HOUSING INDUSTRY ASSOCIATION

Submission to the Treasury

Treasury Laws Amendment (Taxation and Superannuation Guarantee Integrity Measures) Bill 2018

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contents

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ABOUT THE HOUSING INDUSTRY ASSOCIATION

The Housing Industry Association (HIA) is Australia's only national industry association representing the interests of the residential building industry, including new home builders, renovators, trade contractors, land developers, related building professionals, and suppliers and manufacturers of building products.

As the voice of the industry, HIA represents some 40,000 member businesses throughout Australia. The residential building industry includes land development, detached home construction, home renovations, low/medium-density housing, high-rise apartment buildings and building product manufacturing.

HIA members comprise a diversity of residential builders, including the Housing 100 volume builders, small to medium builders and renovators, residential developers, trade contractors, major building product manufacturers and suppliers and consultants to the industry. HIA members construct over 85 per cent of the nation's new housing stock.

HIA exists to service the businesses it represents, lobby for the best possible business environment for the building industry and to encourage a responsible and quality driven, affordable residential building development industry. HIA's mission is to:

> *"promote policies and provide services which enhance our members' business practices, products and profitability, consistent with the highest standards of professional and commercial conduct."*

The residential building industry is one of Australia's most dynamic, innovative and efficient service industries and is a key driver of the Australian economy. The residential building industry has a wide reach into manufacturing, supply, and retail sectors.

The aggregate residential industry contribution to the Australian economy is over $150 billion per annum, with over one million employees in building and construction, tens of thousands of small businesses, and over 200,000 sub-contractors reliant on the industry for their livelihood.

HIA develops and advocates policy on behalf of members to further advance new home building and renovating, enabling members to provide affordable and appropriate housing to the growing Australian population. New policy is generated through a grassroots process that starts with local and regional member committees before progressing to the Association's National Policy Congress by which time it has passed through almost 1,000 sets of hands.

Policy development is supported by an ongoing process of collecting and analysing data, forecasting, and providing industry data and insights for members, the general public and on a contract basis.

The Association operates offices in 23 centres around the nation providing a wide range of advocacy and business support services and products.

1. INTRODUCTION

HIA welcomes the opportunity to make a submission in response to the *Treasury Laws Amendment (Taxation and Superannuation Guarantee Integrity Measures) Bill 2018* (the Bill).

Principally, the Bill proposes a range of changes that seek to enhance the ATO's compliance and enforcement powers to capture circumstances where individuals purposely take actions to avoid compliance with their legal obligations.

However, HIA is concerned that the proposed measures go well beyond that necessary to target those abusing the corporate form, intentionally avoiding their legal obligations and will not achieve the Governments stated objectives[1].

Specifically, the Superannuation Guarantee Cross-Agency Working Group which released its final report in March 2017 noted that:

> *"…while the current penalties provide a strong deterrent, they can also have the effect of harshly penalising 'honest employers' who make an inadvertent mistake, thereby discouraging reporting and rectification of underpayment…. Therefore the Working Group recommends that the regime should be more flexible so that penalties can be tailored to reflect different levels of employer behaviour and culpability."*[2]

Similarly, the Australian National Audit Office (ANAO) reports that the superannuation guarantee scheme operates *"largely without intervention from the ATO, with employers making SG contributions to the superannuation fund of the employees choice."*[3]

The opposite view is articulated by the Bill.

If passed the Bill would also see the extension of Single Touch Payroll to small employers with less than 20 employees. While HIA acknowledges that simplifying and streaming payroll and reporting systems can have some advantages for employers, HIA does not support a mandated approach. Of note, some small businesses in the residential building industry do not currently use accounting or payroll software and as such would face increased costs as a result of the expansion of this measure.

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[1] Consultation on protecting your superannuation entitlements
[2] *Superannuation Guarantee Non-compliance*: A report to the Minister for Revenue and Financial Services (31 March 2017) at pg. 6
[3] *Promoting Compliance with Superannuation Guarantee obligations* (June 2015) at paragraph 4

Other measures proposed by the Bill that would affect the residential building industry include:

- New powers to disclose information about non-compliance with superannuation obligations to current and former employees of a non-complaint employer.
- Allowing the ATO to pre-fill an individual tax file number declaration and superannuation standard choice form in certain circumstances.

These matters are elaborated on below.

