



**MASTER BUILDERS
AUSTRALIA**

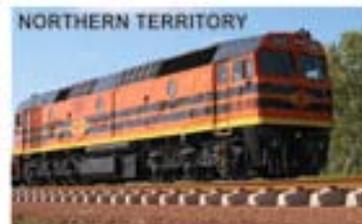
**SUBMISSION TO
TREASURY**

***Consultation Paper: Reporting of Taxable Payments for
Contractors in the Building and Construction Industry***

27 June 2011

Master Builders Australia Limited ABN 68 137 130 182

building australia



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1. INTRODUCTION

- 1.1 This submission is made by Master Builders Australia Limited (Master Builders).
- 1.2 Master Builders is Australia's peak building and construction industry association, federated on a national basis in 1890. Master Builders' members are the nine Master Builder State and Territory associations.
- 1.3 Over the past 120 years the association has grown to represent over 31,000 businesses nationwide. Master Builders is the only industry body that represents all three building and construction sectors: residential, commercial and engineering.

2. PURPOSE OF SUBMISSION

- 2.1 In the 2011-2012 Budget the Commonwealth Government announced that it would introduce a reporting regime for contractors in the building and construction industry. That reporting regime is due to start on 1 July 2012. From that time there will be a requirement to make an annual report to the Australian Taxation Office (ATO) about certain payments to contractors in the building and construction industry. Hence, the first report will be due on 30 June 2013.
- 2.2 The Government's purpose in introducing the reporting regime is to "ensure that all contractors comply with their taxation obligations and pay their fair share of tax."¹
- 2.3 In response to a number of speculative articles concerning the nature and extent of the new reporting requirements,² the Government determined to issue a Consultation Paper which seeks the view of stakeholders about the design of the new tax reporting regime. This submission responds to the Consultation Paper which, amongst other things, broadly outlines various design elements of the new arrangements.
- 2.4 This submission represents Master Builders' preliminary comments only. The Consultation Paper was issued on 30 May 2011 and comments are required to be made by 27 June 2011. Master Builders contends that given the significant ramifications of the new reporting requirements the time provided for comments is grossly inadequate. It is strongly suggested that further material clarifying aspects of the scheme be made available before draft regulations are contemplated. In particular, Master Builders has, throughout this submission, proposed further analysis of available data as a way of assisting to better shape any new regime.

¹ Forward to the [Consultation Paper](#) per the Hon Bill Shorten MP, Assistant Treasurer

² See for example R Gottlibsen *Budget 2011 Contractor Carnage* Business Spectator 11 May 2011

2.5 It should be clear, however, from the outset that Master Builders opposes tax evasion. Deliberately flouting the law so that tax is not properly paid makes it more difficult for Master Builders' members who comply with the law to compete. Those members are disadvantaged directly by having to compete against competitors whose costs are illegitimately reduced. In addition, they are adversely affected as taxpayers, where all taxpayers must pay increased taxes because of the "leakage" from the system via the black economy and mechanisms that are constructed to defeat the law. Master Builders has long sought the full effects of the law to be visited on those who operate illegitimately and has, on many occasions, assisted the Australian Taxation Office (ATO) with policies which assist with the process of strengthening the taxation system to stifle the activities of rogues. We support compliance with the law.

3. BACKGROUND: EDUCATION SHOULD BE THE MAIN FOCUS

3.1 The Consultation Paper acknowledges that unlike individual, non-business taxpayers, contractors in the building and construction industry must deal with complex aspects of income tax law. The Consultation Paper acknowledges that the ATO over the years has made an effort to educate contractors in respect of taxation obligations. Master Builders supports that approach rather than the approach of penalising the vast majority of taxpayers via higher compliance costs to catch a small number of non tax compliant operators. Master Builders endorses the ATO view that the most cost-effective method of collecting revenue is to encourage taxpayers to voluntarily comply with the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936) and the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) (together 'the Acts').

3.2 Master Builders emphasises that compliance with the legislation is not easy for taxpayers while the Acts remain fundamentally complex. Essentially, Master Builders believes that the ATO should continue to promote voluntary compliance to taxpayers and that the current regime proposed should go hand-in-hand with enhanced education campaigns; there should not be a lessening of that educative effort.

3.3 Master Builders is of the view that the emphasis in refocusing Government efforts should be on those operators who are non tax compliant rather than imposing an administrative and cost burden on third party entities which are tax compliant. Whilst the Consultation Paper refers to "providing numerous education programmes and avenues for assistance to contractors" in the industry (page 5) there is no evidence provided as to why this devotion to education has not proved to be

successful. In that regard, we note that the Consultation Paper does not contain adequate analysis of the successes or failures in the various unidentified education programmes, nor is there adequate data about non-compliance, a matter we take up further below.

