SUBMISSION BY THE

Housing Industry Association

to

House Standing Committee on Economics

on

Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011

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HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 43,000 builders, contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.

1 Executive Summary

HIA welcomes the opportunity to provide comment in relation to the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011. However is disappointed that only one week has been provided for comment in relation to the Bill. This is an insufficient timeframe to allow representative associations to consult comprehensively with their membership on the design and impact of such an important piece of legislation.

HIA notes that there were a limited number of responses to the Exposure Draft and has concerns that a number of key representative organisations may not have been advised of the existence of the Bill. HIA encourages the Government to extend the consultation period in relation to the Bill and better inform key stakeholders of its existence to allow interested parties to provide considered submissions.

HIA is particularly motivated to provide comment in relation to Chapter 3 of the Bill entitled "Companies' non-compliance with PAYG withholding and superannuation guarantee obligations.

The Bill proposes to:

- extend the director penalty regime to make directors personally liable for their company's unpaid superannuation contributions;
- allow the Commissioner to commence proceedings to recover director penalties three months after the company's due day where the company's debt remains unpaid an unreported after the three months passes, without first issuing a director penalty notice; and
- in some instances making directors and their associates, liable to pay as you go (PAYG) withholding non-compliance tax where the company has failed to pay amounts withheld to the Commissioner.

These amendments are purportedly "designed to prevent a business 'phoenixing' to avoid its superannuation obligations for employees".[1] The Bill also allows the Tax Office to commence proceedings without issuing a 21-day notice to the relevant directors and this is said to prevent "a company going into liquidation before the tax office starts legal proceedings.[2]

We refer to HIA's submissions dated 15 January 2010 previously provided in response to the Government's "Action Against Fraudulent Phoenix Activity –

[1] House of Representatives Standing Committee on Economics, Media Release issued on 19 October 2011 by the Hon. Ms Julie Owens, MP.
[2] Ibid.

Proposal Paper" as well as HIA's response to the Exposure Draft submitted earlier this year. HIA repeats and relies on these submissions.

HIA opposes the fraudulent use of phoenix company arrangements to avoid paying liabilities. It is important to have strong and effective laws that target such behaviour.

However while there is a need to address phoenix activity, the regulatory environment must promote commercial investment as small business entrepreneurialism remains the key driver of wealth creation in Australia.

HIA opposes the Bill as it is currently drafted as the Bill is not reflective of its policy intent and may negatively impact the Australian economy by artificially adding to the hazards of running a small business, stifling genuine commercial risk taking and investment.

Rather than addressing the issue of phoenixing arrangements by targeting those who are seeking to fraudulently manipulate the law, the Bill casts a wide web of liability and unfairly exposes directors who are operating legitimately.

2 The Bill is not reflective of its policy intent

While the federal budget announcements indicated that changes to the law would have the objective of 'countering fraudulent phoenix activities by company directors', in reality *all* company directors (and potentially even former directors) will be affected personally by the changes proposed within the Bill.

As noted in our submission in response to the Exposure Draft, despite the Bill's policy intent to prevent a business 'phoenixing' to avoid its superannuation obligations, there is no current statutory definition of a 'phoenix company'. Consequently, the Bill does not merely target those who deliberately liquidate a company to avoid paying liabilities. Rather, it casts a much wider web of liability and makes all directors automatically liable for superannuation debts without affording the director any grace period to remedy the matter. This impacts on both solvent and insolvent companies.

The Bill as drafted will have the consequence that directors will be liable for the non-compliance with the company's statutory superannuation guarantee obligations entitlement, even if such underpayment was unintentional or is not received by a fund in circumstances beyond the control of the employer.

3 A denial of natural justice

The current law requires the ATO to serve a penalty notice on a director and the director becomes liable at the expiration of 21 days. The new law proposes that if the tax or superannuation debt is more than 3 months old, the director is personally liable and the ATO can commence proceedings to recover the funds without notice.

The current law also provides that if a director pays the debt, appoints an administrator to the company or the company commences winding up within 21 days of the ATO posting a director penalty notice the personal liability of the director is extinguished. However the Bill provides that if the tax debt is more than three months old, the only way a director's personal liability can be extinguished is by payment of the full amount claimed by the ATO.

The issuing of a Director's Penalty Notice (DPN) should remain as a precondition to the ATO taking recovery action in respect of the debt for directors not involved in phoenix arrangements. As a matter of procedural fairness, it is appropriate that an individual be provided with advanced warning of a charge or liability that applies to them. Deeming all directors to be automatically liable for a company's unpaid PAYG and/or superannuation liabilities after a prescribed period is contrary to the principles of natural justice and whilst such an approach may hasten ATO debt recovery, it does not directly address phoenix behaviour.

Consistent with HIA's submissions in relation to the Exposure Draft, if the Government determines that it is necessary to reverse the onus of proof, HIA would recommend that it be strictly limited to "potential phoenix" directors (to be defined). A possible approach may be to limit the use of the provisions to directors of companies who have been involved in more than one separate voluntary administration/liquidation in the past five years.

