



INSTITUTE OF
**PUBLIC
ACCOUNTANTS®**

**Investigation and
exploration of
undisputed tax
debts in Australia**

December 2019

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to offer our **'Investigation and exploration of undisputed tax debts in Australia'** submission. We look forward to working with the Inspector-General of Taxation and Taxation Ombudsman in providing our observations on the growing trend of uncollected tax debts in Australia.

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

6 December 2019

Inspector-General of Taxation and Taxation Ombudsman

GPO Box 551
SYDNEY NSW 2001

Via email: taxdebts@igt.gov.au

Dear Inspector-General of Taxation and Taxation Ombudsman (IGTO)

Investigation and exploration of undisputed tax debts in Australia

The IPA welcomes the opportunity to provide this submission in relation to the IGTO's investigation and exploration into undisputed and uncollected tax debt in Australia.

The IGTO has observed that there has been an increasing trend of uncollected tax debts over the last four income years (FY16 to FY19). Concerningly, it has also been observed that 63 per cent of uncollected tax debts in June 2018 relate to amounts owing by small business amounting to \$15 billion. The relevance to us is that our constituency provide services to small business owners, of which this cohort accounts for 96 per cent of businesses in Australia.

To assist the IGTO in this scoping study, our submission outlines our observations as to what we consider to be contributing factors to this escalating trend and some possible ways we believe it could be addressed.

Executive summary

In summary, we consider that the upward trend in uncollected and undisputed tax debts for small business in Australia has arisen due to a combination of factors, including but not limited to, the following:

- the current economic cycle in Australia

- the greater reliance placed by business owners on seeking payment plans from the Australian Taxation Office (ATO) in lieu of repaying the debt, and
- the lack of early engagement by new business owners with a qualified accountant or registered tax agent to understand and manage unexpected tax liabilities.

We further consider that aspects of the administration of the tax debt collection process by the ATO, particularly with respect to payment plans could be improved. The processes and procedures for the management of payment plans should be reviewed by the ATO to ensure that they do not cause an administrative burden to businesses.

These considerations are examined below.

The economic cycle and its impact on small business tax debts

It is not unreasonable to say that the last four income years have been challenging for Australian small business owners and the broader Australian economy. Inevitably, this has led to an increase in the amount of business debts owing.

Some of the economic drivers we believe to have contributed to the increase in uncollected tax debts for this period include:

- Businesses facing stiffer competition and disruption by new and innovative players; such as those who operate in the gig economy, who typically have lower cost models;
- The changing nature of work, which has meant that there are more individuals who are choosing to work as contractors rather than as employees. Some of these workers are trading under an Australian Business Number (ABN), whether legitimately or not.
- More recently, there has been a decrease in consumer sentiment which in turn has led to a tightening of profit margins and reduced cash flows for business owners. A corresponding impact has been an increase in a business' debtor

days, which has led to difficulties for some small business in meeting their short- and long-term debts (including tax and tax-related debts).

In our view, the tighter economic conditions could explain in part the growing trend in uncollected income tax and business activity tax debts by small business. To further understand this trend, it would be worthwhile investigating whether other business debts owing to third parties remain uncollected (including outstanding employee benefits) or whether such trends relate exclusively to tax debts. There may be some businesses in the community that take the view their tax debts are not 'legitimate' form of debt and so continue to ignore its repayment.

As to the increasing trend in superannuation guarantee charges, it would be reasonable to conclude that the tougher economic environment has led to the under or late payment of employee benefits. Further, we have recently witnessed the occurrence in certain industries where underpaying their employees is rife; the hospitality industry being a prime example. Such occurrences will only lead to an increase in the quantum of uncollected superannuation guarantee charges (see also discussion on the superannuation amnesty below).

Increased use of ATO payment plans

For those small businesses encountering difficulties with meeting their payments of tax, they can avail themselves of a payment plan with the ATO. The payment plan allows a business to repay their tax in instalments to the ATO over an agreed period. If the taxpayer defaults on the payment plan, then the plan is cancelled and ATO will call upon the debt (unless other alternative arrangements can be made).

