again. There is a requirement under the ITAA that a registered tax agent must be a fit and proper person, which specifically excludes a person who has been convicted of a serious taxation offence.[58] A similar requirement applies in relation to membership of the major professional bodies. Even if not sentenced to imprisonment, this prevents the convicted person from exercising their profession as a principal.

The cost of conviction goes well beyond imprisonment, with the cost to the offender's reputation having a lasting impact on their private and professional life.

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[57] Transcript of sentencing in *R v Pearce* (Unreported, Supreme Court of Western Australia, McKechnie J, 13 July 2004).
[58] ITAA 1936 (Cth), s 251BC(1)(e).