- 3.4 It is noted that nearly all firms in the building and construction industry are small businesses (333,748 non-employing firms or firms employing between 1-19 people), with some medium sized firms (7,523 firms employing between 20-199) and a small number of large firms (351 firms employing 200 or more people).³ The construction industry is project based and exhibits highly volatile characteristics which have a profound affect on its structure and the way it operates. Intense price competition and low profit margins keep fixed overhead costs low and have spawned the growth of the sub-contracting system. This system enables firms to take advantage of specialist skills, and to expand or contract operations rapidly as required. Most of the management systems adopted by the small to medium sized businesses in the sector are informal. Hence, the imposition of a major reporting regime has potentially profound effects on industry participants, inclusive of potentially much larger compliance costs, even where taxpayers are currently compliant. Because of this issue, Master Builders would urge the preparation of a formal Regulatory Impact Statement (RIS).
- 3.5 Master Builders cautions against moving away from education as a principal means of achieving compliance. Field auditors should educate taxpayers as well as enforce the law. The new reporting scheme, if it is to proceed, should go hand-in-hand with renewed efforts by way of education.

4. THE EXTENT OF THE PROBLEM

- 4.1 The Consultation Paper outlines the analysis from the compliance programme undertaken by the ATO. The Consultation Paper asserts that the audit programme revealed significant compliance problems with contractors in the building and construction industry who had not correctly reported payments. The analysis does not adequately distinguish between tax avoidance and tax evasion. This point is important, given that the legislation under which the scheme the subject of the Consultation Paper is proposed was designed to target tax evasion. In particular we note that the Explanatory Memorandum for *A New Tax System (Tax Administration)*

³ ABS Cat No 8165, 16 February 2011

Bill 1999 states in relation to Chapter 4 Payment, ABN and Identification Verification Systems (PAIVS) the following:

The introduction of a targeted reporting and verification system is considered to be an appropriate response to address systematic tax evasion in high risk areas and improve compliance with the taxation laws.

- 4.2 On page 3 of the Consultation Paper there are statistics which purport to illustrate the extent of the problem in the industry. These figures derive from ATO audit work. The figures show that 34 per cent of 11,500 “matched entities” i.e. those which had no ABN quoted or an invalid quotation were from the building and construction industry. This figure is 3,910. This is a very small percentage of the number of businesses operating in the industry referred to in paragraph 3.4 of this submission (around 1 per cent). The next statistic is ambiguous. It states that:

It was found that 31 per cent of those contractors that were matched to ATO records had not lodged a tax return, with a further 20 per cent having lodged but omitting all or part of their income.

Is this 31 per cent of the 3,910, i.e. 1,212 contractors? If so the number is not large when compared with entities operating in the industry (a third of 1 per cent). Is this identified unequivocally as systemic or perhaps general or statistically random evasion? Clearly 20 per cent of 3,910 is only 792 taxpayers. Master Builders would appreciate greater analysis of this and other relevant data, a matter highlighted further in this submission.

- 4.3 Master Builders does, however, accept that these figures may indicate a trend. In other words, we would share the ATO’s concern if the time series data confirmed an increasing level of systemic evasion. We would recommend a greater analysis of the relevant statistics and more palpable indications of the population from which the audit was undertaken and more details of the extent of the problem by greater quantitative and qualitative data being published before determining a new reporting compliance regime.

5. REGULATORY STRUCTURE OF THE REPORTING REGIME

- 5.1 The Consultation Paper at page 5 indicates that the reporting regime is able to operate through the existing PAIVS in Part 5-30 in Schedule 1 to the *Taxation Administration Act 1953* (TAA 53). The Consultation Paper then selectively extracts material from the Explanatory Memorandum. It does not take into account the extract which we have set out at paragraph 4.1 of this submission. Instead, it highlights the notion that the system is intended to be used in areas where non-compliance with the taxation laws is entrenched. That begs the question of whether,

as Master Builders would argue, the system is designed to deal with systemic evasion as opposed to tax avoidance or ignorance of the law which would warrant different compliance approaches being taken. A distinction between these different aspects of the problem qualified by reference to more data would be beneficial especially as we believe that revenue lost is in large part through lack of knowledge of the tax laws.

