Submission

to

Senate Employment, Workplace Relations and Education
References Committee

Building and Construction Industry Inquiry

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4 May 2004

Mr John Carter
Secretary
Employment, Workplace Relations and Education
References Committee
Suite SG 52
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CANBERRA ACT 2600

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Dear Mr Carter

Inquiry into the Building and Construction Industry

Thankyou for your letter to the Commissioner of 14 April 2004 inviting the ATO to appear before the committee at a public hearing to be held in Melbourne on Wednesday 19 May 2004.

I will be attending the hearing together with the Assistant Deputy Commissioner, Ian Read. As requested, I enclose the following published information on the ATO's activities in this industry:

- The Tax and the Building and Construction Industry booklet (x6);
- The ATO's 2003-04 Compliance Program;
- Statement by Mr Read to the Royal Commission into the Building and Construction Industry.

More information is also available on our website at www.ato.gov.au.

We would be happy to expand on this information during the hearing.

Yours sincerely

Mark Konza
Deputy Commissioner of Taxation

BUSINESS	BUILDING AND CONSTRUCTION	UPDATE	NAT 10245-11.2003
SEGMENT	AUDIENCE	FORMAT	PRODUCT ID

Australian Government
Australian Taxation Office

Tax and the building and construction industry

The building and construction industry makes a significant contribution to the Australian economy.

The industry:

> accounts for around 6% of GDP*
> has a level of activity that in June 2002 was measured at $51.8 billion*
> employs over 700,000 people*
> has only 1% of businesses that employ more than 20 employees and over 96% of businesses have a turnover of less than $2 million*, and
> tax collected from the industry was approximately $9 billion in 2002–03^.

*Source: *Royal Commission into the Building and Construction Industry, ^ATO*

BUILDING AND CONSTRUCTION INDUSTRY ENVIRONMENT

The ATO has a continuing history of involvement with the building and construction industry. Compliance activities have revealed a high risk of non-compliance with tax obligations.

Environmental factors include:

> extensive use of cash payments are common in the industry
> labour costs are significant and are typically in the order of 15% to 25% of turnover. Arrangements designed to reduce the costs of labour and the associated costs are often used by businesses to increase their competitiveness
> a trend to engage labour under service or results-based contracts rather than employment contracts. This is consistent with labour market trends more generally, but there is an ongoing need to ensure that contractor arrangements are genuine and that tax and superannuation obligations are being met, and
> the highly competitive nature of the industry places considerable commercial pressure on businesses to minimise costs and non-payment of tax debts is seen by some in the industry as a means of remaining competitive.

Compliance activities have revealed a high risk of non-compliance with tax obligations.

KEY RISKS WE ARE ADDRESSING

Key risks in the large business segment are public trading trusts, property syndicates and issues relating to the trading stock provisions.

For the micro business segment ($2 million turnover or less) and small to medium enterprise segment (turnover between $2 million and $100 million) key risks include:

> payment of cash wages which are not disclosed on payment summaries that are facilitated, for example, by the use of fabricated invoices to disguise cash wages as payments for materials or equipment
> cash and other payments to contractors and sub-contractors which are not returned as income
> fraudulent claims for GST credits
> use of bogus labour hire arrangements ('bodgies') which generate cash in hand for employers and facilitate the payment of undisclosed cash to employees. These practices are often compounded by directors who generate payment summaries for employees to claim PAYG(W) credits on tax that has never been paid
> phoenix arrangements used to evade payment of tax liabilities through deliberate and systematic liquidation of companies
> poor record keeping leading to understated supplies and overstated acquisitions
> failure to lodge Business activity statements
> understated GST on property sales and the incorrect application of the margin scheme
> overstated valuations resulting in an under-reporting of GST
> incorrect classification of new commercial/residential apartments
> incorrect classification of sales and expenses in Business activity statements
> major infrastructure projects, and
> employee/employer contractual relationships and trends.