In most instances, obtaining a payment plan is straightforward. They are typically granted automatically by the ATO, unless the debt is significant (i.e. greater than \$100,000). For debts below this \$100,000 threshold, businesses can apply for a payment plan via myGov (for individuals and sole traders) or via the Business Portal for non-individuals. Registered tax agents are also able to seek these payment plans with the ATO on behalf of their client via the tax agent portal.

The ease and accessibility of a repayment plan for business tax debts, in our view, is a 'double edged sword'; having both positive and negative impacts. While assisting taxpayers to acknowledge and manage their tax obligations by way of a payment plan is an admirable objective of the ATO, the ease with which such plans can be granted to struggling business owners would likely explain the continued growth in uncollected tax debts, particularly in light of the economic cycle over the last four years.

Ordinarily, general interest charge applies for the amount outstanding under the payment plan where the rates applied are higher than what is commercially available. However, we note that the ATO may allow for a 12-month interest-free payment plan for activity statement debt where the business satisfies certain conditions (such as the quantum being less than \$50,000).¹ Those who satisfy the relevant conditions but who are on a different payment plan can also move to the interest-free arrangement.

Considering that uncollected activity statement debt has risen from \$10.2 billion to \$14.3 billion² in the last four years (a \$4.1 billion increase), we consider that the favourable interest-free terms provided to businesses could partially explain the rising trend in uncollected activity statement debts. Further investigation is required to substantiate this observation that businesses are being encouraged to use the ATO as a cheap source of funds.

For completeness, we observe that the trend in uncollected debts for income tax and superannuation guarantee charge have increased by \$2.5 billion (from \$8.3 billion to \$10.8 billion) and \$0.5 billion (from \$0.6 billion to \$1.1 billion) respectively. We are not aware that a similar interest-free arrangement is available for these categories of tax debts.

¹ <https://www.ato.gov.au/General/Paying-the-ATO/Help-with-paying/#Onlineandautomatedpaymentplans>

² Based on ATO data from the terms of reference to this submission

With respect to the rising trend in the superannuation guarantee charge, we note that legislation is currently before the Parliament which will provide an amnesty to non-complying employers to self-correct any superannuation guarantee amounts dating back to 1992.³ The amnesty provides concessions to those employers who make a disclosure (such as being able to claim a tax deduction). The presence of the amnesty would arguably further contribute to the \$1.1 billion of superannuation charge currently owing to the ATO.

Lack of financial literacy can lead to unexpected tax debts

New business owners at the start of their business' lifecycle must turn their minds to such things as business administration, regulations (state and federal), cash flow management, as well as a basic understanding of income tax, GST, employment law and superannuation. In fact, the ATO has recently indicated that 9 out of 10 small businesses will at some time experience cash flow difficulties.

Managing the books and in particular the business' cash flow, whilst fundamental, is often overlooked as business owners are in the throes of keeping their businesses afloat through fulfilling customer orders and attracting new customers. Undertaking financial and compliance duties is often a residual consideration, typically performed outside of business hours with little expertise or external assistance. Consequently, new business owners may not necessarily engage the services of an accountant or tax agent from the immediate outset to help with their business finances nor their compliance until it is too late.

Those who commence a business can easily apply for an ABN without any requirement to prove their financial literacy or their knowledge of their regulatory obligations. Information however is widely available as to what is expected (for example, business.gov.au and ato.gov.au both provide useful information).

³ *Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019*

These new business owners, particularly those who operate as sole proprietors or contractors, can have up to 18 months before there is any need to lodge an income tax return and the pay their tax debt (after such time, PAYG instalments are typically required to be made). The same can also apply to the business' GST obligations.

The tax law provides these business owners with a 'free ride' from their income tax and GST obligations for their first year without any scrutiny. Without having proper regard to these obligations, it is not uncommon for these business owners to be surprised with a significant tax debt upon lodgment of their annual returns for which they do not have the adequate funds to pay.

