INSTITUTE OF
PUBLIC
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Improving the black economy enforcement and offences

December 2018

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our **'Improving the black economy enforcement and offences'** submission. We look forward to working with the Government in providing feedback on the range of enforcement measures proposed to deter those undertaking black economy activities and to level the playing field for taxpayers.

The IPA is one of the three professional accounting bodies in Australia, representing over 36,000 accountants, business advisers, academics and students throughout Australia and internationally. The IPA prides itself in not only representing the interests of accountants but also small business and their advisors.

We look forward to discussing in more detail the IPA's submission and its recommendations. Please address any further enquires to Tony Greco, General Manager Technical Policy via tony.greco@publicaccountants.org.au

21 December 2018

Black Economy Division
The Treasury
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PARKES ACT 2600

Via email: Blackeconomy@treasury.gov.au

Dear Sir/Madam

Improving black economy enforcement and offences

The IPA welcomes the opportunity to provide this submission in response to the "Improving black economy enforcement and offences" consultation paper (the consultation paper).

We are supportive of the endeavors of the Black Economy Taskforce to tackle the issues arising from black economy activities to level the playing field for taxpayers. In this regard, we welcome the Government's initiative to consider alternative forms of enforcement to act as a deterrent for those contemplating or undertaking such activities.

The consultation paper outlines a range of potential financial and non-financial enforcement measures. Amongst other things, these include:

- the granting of certain additional information and data gathering powers to the Commissioner of Taxation (the Commissioner)
- reversing the burden of proof for certain elements of black economy activity
- amendments to the taxation penalty regime to impose greater penalties on repeat offenders
- imposition of travel bans for those with outstanding tax debts
- potentially increasing civil penalties and lowering the "recklessness" test threshold for sham contracting arrangements under Fair Work legislation, and

- record keeping requirements for those in receipt of gambling winnings and gifts.

Executive summary

From our perspective, an overarching theme in the consultation paper was the call to grant additional powers of enforcement to the Commissioner. Specifically, these extended powers include the ability to obtain certain third-party information within a shorter timeframe for criminal investigations, the imposition of freezing orders on banks accounts for longer periods, and the ability to access certain telecommunications data.

We are concerned that the granting of these additional powers to the Commissioner could do more harm than good in how the Australian Taxation Office (ATO) is currently perceived by the community.

In the current environment, small businesses and individual taxpayers, whether rightly or wrongly, are sensitive to the wide-ranging powers of the ATO. These concerns follow reports of unfair influence being exerted. As such, there is a perception that the revenue authority has too much power which could be open to misuse without appropriate safeguards and oversight.

While it is unequivocal that unscrupulous members of the community be deterred from undertaking black economy activities, the granting of any further powers to the ATO without sound justification would only create distrust and reinforce the current community perceptions.

Therefore, to build community confidence in the tax system, the Government must ensure that there are safeguards, accountabilities and oversight in place for any new powers granted. Amongst other things, these safeguards may include:

- Imposing restrictions on when and how certain powers are to be applied;
- Regular reporting on the exercise of those powers and their outcomes to the Government and the community for transparency and to ensure relevance; and,

- Additional oversight from the offices of the Inspector-General of Taxation and the Australian National Audit Office.

It is hoped that such safeguards will go some way to allaying community concerns that the powers granted are not misused or abused.

Another concern proposed in the consultation paper is the reverse onus of proof for certain elements of black economy activity, where the onus is placed on a defendant to disprove certain elements of their offence (rather than the prosecutors as is ordinarily the case). Worryingly, such measures could adversely impact the rights of individuals and their liberties. We therefore strongly urge that the Government give due consideration to any proposal and that caution and restraint be exercised and take time in considering the possible ramifications. The ATO already have the ability to issue an amended income tax assessment whereby the onus is on the taxpayer to prove that the assessment is excessive, which acts as a default reverse onus of proof.

Our submission addresses in detail these and other select issues posed by the consultation paper at **Appendix 1**.

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We trust that you will find our submission of value. Please feel free to contact us directly should you require further clarification on any of the issues raised or other questions related to our submission.

Yours sincerely

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Appendix 1: Detailed discussion of proposed enforcement measures

1. Improving administrative penalties

The current administrative penalties under the taxation law imposes penalties between 25% to 75% of the shortfall, depending on the severity of the offence (ie ranging from whether there is a reasonably arguable position to there being a reckless or intentional disregard of the law).

The consultation paper cites that there are some circumstances where penalties imposed are disproportionate and unfair. An example given, was that the same level of penalty was imposed for someone who had provided five years of misleading statements vis-à-vis someone who had provided a misleading statement for only two years. The consultation paper also observed that repeat offenders were only subject to the maximum penalties available and as such, there is no benefit for them in engaging in good behavior.