- 5.2 Whilst we understand the use of the PAIVS in Division 405 of Schedule 1 of TAA 53, we believe that the terminology within the legislation which indicates that the “purchaser” is to report details to the ATO of its “suppliers” who have paid for its “supply” is not helpful in clarifying the obligations of participants in the new system. The use of these terms in themselves will require a great deal of educative effort, as they do not fit well with the manner in which industry parties view themselves. The labels adopted in the legislation do not fit with reality.
- 5.3 It is proposed that the requirements will be on businesses (a purchaser) to report payments for work undertaken (supply) by contractors in the building and construction industry (the supplier). Obviously the definitions of these words are critical. The Consultation Paper notes at page 7 that the regulations that will be inserted into the *Taxation Administration Regulations 1976* will define the key terms, “purchaser”, “supplier” and “supply” against a background of the broad structure just indicated.
- 5.4 At page 7 of the Consultation Paper, it is noted that the legislation is currently structured to require quarterly reporting of payments. Under the proposal businesses will only be required to report annually, a detail which Master Builders supports. However, we are concerned that in order to give effect to this annual reporting, the Commissioner must exercise a discretion under section 388-55 in Schedule 1 of TAA 53 to change the reporting cycle from quarterly to annually. This matter should not rest on the discretion of the Commissioner and should be properly legislated.

6. DETAILED DESIGN OF THE PROPOSED REPORTING REGIME – SUPPLY

- 6.1 Section 405-5 in Schedule 1 to TAA 53 states that the division will apply to any payments that are made or are liable to be made for supply. The definition of what is supply must be specified in regulations made for the purposes of that section. Payment is liable to be made if the obligation to make the payment is notified in an invoice. In the current context, the Consultation Paper indicates that supply will

- include a supplier under a contract that in whole or in part involves supply of building and construction services.
- 6.2 The Consultation Paper contains a discussion of the definition of supply of building and construction services. It makes it clear that this concept is not currently defined in tax law. On page 14 of the Consultation Paper, a number of questions are posed in relation to the notion of supply.
- 6.3 The first question that is posed asks whether the “supply of building and constructions services” should be developed based on a list of activities/services or from a “principled perspective”. The boundaries of one of the most fundamental definitions that will guide the new scheme is vague and the four questions inclusive of the one just articulated are not ultimately helpful. In Master Builders’ view the Consultation Paper appears to argue that all contracts involving any supply of building and construction services must be reported. This is the case, it seems, even where the major part of the contract is for the supply of goods. Is it the gross amount under these contracts which it is intended to be reported or the net amount? This should be clarified.
- 6.4 Questions 2, 3 and 4 on page 14 of the Consultation Paper are so widely phrased that the answer would not really be helpful in narrowing the question which the Consultation Paper must first answer. Master Builders would urge greater analysis of the data, as discussed below in paragraph 6.5, before these questions are answered. However, whether or not the gross amount under a contract where there is a supply of goods or a net amount and the basis of how that might occur is unclear and is not helped by the discussion in the Consultation Paper. We would suggest the gross amount for ease of administration but this may cause anomalies where say in a \$1m supply contract an amount of, for example, \$500 is allowed for service provision for, say, administration costs.
- 6.5 Ultimately Master Builders’ position would be based on what the ATO data reveals. In other words, what parts of the sector are currently the most likely to systemically evade their taxation obligations? Master Builders therefore once again emphasises the critical importance of further analysis of the ATO data and consultation with industry before a final Treasury view is determined.

7. DETAILED DESIGN OF THE PROPOSED REPORTING REGIME – PURCHASER

- 7.1 As is clear from the Consultation Paper the purchaser will be the entity which is required to report. The Consultation Paper makes it clear that these entities are businesses, including sole traders or contractors that are wholly or principally engaged in the building and construction industry. It is proposed that this will exclude private individuals such as householders or owner/builders.
- 7.2 Master Builders strongly recommends that the ATO review the Consultation Paper proposal to exclude owner/builders. We submit that the ATO should examine the data to determine whether or not owner/builders are currently compliant or whether or not this subsector, as Master Builders believes, is more likely to avoid taxation obligations than legitimate businesses in the industry. In addition, the use of owner/builders could mean that a loophole developed in the system whereby owners of residential property were established as owner/builders with a contract manager who, as agent for the owner/builder, arranged a large number of subcontractors to complete the work. This would, with the label on the person who was contracting the work being “owner/builder”, permit the system of reporting to be avoided.
- 7.3 Master Builders’ view in that regard is reinforced by the second paragraph on page 15 of the Consultation Paper where it is stated that:

A “purchaser” does not include an individual in a domestic capacity, such as a “householder” who undertakes a private or domestic construction project and pays a builder or someone else (under a contract) to organise subcontractors on their behalf for all or part of the project.

- 7.4 This matter is particularly able to be opened up as a loophole given, as is noted in the Consultation Paper, the different definitions within each state and territory of the term owner/builder. Table 1 sets out the owner/builder permit numbers from each state.