From inception, these businesses are 'behind the eight ball' as they struggle to understand and provide for the various taxes which have accrued as they build their business. Rather, there would be a tendency to reinvest those funds back into the business (for example, through the purchase of capital assets or other expenditure). A failure to regularly set aside sufficient funds to meet tax payments may subsequently warrant a payment plan to be entered into with the ATO, or at worse the debt remains outstanding with formal action taken against the business owner.

We therefore consider the role of the registered tax agent or accounting professional to be invaluable at the formative stages of a business' lifecycle. Early engagement by business owners with such a professional can help them better manage their cash flows, their statutory obligations, and to ensure that any debts, including outstanding taxes, can be met as and when they fall due.

To allow new small businesses to obtain the assistance that they require and to set them up for success, we have recently lodged a submission to the Government proposing that a voucher system be introduced to encourage these businesses to engage with an accountant in their formative stages. The purpose of the voucher system is to facilitate early engagement by businesses with their accountant by subsidising some of those costs.

A copy of that submission and how we envisage such a voucher system to operate is contained at **Appendix A** of this submission.

New debt disclosure regime

The Government has recently introduced a new debt disclosure regime, whereby businesses with undisputed tax debts of at least \$100,000 for more than 90 days will have their tax debt information disclosed to credit bureaus by the ATO.

However, such debts will not be disclosed where the business satisfies one of the following:

- the business has entered into a payment arrangement with the ATO
- where the debt is the subject of dispute with the Commissioner of Taxation (e.g. where the business has lodged an objection), or
- the debt remains as an active complaint with the IGTO.

Those with excessive tax debts cannot ignore their ongoing tax debts under this regime. We consider that this measure should change the behavior of taxpayers and contribute to reducing the growing trend of uncollected tax debts by requiring impacted businesses to deal with their outstanding tax debts in a satisfactory manner (for example, by entering into a payment plan with the ATO).

Issues relating to administration of tax debts by the ATO

Based on feedback provided to us, issues experienced by businesses and tax agents when dealing with the ATO with respect to outstanding tax debts can include the following:

(i) *Payment plans defaulted because of other outstanding tax debts*

One particular bugbear arises where a business on an current payment plan defaults on that plan as a consequence of another tax debt becoming outstanding.

A typical example might involve a plan for outstanding income taxes where the business has been meeting their obligations under the plan. However, as a consequence of the business having a new income tax debt arising that remains outstanding; the business is taken to have breached the terms of its existing plan.

The business or their tax adviser is then required to contact the ATO to enter into a new payment arrangement with respect to each income tax debt.

It is highly frustrating for tax agents and business owners to have to deal with the additional administrative burden in ensuring that their can continue on their payment plans. It does not serve any benefit for both the business and the ATO by having to arrange for new payment plans.

A better approach in these circumstances is for the ATO to provide the taxpayer an option to consolidate the new income tax debt to the existing payment plan so as to avoid further administrative hurdles. It should not be the case that the existing plan be defaulted.

In our view, all that taxpayers are asking from the ATO is that they are treated fairly and consistently when it comes to the treatment of their outstanding tax debts. It would be in the interest of the ATO to review its processes and procedures to identify scenarios where red tape could be reduced for those businesses who are trying to do the right thing.

(ii) Refunds applied against other tax debts

The tax law provides for the Commissioner of Taxation to apply tax refunds against other outstanding debts that the taxpayer may have (which may also include debts owing to Centrelink). For example, an income tax refund may be used to offset against an outstanding activity statement debt.

Notwithstanding that this is the operation of the law, such setting-off processes continue to frustrate business owners who were expecting the tax refund to be used to meet their business expenditure. Educating and informing business owners of the relevant circumstances where debts are set-off could alleviate frustration and help assist businesses to better plan their cash flow.

(iii) Written-off tax debts being set-off against tax refund

Another occurrence that has frustrated business owners and tax agents relates to instances where tax debts have previously been written-off by ATO, only for those debts to reappear and to be applied against subsequent refunds of tax.

