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

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## **1. Explanation of the Bill**

Treasury has invited submissions to the Exposure Draft *Treasury Laws Amendment (Black Economy Taskforce Measures No. 2) Bill 2018: Removing tax deductibility of non-compliant payments*.

If enacted as it stands, the Bill would authorise the Australian Taxation Office (ATO) to deny tax deductibility of payments to employees, contractors and others where the ATO alleged that the paying party should have made PAYG tax withholding remittances on the payments.

The outcome of the Bill would be to empower the ATO effectively to bankrupt a business overnight where the ATO alleged, or held a view that, PAYG withholding was required. This is because the ATO's existing powers enable it to act against a business or person on a view of the ATO. Existing law does not require the ATO to prove the facts of its case before it can act.

Combining this draft Bill with the ATO's existing powers would enable the ATO to destroy any business because a denial of tax deductibility of employee/contractor payments would be so devastating to any business's cash flow that it would be forced to close immediately.

## **2. We oppose the Bill. Summary of our reasons**

- The ATO abuses its current powers and cannot be trusted.
- The Bill will expand the ATO's unaccountable powers and would give the ATO power of life and death over businesses on the basis of unproven ATO allegations.
- The Bill goes beyond the intent stated in the *Black Economy Taskforce report* and will enable the ATO to do considerable harm to the economy.
- The rationale for the Bill as stated in the *Black Economy Taskforce report* is illogical. When examined, it appears to be nothing more than a grab for additional ATO power.
- The ATO already has extensive power to sanction improper black economy behaviour and if it is not being successful in this regard, it can only be because the ATO is inept.
- The Bill is unconstitutional.

For these reasons Self-Employed Australia opposes the Bill and calls for it to be withdrawn.

The Bill should not proceed, nor should it be contemplated until such time as the ATO has imposed upon it effective, proper and independent oversight to stop it abusing its powers and until it begins to operate in an ethical, moral and legal manner.

## **Specifics of our objections to the Bill**

### **3. The illogical justification for the Draft Bill**

The draft Bill has been created as a consequence of a recommendation of the *Black Economy Taskforce Final Report* of October 2017. The report says, in part,

***Recommendation 7.5: Removing tax deductibility of non-compliant payments***

Businesses should not be able to claim tax deductions for payments made to employees if they did not report and withhold properly.

Similarly, payments to contractors should not be deductible if the correct ABN was not provided, the payer has not withheld part of the payment under the 'no ABN withholding' requirements, or there is no invoice.

***Description***

Businesses can currently claim deductions for expenses even when these expenses were part of black economy activity, such as paying cash-in-hand wages to employees or paying contractors without withholding tax when no ABN was quoted.

This practice essentially amounts to a loophole and should be closed.

***Problem this recommendation seeks to address***

Businesses paying employees cash-in-hand or paying for contractors without knowing their ABN may still deduct those payments in their Business Activity Statements.

There are several flaws in the reasoning of this section of the Taskforce report.

3a. Cash payments:

If a business makes cash payments to employees or others and then includes the cash payments as items in its expenses, this should show up glaringly in the business's tax return. A half-competent audit by the ATO should reveal the cash payments. In other words, tax withholding amounts are stipulated according to the income of employees. If the withholding tax remitted is less than the required amount, then those cash payments should immediately come under suspicion. The ATO should then know that the employee earned more than he or she is declaring and would charge extra tax. Penalties, interest and tax should apply to the employee. Similarly, sanctions would apply against the employer for not undertaking withholding obligations correctly.

In other words, the reasoning of the Taskforce is irrational and illogical. If cash-in-hand expenses are being claimed but not being detected, then this points to a failure of the ATO's auditing systems. The ATO already has significant ability to stop and sanction such behaviour—assuming the ATO's auditing were competent. The new powers proposed in the Bill are not needed because existing strong sanctions already exist. Further, if the Bill were passed, the new sanctions would be useless if the ATO's auditing remained incompetent.

3b. Non-withholding if ABN not declared:

The current law holds that if someone fails to quote an ABN when they should or quotes a false ABN, then that person can face jail. Yet it appears that the

ATO has never prosecuted anyone for falsifying an ABN. If false ABNs are being quoted, this should be easily detectable through simple competent auditing and data matching by the ATO. Assuming the ATO has not prosecuted anyone for quoting false ABNs, this must point to a failure by the ATO to enforce its existing powers.