It was therefore proposed that a third tier of penalties be introduced as a deterrent for repeat offenders. An example given was that an individual would be subject to double the amount of the shortfall penalty if they had had a penalty imposed in at least three of the preceding seven years (without any of those penalties being revoked or wholly remitted).

We are supportive of a further scale which seeks to impose penalties on repeat offenders provided that such a tiered system does not produce disproportionate or unfair outcomes. Some situations where the proposed model might do this are as follows:

Repeating the same error in prior years

It is not uncommon for there to be situations where the taxpayer has repeatedly applied the taxation laws incorrectly over a number of income years, such as an

individual or their tax agent unknowingly and incorrectly claiming a deduction over a consecutive number of years. In our view, it would be unfair and disproportionate to apply a tiered penalty system for repeat offenders who have committed the same error. We therefore consider that any future law account for these circumstances.

Interaction with amendment time limits

Consideration should also be given to how the proposed tiered penalty system would interact to the time limits currently available to amend tax assessments.

The standard period of review for amending tax returns is currently four years (or two years for certain "shorter period of review" (SPOR) taxpayers). That period however is indefinite if there is some form of fraud or evasion.

It would be necessary to evaluate how the proposed seven-year period interacts with imposition of penalties under a tiered system when the Commissioner is restricting to amending only a certain number of tax returns because he is out of time under the relevant period of reviews.

Consider the following example:

- Assume that an individual taxpayer has never been subject to any penalties for false and misleading statements in the last seven years
- If a condition for imposing higher penalties requires that penalties be imposed in at least three of the preceding seven years (as proposed) then:
    - if the individual is a SPOR taxpayer:
        - the individual can only be subject to penalties for the last two years if their return is amended by the Commissioner for a false and misleading statement, and
        - the individual would not be subject to the higher tier of penalties as it requires three years of penalties for them to be classed as a "repeat offender"
    - in contrast, if the individual is a non-SPOR taxpayer:

- the individual can only be subject to penalties for the last four years if their return is amended by the Commissioner for a false and misleading statement, and
- the higher tiered penalties would apply in this case.

We note that such anomaly would need to be addressed in any iteration of a tiered penalty system.

2. Reversing the onus of proof on serious elements of black economy activity

The consultation paper outlines that in some very serious offences the burden of proof is reversed to require the defendant to disprove certain elements of their offence. This presently applies for serious offences relating to terrorism, drugs and child sex offences.

Worryingly, the consultation paper proposes that the onus of proof in relation to certain elements of black economy activity should also be reversed. The paper cites that this is to improve the likelihood of success of prosecution, act as a deterrent and reduce the cost of enforcement. This is contrary to the common law position where a defendant to a proceeding is presumed innocent until proven guilty and the onus is on the prosecution to disprove any defenses put forth by the defendant.

While the paper indicated that these measures would be reserved for very serious black economy offences, it did not specify the nature of black economy offences that should be considered; instead seeking recommendations on appropriate offences.

Prima facie, we are not supportive of a reverse onus of proof for black economy activity. Our concerns rest with those who may be wrongly prosecuted for offences because they cannot disprove the relevant element under a reversal of proof. Further, we also do not necessarily believe that such a measure would act as a deterrent as those who seek to commit such serious activities would do so with a complete disregard of the law and their repercussions.

Given the adverse impacts that a reverse onus of proof has on an individual's rights and their liberties, we strongly urge the Government to exercise caution and restraint if they were to introduce such a measure for certain elements of black economy activity. This must not be rushed.

The ATO can and has on many occasions issued amended assessments to taxpayers who they believe are understating their income. It is up to the taxpayer to prove that the assessment is excessive so in effect the ATO already have powers to reverse the onus of proof. Amended assessments are quite common for businesses operating in the cash economy. We need to better understand the rationale for these proposed change and how it will be used for the most egregious taxpayer situations.

3. Review of penalties for sham contracting

In the small business community, there is often uncertainty with respect to whether contract for services rendered by individuals represent an employment or contractor relationship.

To maintain a competitive advantage, it is often misconstrued by small business that these arrangements could be "structured" as a contractor arrangement without giving due consideration to whether the activities instead constitute a common law employment arrangement.

These occurrences are often inadvertent and typically arise from misinformation without appropriate advice being obtained by the business from an accountant or adviser. For example, some businesses have wrongly misconstrued that requiring an individual to obtain an Australian Business Number (ABN) would be sufficient for that person to be classed as a contractor.

The ATO have made concerted efforts over the years to demystify the misinformation by publishing educational materials on its website and providing an online decision tool. Notwithstanding this, there are however, businesses that have knowingly and

deliberately chosen to treat all their service arrangements as sham contractor arrangements in order to avoid their tax and superannuation obligations.