Table 1

Owner Builder Permit Numbers					
	2005-06	2006-07	2007-08	2008-09	2009-10
NSW	13991	11941	10758	9776	10937
Queensland	4186	3459	2858	2805	2322
Victoria	12310	11320	10476	9124	9973
WA	3812	3737	3131	2584	2988

Source: State Building Authorities

7.5 In response to the question on page 15 of the Consultation Paper as to whether or not there are any entities that would be captured within the proposed definition of “purchaser” which should not be required to report under the regime, Master Builders believes that the test of being wholly or principally engaged in the industry is a good test to ground those who should, if the scheme proceeds, report. The test of where a “sufficient connection” to the industry exists for persons to be included in the reporting regime would not create a bright line and would unacceptably extend the reporting requirements. Those who principally supply material or products to the industry should not be caught in the reporting regime, even though they have a sufficient connection with the industry.

8. DETAILED DESIGN OF THE PROPOSED REPORTING REGIME – SUPPLIER

8.1 The supplier is, of course, the entity which receives the payment for the purposes of the law and which supplies the relevant goods and services. In other words, the “suppliers” are those towards whom the reporting regime is targeted.

8.2 At page 16 of the Consultation Paper, it is made clear that for the purposes of the proposed law the “supplier” will be any contractor or subcontractor, both an individual or non individual, which is engaged in the industry with an ABN and which receives a payment under Division 405.

8.3 The Consultation Paper notes that a contractor is required to quote their ABN and that a contractor will not be subject to the reporting regime where they fail to provide a purchaser with an ABN. The Consultation Paper notes that currently purchasers are already required to withhold an amount from a supplier where there has been no ABN quoted, together with a reporting of that transaction to the ATO. The extent to which that reporting regime is working or where non compliance with that regime now occurs will be useful data in the current context. This is particularly the case where, as the Consultation Paper points out, the ATO is to consult with industry and software developers on the form of reporting for the new regime including how to report payments for which no ABN has been quoted. The Consultation Paper is implying therefore that there will need to be new forms and new reporting obligations so that new, as yet undetermined, data collection will be required by all industry participants covered by the scheme. This matter therefore reinforces our concern that a RIS be prepared, as indicated in paragraph 3.4 of this submission.

9. ADMINISTRATION

- 9.1 The Consultation Paper addresses the question of what is required to be reported and how this will occur under the new regime. Essentially, entities will be required to report via an annual report in an approved form. This annual report will contain information that identifies the “supplier” as well as the Division 405 payments made to the “supplier” in the reporting period. The form and method of reporting remain unclear.
- 9.2 The Consultation Paper at page 17 sets out that the report will contain information which will include the name of the “supplier”, the “supplier’s” ABN if known by the “purchaser” (although the full extent of the absence of that ABN is still to be established), the total of the Division 405 payments that the “purchaser” made or was liable to make in the reporting period and any other information relevant to the payment the Commissioner requires.
- 9.3 The Discussion Paper at page 17 asks whether or not the information that is proposed to be included in the required report is information that businesses currently collect and/or record. In our view, it is likely that most businesses in the industry will incur an additional burden in the need to collect and report the required information. Much of the information is currently collected. However, capturing the material required in one report will mean drawing together the strands from a number of different internal sources of information held within the entity. Because of this, Master Builders believes that the new system will cause significant costs which should be assessed through a RIS.
- 9.4 One of the issues which will mean that there would be greater complexity associated with the reporting proposed is the need to make it clear whether or not the gross amount under a contract or a net amount where that contract also involves a “supply” of goods is to be required.
- 9.5 The Consultation Paper asks what changes to business systems will be required to collect the information proposed for the relevant report. Master Builders believes that whilst a great deal of the information may currently be collected, consolidating that information into an appropriate form and in effect setting out each and every payment made to its “supplier” will take a considerable amount of time, particularly for small to medium size business operations which might not be fully computerised. The extent of modifications of computer software may be better able to be assessed via focus groups which we urge Treasury to conduct in cooperation with Master Builders. These should involve a spread of industry participants which should be small, medium and large businesses.

10. CONCLUSION

- 10.1 The final page of the Consultation Paper asks if there are other administrative arrangements or mechanisms that could be adopted for the proposed regime to reduce the compliance burden on businesses and contractors. Master Builders does not believe that that is a question which can be presently fully answered, given the lack of quantitative and qualitative data, particularly about the subsectors which should be targeted based on the ATO results which are touched upon at page 3 and 4 of the Consultation Paper.
- 10.2 Given the short timeframe for responses to the Consultation Paper, Master Builders has not had the opportunity to consult extensively with its members. Accordingly, we would suggest that any regulations be provided in draft with the rationale for their drafting and that greater analysis of the ATO data proceed and a RIS be started in respect of those draft regulations. In the meantime Master Builders offers its assistance in planning measures that will punish evaders but not act to the detriment of those who merely misunderstand their obligations.
- 10.3 Master Builders strongly recommends the responses to the Consultation Paper be collated and only considered as a preliminary response from industry and that a further round of targeted consultations be undertaken before finalising the details of any additional reporting arrangements.
- 10.4 Master Builders looks forward to further consultations with Treasury and the ATO on this important subject area.