Further, it is not a requirement to quote an ABN if a person earns less than \$75,000 a year. Businesses paying small businesses are not in a position to verify the income of the small business and therefore to know if withholding should occur on non-ABN declaration. But if the ATO were doing its job competently, simple auditing of businesses would identify non-ABN payments thereby enabling the ATO to audit and catch the persons not declaring their ABN. In catching such persons the ATO has sanctions it can apply. It can also then inform the paying business that withholding is required. If the ATO is not doing this (and it would seem from the Taskforce report that that ATO is not), then this indicates auditing incompetence by the ATO. And additional powers proposed in this Bill would not improve the situation if the ATO's auditing remains incompetent.

### 3c. Conclusion

The *Black Economy Taskforce* recommendation 7.5 (above) is fundamentally flawed on its facts, analysis and conclusions. It does not present an argument that justifies the recommendation. Instead it presents an argument that points to incompetence on the part of the ATO.

## **4. The Bill is a draconian extension of the already draconian powers of the ATO. It will do harm and cannot be justified**

Below we explain the ATO's existing powers, how it abuses those powers and the evidence of abuse—in relation to small business people at least.

In part summary, those existing powers enable the ATO to:

- Form an 'opinion' or view that someone owes tax and not prove that the tax is owed.
- Require payment of the unproven tax debt before a person can challenge the debt. This includes forcible garnisheeing of a debt.

The ATO's powers are much more extensive than this and operate outside the normal concepts and practices of justice and the rule of law. The ATO arguably has the powers of a dictator.

If this proposed Bill were enacted, the ATO would be handed an unrestrained power to bankrupt businesses, particularly small businesses, on an unproven 'opinion'/allegation by the ATO. We explain the most likely scenario below.

The core of the Bill reads as follows

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

## **26-105 Non-compliant payments for work and services**

*No deduction if amount not withheld or Commissioner not notified*

- (1) You cannot deduct under this Act a payment if:
  - (a) any of the following provisions in Schedule 1 to the *Taxation Administration Act 1953* require you to withhold an amount from the payment:
    - (i) section 12-35 (about payments to employees);
    - (ii) section 12-40 (about payments to directors);
    - (iii) section 12-47 (about payments to \*religious practitioners);
    - (iv) section 12-60 (about payments under labour hire and certain other arrangements);
    - (v) in relation to a \*supply, other than a supply of goods (within the meaning of section 195-1 of the \*GST Act) or real property (within the meaning of that section) section 12-190 (about quoting of \*ABN); and
  - (b) either:
    - (i) you fail to withhold any amount from the payment; or...

One plausible scenario in which the ATO would be able to bankrupt a business under the Bill, almost overnight, is as follows.

The ATO currently goes to great lengths to allege that contractors are employees. It does this through its control of ABN allocations, allegations of non-payment of superannuation and employee withholding. The ATO are known to cancel ABNs on spurious analysis of the facts and law in specific cases.

From the ATO's perspective, it can reasonably be suggested that the ATO finds the need to collect withholding amounts from several million self-employed people highly inconvenient. It makes more sense (for the ATO) to force people into employment thereby administering withholding from a much smaller number of employers. The ATO can also be said to be involved in a social and industrial agenda to suppress self-employment. This can be witnessed in the ATO's overreach of its stated agenda to clamp down on 'sham employment'.

The ATO prejudices cases, cancels ABNs and causes great distress to small business people. This prejudice is also reflected in the *Black Economy Taskforce* report. However, even though the ATO does not have the jurisdictional authority to address sham employment (which lies within the Fair Work Ombudsman's jurisdiction), that does not seem to constrain the ATO.

Within this understanding of what probably motivates the ATO, the use of this Bill, if enacted, would give the ATO massive, additional and draconian power to suppress any self-employment it chose to suppress. The process would be simple:

- a) The ATO would form a view that the contractors engaged by a business were, in the opinion of the ATO, employees of the business.
- b) Under existing law, the ATO could then immediately act on that 'opinion' and declare that all the contractor payments made by the business were no longer tax deductible.
- c) Such an ATO declaration would immediately ramp up the business's alleged profit and tax payable on the 'profit'.
- d) The ATO would impose penalties and interest.
- e) The ATO would then require immediate payment of the 'debt', even before the business could appeal.

- f) The business would be incapable of paying the sudden and unexpected debt and would also be starved of funds to organise and run an appeal.
- g) The business would be broke.

This scenario can play out in a matter of (say) two months from the time the ATO formed an ‘opinion’ of a debt to the time of enforced payment and business collapse.

In other words, if passed, the Bill would give the ATO the power to swiftly execute any business on the basis of unproven ATO ‘opinions’ and allegations.