As identified in the consultation paper, the Fair Work legislation currently contains provision which imposes civil penalties for those who knowingly or recklessly mispresent an employment arrangement as a contractor arrangement.

In this regard, the consultation paper raises the issues of whether it would be appropriate to impose higher civil penalties for such sham contracting arrangements under Fair Work legislation. The current penalties are 60 penalty units for an individual (i.e. $12,600) and 300 penalty units for a body corporate (i.e. $63,000). The consultation paper also considers whether the "recklessness" test contained in s357 of the *Fair Work Act 2009* should be lowered to a "reasonableness" test.

Increasing of civil penalties

As discussed above, the issues in deterring businesses from misrepresenting employment arrangements as contractor arrangements is not clear, given the complexities in classifying such arrangements.

In our view, merely increasing the financial penalties under Fair Work legislation for sham arrangements in itself would not act as a deterrence from such sham contractor activities. It would be necessary for the Government to evaluate the adequacy in relation to the current suite of penalties where a business fails to appropriately classify an employment arrangement as a contractor arrangement.

The taxation laws already impose administrative penalties where a business fails to comply with its employer obligations, such as PAYG withholding, fringe benefits tax and superannuation guarantee payments. As a case in point, where a business fails to meet their obligations, an administrative penalty is levied for making false and misleading statements, with penalties of 75% of the shortfall amount applying where there has been an intentional disregard of the law. General interest charges can also apply for late payments.

For superannuation guarantee obligations, a superannuation guarantee charge of up to 200% can also be applied for failure to lodge a superannuation guarantee statement. New laws, which at the time of writing are before the Senate, will allow the Commissioner to issue directions to employers who fail to comply with their superannuation guarantee obligations to make payment.[1] Financial penalties of up to 50 penalty units, 12 months' imprisonment or both, can be imposed where there is a failure to pay.

Lastly, apart from federal tax obligations, there are obligations under state laws in relation to payroll tax and workers' compensation legislation which must be complied with for those businesses with employees. These laws have their own penalties and charges for failing to comply.

Based on the foregoing, we consider that there are adequate financial penalties under a suite of laws for those businesses that choose to engage in sham contracting arrangements. When tallied, such financial penalties can be substantial for a business and in their own right act as a sufficient deterrent. The mere increasing of civil penalties under the *Fair Work Act* in respect of sham contractor arrangements may not achieve the desired effect.

We therefore consider that financial penalties alone are not sufficient and instead argue that there would be greater impact if the existing penalties are coupled with non-financial penalties. Additional penalties such as minimum terms of imprisonment, travel bans (as discussed below), deregistration from operating a business or being a company director, may better tackle these sham arrangements and act as a more forceful deterrent.

Lowering the "recklessness test" under the *Fair Work Act*

[1] Treasury Laws Amendment (2018 Measures No. 4) Bill 2018

By way of background, the *Fair Work Act* currently imposes civil penalties where, amongst other things, the employer knowingly or recklessly misrepresented an employment relationship as an independent contracting arrangement (s357).

The consultation paper discusses the possibility of lowering this "recklessness" test to a "reasonableness" test. The paper cites that the lowering of such a test is to remove the higher burden of proof in establishing that an employer was 'reckless' in misrepresenting a contractor arrangement. This is in light of many sham cases not making it to court and are instead settled between the parties.

While we are open to the current test being lowered to reduce the burden of proof so that such penalties could be properly imposed under the law, we urge the Government to consider whether there could be any unintended consequences from a lowering of the test.

As noted earlier, there are some businesses that enter into contractor arrangements for services rendered by individuals premised on misinformation and hearsay that such arrangements are legitimate. Given the difficulties in identifying whether an arrangement is an employment or contractor relationship for businesses, any lowering of the requirement under s357 of the *Fair Work Act* from a "recklessness" to "reasonableness" test must ensure that businesses that inadvertently misrepresent their service arrangements not be unfairly penalised.

We therefore urge the Government to consider the circumstances to which an inadvertent misclassification of a contractor arrangement might fall within the ambit of any proposed "reasonableness" test so as to avoid any unintended consequences.

4. Enhanced record keeping for gambling winnings

For income tax purposes, the generally accepted view is winnings from gambling winning and gifts are not assessed to the taxpayer as they are taken to be windfall gains. As such, there is no requirement for those amounts to be disclosed in the individual's income tax return.

The consultation paper proposes that records be kept for substantial gambling winnings and/or gifts. From our discussions with members from Treasury and the ATO, we understand that the objective for seeking such information, amongst other things, is for asset betterment testing purposes.

As such, an example given in the paper was that those who had winnings and gifts in excess of $50,000 could be required to provide evidence supporting amounts which exceed this threshold.

