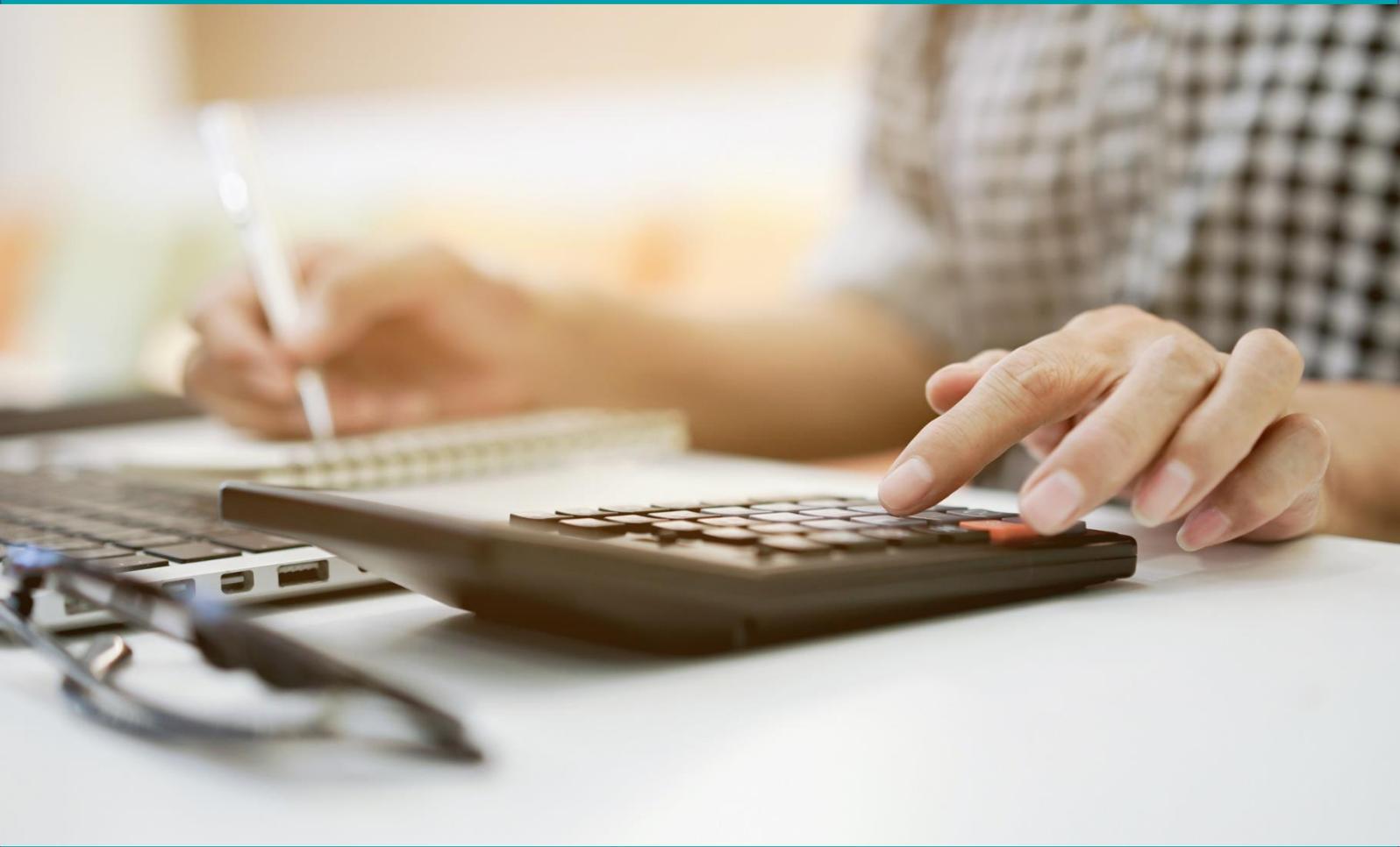




Australian Government



Australian
Small Business and
Family Enterprise
Ombudsman



**A tax system that works for
small business**

March 2021

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Foreword



As Benjamin Franklin once said, nothing can be said to be certain, except death and taxes. This is absolutely true for small businesses in this country, and unfortunately in many circumstances, the taxation system can lead to the ‘death’ of a business. This was highlighted in my Office’s May 2019 report, *Australian Taxation Office – Enforcement of disputed debts before the AAT*.

The Australian Taxation Office (ATO) has a mandate to collect taxes for the government, and for many small and family businesses this results in a combative relationship, and fear of the powers of the agency. The ATO quite reasonably sees their role as enforcers of the taxation laws, but regularly lose sight of the individuals running the businesses. This is particularly evident in the operations of the enforcement and debt collection teams, exacerbated by the overwhelming complexity of our tax laws.

Complexity leads to inadvertent mistakes, significant stress, and necessitates an enormous investment of time by small business owners who would otherwise be focussed on building their business and servicing their communities. Along with our industrial relations system, the current taxation system has been built, amended, and re-engineered over time, resulting in more than 98% of all businesses being shoe-horned into an environment designed to regulate the operations of large business.

This does not need to be the case. In the midst of the COVID-19-induced economic challenges, particularly for small business, the time is right for Government to deliver a system that suits the small business sector and will allow them to achieve greater productivity, return to profitability, and grow employment.

In some jurisdictions, such as Sweden, the tax office is proactive and supportive in their engagement with taxpayers. The relationship is rated as highly satisfactory by the population, including small businesses. The French tax framework may appear complex, however, it provides for different treatment of different sized businesses with a small business owner opting at the beginning of each financial year as to which system they will operate within. These countries enthusiastically embrace opportunities to use data and technology to streamline reporting and payment systems. They also focus on ensuring that the tax system is not ‘one size fits all’.

This report focuses on ways to make small changes to our tax system that will make a huge difference to small businesses. Some are policy changes that would make life easier for the small business community, and encourage spending with them, but the bulk are administrative changes that should be quick and easy to implement.

Without change, many small businesses will fail, leaving employees looking for work, communities lacking services, owners devastated and facing bankruptcy and an economic black hole at a time when Australia needs small business to pull us towards recovery.

A handwritten signature in black ink, appearing to read 'Kate Carnell'.

Kate Carnell AO
Australian Small Business and Family Enterprise Ombudsman

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Findings, Approach and Recommendations

Findings:

The business taxation system in Australia has been broadly designed to regulate the tax obligations of large businesses that have resources and staff to support compliance. However, large business taxpayers account for less than 2% of total Australian businesses. In its current form, the business taxation regime is too complicated and demanding for small business taxpayers.

While the ATO carries out a number of important roles, including maintaining the integrity of the Australian taxation system and administering the complex legislative environment governing the tax regime, it is businesses that overwhelmingly undertake the practical task of collecting tax on behalf of the Australian Government. This takes the form of time-consuming administrative responsibilities such as calculating, recording, withholding and remitting various types of tax collections that are demanded without reward or compensation to the small business operator.

An avoidable by-product of this imposed obligation is that the ATO is typically one of the largest creditors of a small business. The subsequent enforcement and debt recovery actions of the ATO can have a significant negative impact on a small business, particularly at times when the business finds itself in difficulty. The automatic imposition of interest charges and penalties by the ATO can tip a small business entity into a state of insolvency and potentially closure.

Tax is merely one of a number of complex regulatory matters that small business owners must grapple with and, for the vast majority, must rely on their trusted advisers. The current system uses small businesses as unpaid tax collectors and, even where mistakes are honestly made, the power imbalance means that small business owners can be subject to significant interest, penalties and other rectification costs. The current system makes compliance easy to get wrong and hard to get right.

Approach:

Our recommendations are based on the current tax mix and are designed to provide a better overlay to the complexity of the system to help relieve the compliance burden on small business. This is achieved by both making it easier for small business to get it right and providing better general support to small business taxpayers. Where disputes emerge, the approach is to create a better balance of power between a small business and the ATO so that the small business can access justice and be assured of fair treatment. The recommendations also incorporate approaches to ensure that the ATO and the Department of the Treasury better understand small business in administration of the system and the development of new measures.

Recommendations:

Make the tax system more small business friendly

1. Remove the imposition of Fringe Benefits Tax (FBT) on small business entities and make all fringe benefits acquired from small business suppliers exempt benefits to support business recovery.
2. Reform the FBT regime so that all defined “work” benefits are exempt and “choice” benefits (like a car used for personal purposes or other private benefits) are taxed as “income” in the hands of employees with simple and straightforward valuation rules.
3. Make the Instant Asset Tax Write Off permanent at its current threshold of \$150,000 and limit the concession to only those assets purchased from an Australian registered business.
4. The ATO should collect and distribute an expanded range of employee withholding obligations including superannuation and child support. This could be extended to include other regular payments such as employee union fees.