OUR COMPLIANCE APPROACH

In the early 1990s, audits of selected sub-industries commenced to gain a better understanding of the level of compliance across the industry. This work led to a series of projects to investigate areas such as the cash economy, the Prescribed Payments System, the Olympics Construction Project, phoenix companies and money laundering schemes operating through sham labour hire companies.

From early 2000 most of our field staff were involved in help and education activities supporting the introduction of the new tax system. The focus was to ensure people had the information they needed to meet their obligations. However, the ATO maintained a program dealing with evasion in the building and construction industry.

By the middle of 2002, two years into the new system, we shifted our focus to compliance and field staff began undertaking more visible verification and enforcement activities across all market segments.

In late 2002, we published our first *Compliance Program* setting out how we identify risks to revenue and the work the community could expect from us to combat these risks. We followed this up recently with the release of the *Compliance Program 2003–2004*. These documents make specific mention of the building and construction industry and the work we have done, and plan to do, to improve compliance.

The report of the Cash Economy Task Force, *The Cash Economy under the New Tax System*, and our response to it, released in September 2003, detail our continuing approach to handling cash economy issues.

Activities in the building and construction industry outlined in the report include:

> 800 visits to identify and quantify risks in the industry
> 2000 visits to companies with trading activities outside industry norms
> 400 visits to check GST treatment of display homes
> monitoring of major infrastructure projects, and
> a special focus on phoenix activities and other tax evasion issues.

ROYAL COMMISSION

The findings of the Royal Commission into the Building and Construction Industry have highlighted the need for a continuing relationship between the ATO and key players in the industry.

The Commission's work identified tax issues and made recommendations in a variety of areas including:

> combating tax evasion
> controlling fraudulent phoenix activities (companies that fail and the business continues to trade in the industry through a new company, which does not accept the debts of the earlier company)
> reviewing the exchange of information processes across agencies – federal, state and territory
> defining key terms such as 'employee' and 'wages' across all jurisdictions
> reviewing the impact of amendments to the Superannuation Guarantee legislation
> reviewing the impact of the Alienation of Personal Services Income legislation
> reviewing entitlement to ABNs, and
> establishing a building and construction industry forum to discuss significant taxation issues across the entire industry.

The ATO gave evidence to the Royal Commission detailing our understanding of tax risks in the industry, information about our current and planned strategies and details of revenue raised from past activities.

We identified 160 tax-related issues arising out of the Commission's work. An examination of these issues confirmed that 85% of them had been or were being dealt with by the ATO. The majority of the issues related to phoenix activity, fraud and evasion cases. Around $28 million in tax and penalties has been raised by the ATO from these cases.

Some of these cases were referred to the Director of Public Prosecutions (DPP) and the Australian Federal Police (AFP). In most cases, the taxpayers concerned have been prosecuted and some have received significant jail terms.

We have also followed up matters raised before the Commission where it was alleged that tax was at risk where it was subsequently found not to be the case. For example , it was alleged to the Commission that some illegal workers had tax deducted from their pay and that this tax was never remitted to the ATO. This was found to be incorrect.

Other matters identified by the Commission, which may lead to tax evasion being uncovered, are still under investigation.

We continue to liaise with the Interim Building Industry Taskforce to assist it in recognising potential breaches of tax law.

SOME RESULTS

Between July 2002 and October 2003, we completed over 6600 enquiries, investigations and audits, and raised in excess of $240 million in tax and penalties.

We have enhanced our understanding of the industry and identified areas of concern. This has enabled us to apply better case selection techniques and address non-compliance more effectively. Our relationships with key players in the industry are much stronger than in the past. This has led to intelligence being shared across the federal and state agencies more regularly.

We have participated in raids on building sites with other agencies such as Centrelink and the Department of Immigration, Multicultural and Indigenous Affairs (DIMIA) to detect illegal workers being paid 'off the books'.

We have also coordinated our visits to building sites with the Interim Building Industry Taskforce and DIMIA to better target areas of non-compliance.

As a result of enhanced liaison with the Australian Securities and Investments Commission (ASIC) we have improved the quality of information we hold about company directors and their associated entities. This has assisted us to more effectively identify phoenix companies.