The Commissioner of Taxation has the discretion to write-off primary tax debts and general interest charges where appropriate. Where the Commissioner exercises that discretion, it is expected and appropriate that those debts should not be reinstated where the taxpayer becomes subsequently entitled to a tax refund.

It appears that the ATO's systems do not 'permanently' write-off these debts but retains some record of it, only for these debts to be reinstated when a refund of tax is identified.

Most taxpayers act in good faith that their tax debt has been written-off and having debts reinstated can be distressing to business owners. In the interest of transparency and to build taxpayer trust in the tax system, it would be necessary for the ATO to review its system specifications to ensure that taxpayers are not unfairly and adversely impacted under this particular circumstance.

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 if you have any other questions related to our submission.

Yours sincerely



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Appendix 1: Policy Proposal – voucher for professional help

Small business is a large and critical part of our economy. Small business accounts for 96 per cent of all businesses in Australia and employs 5.6 million Australians and produce over \$330 billion of Australia's annual economic output. Small businesses are currently grappling with fundamental changes to traditional ways of doing business, including the sharing 'gig' economy, digital disruption, and associated tax and regulatory changes; all of which, are creating a myriad of threats, opportunities and challenges.

Achieving a level playing field for small businesses, also remains a key challenge as they face competition not only from their larger more established operators, but also from black economy operators who can undercut on price. The Government is implementing most of the Black Economy Taskforce recommendations. This will support the levelling of the playing field, particularly for small business once most of the recommendations are implemented.

Launching a new business in the current economic climate requires much more than a marketable product or service. It also requires skills in business administration, regulations (State and local Government) and cash flow management, as well as a basic understanding of income tax, GST, fair work and superannuation. Acquiring this knowledge is one of the biggest challenges facing new business owners. Small business owners generally have limited business acumen and usually find the challenges of operating a small business overwhelming. New businesses have historically had a higher rate of failure and the challenges facing new business entrants has not eased in today's digital world. More than ever they require a supportive environment to encourage entrepreneurial risk taking.

Cash flow is a crucial concern for many small businesses, especially when they are at the most critical phase in their life cycle, such as during the inception stage. The challenges faced by small businesses in managing cash flow can often reflect a lack of financial literacy or limited access to relevant tools or expertise.

The tax system can also affect small business cash flow in a more direct way. For example, some of the most valuable concessions operate to reduce tax payable through concessional rates of tax or increased (or accelerated) tax deductions (instant asset write-off and write-off of business start-up costs). However, for a business in the start-up phase, these concessions may merely add to the stock of tax losses, rather than providing an immediate cash flow benefit. If there is no assessable income which can be offset against such deductible expenses, then they provide limited relief until the business is profitable.

There is scope to complement the existing suite of small business tax concessions by providing an incentive to seek professional advice at the earliest point in the business life cycle such as when a new business seeks to obtain an Australian Business Number (ABN).

We believe there is merit in our policy proposal to address some of the concerns noted above.

There are a number of strategic benefits, if such a proposal was implemented. Most of the benefits will occur over time, which will reduce the overall cost of such a measure. These downstream benefits need to be considered in evaluating this proposal. In addition, we have made some suggestions for reducing the overall initial financial impact of introducing this proposal.

Accountants who are members of a professional accounting body are well equipped to provide this early assistance. There are strong ethical and professional standards that members in practice must adhere to in order to provide services to the public. Nearly 95 per cent of businesses use the services of a tax agent in complying with tax obligations. If the tax agent assisted earlier in the life cycle, we believe this would be highly beneficial to the business as well as the community more generally. Better record keeping, cash flow management and adherence to tax obligations would be addressed much earlier providing the business with the necessary tools to better succeed in a competitive economic environment.

Benefits for small business receiving professional advice at the earliest point in the business life cycle:

1. Time-poor business owners have access to a plethora of information. Many do not understand the information, or cannot confidently apply the information to improve their day-to-day business administration and operations.