Make it easier for small business to get it right and harder to get it wrong

5. In addition to ongoing and appropriate integration of accounting software with tax systems, all known and relevant ATO data should be easily available to registered tax agents and the ATO should pre-populate a small business taxpayer’s return (including data from the Taxable Payments Reporting System).
6. Make ATO specialist advisers available in certain Centrelink Offices to personally assist small business taxpayers.
7. Ensure interpretive consistency across ATO and other agencies on critical issues such as the employee-contractor distinction and the research and development tax incentive program. Where there is not agreement on a relevant and material interpretation, taxation penalties and interest charges cannot be applied to a small business taxpayer.

Encourage ongoing compliance by small business taxpayers

8. The government should commit to ongoing support of the national tax clinics with administration and governance moved under an appropriate agency (such as the IGTO or ASBFEO) or to a private organisation via an open competitive grant.
9. Suspend penalties and interest charges for first tax offences and then waive them after 3 years of tax compliance.
10. In order to assist with small business cashflow and encourage compliance, small business taxpayers should be able to opt in to;
 - a. The Goods and Services Tax (GST) collected to be remitted directly to the ATO at the electronic point of sale of goods and services at an estimated rate appropriate to the business;
 - b. An option to remit amounts to the ATO in the first year of operation in respect of their estimated income tax based on their BAS reporting;
 - c. Income averaging measures as offered to sportspersons and artists should be extended to individuals in business.

11. Where an income tax return or activity statement is prepared by a registered tax or BAS agent, the review period is reduced to 12-months following lodgement, where that agent has proven compliance over 3 consecutive years with:
 - a. Full membership of a recognised professional association with a Professional Code of Conduct and compliance with continuing professional education requirements;
 - b. No record of substantiated client complaints to either the Tax Practitioners Board or their professional association;
 - c. Full compliance with their own taxation lodgement and payment obligations; and
 - d. Achievement of tax agent lodgement program benchmarks annually.

Assist and support small business in tough times

12. Establish a government-funded small business viability review by a trusted and accredited adviser:
 - a. triggered by data (whether ATO debt balances or accounting software reporting);
 - b. supported by ASBFEO working with ATO to update the ATO's online business viability assessment tool, including for crises, such as natural disasters and pandemics;
 - c. where small businesses are found to be viable, automatically providing for debt hibernation (with interest and penalties suspended) and allowing for economic hardship with potential to compromise tax debt;
 - d. with a potential outcome being a government-provided revenue-contingent small business loan, with repayments administered by the ATO.
13. Where a small business has generated, in conjunction with a small business restructuring practitioner, a small business restructuring plan, and that plan is recommended by the restructuring practitioner to the creditors of the small business, the ATO cannot vote against the plan.

Help small business get access to tax justice

14. Improve and formalise an extension of legal professional privilege to registered tax agents and registered BAS agents.
15. ATO to expand and make permanent its Small Business Independent Review process after the pilot program finishes in March 2021. The ATO should consistently promote and notify small business taxpayers of the availability of the process, as well as review by the IGTO and support via the ASBFEO Small Business Tax Concierge service.
16. Tax secrecy should be suspended where needed to allow sharing of taxpayer information with the ASBFEO or other relevant Commonwealth agency, coupled with similar suspension for the IGTO sharing with the ASBFEO or other relevant agency.
17. The IGTO should have unrestricted access to ATO systems without the need to notify the Commissioner.
18. There needs to be strengthened protections for people making disclosures to the IGTO, especially to protect ATO employees.
19. All ATO decisions regarding small businesses should be able to be reviewed by the AAT, with the ATO required to always provide a written statement setting out its reasons for a decision, including findings on material questions of fact and evidence relied upon.

Give small business taxpayers in a dispute with the ATO a fair go

20. Freeze enduring garnishment orders for 21 days from service on a small business taxpayer and provide an opportunity to appeal to the AAT with non-enduring garnishment orders being subject to the same process or otherwise made only with Federal Court oversight.
21. ATO to be prohibited from charging penalties and interest, issuing garnishee notices or instigating other recovery action on tax debt arising from a decision that is disputed until all avenues of appeal taken by the small business taxpayer are exhausted, with general interest charges (GIC) to be applied only from that time.

Ensure that tax policy and administration is based on an understanding of small business

22. Re-commence regional visits to small business groups to share what is happening on the ground throughout Australia with public reporting of agreed issues (e.g. ongoing impacts of bushfires, drought, flood etc.) with particular industry focus (such as farmers and related industries) and coupled with published minutes that note questions asked and answers provided.
23. Create a small business sub-group (possibly as part of the Board of Taxation) to be dedicated to small business issues, including with a specific focus on remedial measures for annual inclusion in a scheduled remedial tax bill. The group would include representatives of small businesses, tax professionals, software providers and other relevant people and organisations.
24. Department of the Treasury publication of an 18 month consulted tax program that is based on Treasury engagement including with small businesses that are then consulted at all stages as measures are developed (with draft legislation provided at an early stage of policy development and small business compliance costs fully costed), although integrity measures would be excluded where appropriate.
25. Legislative requirement to consult the Australian Small Business and Family Enterprise Ombudsman on any legislative or regulatory change that has a substantive impact on small business with the Ombudsman having the power to provide a Disclosure Statement that must be included with a RIS that points out issues, gaps etc.

Background

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) published a report in May 2019 entitled *Australian Taxation Office – Enforcement of disputed debts before the AAT*. That report contained eight recommendations and suggested three areas where further work would be constructive.

Since July 2019 devastating bushfires, floods and the COVID-19 pandemic have swept across Australia. On 12 March 2020, the Federal Government announced a stimulus package worth \$17.6 billion and within ten days secured the borders to all but returning citizens, closed non-essential businesses and announced a further financial stimulus package of \$66 billion.

Federal government agencies were tasked with delivering the stimulus package and generating further practical measures which would support and assist small businesses during the economic downturn. The ATO did just that through various initiatives, including:

- Introducing a simplified method of claiming additional running costs while working from home during the pandemic, available from 1 March 2020 to 30 June, 2021.
- Automatic deferral of lodgement dates for returns prepared by registered tax agents, including Fringe Benefits Tax (FBT) returns.
- Further deferral of lodgement dates, by request.
- Provision of an Emergency Support Infoline, in several languages.
- Provision of low interest payment plans.
- Provision to vary PAYG income tax instalments and claim a refund for prior instalments paid.
- Administration of the Cash Flow Boost and JobKeeper schemes.

We now know that the COVID-19 pandemic will result in a forecast deficit of more than \$213 billion this year, with net Government debt expected to reach \$966 billion in 2024.

The 2020-21 Federal Budget provided much welcome relief and support for small businesses through the JobTrainer¹ and JobMaker initiatives. The Government reintroduced tax loss carry back provisions² for companies, accompanied by changes to the instant asset tax write-off (IAWO), deductions for capital expenditure³, the R&D tax incentive⁴, the National Digitisation Plan⁵ and some minor changes to FBT⁶. Small business owners will receive additional mental welfare support through the NewAccess program.⁷

As we move into 2021, the ongoing economic impact of the pandemic provides an opportunity to reassess the regulatory landscape in which small business operates; to determine which interim financial stimulus measures are so beneficial that they should be made permanent and what other reforms would improve the legal, regulatory and compliance environment for small business and the Australian economy more generally.

The scope of this report therefore is to make strong and practical recommendations on how the taxation system can be reformed around the principles of:

- Relevance: a tax system needs to be appropriate for small business.
- Clarity: a tax system should be easy to comply with, and hard to get compliance wrong.

¹ Commonwealth of Australia, Budget 2020-21 Paper 2, page 227

² Commonwealth of Australia, Budget 2020-21 Paper 2, page 21

³ Commonwealth of Australia, Budget 2020-21 Paper 2, page 20

⁴ Commonwealth of Australia, Budget 2020-21 Paper 2, page 19

⁵ Commonwealth of Australia, Budget 2020-21 Paper 2, page 64

⁶ Commonwealth of Australia, Budget 2020-21 Paper 2, page 15

⁷ Commonwealth of Australia, Budget 2020-21 Paper 2, page 114

- **Simplicity:** there should be encouragement for ongoing compliance by small business taxpayers.
- **Service:** the ATO should assist and support small business owners in both good and tough times.
- **Fairness:** small business lacks the resources to take on the ATO and needs help to access tax justice.
- **Proportionate response:** when disputes arise, the ATO must give small businesses a fair go.
- **Nuance and consistency:** policy and administration should be driven by a superior understanding of the issues which affect small business.
- **Engagement and transparency:** the ongoing maintenance of the tax system – especially the law and administration of the system – should be dealt with as a matter of priority by the ATO and Treasury.