2. GENERAL COMMENTS

2.1 SUPERANNUATION IN THE RESIDENTIAL BUILDING INDUSTRY

The residential building industry is principally comprised of small businesses and self-employed independent contractors. Some of these businesses may have obligations as employers to pay superannuation and in other cases these businesses may have entitlements to receive super as 'employees'.

Introduced in 1992, the Superannuation Guarantee Scheme (SG Scheme) requires employers to contribute a minimum level of superannuation support for employees to fund their retirements.

HIA supports the broad policy intent of a compulsory superannuation scheme to provide an adequate level of retirement income, relieve pressure on the aged pension and increase national savings.

HIA does not support employers or businesses deliberately avoiding their superannuation obligations and failing to pay their superannuation entitlements.

At the same time, the SG Scheme has placed additional regulatory obligations upon employers to ensure that the correct amount is paid to their 'employees' at the right time, to the chosen fund and in the right manner.

In HIA's experience, the majority of employers in the residential building industry do their best to meet these obligation whilst managing the additional red tape costs and monetary costs that the SG Scheme imposes. This Bill does very little to relieve that red tape burden and fails to recognise that cash flow problems and trading difficulties are the foremost factors for non-compliance or non-payment of superannuation rather than intentional attempts to flout the law. As such, the imposition of draconian penalties, including imprisonment, is unlikely to address those circumstances.

The approach proposed in the Bill will not only unfairly penalise small businesses but will act as a further disincentive to start and stay in business. The liability to be borne by individual directors goes well beyond that notionally accepted as the responsibility of a 'company director'. This punitive approach will have a negative effect on businesses in the residential building industry.

3. RESPONSE TO THE BILL

3.1 SCHEDULE 1 – DIRECTION AND PENALTIES IN RELATION TO THE SG CHARGE

Education Direction

While HIA supports measures that would see those in the residential building industry better understand their legal obligation, it is unclear how taking a mandatory course will facilitate a better outcome. There are a number of concerns with proposed new power.

Firstly, there is limited evidence that mandatory education enhances regulatory administrative outcomes.

For example, some states require that in order to maintain a residential builder's license, continuing professional development be undertaken. In recommending the removal of mandatory CPD in NSW the Independent Pricing and Regulatory Tribunal (IPART) in its report *Reforming licensing in NSW* noted that:

> *"Mandatory CPD is seen as a strategy to improve the standard of construction. However, it should be noted that:*
> - *CPD is not a guarantee that learning takes place, or if it does, that it will be translated into changes that improve practice.*
> - *When CPD is mandatory, standardisation and uniformity is encouraged. However, the focus can become course attendance rather than responding to individuals' learning needs."*[4]

Secondly, the ATO has already committed to re-focusing on their education activity. Of note, in the final report of the Superannuation Guarantee Cross Agency Working Group[5] the ATO committed to the following action to enhance and review their education functions:

> ***"AGENCY ACTION 6***
> *To assist employers the ATO will actively promote and make more visible its education and assistance services, tools and calculators, including the recently updated Employee Contractor Decision Tool.*

[4] Pg.121
[5] *Superannuation Guarantee Non-compliance*: A report to the Minister for Revenue and Financial Services (31 March 2017)

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To provide more clarity and administrative ease for employers the ATO will review the useability of the superannuation guarantee charge form, instructions and lodgement processes."[6]

Thirdly, the Bill allows for the setting of fees associated with undertaking the courses required in order to comply with an education direction. It is unclear how the market will respond to the development of an approved course and the type of costs that will be involved in delivering or undertaking this type of training.

Finally, it is unclear if this education direction is in lieu of, or as well as, issuing a direction to pay or the imposition of other penalties. To deploy multiple compliance methods simultaneously would seem unduly harsh. A hierarchal approach should be taken in respect of these new enforcement powers such that an education direction is a first step unaccompanied by any other enforcement measures or penalties.

Direction to pay

If the Bill is passed, the ATO would be given power to issue a direction to pay. Failure to comply with a direction to pay could result in significant penalties and/or 12 months imprisonment.

The ATO already possess sufficient powers to address non-payment of superannuation, as such HIA opposes the introduction of any further compliance and enforcement powers of this nature.

If an employer does not meet their obligations – that is if they do not pay on time, if they underpay, or pay into the wrong fund – they must declare and pay a Superannuation Guarantee Charge (SG charge) to the ATO. The SG charge comprises 9.5 per cent of the amount outstanding, an administrative fee and 'nominal interest' (about 10 per cent), accruing from the beginning of the quarter the shortfall is associated with, until either the last date for timely payment or when the shortfall is actually paid.

