

## **Executive summary**

A study of 235 High Wealth Individuals (HWIs) and the entities they control was undertaken on 1997 and 1998 tax returns. From this data, and using a list of 207 candidate issues, five red flags for overall risk of aggressive tax planning by HWIs were identified. These red flags indicated recurrent risks that can be predicted using different kinds of analyses of overall high risk. The red flag issues were:

- trust distributions (especially capital distributions in cash to the HWI);
- capital loss creation (especially through asset sales, but not revenue loss creation);
- use of an offshore entity in a country that may be a tax haven;
- utilisation of revenue losses via transfers within the group controlled by the HWI; and
- other risks that fall between the cracks of the main issues.

To some degree, these results are only of historical interest as some of the risks associated with these issues have been reduced by recent Australian corporate tax reforms. With the exception of the last red flag, it could be said that the red flags highlight fundamental issues rather than issues that are believed to be symptomatic of deeper problems – such as converting activities undertaken for private pleasure into tax deductions (for example pleasure craft, horse breeding and racing).

The surprisingly strong and robust predictive power of ‘other’ issues is not interpreted as an anomaly, but rather as suggesting an evolutionary ecology of aggressive tax planning. Tax planning strategies that everyone, particularly the Tax Office, knows about will not be the most lucrative. While there will be recurrent predation strategies, the best new strategies will

be those that are not crowded out by others who use a similar strategy. Minority strategies flourish. We caution therefore against the idea that we can settle in advance all risk categories for aggressive tax planning. We also highlight the importance of intuitive detective work to follow risks that fall between the cracks. This advice follows not only from the importance of the ‘other’ category, but also the result that the estimated ‘objective’ dollars at risk added little explanatory power to the ability to predict high risk above and beyond that provided by subjective risk ratings by Tax Office analysts.

It is also argued that it may be more important to consider dollars at risk for certain strategic issues that are not normally red flags for systemic risk, rather than to use the dollars at risk as red flags. For example, negative gearing is not a red flag itself, but exceptionally high levels of negative gearing might raise questions.