It is critical that these principles are applied across tax system regulation and administration. This is a system that has been added to and tinkered with for almost a century. This has created an increasingly complex system that lacks the coherence that small business desperately needs. The result is high compliance costs, red tape that impedes small business growth and employment, and the denial of justice to small businesses when things go wrong.

Make the tax system more small business friendly

Small business makes up the large majority of the Australian business population, at more than 98% of all registered businesses. Yet, over the years, the various tax acts have become onerous for the average small business to remain compliant with. The fact that the Australian tax system is built on a number of individual pieces of legislation, each of which is long and complex in its own right, and income tax is dealt with in approximately 47 separate pieces of legislation, indicates that the current system is obscure.

Our recommendations reflect simple changes that would greatly benefit small business operators while aiding economic recovery post COVID-19.

Recommendation 1: Remove the imposition of Fringe Benefits Tax (FBT) on small business entities and make all fringe benefits acquired from small business suppliers exempt benefits to support business recovery.

Recommendation 2: Reform the FBT regime so that all defined “work” benefits are exempt and “choice” benefits (like a car used for personal purposes or other private benefits) are taxed as “income” in the hands of employees with simple and straightforward valuation rules.

Recommendation 3: Make the Instant Asset Tax Write Off permanent at its current threshold of \$150,000 and limit the concession to only those assets purchased from an Australian registered business.

Recommendation 4: The ATO to collect and distribute an expanded range of employee withholding obligations including superannuation and child support. This could be extended to include other regular payments such as employee union fees.

Recommendation 1: Remove FBT

We acknowledge the changes to FBT announced in the 2020-21 Federal Budget, however, these are relatively minor amendments which tinker at the edges of a system and which do not go far enough. Following on from our recommendation in our 2020 *COVID Recovery Plan*⁸ that FBT should not be payable by a small business, we are further recommending that FBT should be removed from transactions conducted with a small business supplier.

As noted in the *Recovery Plan*, there are increasingly a number of benefits, such as gym memberships, internal cafes, restaurants, refreshment bars, and child care offered by large businesses on premise and which are a direct expense, which when offered by a small business, would attract FBT. The first part of this recommendation helps to alleviate this discrepancy.

My Office also recommends that transactions made with a small business supplier should be free of FBT, to encourage business to business dealings with the small business sector. With the increasing availability of regtech, it is possible to recognise when a supplier is a small business; with the now-accessible searchable register of small businesses – the Small Business Lookup Tool implemented as part of the Payment Times Reporting Framework – there should be a minimal increase in administrative burden for recognising when a transaction has been conducted with a small business. The exemption on transactions with a small business will increase the attraction of doing business with this sector.

We recognise that FBT raises around \$3.9 billion per financial year in total⁹, and we note that this figure has been decreasing for the last three years¹⁰ and is forecast to drop for the next two years.¹¹ It is our view that allowing small business to be competitive with large businesses, as proposed by the first part of our recommendation, and to make small business an attractive proposition for general business-to-business engagement, as proposed by the second part of our recommendation, will generate improved economic activity and that any shortfall should be offset by other areas of Government revenue generation.

Recommendation 2: Reform the current FBT regime

There is widespread support for a comprehensive review of the FBT regime, not least of which is its rate having remained steady at the highest marginal personal income tax rate. The FBT regime has been described as over-engineered and unnecessarily complex.¹² We recognise the policy intent to create a level playing field between cash salary and non-cash benefits provided by employers, but with simpler valuation rules and self-assessment of the otherwise deductible exemption, the current system could be improved.

Recommendation 3: Make the Instant Asset Write-Off permanent

The Instant Asset Write-Off (IAWO) should be made permanent at the current cap of \$150,000. As noted in our *COVID Recovery Plan*:

The frequent changes to thresholds and uncertainty over whether the instant asset tax write-off will apply in any year has complicated what should be a straightforward incentive for small businesses to invest in plant and equipment. Recent thresholds of \$20,000 and \$30,000 are too low for primary producers and manufacturers.

⁸ <https://www.asbfeo.gov.au/sites/default/files/COVID%20Recovery%20Plan%20v3.pdf>

⁹ This office is researching the percentage of this figure which is attributable to small business activity

¹⁰ ATO Annual report 2018-19 p48

¹¹ Commonwealth of Australia, Budget 2020-21 Paper 1, page 10-24

¹² Submission on Fringe Benefits Tax reform by Chartered Accountants Australia and New Zealand 9 June 2020

While the temporary increase to the IAWO (for those small businesses who opt-in to the simplified depreciation regime) and the temporary full expensing of eligible new depreciating assets until the end of the 2021-22 financial year is welcome, we recommend that, at the end of that period, the IAWO be made permanent at the level of \$150,000, and that threshold be regularly reviewed to ensure its relevance.

Further, to ensure that economic activity associated with the IAWO increases benefits to Australian businesses, we recommend that the IAWO only be available where the asset has been bought from an Australian registered business. Should businesses be able to buy direct from overseas manufacturers or suppliers, there will be a lost opportunity to build in additional economic benefit for Australian businesses.

Recommendation 4: ATO to reduce the administrative burden on small business employers

This recommendation builds on the one included in our *Recovery Plan*.

In addition to navigating the complex personal income tax regime, small business operators are required to act as collection agents for the government and superannuation funds. When a new worker is engaged, a small business owner must:

- Determine their correct status as an independent contractor or an employee and within that, whether they are full-time, part-time or casual.
- Determine the correct award that governs the individual's pay and entitlements.
- Calculate the correct PAYGW tax to be withheld from the employee's gross salary and remit it to the ATO.
- Determine if the worker is eligible for Superannuation Guarantee (SG) contributions (noting that this may vary from pay run to pay run).
- For now, comply with Choice of Fund rules and enrol as an employer in any number of funds that the individual workers nominate, or register through the Small Business Superannuation Clearing House. From July 2021, these rules will change again with employers needing to identify a new worker's stapled fund.
- Calculate the SG contribution payable which can vary depending on hours, entitlements, leave etc.
- Remit the SG contributions on a strict timetable – most usually quarterly, although in some instances it is monthly, alongside child support and additional superannuation contributions.

Small business owners are not compensated for this administrative burden and if they make errors, they bear the brunt of penalties and, potentially, personal liability for any resultant debt. Extensive resources are expended by government agencies in reviewing, auditing, and recovering unpaid employee entitlements. Small businesses sometimes use the withheld amounts for working capital and fall into arrears – a situation which is regrettable but understandable especially in times of economic stress. Similarly, the complexity of compliance with awards, pay rates, and the rules surrounding SG entitlement, sees some small businesses struggle to maintain compliance on an ongoing basis.

The current tax administration system maintains these sub-accounts for taxpayer entities:

- Income Tax Account (ITA) which processes the result of an annual income tax return and any payments or refunds made.
- Integrated Client Account (ICA) which processes activity statement obligations including PAYGW, GST and instalments of income tax – Pay-As-You-Go (Instalment).

We suggest that the ATO create a third sub-account within their systems – an Employer Account (EA) which receives one amount from the employer every pay run – linked to Single Touch Payroll (STP). Based on the amounts recorded through STP, the ATO would then distribute the funds to the

respective superannuation funds (SG and additional contributions) and other withholdings (child support) and retain and account for the PAYGW tax.

This measure is a simple, technologically efficient manner in which to make it easy for small business to get their tax compliance right, first time. Combined with a simplified award structure, and STP, small business employers will be relieved of onerous and unpaid administrative duties.

Make it easier for small business to get it right and harder to get it wrong

Australia's system of legislation covering taxation and the surrounding regulatory environment is one of the most complex in the world. While the system is built on three main pieces of legislation – the *Income Tax Assessment Act 1936*; the *Taxation Administration Act 1953*; and the *Income Tax Assessment Act 1997* – there are approximately 47 Acts in force which deal with various sections of income tax alone, on top of which are relevant Acts for other specific taxes, for example those relating to the GST. In total, Australia has about 125 different taxes, operating within their associated legislative and regulatory environment.