Additionally, an employer who fails to lodge the superannuation guarantee statement on time is liable to pay an additional SG charge which can be up to 200 percent of the amount of the underlying SG charge.

These measures amount to a healthy incentive to comply with a severe penalty for non-complying.

[6] *Superannuation Guarantee Non-compliance*: A report to the Minister for Revenue and Financial Services (31 March 2017) at pg. 49

Further, the circumstances in which the discretion to issue a direction to pay are unclear. The Explanatory Memorandum states:

> *"It is intended that the Commissioner only issue direction in relation to serious contraventions to the obligations to pay superannuation guarantee related liabilities by employers whose actions are consistent with an ongoing and intentional disregard of those obligations."*[7]

Yet this approach is not reflected in the Bill.

HIA is also concerned with proposed section 296-25(3) that empowers the ATO to convict for an offence in relation to a direction to pay even if the liability is discharged/ceases to exist. This seems a particularly draconian approach, particularly when the stated aim of these new measures is to encourage compliance with, and payment of, superannuation contributions. Once the underlying cause of the offence is rectified no further penalty is justified.

3.2 SCHEDULE 2 - DISCLOSURE OF INFORMATION

If the Bill is passed, the ATO would have the power to disclose information to an employee about a failure, or suspected failure, by an employer to comply with their Superannuation Guarantee obligations.

Whilst HIA would not oppose measures to assist an employee receiving superannuation when they are entitled to it, a cautious approach needs to be adopted in exercising this proposed new discretion.

This approach may mislead those who are legitimate contractors to unnecessarily question their status to the point of believing a superannuation guarantee obligation arises, or has arisen, when in fact it has not. It is also unclear whether the employer will be advised of the proposed information disclosures. HIA's preference would be for the employer to be advised of an intention of an ATO officer to disclose this type of information to a current or former employee prior to this notification being made.

3.3 SCHEDULE 3 - SINGLE TOUCH PAYROLL

Under the Bill, Single Touch Payroll reporting would be required for small employers from 1 July 2019.

On previous occasions HIA has expressed concern with the introduction and mandating of Single Touch Payroll. These moves appear to be motivated by the government's desire to *"level the playing field for business by reducing non-lodgment and phoenix opportunities, as the ATO would be alert to non-payers sooner"*[8] and to *"improve the Commissioners ability to monitor superannuation guarantee compliance*

[7] Pg.16, paragraph 1.76

[8] The Honourable Bruce Billson MP, Minister for Small Business "Address to the G20 Agenda for Growth: Opportunities for small and medium enterprises conference, Melbourne" , 20 June 2014 accessed at http://bfb.ministers.treasury.gov.au/speech/015-2014/

by increasing the visibility of non-payment by all employers"[9]*.* Yet this mandatory approach will have a potentially damaging effect on small businesses in the residential building industry.

Firstly, while reducing the number of reports that have to be manually produced will conceivably reduce the time many small business owners will spend completing ATO paperwork, small businesses that currently do not use accounting or payroll software will face increased costs in terms of acquiring the accounting software (at $70-$100 per month), making upgrades to existing IT systems and platforms to manage and accommodate the new software (data migration), potentially upgrade internet connections and cover the costs of training staff to use the new software.

Secondly, and of most concern, is the negative impact for business in the residential building industry, all of whom already operate under a negative cashflow model.

This proposal effectively distorts payment arrangements such that the ATO is paid in preference of other creditors such as suppliers, manufacturers and subcontractors.

In some cases a business's tax withheld and super payments would be brought forward by up to three months. It is unfair, unrealistic and unreasonable for the Government to expect businesses to be able to bring forward such significant cash payments.

Cashflow management is a day to day reality in most business, but particularly so for the high proportion of small and micro builder businesses in the residential building industry, as the builder essentially 'finances' a job throughout its construction.

Strict state by state industry specific consumer protection laws preclude builders from taking payments in advance, meaning that residential builders carry the risk on projects, trading in an environment dominated by negative cash flow.[10]

Builders are reliant on milestone progress payments that are made under their contract with the home owner.

Yet the way these progress payments are scheduled does not in any way correlate with the way expenses are incurred by the building company.