In addition, the Proceeds of Crimes Act amendments, which took effect from January 2003, will assist in recovering assets stripped or hidden for illegal purposes.

Over the past five years almost $200 million in tax and penalties has been raised by the ATO by targeting phoenix practices of which almost $90 million has been collected.

Some employers are seeking to engage workers as sub-contractors, where the law is clear that they are employees. We are taking action to address this and other obvious breaches of the law and undertaking ongoing analysis of labour market trends to help shape our future strategies.

WHERE TO NOW?

The ATO is committed to improving compliance in the building and construction industry and to working with industry to achieve this. One of the recommendations of the Royal Commission was that the ATO convene a building and construction forum to examine taxation issues of significance to the industry.

By involving industry participants including unions, employer organisations, businesses, individuals, and federal, state and territory stakeholders we hope to develop workable solutions to tax issues in this significant Australian industry.

Statement by Ian Read
Assistant Commissioner, Small Business
Australian Taxation Office

to the

Royal Commission into the Building and Construction Industry

25 July 2002

The Australian Taxation Office and the Building and Construction Industry in NSW

Preface

This statement does not contain information about any identifiable taxpayer and can be disclosed by the Australian Tax Office in a public statement or public hearing.

General observation about the building and construction industry in NSW

The Tax Office has identified significant tax evasion within the labour intensive sub-industries of the building and construction industry, in particular, excavation and site preparation, formwork, scaffolding and steelfixing. We have identified several methods of tax evasion, most of which are centred around generating untaxed cash payments to workers and/or using company liquidation and phoenix arrangements to avoid the payment of outstanding tax liabilities. We are currently undertaking a national Property, Building and Construction Project which will provide us with further information to help determine the level of taxation compliance in the industry.

Some examples of tax evasion schemes

Tax evasion schemes that have been identified in NSW include:

- untaxed cash payments for overtime, Rostered Days Off (RDO) and bonuses;
- 'bodgie' or bogus labour hire companies;
- phoenix activity;
- fraudulent claims for GST Input Tax Credits
- false claims for Tax Instalment Deduction (TID) by directors of phoenix companies; and
- untaxed cash payments to non-residents without working visas.

Untaxed cash payments and Tax Office action

Between 1997 and 1999 the Tax Office carried out extensive research into 'cash in hand' payments in several labour intensive sub-industries. Audits were undertaken in respect of the formworking and steelfixing sub-industries to identify cases involving untaxed cash payments to workers. Audits were completed on 13 formworkers and steelfixers and untaxed cash payments were identified in 11 of these cases. Cash payments were for overtime, RDOs and bonuses. In two cases records were falsified by trying to pass off cash payments as purchases of materials. Tax and penalties arising from the audits exceeded $20 million.

Sydney-based Building and Construction teams currently have 40 audits in progress involving formworkers, steelfixers and plasterers. In these cases, cash payments exceeding $30 million were identified through the Australian Cash Transactions Reporting Agency (AUSTRAC).

Other teams are currently profiling cases in the scaffolding industry. AUSTRAC identified 79 companies with cash withdrawals of $13.7 million covering 550 transactions. Some of the companies cannot be identified on Tax Office systems and some have not lodged any BAS for the past 15 periods. One company was found to have an outstanding BAS debt of $1.77 million. Another company that was audited went into voluntary administration owing $1.8 million in PAYE and PAYGW. We are continuing our investigations into this company and other companies that may have defrauded the revenue.

The extent of 'cash in hand' payments in the building and construction industry

Project-based audit activity has consistently identified undeclared cash payments to contractors, payments of cash to employees claiming social security benefits, and undeclared cash payments for weekend work by employees legitimately employed on weekdays. In one case, the husband and wife directors of a formwork company involved in phoenix activities were identified as not lodging tax returns and being in receipt of sickness and invalidity benefits for almost 20 years[1].

Compliance activities have consistently identified practices designed to generate cash used to pay for labour. These practices include cheque cashing, false invoicing and the use of bogus labour hire firms.