The foundation for the existing laws were written over 80 years ago and the attempt at simplification in 1997 resulted in an additional piece of complex legislation.

With the advancements in regtech and business accounting and compliance software, we should be able to make it easier for small business operators to understand their compliance obligations and to meet them in a timely manner. The first step in this process is to incentivise small business owners to digitise across their accounting and record keeping systems. STP has laid the groundwork for this.

The next step is to integrate that data into tax compliant reporting to streamline the lodgement and payment functions.

Recommendation 5: In addition to ongoing and appropriate integration of accounting software with tax systems, all known and relevant ATO data should be easily available to registered tax agents and the ATO should pre-populate a small business taxpayer's return (including data from the Taxable Payments Reporting System).

Recommendation 6: Make ATO specialist advisers available in certain Centrelink Offices to personally assist small business taxpayers.

Recommendation 7: Ensure interpretive consistency across ATO and other agencies on critical issues such as the employee-contractor distinction and the research and development tax incentive program. Where there is not agreement on a relevant and material interpretation, taxation penalties and interest charges cannot be applied to a small business taxpayer.

Recommendation 5: ATO should pre-populate small business tax returns

Since 2009, the ATO has provided a pre-filling facility for individual taxpayers, where their tax return can be automatically populated with data reported to the ATO by third parties. This includes wages, interest received, dividend income, managed fund and trust distributions, and superannuation contributions made.

My Office proposes that the ATO extend the pre-filling service to small business. The business schedule in the annual income tax return would be populated with data held by the ATO; gross revenue obtained from the lodged business activity statement (BAS) returns, and wages and superannuation expenses as reported through the STP system.

Importantly, this proposal provides certainty to taxpayers who have reported revenue and employee entitlements honestly throughout the year.

Businesses that operate in certain industries and supply specific services have been required to provide details of payments made to contractors, in an effort to counter the informal economy.¹³ These payments are reported annually to the ATO via a taxable payments reporting system (TPRS).

The intention of the TPRS is reasonable, and my Office welcomes any technological improvement to assist businesses to ensure the correct amount of tax is paid.

It seems reasonable, and simple, that a small business contractor who has been reported via a TPRS report should receive an electronic summary of payments which have been made to them over the previous financial year in order to simplify their own tax affairs.

Recommendation 6: ATO advisory officers within Government shopfronts

Centrelink offices have become hubs for government services, allowing individuals to deal with Centrelink, Medicare, and Child Support in the one location. Various States have introduced shop front service centres where any government matter can be dealt with at the one location.

The Ombudsman recommends that the ATO should make small business advisers available in certain Centrelink offices, to be able to assist small business owners with taxation matters. Importantly, these small business advisers should be able to give real world, specific advice to a small business owner, and be able to explain their current tax position in terms of lodgement and account balances.

Naturally, the ATO advisers would not be able to provide specific financial services advice, or any other advice which they are unqualified to deliver. However, the adviser should be able to provide more detailed advice than that which can be found on the general ATO website and help explain the taxpayer's position to them.

Recommendation 7: Interpretive consistency between agencies is crucial

In December 2019 ASBFEO released a *Review of the R&D Tax Incentive (R&D TI)*, which highlighted the current difficulties and negative consequences for small business taxpayers when government agencies operate in an inconsistent manner on common ground. We wrote:

The (R&D TI) program requires a fairer, more consistent, educative and customer-focused approach by both the Department of Industry, Innovation and Science (AusIndustry) and the Australian Taxation Office (ATO) embedded consistently throughout both networks.

A system of self-assessment for registration in the R&D TI program, without any process for confirmation or approval of such registration leaves small business participants without certainty and at risk of retrospective amendment or outright rejection of their R&D activities. The very real potential for financially devastating consequences is detailed in our report.

Further, our Assistance function within ASBFEO regularly receives complaints regarding the inability to obtain reliable advice from Fair Work Australia or the ATO on the categorisation of workers as employees or independent contractors. Business.gov.au provides general advice on the distinction between an employee and a contractor and the ATO website hosts a employee/contractor decision tool, which

- uses the information the user provides to outline their tax and super obligations;

¹³ [Black Economy Taskforce: extension of the taxable payments reporting system \(TPRS\) | Australian Taxation Office \(ato.gov.au\)](#)

- draws on outcomes of court cases that considered various indicators to establish whether a person is an employee within the common law meaning of the term;
- does not consider other obligations – for example, payroll tax or WorkCover obligations; and
- is designed to guide the user’s decision.

The ATO website advises users that if they are still unsure about their individual circumstances, independent advice or a private ruling should be sought.¹⁴

The consequences of not having clarity and certainty on the status of workers engaged by a small business can be catastrophic to that business. Under ATO review, if the small business is found to have wrongly categorised workers and particularly where superannuation guarantee contributions are involved, the cost of correction including administrative penalties and foregone earnings can make the entity insolvent. We understand there is no discretion in the superannuation guarantee charge regime, and audit and review work is often commenced on the inquiry of a worker, who may not have understood the initial offer of work or engagement contract in the first place.

Given the government’s recent proposed amendments to the industrial relations system, including a definition of ‘casual employment’¹⁵ we seek to resolve this potentially devastating issue for small businesses by defining employee, defining contractor and ensuring interpretive consistency across agencies.

¹⁴ <https://www.ato.gov.au/Calculators-and-tools/Host/?anchor=ECDTSGET&anchor=ECDTSGET/questions/ECDT#ECDTSGET/questions/ECDT>

¹⁵ Fair Work Act (Supporting Australia’s Jobs and Economic Recovery) Bill introduced to Parliament on 9 December 2020

Encourage ongoing compliance by small business taxpayers

Recommendation 8: The government should commit to ongoing support of the national tax clinics with administration and governance moved under an appropriate agency (such as the IGTO or ASBFEO) or to a private organisation via an open competitive grant.

Recommendation 9: Suspend penalties and interest charges for first tax offences and then waive them after 3 years of tax compliance.

Recommendation 10: In order to assist with small business cashflow and encourage compliance, small business taxpayers should be able to opt in to;

- a. The Goods and Services Tax (GST) collected to be remitted directly to the ATO at the electronic point for sale of goods and services at an estimated rate appropriate to the business;
- b. An option to remit amounts to the ATO in the first year of operation in respect of their estimated income tax based on their BAS reporting;
- c. Income averaging measures as offered to sportspersons and artists should be extended to individuals in business.

Recommendation 11: Where an income tax return or activity statement is prepared by a registered tax or BAS agent, the review period is reduced to 12-months following lodgement, where that agent has proven compliance over 3 consecutive years with:

- a. Full membership of a recognised professional association with a Professional Code of Conduct and compliance with continuing professional education requirements;
- b. No record of substantiated client complaints to either the Tax Practitioners Board or their professional association;
- c. Full compliance with their own taxation lodgement and payment obligations; and
- d. Achievement of tax agent lodgement program benchmarks annually.

Recommendation 8: Ongoing support of national tax clinics

Small business owners are time poor and are usually responsible for several, if not all roles within the business; sales, purchases, accounting, engaging and managing workers, occupancy and logistics and so on. With the complexity of the current taxation system as it applies to small businesses, it can take just one unusual transaction or one overdue lodgement to cause stress and fear.

In some instances, where the small business experiences financial difficulty – as simple as a major client not paying on time – their trusted adviser declines to assist until their professional fees are paid up-front, leaving the small business owner in a desperate situation.

The National Tax Clinics program fulfils a critical role in providing advice, most often practical advice on lodgements and debt arrangements, and tax assistance to small business owners who may otherwise continue to fall behind. Many vulnerable clients lack the ability or confidence to speak with ATO staff and the tax clinics provide an essential link in the communication chain. This can also be used to help prevent matters escalating into disputes, acting as a way to mitigate future costs to both the small business taxpayer and the ATO.

The data collected by the tax clinics gives rise to a perception of a conflict of interest with the ATO as program administrator. This threatens to undermine confidence in the clinics, especially by small business taxpayers who are already in debt to the ATO and are concerned about recovery action by the ATO. As a result, oversight of the tax clinics program should be managed by an entity other than the ATO, such as the IGTO or ASBFEO.

Recommendation 9: Suspend penalties on first tax offences

As noted earlier in this report, Australia has a particularly complicated taxation environment. However, the small business sector maintains a high level of compliance. In our 2019 report *Australian Taxation Office - enforcement of debt recovery*, the ATO reported that there were approximately 3.8 million registered small businesses including 1.6 million sole traders. In the 2017- 18 year, of the 3.8 million small businesses, the ATO undertook about 130,000 reviews (audits and default assessments) and consequently issued approximately 68,000 amended assessments¹⁶.