While we are open to further disclosure of gambling winning and gifts, we note that this should not be done at the expense of increasing compliance burden on the community. Providing the Commissioner with powers to request such documentation to substantiate these winning and gifts may be the better approach than requiring all taxpayers who have had significant windfalls to report or keep records. Having a dollar threshold for record keeping as suggested, may assist in alleviating the need for all individuals in receipt of winnings or gifts to retain records.

The Government should also evaluate whether there are other appropriate means of obtaining this data. For example, gambling and lottery winnings can be obtained from bookmakers, casinos and lottery agencies.

Of course, there would still be difficulties where funds are obtained from private or illegal sources or in respect of family dealings. For example, gifts from family members for love and affection can be difficult to prove unless there was some form of deed of gift or can otherwise be appropriately justified; for example, a contribution from parents to purchase a first home by their adult children. In that regard, it may be appropriate to provide a list of acceptable types of documentation to prove any forms of windfall gain.

5. Access to third party information and telecommunications data

The consultation paper notes that the Commissioner's current powers with respect to accessing third party data and telecommunications data in some cases are inadequate in dealing with black economy activities, particularly where it involves criminal activity.

The paper recommends that the powers of the Commissioner be extended to allow access to third party data, most notably data from financial institutions (ie banking records).

Notwithstanding the Commissioner's current powers to access information, the paper cites that third-party data takes longer to obtain where it is under the criminal code; requiring collaboration with the Australian Federal Police to obtain a search warrant which can take up to 12 weeks. The paper suggests that the timeframe be reduced to 28 days in line with notices under section 353-10 of Schedule 1 to the *Taxation Administration Act 1953* (TAA1953).

For telecommunication data, the paper indicates that certain historical telecommunications cannot be accessed by the ATO unless this forms part of a joint investigation with the AFP. Such data, according to the paper, includes subscriber details, call time and location details (ie triangulation). It was the Black Economy Taskforce which recommended that the ATO be provided with the ability to access such data in a timely manner rather than rely on the AFP.

Based on our discussions with members of Treasury and ATO, it was indicated that the basis for granting these additional powers to the Commissioner was to facilitate the timely access of third-party information and telecommunications data, particularly for criminal investigations, which in turn will remove the reliance of the ATO and resourcing on joint investigations with the AFP.

It is without doubt that black economy activity must be eradicated for the benefit of the community. However, the granting of any additional powers to the ATO comes at a time when the community holds, whether rightly or wrongly, a negative perception

of the ATO's extensive powers with reports of its unfair influence over taxpayers. Unfortunately, the granting of additional powers may well reinforce the current sensitivities of the community.

Notwithstanding this, we hold the view that if any additional powers be granted to the Commissioner, that certain safeguards, accountabilities and oversight be implemented to ensure that those powers are appropriately used. This to some extent, should allay the concerns of the community and provide some balance in protecting the rights of those who are the subject to review and investigation by the ATO.

To achieve this, we would expect the laws to be drafted in such a way which limits the circumstances to when and how they can be used. As a case in point, Division 370 of the TAA provides the Commissioner with remedial powers to modify the operation of the tax law but in very limited circumstances (where reasonable) and only as a provision of last resort.

Further, for those required to furnish information, there should be reasonable grounds to object or appeal such requests for information where it breaches other areas of the law (for example, legal professional privilege).

To provide some level of accountability, imposing requirements on the ATO to periodically report to Federal Parliament and the community on the extent and success of how these additional powers have been applied would provide transparency that the powers have not been misused and of their relevance. Further oversight from the offices of the Inspector-General of Taxation and the Australian National Audit Office could also provide further comfort to the community.

6. Travel bans for those who have outstanding tax debts

The consultation paper also sought views on whether there were other forms non-financial penalties which could be imposed which will act as a deterrence against black economy activity.

The paper outlines that one way of achieving compliance is to issue travel bans to those who have outstanding tax debts. Specifically, the paper refers to the model employed in the United States where 'delinquent' taxpayers (ie those not addressing their tax debts) who have significant tax debts outstanding of more than $51,000 USD (indexed) are revoked of their passport.

We are of the view the imposition of travel bans for 'delinquent' taxpayers with debts of a certain quantum warrants consideration in an Australian context.

Our observations in relation to how such a ban could apply include:

- As is the case with the United States, providing a non-discriminatory basis for revoking an individual's passport would ensure transparency and clarity. The issuing of any bans should not be at the discretion of the Commissioner as is currently the case with Departure Prohibition Orders (DPO).
- Consideration should be given to those taxpayers who are currently under a repayment plan and whether they should also be included in the ban, particularly if they are a flight risk.
- The interaction between how these travel bans would operate in conjunction with the Commissioner's issuing of a DPO should also be made clear. It is also worth considering whether DPOs would still be necessary in light of this measure.
- Having situations where a travel ban is not imposed on compassionate grounds; for example, an individual travelling overseas to visit a sick or dying family member.

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