Audits conducted in the early to mid-1990s covering bricklaying, concreting, welding, steel construction and housing construction found high rates of non-return of income with amounts omitted in the range of 20% to 40% of income.

Cash transaction analysis of banking industry data confirms that payment of cash is a common practice in the industry. This is particularly the case in labour intensive sub-industries.

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[1] As part of our current audit process we advise Centrelink of employees who may be in receipt of Centrelink benefits to which they are not entitled. Prosecution action has resulted in some cases.

In November 1999 the ATO analysed specific industry data concerning reportable cash transactions. The information was sorted by location and industry and covered the preceding four years. An extract is below:

Cash Transactions - NSW Building and Construction Industry

Industry	Cash $m
Formworking	$99.8m
Concreting	$62.3m
Scaffolding	$49.8m
Excavation	$34.4m
Steel Fixing	$13.9m
Total	**$260.2m**

Further analysis is continuing in respect of more recent trends.

Leverage activities

During June 1999 the Tax Office mounted a publicity campaign in NSW focusing on the issue that receiving cash was not illegal but not paying tax on it was. Assistance was received from the CFMEU which placed Tax Office posters on notice boards at building sites throughout Sydney. A hotline was established enabling workers to make a voluntary disclosure and receive concessional treatment in respect of penalties. The CFMEU also ran an advertisement in its magazine 'Unity' and published an editorial supporting the campaign.

The Sydney daily newspapers ran stories about Tax Office prosecutions that were before the courts as well as the Tax Office's focus on the cash economy.

The Tax Office has also sought to promote what it has been doing in respect of the building and construction industry at industry association liaison meetings. Other education activities include Tax Office staff making presentations to bookkeepers at the Master Builders Australia (MBA) Pay Administration Course held every six weeks. Other educational activities have been conducted under the umbrella of the Illawarra Building and Construction Forum which operates closely with the NSW TAFE.

One of the aims of the current Property, Building and Construction Project is to target cash payments in the industry. Project teams are using AUSTRAC data to monitor the extent of cash payments in the construction trades. They also access Tax Office databases to identify cases of non-registration, non-lodgement, non-reporting and non-payment of tax. Analysis of tip offs received from the community also provides valuable information.

The Tax Office has found the reasons for cash payments depend on who you ask, for example:

- workers claim employers force them to take cash
- employers say the workers won't work overtime unless they are paid cash

'Bodgie' or bogus labour hire companies

In November 1997 the National Crime Authority (NCA) commenced investigating a tax evasion scheme involving bogus labour hire companies within the building and construction industry in NSW. They became known as 'bodgie' companies.

The operation of a typical scheme was simple. The promoter of the scheme would receive cheques from businesses and deposit them into the promoter's bank accounts. Once cleared, the funds were withdrawn in cash or cash cheques. The cheques were always less than $10,000 to avoid a cash transactions report being submitted by the bank under the provisions of the Financial Transaction Reports Act 1988. The promoter of the scheme retained a commission, usually 7% of the cheque amount, and returned the balance in cash to the payer. The payer then used the cash to pay employees or keep some or all of the cash for personal use.

When the cash or cheque was exchanged, a blank or partially completed invoice was provided by the promoter. The false invoice was used to make it appear that the payment was for services such as labour or plant hire. Those services had not in fact been provided.

The false invoices were used by the payer to claim deductions for business expenses, thus reducing the payer's taxation liability. By providing cash wages to employees the payer was able to evade the payment of group tax and avoid any payment of superannuation and worker's compensation payments. The business claimed that the promoter or bodgie labour hire company had the liability to withhold payment of group tax.

The NCA identified 55 companies used by promoters of 'bodgie' schemes and over 400 payers.

