

KPMG submission

Exposure Draft

*Treasury Laws Amendment (Black
Economy Taskforce Measures No. 2) Bill
2018: Removing tax deductibility of non-
compliant payments*

Released 23 July 2018

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Executive Summary

KPMG supports the Federal Government's action against the black economy. The black economy is a significant cost to society, and government revenue and services, and a haven for some of the most egregious criminals.

Broadly, we support the proposal that, where PAYG income tax amounts are not withheld by a payer, a tax deduction for the corresponding wages should not be claimable by the payer.

However, we would like to comment on the current proposal in terms of further measures which may increase its effectiveness in curtailing the black economy. Our recommendations include:

- **Also deny the deduction for employers who significantly under-withhold PAYG:** We recommend that the non-deductibility provision should also apply where the employer withholds an amount of PAYG income tax that is less than 25% of the amount that should have been withheld.
- **No defence where payee provides an incorrect ABN which could have been checked:** We recommend that payers should be required to confirm the accuracy of ABNs quoted to them by payees. Payers should not be able to deduct payments where payees provide incorrect ABNs which the payer could have identified through a simple check of the Australian Business Register.
- **Employers found to have been reckless in their categorisation of workers should also have deductions denied:** we recommend deductions should be denied in certain cases of payers making incorrect employee / contractor determinations resulting in prosecution or an administrative penalty consistent with recklessness, or intentional disregard for the law.

Detailed comments

1. **General**

1.1 KPMG welcomes the opportunity to comment on the Exposure Draft (ED) of *Treasury Laws Amendment (Black Economy Taskforce Measures No. 2) Bill 2018: Removing tax deductibility of non-compliant payments* and associated explanatory material as published by Treasury on 23 July 2018.

1.2 KPMG believes that implementing measures to curtail the black economy is rightfully a high priority for the Commonwealth Government. Accordingly, we broadly support the intention of this reform – to ensure that an entity is not able to claim deductions for otherwise deductible payments unless the entity complies with its tax withholding and reporting obligations.

2. **Extending the denial of a deduction to situations where the PAYG withheld is less than 25% of the correct amount**

2.1 Entities are required to withhold certain PAYG amounts from salary and wages paid to employees, and from payments to contractors who do not quote a valid ABN, and also to notify the Australian Taxation Office (“ATO”) of these withholding payments through the Single Touch Payroll (“STP”) process.

2.2 The ED proposes that deductions for these kind of payments will only be disallowed under the proposed amendments where no amount is withheld by the payer, or no STP notification is made at all by the payer to the ATO.

2.3 As a result, the proposals will not deny a deduction where a significantly incorrect amount is withheld. Conceivably, where payers withhold only a token amount – of even just \$1 from a significant deductible payment – they would be entitled to the full amount of the payment as an income tax deduction.

2.4 Consideration should be given to also disallowing the income tax deduction where amounts withheld are incorrect by an amount that suggests no reasonable care has been taken (e.g. the payer has withheld less than 25% of the correct amount). This should not significantly impact responsible employers who make a genuine mistake, as their control systems should highlight the error in due course and enable them to take advantage of the exclusion for amounts that the payer voluntarily corrects.

2.4 In order to avoid penalising payers for mistakes in cases where only very small amounts of withholding are involved, the payer could be allowed to retain eligibility for the deduction where there is a gap of less than \$100 between the amount withheld and the “floor” of 25% of the correct amount.

3. Failure to check that an ABN is genuine, and belongs to the payee, should result in denial of the deduction

3.1 Payers should not be allowed deductions for payments made to individual (i.e. non-corporate) contractors in cases where the contractor provides a false ABN, or one that does not belong to them, in order to avoid their tax and business registration obligations.

3.2 The Black Economy Taskforce reported that it has been a common occurrence for workers or suppliers to provide an incorrect ABN, or the ABN of another business, and it is reasonable to conclude that significant tax avoidance is a consequence.

3.3 Given the scale of the black economy in Australia and its large negative social and economic impact, a payer should not benefit from tax deductions in cases where they make an otherwise deductible payment to a worker who has provided an incorrect ABN, or an ABN that does not belong to them.

3.4 ABN-holder data including the name and business address of the holder is publicly available, for minimal effort, via the Australian Business Register’s ABN Lookup website. Employers and payers who are not prepared to make this effort should prima facie have their deductions disallowed on review by the ATO where payments are made to a worker who provides an incorrect ABN, or one that is not their own.

4. Reckless categorisation of workers as contractors should also result in denial of the deduction

4.1 The ED proposes that deductions would not be disallowed where employers do not withhold tax from payments they make to workers who they believe to be contractors, and from whom they obtain a valid ABN, in the case where the ATO subsequently determines the workers to be employees for PAYG withholding purposes.

4.2 We acknowledge that the employee versus contractor determination requires an assessment of several factors, and that consequently payers may in good faith determine that a payee is a contractor, yet subsequently find that the ATO is in

disagreement. However, the ED as it stands provides no deterrence to the practice of so-called “sham contracting” where employers will only take on workers if they obtain an ABN, even though they are in fact common law employees.

- 4.3 Where a PAYG withholding shortfall occurs, the ATO may either prosecute the payer for the failure to withhold, or apply an administrative penalty of up to 100% of the shortfall amount. The ATO has publicly available administrative guidelines (PS LA 2007/22) governing its approach to the remission of administrative penalties for withholding failures. Taxpayers have the opportunity to seek review of a remission decision under section under Part IVC of the *Tax Administration Act 1953*.

If a taxpayer has either been successfully prosecuted or is liable for a penalty of at least 50% (indicative of reckless behaviour with no mitigating factors) for a breach of its withholding obligations as the result of an incorrect employee / contractor determination (and any applicable review or appeal against a penalty or prosecution has been finalised), we submit there would be reasonable grounds for denying a deduction for the payments to those workers.

It would be inconsistent with the objectives of this measure for there to be a different outcome for an employer who makes a reckless “contractor” classification, and one who makes no effort to withhold at all. In some instances, the former case may even represent the more deliberate black economy behaviour.

- 4.4 Consideration could be given to allowing taxpayers a single “free pass” where they would not be denied a deduction if it was the first time they had been penalised for their failure to withhold. There could also be consideration of a safe harbour for taxpayers who provided their tax agent with all of the relevant information needed to carry out the proper withholding, but whose tax agent did not then carry this out correctly. We note that in each of these situations, prosecution or a determination of recklessness may be unlikely in any case.
- 4.5 The addition of this recommendation would also be consistent with the Government’s acknowledgement of the very large number of ABNs that have been granted in recent years (and the role of these in the black economy), and instances of sham contracting where employers force workers to obtain ABNs in order to treat them as contractors and avoid their employment-related obligations.