The ATO also noted that over 85% of all small business tax is paid on-time or within 90 days of the due date. These are remarkably good figures given the inherent complication of the regime under which these small businesses must operate.

However, given the complexities of the tax regime, we recommend that where a small business commits an error for the first time, penalties and interest are suspended (that is, not recovered) where a small business makes good on the error. It is important to recognise that the definition of where the error first occurs should include all instances of the same error up to the point where the ATO advises of the error, or where the small business recognises that the error has been made, rather than on the errors first occurrence only. This will alleviate the unfair situation where a small business has, in good faith, been making an error on an ongoing basis, but only gets relief for the first individual instance of the error.

After 3 years of lodgement and payment compliance by the small business taxpayer, those initial penalties and interest are waived in recognition of sustained compliance by the small business.

Recommendation 10: Remit GST collected at source

The current GST system requires a 'netting off' calculation with every Business Activity Statement (BAS) return – the computation of input tax credits against the GST collected. A sale of \$1,100 means the business has collected \$100 from the customer on behalf of the government. If the small business incurred costs in order to make that sale, they have paid GST on those inputs. The GST included in the price of those costs is 'netted off' from the \$100 collected and only the difference is remitted as part of the BAS return. In the case where expenses to run the business exceed sales (or if the sales made are GST-free such as medical or educational supplies) there may be a GST refund due to the business.

We recommend that there be an option by which GST is remitted directly to the ATO when the small business is paid for goods and services provided to customers, calculated as a percentage which aligns with previous annual net rates. When the BAS return is due, the small business will continue to calculate and report the exact amounts of GST collected on sales and GST input tax credits to which they are entitled on business expenses, along with any PAYG(I) liability. The result will be reduced by the amount already remitted to the ATO at the time the customer paid for the sale.

My Office recognises that some small businesses use their collected GST amounts for additional cash flow and are able to balance their payments on time and as needed. This recommended option however, will provide greater certainty, a much-reduced administrative burden, and ease of use for a considerable proportion of small businesses.

An extension of this proposal is to develop opportunities for small business taxpayers to "opt in" to other mechanisms which support their ongoing compliance. We understand that new small

¹⁶ The Australian Small Business and Family Enterprise Ombudsman, *Australian Taxation Office – enforcement of debt recovery*, page 18 – this figure differs from the figure recognised by ASBFEO, as it includes some enterprises which ASBFEO does not count in its consideration of small businesses, such as, for example, self-managed superannuation funds.

businesses may not be aware of their exact income tax liability until many months after their first year of operation. A profitable first year will see the new business taxpayer faced with a lump sum tax bill and a catch up of subsequent year PAYG(I) instalments. If the profits have been reinvested in the business or used to reduce debt, the business' cashflow may not meet these tax debts.

An option to remit amounts to the ATO in the first year of operation, as part of their activity statement, would assist and support new small business taxpayers.

While we support the Budget initiative to reintroduce the tax loss carry back provisions, we also consider that income averaging provisions currently available to sportspersons, performing artists and primary producers, should be extended to individuals in business.

Recommendation 11: Reduced period of ATO review

The Assistance team of this Office hears complaints from small business taxpayers about their experiences with tax advisers; both those registered and not registered with the Tax Practitioners Board (TPB). It is currently difficult to know whether a tax agent is reputable, has current knowledge, or has had complaints raised against them.

We propose an accreditation scheme be introduced in Australia, whereby a registered tax agent may apply to be granted special status as a quality controlled, experienced, and competent adviser in tax matters, with the scheme to be administered by the ATO. The accreditation would cover:

- Maintaining full membership of a recognised professional tax association, which has an appropriate Professional Code of Conduct which includes a dispute resolution process – this provides a base level for the standard within the tax agent industry, recognises the role of tax associations, and provides for a clear, codified dispute resolution process.
- Having no record of substantiated client complaints to either the TPB or their professional association – it is currently difficult to determine whether a tax agent has had a substantiated complaint made against them. The search function on the TPB website is difficult to find and is specific in the way in which it operates.
- Maintaining full compliance with their own taxation lodgement and payment obligations – this will ensure that accredited tax agents are timely and compliant in their own tax affairs.
- Achieving tax agent lodgement program benchmarks consistently – achieving benchmarks ensures that tax agents can be measured against a similarly qualified specialist.
- Achieving and maintaining each of the above concurrently for 3 consecutive years – ongoing compliance ensures that standards are maintained continuously.

Successful accreditation as a tax agent would give assurance to a small business owner who relies heavily on the expertise of their tax adviser. As an incentive for small business owners to utilise the services of an accredited tax agent, the ATO would have a shorter period of time – our proposal is 12 months – in which to start a review or audit for small business tax returns. We expect that accreditation will also highlight those advisers who need closer supervision or intervention.

ATO to assist and support small business in tough times

The ATO and the bank are most likely the first entities to become aware that a small business is in financial or operational difficulty. The ATO holds large volumes of contemporaneous data on small business income tax and activity statement lodgements, STP and the flow through to debt balances on the various sub-accounts mentioned earlier (Income Tax Account and Integrated Client Account).

While the ATO has developed content, including videos and tutorials, on their website to inform small business operators, we look for nuanced, empathetic and proactive interaction when it becomes apparent that a small business is falling behind. The ATO uses behavioural insights to nudge taxpayers and guide optimum practices in terms of contact method and timing, but still more needs to be done and in a timely manner, to engage with, assist and support small businesses when they are doing it tough.

Recommendation 12: Establish a government-funded small business viability review by a trusted and accredited adviser:

- a. triggered by data (whether ATO debt balances or accounting software reporting);
- b. supported by ASBFEO working with ATO to update the ATO's online business viability assessment tool, including for crises, such as natural disasters and pandemics;
- c. where small businesses are found to be viable, automatically providing for debt hibernation (with interest and penalties suspended) and allowing for economic hardship with potential to compromise tax debt;
- d. with a potential outcome being a government-provided revenue-contingent small business loan, with repayments administered by the ATO.

Recommendation 13: Where a small business has generated, in conjunction with a small business restructuring practitioner, a small business restructuring plan, and that plan is recommended by the restructuring practitioner to the creditors of the small business, the ATO cannot vote against the plan.

Recommendation 12: Business viability review and revenue contingent loans

The *small business viability review* is a proposal whereby small business owners facing significant financial stress can obtain funding of up to \$5,000 to access tailored specialist advice on how to improve the operation of their business, or, where the advice is to wind up the business, to implement that. We propose eligibility to be based on a 20% reduction in cashflow – as captured by activity statement data for taxpayers using the cash basis of reporting to the ATO on a rolling 12 month basis, or where a systemic shock, for example, a natural disaster or a sudden economic downturn such as the Global Financial Crisis or the COVID-19 pandemic has been declared by a State, Territory or the Federal Government. A business owner (or their representative, for example, their accountant or certified bookkeeper) would apply for a small business viability review and an initial amount of up to \$3,000 would be paid to an appropriately accredited and experienced professional business adviser. The adviser would assess the current financial position of the business, its viability to continue as a going concern and make recommendations on issues and options of turnaround or exit.

We have previously proposed the introduction of a *Small Business Debt Hibernation* instrument¹⁷, which would allow a State, Territory or the Federal Government to declare a systemic shock such as those experienced during natural disasters, pandemics, significant economic down-turns or other crises. The instrument would run for a minimum of 90 days, and during that period tax payments could be deferred, with an extended period for the repayment of debts once the instrument has lapsed.

¹⁷ Recommendation 2, Insolvency Practices Inquiry Report, Australian Small Business and Family Enterprise Ombudsman, 2020.

As recently highlighted in a matter heard by the AAT¹⁸, the ATO continues to pursue small business owners for matters which have the potential to significantly impact that person financially, emotionally, and, in the case mentioned, potentially leave a person homeless.

Case Study:

The case of Cox and Commissioner of Taxation highlights that, even where GIC and penalties are waived, the tax debt may be too large for the business owner to pay off within their lifetime. It may also be the case that, once GIC and penalties already accrued have been set aside, they will start accruing again on the remaining liability. As was the case in the Cox matter, the small business owner may not be in a position to make repayments large enough to pay off the GIC each payment period, let alone start to reduce the actual tax debt.