4 The Bill ignores the complexity of superannuation guarantee legislation

HIA opposes the Bill's proposal for an automated director penalty regime extending to unpaid superannuation entitlements.

Superannuation guarantee legislation is complex and it is not always clear whether there is a superannuation guarantee liability or whether the amount of a payment is reflective of the ATO's interpretation of what amounts constitute 'ordinary time earnings'.

The question of who is required to be covered by the superannuation guarantee legislation is matter of fact coming down to the particular circumstances of engagement and the Court's interpretation of the facts. This is the case even though a person may hold a genuine belief that the workers they engage are contractors, the workers themselves holding a belief that they are contractors and despite workers being compensated with a higher fee in lieu of receiving superannuation contributions. The resolution or determination on the status of a worker for superannuation purposes may sometimes occur on a timeframe outside the required lodgment period.

Whilst ATO superannuation guarantee ruling SGR 2005/1 provides guidance, as does the ATO online decision tool, to demand a 100% accurate track record from the average company director is grossly unfair and unworkable.

Employers must also use ordinary time earnings, as defined in the superannuation guarantee law, to calculate the minimum superannuation guarantee contributions for eligible employees. Whilst ATO superannuation guarantee ruling 2009/2 provides guidance as to the meaning of 'ordinary time earnings', this meaning is still open to interpretation.[3] This is particularly relevant in the context of an award as complex and the Building and Construction General On-site Award 2010 which contains a number of wage related provisions that are ambiguous or unclear in their application.

Despite taking the best legal advice and acting in good faith, the reality is that the law is open to interpretation and companies, sometimes several years later, may be found by a court or tribunal to be in breach.

It is therefore important that the Bill be amended to extend defences to directors of companies who have inadvertently breached the superannuation guarantee laws in these circumstances.

5 Reducing entitlement to credits

The Bill provides the Commissioner with broad discretion to reduce a director's entitlement to PAYG withholding credits along with those of their associates. The effect of these provisions is that if a company withheld PAYG tax from the wages of directors and their associates and failed to remit PAYG withholding amount to the ATO, any credit claimed by the directors or their associates in their individual tax returns in respect of the PAYG amount will be reduced and give rise to an increased individual tax bill.

HIA does not support these measures that they are dependent on the ATO's ability identify directors who are claiming PAYG withholding credits that have not been remitted. Any error in the ATO's identification systems are likely to impact on the cash flow of legitimate businesses.

HIA opposes the proposal to deny PAYG withholding credits to an associate of a director. Such measures are unnecessary as associates who are "shadow directors" are already caught by the DPR. If an "associate" is actively involved in the company's tax fraud or evasion, then appropriate criminal and civil penalties

[3] See for example *Quest Personnel Temping Pty Ltd v Commissioner of Taxation* [2002] FCA 85 where the Federal Court found that hours regularly worked above the minimum weekly requirements were ordinary time earnings despite the employer classifying these hours as 'overtime hours'.

should apply (as they already do). However it is inappropriate for the Commissioner to hold a broad discretion to arbitrarily impute the company's (or director's) conduct on the associate in the manner contemplated in the Bill.

6 The Bill is a disincentive to entrepreneurship

A company's status as a separate legal entity and the corporate veil which protects its officers and shareholders from bearing liability for corporate debt is essential to ensuring viable levels of economic investment. However it is increasingly the case that legislation will permit the corporate veil will be lifted to impose liability on company directors.

The Bill will further erode the benefits of incorporation by imposing exceedingly harsh liability on a Director through regulation which will exist in addition to a range of other corporations and taxation laws targeted toward fraud, directors' duties, insolvent trading and unpaid tax liabilities. The defences in the Bill are limited in their application and fall short of, save for illness or fleeting managerial involvement by the director, providing a balanced approach to personal liability.

Such imposition of personal liability for corporate breaches will act as a disincentive to the taking up of directorships and management positions. For larger corporations, this may significantly detract from the talent pool that is essential at the senior executive level where there is a need to make critical business decisions. For smaller businesses and prospective entrepreneurs, such regulation may cause many operators to close the doors of their business or refrain from starting a business.

HIA supports strong laws and penalties applying against businesses and individuals that intentionally evade their legal obligations, whether these are taxation, superannuation or industrial relations obligations.

However the Bill presents itself in a climate of regulation which unfairly targets genuine small businesses in the housing industry. By way of example, HIA has expressed concern with the proposal to introduce mandatory payer reporting of taxable payments made to contractors in the building and construction industry. Such measures impose significant additional administrative and accounting costs onto principal contractors and builders in the residential building industry. Coupled with existing Business Activity Statement (BAS) reporting obligations, they unnecessarily add to the burdens and risks of operating a small business.

The residential building industry, including the home improvements and alterations market, is a key component of the Australian economy. Access to shelter is a basic necessity of life and it is important that the regulatory environment for the housing industry supports the small businesses that underpin it.