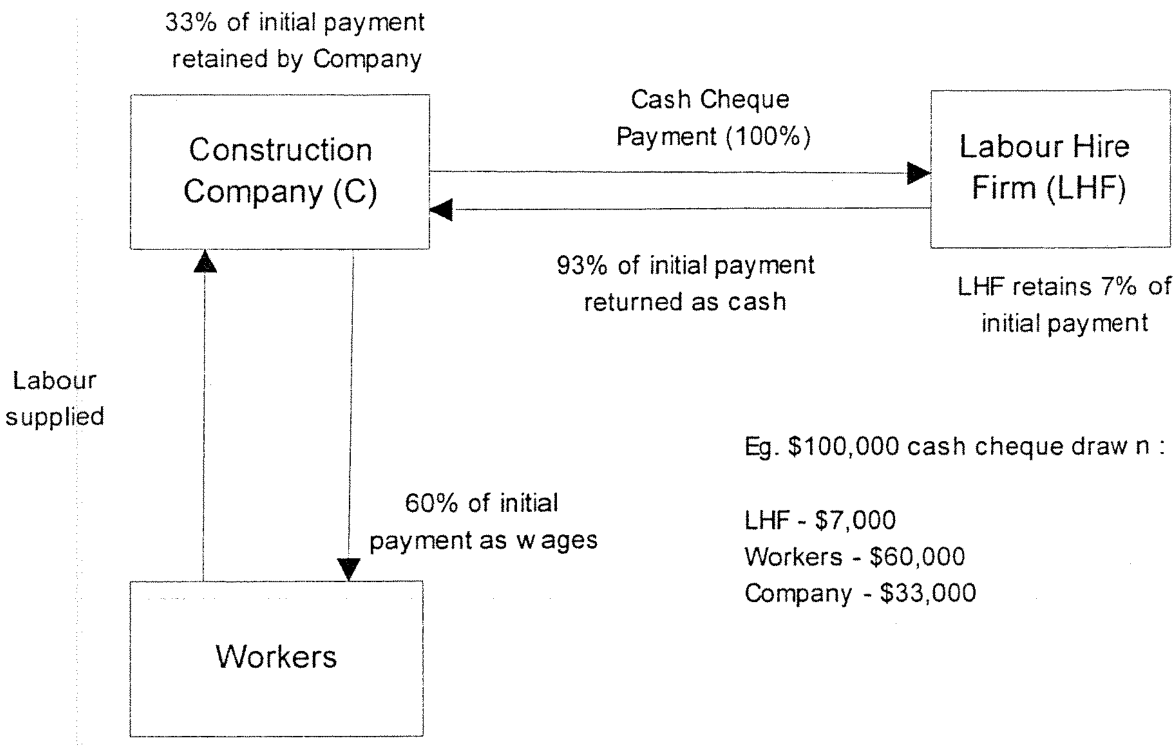
During the life of the Bodgie Project from February 2000 to December 2001, $26.2 million was raised in tax and penalties. An additional estimated $94 million was raised after businesses ceased using the bogus labour hire schemes and remitted the appropriate taxes for PAYE and PPS.

All except two identified scheme promoters have now been gaoled. One is awaiting sentencing after having pleaded guilty to defrauding the Commonwealth. The other is no longer resident in Australia. As far as the NCA and ATO are aware these particular schemes are no longer operating.

As part of its monitoring of the building and construction industry the ATO is continuing to check on prior scheme participants. Any resurgence will be quickly addressed.

Below is a diagram of the bodgie arrangements.

Cash Flow in a Typical Bodgie Scheme



Phoenix practices

The major focus of the Tax Office's Phoenix Project has been on serial offenders who use deliberate and fraudulent methods to avoid their obligations.

This fraud typically occurs when individuals use limited liability companies to accumulate debts (usually to the Tax Office), allow the company to go into liquidation, and then carry on the business via a newly formed company. In almost all cases the entities placed into liquidation have no assets. Many of the companies are insolvent as soon as they start trading.

In recent years it has become more obvious for businesses involved in phoenix activity to structure their company group to avoid risking the assets of the business. Previously, the more common practice was for assets to be moved out of an entity within the business group prior to it proceeding into liquidation thus placing assets out of reach of creditors.