Where a business viability review has shown that a small business owner is in economic hardship, and where the recovery of the central tax debt is unlikely to be fulfilled under any circumstances, the ATO should consider the compromise of that tax debt, rather than simply waiving any GIC or penalties.

Where the advice is that the small business is viable and can continue trading and return to profitability, we propose they be eligible for a government-provided small business loan, with revenue-contingent repayments administered by the ATO. First proposed by ASBFEO in the *COVID-19 Recovery Plan*, this loan to support viable small businesses, remains a central recommendation.

These loans would be Government provided (although may be funded privately), and further eligibility criteria may include the business having been in operation for at least 3 years, with tax and activity statement lodgements currently up to date. The amount able to be borrowed will be set at a percentage of the business' annual turnover.

Similar to the HECS – HELP loans, repayments for the small business loan will be made through the tax system and the unpaid balance indexed every 12 months in line with the Consumer Price Index.

Should the advice indicate that the business is nonviable and should be wound up, \$2,000 more, taking the total paid to \$5,000 should be made available for a registered professional who can undertake this process within the recently enacted small business simplified insolvency regime.

ASBFEO will act as a concierge for the *small business viability review* scheme, and we repeat our proposal that details of the scheme are included in the ATO's compliance notes, and that the ATO business viability assessment tool be updated.

Recommendation 13: ATO cannot vote against a recommended restructuring plan

The ATO is frequently one of the largest creditors when a small business enters external administration, and is, in 15% of cases, the creditor which initiates the administration process¹⁹.

Legislation passed in December 2020 providing eligible, registered small businesses the ability to seek the assistance of a small business restructuring practitioner, is a good first step. The process is designed to ensure that viable businesses are given the opportunity to restructure appropriately, to manage their liabilities, debts, and creditors, and exit the restructure process in a stronger position.

¹⁸ [Cox and Commissioner of Taxation \(Taxation\) \[2020\] AATA 3857](#)

¹⁹ The Australian Small Business and Family Enterprise Ombudsman, "*Insolvency Inquiry Report, July 2020*", page 11

However, where it is the ATO which is owed more than 50% of the total liabilities of the business, the ATO will have the single decision on whether the restructure proposal is accepted. Similarly, where the ATO holds a significant proportion of the liabilities of a business, the ATO again holds a significant weight of power in the discussion whether the business should be able to restructure.

We recommend that, where a qualified and fully independent small business restructuring practitioner has approved the proposed restructure, the ATO should be bound to accept that restructuring proposal. The Federal Government has implemented a regulatory and qualification framework regarding the registration of small business restructuring practitioners. As such, it should satisfy the ATO that, where a restructuring plan has been created with such a practitioner, the small business will have a reasonable chance to manage its liabilities and repayments and continue as a viable entity.

Help small business get access to tax justice

Recommendation 14: Improve and formalise an extension of legal professional privilege to registered tax agents and registered BAS agents.

Recommendation 15: ATO to expand and make permanent its Small Business Independent Review process after the pilot program finishes in March 2021. The ATO should consistently promote and notify small business taxpayers of the availability of the process, as well as review by the IGTO and support via the ASBFEO Small Business Tax Concierge service.

Recommendation 16: Tax secrecy should be suspended where needed to allow sharing of taxpayer information with the ASBFEO or other relevant Commonwealth agency, coupled with similar suspension for the IGTO sharing with the ASBFEO or other relevant agency.

Recommendation 17: The IGTO should have unrestricted access to ATO systems without the need to notify the Commissioner.

Recommendation 18: There needs to be strengthened protections for people making disclosures to the IGTO, especially to protect ATO employees.

Recommendation 19: All ATO decisions regarding small businesses should be able to be reviewed by the AAT, with the ATO required to always provide a written statement setting out its reasons for a decision, including findings on material questions of fact and evidence relied upon.

Recommendation 14: Improve and formalise an extension of legal professional privilege

The ATO's powers of access are limited by the common law doctrine of legal professional privilege (LPP). In general, LPP applies to protect communications made between a legal adviser and the client for the dominant purpose of giving or receiving legal advice, or for use in existing or anticipated litigation.

It generally does not apply to communications between accountants or bookkeepers and their clients, but the ATO has put in place the "accountants' concession", which is an administrative concession in respect of certain types of "documents" that exist due to the relationship between an accountant, bookkeeper or other non-legal professional and their client. As a general rule, the ATO abides by those administrative rules.

However, the accountants' concession is not legally binding.

In New Zealand, there are 'approved advisor groups' that give tax advice, follow a certain code of conduct, and are approved by the Commissioner of Taxation. As a member of one of these approved advisor groups, tax agents are covered by the 'right of non-disclosure' where advice provided to a client cannot be used against the tax agent. This is intended to promote voluntary compliance with the New Zealand tax code through the full and frank discussion of tax matters between a tax agent and their client. Currently, there are 4 organisations that have approved advisor group status in New Zealand including the Accountants and Tax Agents Institute of New Zealand, CPA Australia, Chartered Accountants Australia and New Zealand, and the Certified Practising Accountants of NZ.²⁰ We recommend that the current position of LPP for registered tax and BAS agent be strengthened so that it is not discretionary or an administrative concession but is extended and formalised to cover all relevant advice.

Recommendation 15: Extension of Small Business Independent Review Process

From 1 July 2018, the ATO implemented an internal independent review process for small business taxpayers which was trialed in South Australia and Victoria for an initial 12 months. The trial was subsequently extended for an additional 18 months to the end of 31 December 2020 and then further to 31 March 2021.²¹ Eligible small businesses are currently able to dispute matters regarding income tax, GST, excise, the luxury car tax, the wine equalisation tax, and fuel tax credits. We note that, based on the ATO 2019-20 Annual Report, 66 independent reviews were completed in the 2018-19 financial year and 87 during 2019-20.²²

While the number of completed reviews is small, and the outcomes of the reviews are not noted in the ATO Annual Report, we welcome this extension and my Office has anecdotally received good feedback where the review process has applied. We believe that the Small Business Independent Review process should be continued.

Notwithstanding that the current process is for the ATO to advise small businesses when they are eligible for the Independent Review process²³, we also believe that the process should be promoted on all relevant ATO webpages, notifications etc. especially those which include information regarding dispute resolution processes²⁴.

Recommendation 16: Suspend tax secrecy across relevant agencies

This Office is frequently contacted by small business owners who are looking for assistance in their dealings with the ATO. The secrecy provisions of taxation legislation dictate that the ATO cannot discuss tax matters with a member of ASBFEO directly. This obviously has an impact on the ability of this Office to assist in resolving tax matters.

It would be simple to amend the relevant Act to allow the ATO to discuss with ASBFEO and certain other government agencies the tax matters of a small business owner where that small business has given clear and informed consent.

²⁰ <https://www.ird.govt.nz/roles/tax-agents/tax-agent-status>

²¹ <https://www.ato.gov.au/General/Dispute-or-object-to-an-ATO-decision/In-detail/Avoiding-and-resolving-disputes/Independent-review/Independent-review---small-business-pilot/>

²² Australian Taxation Office for The Commonwealth Of Australia, 2020, "Commissioner of Taxation Annual Report 2019-20", p185

²³ https://www.ato.gov.au/general/dispute-or-object-to-an-ato-decision/in-detail/avoiding-and-resolving-disputes/independent-review/independent-review---small-business-pilot/?page=1#How_to_request_an_independent_review

²⁴ An example is the webpage located at <https://www.ato.gov.au/General/Dispute-or-object-to-an-ATO-decision/Options-for-resolving-disputes/> (accessed on 21 October 2020) which mentions the independent review process for businesses with a turnover above \$250 million, but does not mention the process for small business

Recommendation 17: IGTO to have unrestricted access to ATO systems

Currently the IGTO must notify the Commissioner before commencing an investigation and can only obtain tax secret information once the investigation has started and can then only receive requests for information which the Commissioner has approved. ie the Commissioner decides what access is granted and the IGTO therefore cannot independently verify that his office has received all the relevant information. The Commissioner's right to withhold hampers investigations and dispute resolution processes.

Unrestricted access would allow the IGTO to properly self-investigate in a timely way, follow the office's own lines of inquiry and reach conclusions based on diligent verified searches, removing the delay and uncertainty of Commissioner requests and responses. The IGTO should have full and unfettered access to ATO data. Access by the IGTO to Commissioner systems would produce an audit trail to show where information was obtained and ensure integrity of the system.