## 5. The Bill is unconstitutional

This Bill seeks to add to the *Income Tax Assessment Act 1997* a new section: ‘s26-105 Non-compliant payments for work and services.’ This drafting approach is constitutionally flawed. It is submitted that the proposed section is in the nature of a penalty and is thus *ultra vires* the Constitution.

### *COMMONWEALTH OF AUSTRALIA CONSTITUTION ACT - SECT 51*

#### *Legislative powers of the Parliament*

*The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:*

*(ii) taxation; but so as not to discriminate between States or parts of States; ...*

Concentrating on the taxation and leaving aside “discrimination between the states”, the distinction between a tax and a penalty has been thoroughly explored in the High Court.

The dividing line between provisions dealing with the imposition of taxation and provisions which cannot be so described was explained as follows by Fullagar J in *Re Dymond*:

*[T]he specification of the persons who are to be liable to taxation and the definition of their liability is part of the denotation of the term "imposition of taxation". But provisions for administration and machinery, the appointment and powers and duties of a Commissioner of Taxation, the making of returns and assessments, the determination of questions of law and fact relating to liability, the collection and recovery of tax, the punishment of offences, stand on a different footing. They "deal with" matters which must be dealt with if the imposition of tax is to be effective. But they cannot be said to deal with the imposition of taxation, because their subject matter is not comprehended within the meaning of the term "imposition of taxation". The creation of a liability and (for example) the enforcement of the liability by civil or criminal proceedings are different subject matters. "Dealing with the imposition of taxation" is a different thing from "dealing with taxation", and the former expression does not mean or include "dealing with matters incidental to the imposition of taxation". [\[1959\] HCA 22](#); [\(1959\) 101 CLR 11](#), 21 ("*Re Dymond*")*

The proposed inclusion into the *Income Tax Assessment Act 1997* by the Bill of the new section: “26-105 Non-compliant payments for work and services”, creates a penalty and is thus unconstitutional.

## **6. ATO’s existing powers and ATO abuse of those powers: Overview**

- a) The ATO already possesses draconian powers that far exceed those of any police force in Australia or arguably any other government instrumentality.
- b) The ATO already has the unsupervised and unreviewable power to raid a person’s home without a warrant, demand documents, allege a debt, demand payment of an alleged debt, garnishee a person’s bank account to force settlement of an alleged debt, sell a person’s house and bankrupt a person before the person has a chance to ‘disprove’ the debt.
- c) Our opinion, based on solid evidence, leads us to allege that the ATO abuses those powers in order to bully and harass small business people into paying alleged tax debts that are often false or poorly supported by the evidence. The ATO’s abuses of its powers are such that they routinely destroy the businesses, personal lives and often the mental health of small business people.
- d) The ATO is not subject to any effective oversight other than to bodies that ‘review’ and make ‘recommendations’ on ATO behaviour, but which have no power to sanction ATO abuses or order abuses to stop.
- e) If Parliament were to give the ATO additional power to deny tax deductibility of payments to contractors/employees it would further extend the ATO’s ability to bully, harass and destroy small business people. This is unacceptable. There is no justification for this extension of the ATO’s powers.

## **7. The ATO’s existing (draconian) powers: Specifics**

### 7.1 Powers that arguably exceed those of any police force in Australia

The ATO has the power enter someone’s premises at any time without a warrant and to seize documents of its choosing. This power is derived from Section 263-264 of the *Income Tax Assessment Act 1936* (now contained in Schedule One of the *Tax Administration Act*.)

Police, by comparison, must obtain from a Court an approval (warrant) for a search. This is an important oversight of police activities designed to protect justice and limit the abuse of power by police. Such oversight makes for better police forces by improving public confidence in policing. The ATO has no such oversight.

### 7.2 Taxpayers are guilty until they prove their innocence

The ATO has the following power:

- Where the ATO raises an assessment against a person (for example, for extra tax) the ATO’s action and people’s appeal rights is a Part IVC application. Part IVC is a statutory regime of appeal under the *Tax*

*Administration Act 1953*. The issuing of an assessment by the ATO is the issuing at law of a debt. It is not a ‘claim’ of a debt. Rather, at law, it is an actual debt that the person must pay. The person must ‘un-prove’ the debt. The ATO does not have to ‘prove’ the debt.

- To appeal (un-prove the debt) people must go through the following procedure:
  - (a) They must object under the ATO’s internal processes.
  - (b) When/where the ATO decides against someone, that person must take their case either to the Administrative Appeals Tribunal or the Federal Court. In the Court or Tribunal, the person must demonstrate that the tax burden is excessive—that is, the person must prove what amount of tax is actually owed.