It is generally the case that progress payments are at least one construction stage behind the expenditure incurred by the builder (for example, the framing stage is well under way by the time the builder receives payment for completion of the internal and external floor slab). Clients are not generally charged interest in the process (although builders have the contractual right to do so). Smaller

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[9] EM at pg.31, paragraph 3.16

[10] See *Home Building Act 1989 (NSW)*, *Queensland Building and Construction Commission Act 1991 (Qld)*, *Domestic Buildings Contracts Act 1995 (Victoria)*, *Home Building Contracts Act 1991 (WA)*, *Building Contractors Act 1995 (SA)*, *Building Act (Northern Territory)*, Building Act (ACT), *Housing Indemnity Act* (Tas)

businesses also operate under a model where progress payments are at least one payment behind – these business are normally 10 to 15 per cent behind on the costs of their projects.

A number of factors affect cash flows on a construction project, such as the duration of the project, deposit restriction, the lag on receiving payments from the client/ the client's bank, credit arrangement with suppliers of building products and materials, equipment rentals (eg excavating and scaffolding equipment), and timing of payments to subcontractors, etc.

Typical cash flow on a construction project consists of:

- Cash out: such as tender costs, preconstruction costs engineering, design, etc., materials and supplies, equipment and equipment rentals, payments of subcontractors, employees and business overhead; and
- Cash in: such as deposits, progress payments, director's loans, bank overdrafts and finance.

For smaller building companies, the negative cash flow environment and reliance on working capital is more onerous again, as there is little scale involved to compensate for considerable start-up costs.

It is also of note that during the period in which work is being carried out and notwithstanding no further payments are received, payments still need to be made to subcontractors and suppliers. These subcontractors and suppliers will naturally not wait for the builder to receive payments from the client. In fact under Security of Payment legislation there are time limits for payment to subcontractors and a principal contractor/builder cannot require that payment to a subcontractor be withheld or delayed due to payment from the client not yet received.

In HIA's view all of these factors lend against the expansion of mandatory Single Touch Payroll to small businesses.

3.4 Schedule 5 – Compliance Measures

The Bill proposes to introduce measures aimed at improving superannuation guarantee and PAYG withholding compliance.

The first, seeks to give the ATO the power to use the estimate of a company's unreported liability to estimate the director's penalty to enable recovery of the employees' superannuation guarantee entitlements and PAYG liability.

The second seeks to prevent company directors extinguishing a Director Penalty Notice for unpaid superannuation contributions by placing the company into administration or liquidation within 3 months of the issuing of the Director Penalty Notice. This proposal would 'lock down' Director Penalties related to a SG charge as soon as they are incurred; not 3 months later.

The intentional avoidance of compliance with superannuation obligations is not supported, however HIA is concerned that the changes shift the focus to penalising individual company directors over the recovery of the employees entitlements.

In 2012 the *Tax Laws Amendment (2012 Measures No. 2) Bill 2012* extended the director penalty regime to make directors personally liable for their company's unpaid superannuation guarantee amounts.

At that time the Explanatory Memorandum stated:

> *"The policy objective of the director penalty regime is to ensure that directors cause their company to meet certain tax obligations or promptly put the company into liquidation or voluntary administration."* [11]

The current Director Penalty Regime can have a harsh application as the time allowed to arrive at an agreement with the Commissioner, appoint an administrator, or commence the winding up of the company is already very short.

The proposed changes provide no opportunity for Company Directors to investigate options for compliance without incurring a penalty and may unduly impact those with every intention to comply.

The current proposals take a punitive approach that is at odds with the policy objectives of the director penalty regime.

Further there are broader measures under consideration by the Phoenixing Taskforce that have the potential to improve collection of unpaid superannuation guarantee including:

- Director Identification Numbers;
- Improved director disqualification/qualification rules; and
- Grouping rules to apply to debts (to protect superannuation guarantee and wider employee entitlements) by enabling collection from other arms of a business where the labour hire arm is continually liquidated.

The consultation paper *'Combatting Illegal Phoenixing'* also proposes a number of measures targeted at avoiding non-compliance with legal obligations through illegal phoenixing.

In light of the above these changes should be delayed and more fully considered within the broader regulatory context and with further consultation.

3.5 SCHEDULE 6 - EMPLOYEE COMMENCEMENT PROCEDURE.

HIA does not opposed the measures outlined within Schedule 6 of the Bill.

[11] Paragraph 1.5