Recommendation 18: Increased protection for whistleblowers

Currently, the IGTO is carved out of public interest disclosures with relevant disclosures needing to go to the Commonwealth Ombudsman. With increased protection of disclosures from statutory and civil proceedings where self-initiated, direct disclosures to the IGTO would better serve the public interest by effectively providing "no wrong door" approach and IGTO could then on-refer as necessary. We acknowledge this proposal would require increased resourcing.

Recommendation 19: All decisions should be reviewable by the AAT

The current framework for which decisions of the ATO can be reviewed by the Administrative Appeals Tribunal (AAT) is overly complex for a small business owner to understand easily. Some penalties imposed by the ATO – such as the GIC²⁵ and actions taken, including the issue of garnishee notices²⁶ – cannot be reviewed by the AAT and must be challenged through the court system. Given that GIC and garnishee actions continue to have effect during appeal processes, there is, again, a disincentive for a small business to make an appeal.

We recommend that all small business matters should be reviewable decisions as defined by Part IVC of the *Taxation Administration Act 1953*, and that all matters should be able to be heard by the AAT as a first stage of external review.

Section 28(1) of the Administrative Appeals Tribunal Act 1975 notes:

"if a person makes a decision in respect of which an application may be made to the Tribunal for a review, any person (in this section referred to as the **applicant**) who is entitled to apply to the Tribunal for a review of the decision may, by notice in writing given to the person who made the decision, request that person to give to the applicant a statement in writing setting out the findings on material questions of fact, referring to the evidence or other material on which those findings were based and giving the reasons for the decision, and the person who made the decision shall, as soon as practicable but in any case within 28 days after receiving the request, prepare, and give to the applicant, such a statement."²⁷

²⁵ <https://www.ato.gov.au/general/dispute-or-object-to-an-ato-decision/request-remission-of-interest-or-penalties/remission-of-interest-charges/#Furtheravenuesofreview>

²⁶ Rossi and Commissioner of Taxation (Taxation) [2015] AATA 601, 10 July 2015
)<http://www6.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2015/601.html>

²⁷ *Administrative Appeals Tribunal Act 1975 (Cth)*, <https://www.legislation.gov.au/Details/C2018C00172>, retrieved 21 October 2020

However, Section 14ZZB(2) of the *Tax Administration Act 1953* notes:

“Sections 28 and 44A of the AAT Act do not apply in relation to a reviewable objection decision.”²⁸

We note that where the ATO has made a settlement with a small business, that settlement has, on average, resulted in a 39% decrease in the value of the ATO position.²⁹ Generally, where an ATO decision is reviewed by the AAT, there is a 58% reduction in value of the ATO’s previous position.³⁰

Given this, it seems reasonable that the ATO should provide a reason for its initial position when matters are reviewed by the AAT. It may be that by providing this reason, an ATO decision is better understood, or a higher level of knowledge of the taxation framework is gained by a small business owner, which may also result in a lower decrease of the ATO’s value position.

Give small businesses in dispute with the ATO a fair go

Australia’s current income tax system is based on self-assessment, where an entity’s income tax return, or periodical BAS return, is accepted on face value by the ATO when it is lodged. A taxpayer may later amend their own annual income tax return or BAS if they realise they have made an error. Such actions are called “voluntary disclosures” and may not attract the GIC or penalties.

Still, an unwieldy taxation system has an overbearing impact on small business owners. Unclear rules and minimal guidance delivered using confusing language adds a relatively higher degree of burden for small businesses over large businesses, as small business owners use what little spare time they have to ensure they are abiding by the rules. As noted in this Office’s 2019 report *Australian Taxation Office – enforcement of debt recovery*, the ATO itself recognises that “due to the complexity of tax and superannuation law, it is inevitable that some areas of disagreement will arise” between the ATO and small business.³¹

Recommendation 20: Freeze enduring garnishment orders for 21 days from service on a small business taxpayer and provide an opportunity to appeal to the AAT with non-enduring garnishment orders being subject to the same process or otherwise made only with Federal Court oversight.

Recommendation 21: ATO to be prohibited from charging penalties and interest, issuing garnishee notices or instigating other recovery action on tax debt arising from a decision that is disputed until all avenues of appeal taken by the small business taxpayer are exhausted, with general interest charges (GIC) to be applied only from that time.

Recommendation 20: Garnishment orders to be frozen

Penalties, interest, and the extreme debt recovery action of garnishing bank accounts can commence even while a small business grapples with the issues which are under dispute with the ATO. Our 2019 report concluded:

²⁸ *Tax Administration Act 1953 (Cth)*, <https://www.legislation.gov.au/Details/C2020C00279>, retrieved 21 October 2020

²⁹ Australian Taxation Office for The Commonwealth Of Australia, 2020, “*Commissioner of Taxation Annual Report 2019-20*”, p186

³⁰ *ibid.*

³¹ Commissioner of Taxation *op. cit.* p.36

Any of the stronger forms of debt recovery action by the ATO (garnishees, Director's penalty notices, statutory demands, and sequestration or winding-up applications) can directly cause the failure of a small business. These options should be considered only when all other avenues for securing a payment arrangement or resolving a dispute through established channels (including alternative dispute resolution and the AAT) have been unsuccessful. Further, these options should be authorised only at the highest level within the ATO, with a small business specialist being intimately involved in all cases before stronger forms of debt recovery action are adopted.

This current recommendation echoes our earlier call:

It is important to recognise that it is the ATO that chooses to produce these orders and, despite its seriousness, not a court. Further, the ATO regards these orders as examples of "firmer" action and not "stronger action" that they view as statutory demands, actions to wind up and so forth. Put simply, garnishee notices should not be used and, should they be required, there should be mandated external oversight and approval (such as through the court system) before such an order is made.

My Office acknowledges that in extreme cases where there is compelling evidence of an imminent flight risk or high probability of removal of assets, a 21 day freeze from the date of service may not be appropriate. However, external oversight by a court will increase public confidence in the processes leading up to this stronger form of debt recovery.

The current ATO practice of issuing a garnishee order in respect of a taxpayer by electronic means to the institution but by ordinary mail to the taxpayer is an inappropriate exercise of power and has potentially devastating effects on the small business. We recommend that a 21 day freeze on any non-court ordered garnishment action be standard practice and that the order be reviewable by the AAT.

Recommendation 21: No interest or penalties charged until appeals process is exhausted

We acknowledge the role of the ATO as the Australian Government's principal revenue collection agency, administering the legislation governing tax and supporting the delivery of government benefits to the community. As this office has noted previously, under self-assessment, a Notice of Assessment, including an Amended Assessment after a review or audit, is conclusive of the correctness of the amount shown on it. If tax is payable on the assessment notice, it constitutes a liquidated debt due in law and payable upon expiry of the prescribed period for payment.

Where a taxpayer disagrees with an ATO decision, they have the right to have that decision reviewed through the objection process. However, the legislative framework underlying ATO policy is designed to ensure that objections, applications for review or appeals are not to be used to delay the payment of tax. The Commissioner can take legal action to recover outstanding tax irrespective of whether the tax is subject to an objection, review, or appeal.

Our past inquiries and reports have identified and discussed the difficulties, the costs, the potential harm and stress that the objection and subsequent external review mechanisms cause small business operators. Further this office is aware that there are frequent delays within the ATO in resolving objections, reviews, audits, and disputes when a decision is appealed by the taxpayer.

Given that the system allows for the ATO to increase the principal of a disputed tax debt owed by a small business taxpayer by the imposition of penalties, shortfall interest charge and daily compounding GIC, and the threat of garnishing bank accounts, it is fair that small businesses be given every avenue to appeal a decision which negatively impacts them without those potential penalties continuing to accumulate.

Where interest accumulates against a penalty which has already been imposed by the ATO, there is a real disincentive for a small business to seek a review of the decision: should the ATO decision be upheld, interest will have been accruing against the original debt on a daily basis. The incentive, in this instance, is to just accept and pay the penalty rather than seek a review. The GIC, which is currently charged at 7.02% compounding daily, is automatically generated and debited to the taxpayer's account and the sight of a "debt" balance continually increasing can have a severe impact on a small business owner's wellbeing.³²

We recommend that the ATO should be required to follow a system similar to that in the United States whereby the Inland Revenue Service (IRS) cannot collect a tax debt until all avenues of appeal have been exhausted. We believe that removing the ability to charge interest or recover the disputed debt will be a strong incentive for the ATO to publish accessible, effective and reliable guidance on critical issues for small business, respond to audited taxpayers in a timely manner and to proactively offer ADR options to resolve disputes faster. To dissipate any opportunity for a small business to use an appeal as a stalling tactic while the business disposes of assets which could be used by the ATO to service a debt, we believe there is merit in the United Kingdom system where action to dispose of significant assets can be frozen during a dispute. This was noted in our earlier report *Australian Taxation Office - enforcement of debt recovery*³³. However, there clearly needs to be a balance between the value of the assets which may be frozen and the level of the debt in dispute.