For small business people these powers of the ATO put them in a highly vulnerable position. The processes of defence are not easily or cheaply accessed by a small businessperson. A legal defence requires access to highly specialized tax lawyers and accountants at enormous cost. The process itself creates abuse, stripping people of their normal rights at law and creating oppression. The ATO knows this and, we allege, exploits this huge power to abuse small business people.

### 7.3 The ATO can (and often does) require people to pay an assessed/alleged tax debt ‘up-front’ before the person can appeal

Once the ATO has issued an assessment stating that a person owes additional tax, the ATO has a policy of “pay now, dispute later”. The ATO’s authority for this lies in Section 350-10 Schedule One of the *Tax Administration Act 1953*. This section effectively states that any Assessment by the ATO is conclusive evidence of the truth.

The steps the ATO can employ to force payment are:

- a) It issues the assessment as ‘proof’ that a person owes money.
  - b) There is no trial and a judgment is basically automatic for the ATO.
  - c) The ATO issues a garnishee notice against a person’s bank accounts requiring the bank to immediately pay the ATO without the person’s authority.
  - d) Where it is deemed necessary, the ATO applies to bankrupt the person.
- The ATO can and does do the above quickly.

The only way to stop this process from occurring is to apply to the Courts for a ‘Stay’ order. There have only been three or four of these issued in the past 20 years.

The implications of the foregoing for small business people is that even if a tax debt is disputed, the ATO can force the payment, sell a person’s assets (house, etc.) perhaps even bankrupt a person before the person even launches an appeal. Such action obviously puts a person in the position of being incapable of conducting and paying for his or her defence.



#### 7.4 The ATO forms an ‘opinion’ of fraud and you are guilty

Under the Income Tax Assessment Act 1936 s170 the ATO can only go back two years in reviewing an individual’s tax return. This is intended to give people some certainty and some protection from the ATO and to ensure that the ATO operates efficiently in checking and reassessing peoples’ tax.

However, if the ATO ‘forms an opinion’ that a person has conducted ‘fraud or evasion’, then it can investigate as far back as it likes. The ATO has this power under Section 170 of the *Income Tax Assessment Act 1936*. In ‘forming an opinion’ the ATO does not have to prove anything. The ATO can and does act on its opinions of fraud or evasion without going to a court to prove such ‘opinions’ are correct. And the allegation of fraud is effectively an allegation of criminal behaviour against someone. It is serious.

Most people would likely think that such ‘opinions’ of fraud and evasion would be brought against people who had falsely declared their income. But the ATO regularly ‘forms an opinion of fraud’ against people who have declared all their income. The ‘evidence’ which the ATO has used for fraud or evasion ‘opinions’ has included instances where people have:

- Completed their tax return without seeking professional advice.
- Completed their tax return using professional advice.
- Filled out their tax return based on advice from the ATO’s website.
- Been unable to cite a legal case that had appeared on the ATO’s website and upon which the person had based their tax return. Subsequent investigations proved that the legal case reference had been removed from the ATO’s website.

The reason the ATO uses fraud and evasion ‘opinions’ extensively is because

- a) The ATO can turn a small tax debt based on a two-year review period into a big tax debt over many years. For example, a \$40,000 tax debt can be turned into \$400,000. This makes the ATO audit process revenue-‘juicy’ and worthwhile.
- b) The ATO does not have to be efficient. By forming ‘opinions’ of fraud or evasion the ATO can ignore the discipline of the two-year limitation.

#### 7.5. ATO charges penalties of up to 90% of the tax debt

By the ATO charging penalties, people can wind up with an alleged debt that is greater than the actual tax a person owes the ATO. The penalty regime is as follows:

- 25% for ‘failure of reasonable care’;
- 50% for ‘recklessness’;
- 75% for ‘intentional disregard’;
- 90% for doing something twice or obstructing the Commissioner.

The ATO imposes these penalties based on its ‘opinion’ of a person’s behaviour and there is no identifiable set of standards for each term that might readily be understood by the public. For example, what is the difference in terms of someone’s behaviour between ‘failing to take reasonable care’ and being ‘reckless’? Yet massive increases in debt are imposed on people.

## 7.6 Summary of the ATO's powers

The powers described above mean that the ATO is effectively police investigator, prosecutor, judge, jury and financial jailer—all in one.

The constraints on the ATO's power are minimal, complex to access, require high technical knowledge of ATO processes and tax law and are massively expensive to apply. The situation gives the ATO a huge capacity to abuse its powers and it does so on a systematic basis. This is the opinion and view of Self-Employed Australia, based on our extensive experience in dealing with the ATO when attempting to assist small business people.