Without a helping hand many mistakes can occur which result in costly avoidable errors. It is not uncommon for most new business owners to source information from non-Government sources. Information from a trusted source such as from an accountant has been repeatedly confirmed by numerous independent research papers.

2. There is potential to influence small business owners so they can adopt a digital platform to leverage technology in order to relieve some of the regulatory burden they face.

Pressure is rising for small businesses to 'go digital' both in the way they interact with consumers and in how they comply with their tax obligations and other regulations. Small businesses spend a disproportionate amount of time dealing with government regulations. Adopting a digital platform can be a cost effective way to relieve the compliance burden which is what the Government would like all businesses to move towards over time.

3. Cash flow is critical in the early stage of a business lifecycle. Many small business entrepreneurs lack the necessary skills to manage this important business operational task.

The Australian Taxation Office (ATO) have developed a cash flow coaching kit for accountants to help educate clients manage this vital task. Many business failures can be linked to poor cash flow management and the importance of this task cannot be understated.

The ATO are funding this initiative (Cash Flow coaching kit) as a way to manage small business tax debts. Small business represent the bulk of outstanding tax debt and the figure is rising which is a significant concern. Accessing these tools can help the business owner better understand important business concepts such maintaining margins and to better understand the interaction between profit and cash.

4. If the business intends to employ staff, understanding awards under the Fair Work Act and super guarantee obligations are essential. Accountants can provide a concierge service to facilitate this process.
5. There are many individuals who are applying for an ABN as a contractor who should be more appropriately classified as employees. Having someone vet their ABN application is an important integrity measure to strengthen the ABN system. It avoids all the reverse workflow consequences if a contractor has been incorrectly classified, and should have been treated as an employee. This situation unfortunately is common place as employers are trying to minimise employment cost by treating staff as quasi contractors to avoid award payments, employment on-costs and super guarantee.
6. Tax obligations are one of the compliance burdens that a small business needs to get on top of very quickly. Most small business operators do not know what they don't know and hence, errors are common place. It can take up to 18 months before a small business lodges its first tax return and comes under the ATO radar. By this time the horse has literally bolted and there is insufficient funds to meet tax obligations which could consist of GST, income tax, FBT and PAYG.

To make matters worse, as well as having to deal with past overdue taxes, there is also the requirement to pay tax as you go for the current financial year. This is a common trap for new businesses as they are unaware of their tax obligations and also do not exercise discipline in putting money aside for withholding taxes such as GST and PAYG. By the time the ATO tries to chase the overdue debt, the business may already be experiencing cash flow issues from poor management practices.

Proposal

There are significant benefits to the community if entrepreneurs have a supportive environment to encourage risk taking. What is required, is professional help at the earliest

possible stage in the business life cycle. A voucher system to encourage a small business owner to engage with a professional in its formative planning stage is what we propose. The voucher can act as a co-payment towards the total cost. Alternatively, the professional can decide not to charge for the service on the basis of the expectation that the small business owner may become a client of the practice.

When a new business applies for an ABN, they can do so fairly easily, which can be viewed in both a positive and negative light. Anyone can self-apply for an ABN which can be granted in minutes. This facilitates the process of commencing a new business.

On the negative side, there is limited rigour in the application process to monitor the quality of the applicant to ensure they meet the eligibility criteria and more importantly understand all the regulatory obligations that they are signing up for. It is for this reason that there should be a process early in the piece to educate the new small business and set them up with processes that best help them meet their compliance burdens and also run their business successfully from a business management perspective.

To limit the financial cost of such a voucher proposal, it could be limited to individuals (sole proprietors or contractors) and partners in a partnership. More sophisticated small business owners who choose to run their business through a trust or company can be excluded on the grounds that such individuals will most likely be seeking assistance already during the early formative stages of setting up a business. The eligibility criteria for the voucher for professional advice could also be restricted to first time business entrepreneurs.

We trust that you will find our proposal of value. The intent behind our proposal is to give a new small business, the tools to succeed by using the extensive network of accountants who already provide a trusted concierge service to the small business community. The benefits it can provide to the Government are significant and we believe worthy of consideration.

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