While there may be an incentive for some business owners to continue to seek an appeal in order to delay the payment of a legitimate outstanding debt, we believe the financial cost of seeking further reviews past a point (for example, beyond the AAT), will be more onerous than the actual penalty. This means that vexatious appeals against decisions are unlikely to proceed, especially where a small business owner knows their chance of winning the case is negligible.

Ensure that tax policy and administration is based on an understanding of small business

The complexity of the taxation laws and the system of self-assessment also underlies a sense of distrust between small businesses and the ATO. Their inability to obtain clear guidance without engaging costly professional tax advisers exacerbates the risk of getting it wrong. While a small business may, in many cases for years, believe they were doing the right thing, their first substantial interaction with the ATO can be the notification of an error from years ago with significant financial repercussions.

The complexity of a tax system does not necessarily have to mean a fraught relationship with a tax office. Tax offices in other parts of the world enjoy an enviable relationship with their constituents. Sweden created a successful start-up and small business culture, which has today developed largely around the technology sector. The French tax framework has a reputation for complexity, however, it is complex only so far as it treats different entities in different ways and has several categories of business based on size and sector in which that business operates.³⁴ The French system also allows a small business owner to choose at the beginning of each financial year whether they will operate under a micro-enterprise regime, a simplified small business regime or under the general company tax regime.³⁵

³² It is worth noting that the current interest rate which the ATO pays back to taxpayers is 0.02%

³³ The Australian Small Business and Family Enterprise Ombudsman, *Australian Taxation Office – enforcement of debt recovery*.

³⁴ <https://www.economie.gouv.fr/entreprises/micro-entreprise-auto-entreprise-regime-reel-regime-imposition>

³⁵ Ibid

Recommendation 22: Re-commence regional visits to small business groups to share what is happening on the ground throughout Australia with public reporting of agreed issues (e.g. ongoing impacts of bushfires, drought, flood etc.) with particular industry focus (such as farmers and related industries) and coupled with published minutes that note questions asked and answers provided.

Recommendation 23: Create a small business sub-group (possibly as part of the Board of Taxation) to be dedicated to small business issues, including with a specific focus on remedial measures for annual inclusion in a scheduled remedial tax bill. The group would include representatives of small businesses, tax professionals, software providers and other relevant people and organisations.

Recommendation 24: Department of the Treasury publication of an 18 month consulted tax program that is based on Treasury engagement including with small businesses that are then consulted at all stages as measures are developed (with draft legislation provided at an early stage of policy development and small business compliance costs fully costed), although integrity measures would be excluded where appropriate.

Recommendation 25: Legislative requirement to consult the Australian Small Business and Family Enterprise Ombudsman on any legislative or regulatory change that has a substantive impact on small business with the Ombudsman having the power to provide a Disclosure Statement that must be included with a RIS that points out issues, gaps etc.

Recommendation 22: ATO should re-commence regional visits

The ATO is a very large and centralised government agency. We have heard from the inaugural National Taxpayer Advocate of the United States (USA) that in past years, USA IRS managers were required to undertake outreach and engage directly with taxpayers. The IRS managers learned from industry players in geographical zones, getting a real life understanding of their issues. Indeed, the Office of the National Tax Advocate itself had at least one office in every state in order to be accessible and relevant to taxpayers.

In 2019, the ATO undertook many regional visits around the country under the banner of education, awareness and the black economy 'strike force' intent, with many being targeted unannounced visits to small businesses. At the conclusion of the road trips and after feedback, the ATO undertook to move this program back to education and awareness and away from unannounced on site visits and interviews. While this program was necessarily suspended due to COVID-19 in 2020, we encourage the ATO to reinstate regional visits, particularly by industry focus, to learn about the real-life issues associated with regulatory compliance and to record and publish the questions asked and responses provided.

Recommendation 23: Establish a small business sub-group

The Board of Taxation advises the Treasurer on opportunities to reduce red tape in the tax system and also provides an important consultation mechanism for more substantive tax regulation matters. The Board maintains a Regulatory Reform Working Group comprising of representatives from the Board, Treasury and the ATO which meets regularly to assist the Board in undertaking this work.

A small business sub-group should be established to focus on small business taxation regulatory issues with a view to determining remedial measures to be legislated in an annual remedial tax bill.

The sub-group could incorporate and assess the suggestions on the Board’s collaborative website; *Sounding Board*.

In addition to members of the regulatory reform working group, the small business group would include practitioners in accounting, taxation practice and taxation law, software developers and other relevant advisory groups (such as the national tax clinics).

While the ATO hosts a number of stewardship, stakeholder and consultative working groups, there is still a gap in the consultative process. For tax agents, there is a need to ensure proper formal consultation on changes with electronic and online systems (not just overarching policy and change) but implementation consultation – as well as other formal and informal consultation across the profession and with software providers. This will need to be a dedicated group that is not “just strategic” but practical like the previous Tax Agents Working Group (disbanded) to ensure that changes work on the ground with direct input from technical specialists from accounting, bookkeeping, tax return preparers and software providers.

It must be ensured that the “small and mid-tier” profession is fully represented, heard and responded to – a true partnership where changes are developed with these parties in a timely way that allows the time for practical change to what the ATO might be envisaging to ensure that proposals actually work in practice.

Recommendation 24: Treasury to publish a consulted small business tax program

My Office is acutely aware of the extraordinary circumstances of the last 12 months. In particular, the postponement of the 2020-21 Budget to October 2020 and the resultant load of proposed legislative and regulatory change. Often consultation times were limited, in some instances to 48 hours.

Consultation is crucial to a robust review and assessment of proposed legislation and regulation. However, consultation is also useful before the drafting of proposed legislation commences. New Zealand has a formalised Generic Tax Policy Process (GTPP) which contains opportunities for public engagement throughout the different phases of the policy process.

The main objectives of the GTPP are:

- to encourage early consideration of key policy elements and trade-offs;
- to provide an opportunity for substantial external input into the policy formation process;
- and
- to clarify the responsibilities and accountability of participants in the process.

A review of the GTPP conducted by the Tax Working Group in September, 2018 stated:

The GTPP and public engagement improves policy and regulatory outcomes, and informs stakeholders in advance of regulatory changes. Consultation can also enhance voluntary compliance because it allows taxpayers more time to understand why we need to change, and more time to adjust to changes. There are costs to both submitters and the government in terms of resources required to make a submission, and it can increase the time it takes to develop policy proposals. However, on balance we consider that the benefits outweigh the costs.³⁶

Further documents supporting the GTPP can be found in the Appendices to the Review document.

We propose that Treasury produce an 18 month rolling forward plan of proposed taxation measures relevant to small business entities to ensure that Treasury engagement with stakeholders is

³⁶ Tax Working Group Information Release Document, September 2018 p 4

comprehensive at all stages and compliance costs to small business are fully costed. This could be modelled on the GTPP approach.

Draft legislation should be provided early, in time for proper consultation on words and practical impacts and allowing time for changes as necessary.

We would expect that such a forward work program, by including small business stakeholders, will go towards reducing the workload of the Board of Taxation sub-group preparing remedial bills.

We acknowledge that integrity measures would be necessarily excluded where appropriate.

Recommendation 25: Legislate the requirement to consult ASBFEO

My Office has the capacity to significantly value add to the process of ensuring proposed legislative and regulatory changes are not detrimental to small and family businesses. If my Office was consulted in the early stages of proposed changes, we could identify any issues, gaps or unacceptable consequences for Australian small businesses.

Since July 2013, the government of New Zealand has used *disclosure statements* for all new government Bills with the aim of improving legislative quality by giving more attention to good practices during the development of the proposed legislation. A *disclosure statement* brings together in one place a range of information to support and enhance the Parliamentary and public scrutiny of any draft Bill. It identifies:

- the general policy intent of the Bill and other background policy material;
- some of the key quality assurance products and processes used to develop and test the content of the Bill;
- the presence of certain significant powers or features in the Bill that might be of particular Parliamentary or public interest and warrant an explanation.

Disclosure statements could be prepared by my Office and included with the Regulatory Impact Statement (RIS).