## **8. Evidence of ATO abuse toward small business people**

Self-Employed Australia has been active for many years in discovering, researching collating and reporting on the poor behaviour of the ATO towards small business people. Our case studies and evidence have been documented in submissions to official enquiries. The three links below are to those submissions which are included as part of this submission.

- 1) [ICA Submission to Parliamentary Tax Office Review of ATO Scrutiny](#) [March 2016]
- 2) [ICA Submission to Inspector-General of Taxation](#) [December 2015]
- 3) [ICA Submission to Board of Taxation Review](#) [2014]

Following the ABC *Four Corner's* program 'Mongrel Bunch of Bastards' (9 April 2018) [<http://www.abc.net.au/4corners/mongrel-bunch-of-bastards/9635026>] Treasury was commissioned to produce a review of the allegations of ATO abuse of small business people as portrayed in the program. The review (not yet released) required submissions from the Inspector-General of Taxation and the Small Business and Family Enterprise Ombudsman.

The reports from the IGT and Small Business Ombudsman confirmed problems as detailed in their reports.

*IGT: Investigation into matters reported by the Four Corners program about small business dealings with the Australian Taxation Office*

[<https://www.selfemployedaustralia.com.au/Downloads/Taxation/IGT-Submission-Treasury-April-2018.pdf>]

Some of the things the IGT says about the ATO include:

- Creates perceptions of bias in its processes.
- Debt collection has been 'random and ad hoc'.
- Badly supervised junior staff issue garnishees.
- Compensation is just a token scheme and reform is required.
- 86 per cent of debt actions are against self-employed people.
- An independent review process is only available to the wealthy.
- Community confidence and trust have been in decline.

### Small Business Ombudsman

[<https://www.selfemployedaustralia.com.au/Downloads/Taxation/ASBFEO-report-July-2018.pdf>]

Based on this fact-finding examination of actual cases, the Ombudsman reports that the ATO:

- Operates its systems to target revenue collection.
- Can even (and does) take away ABNs, thereby stopping businesses from operating.
- Raids people's bank accounts even before taxpayers have any knowledge that there is an issue.
- Lacks true independence in terms of its internal review processes.
- Does not provide adequate compensation for its own wrongdoing.

The Ombudsman talks of:

- Abuse of ATO power.
- ATO delays on decisions so that it can collect debt.

### **9. Existing ATO oversight**

Existing oversight of the ATO's powers and behaviour effectively only consists of review powers by:

- The Inspector-General of Taxation (IGT).
- The Parliamentary Standing Committee on Tax and Revenue.

These bodies have the power to review the ATO's systems and overall performance, but can only make recommendations. They have no power to enforce anything.

The IGT has the power to investigate individual cases and (again) make recommendations, but has no power to enforce anything.

If a small businessperson objects to a debt alleged by the ATO, the only appeal is to the ATO's internal processes and, if those fail, the small business person can appeal to the Administrative Appeals Tribunal or to the Federal Court. Both the Tribunal and Court processes are hugely time-consuming, require specialised, legal and accounting experts to conduct the cases and are hugely expensive to conduct. Most small business people are unable to afford such a defence. Further, as explained above, the ATO can enforce payment of an alleged debt, sell a person's home and bankrupt them before they can conduct a defence. The outcome for small business people is that justice is denied because justice simply cannot be accessed.

But, even when a small businessperson manages to conduct a defence, the behaviour of the ATO is occasionally revealed. This was tellingly exposed in October 2017 in a case involving small businessperson Michael Shord when defending himself against the ATO. Justice Logan commented on the ATO's treatment of Michael Shord as follows:

the "...denial of procedural fairness to Mr Shord ... is patent."

and

The ATO's "...Departures from model litigant behaviour can, in particular circumstances, constitute professional misconduct, a contempt of court or an attempt, contrary to s 43 of the *Crimes Act 1914* (Cth), to pervert the course of justice."

(Full Federal Court judgment of 26 October 2017 (*Shord v Commissioner of Taxation [2016] FCA 761. File number WAD 332 of 2016*.)

## **10. Conclusion**

In relation to this proposed Bill;

- The ATO already has wide and draconian powers to address the black economy issues allegedly targeted by the Bill.
- The evidence is that that the ATO abuses its power at least in relation to small business people.
- The Black Economy Taskforce Report points to incompetence on behalf of the ATO in its auditing activities.
- More draconian sanctions will not address the alleged black economy issues whilst the ATOs auditing remains incompetent.
- Further draconian powers will lead to more opportunity for the ATO to abuse its powers.
- This Bill should not proceed and only be contemplated after the ATO has been reformed and it can prove competency in auditing and that sufficient checks and balances are in place regarding the use of the ATOs powers.