Should an entity within the group become unable to meet its tax obligations such as PAYE or PAYG(W), the entity can be placed into liquidation without affecting others in the group or the business as a whole. Typically, the entity that falls behind in meeting its tax obligations is the labour supply entity that manages the bulk of the workforce for the group. Ordinarily this entity does not have any assets. Upon liquidation the workers employed by this entity are simply moved into a newly created labour supply entity. The pattern repeats itself when the new entity becomes unable to pay its taxes.

The Income Tax Assessment Act (ITAA) contains provisions that allows the Tax Office to render a director of a phoenix company personally liable for the PAYG(W) tax debts of the company. A Directors Penalty Notice (DPN) issued by the Tax Office gives a director two weeks from the date of service of the notice to take one of the following options:

- pay the tax debt in full;
- enter into a formal agreement to pay the tax debt in full;
- place the company into voluntary administration; or
- take steps to place the company into liquidation.

Should a director in receipt of a DPN not undertake one of these four options within the statutory two week period the director could become personally liable for payment of the debt to the Tax Office.

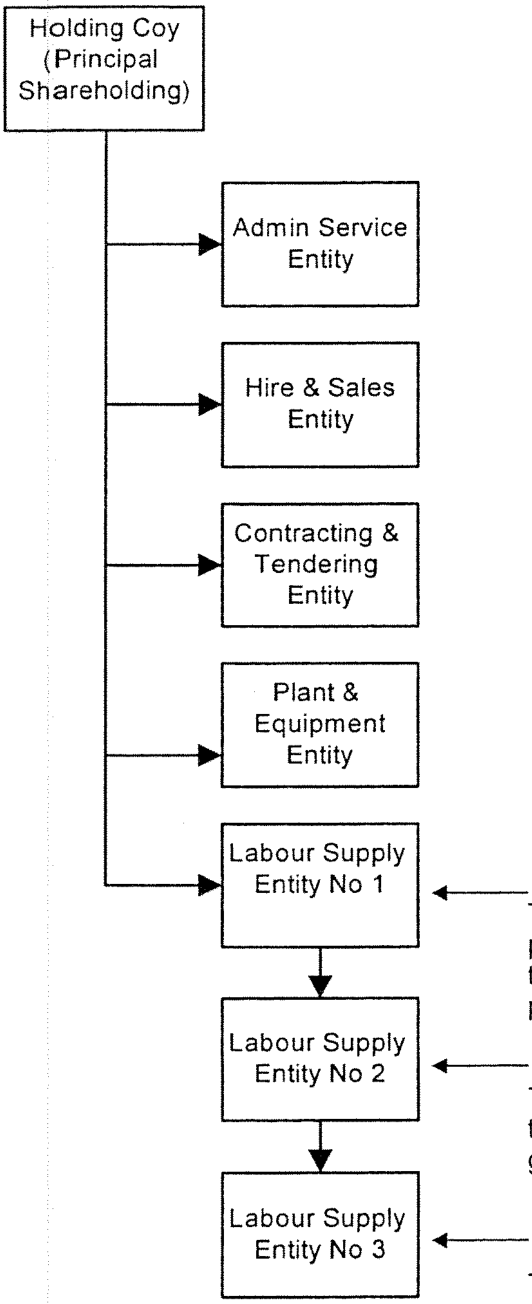
Usually, directors of phoenix companies who are served with a DPN choose to place their company into liquidation. They do not have the capacity (or compulsion) to pay off the often large tax debts incurred by their company so they simply liquidate the company and carry on their business via another new entity.

When a director has been served with a DPN and elects to have the company wound up within the statutory two week period, that director ceases to be personally liable for the debt. It is then up to the administrator or liquidator, on behalf of creditors, to recover any assets of the company. Typically there are no assets to recover.

Sanctions exist for acts of 'fraud' under the Criminal Code (Crimes Act) and the Proceeds of Crimes legislation and the Tax Office usually undertakes investigations in respect of the most serious phoenix offenders. Such investigations are expensive in time and resources. The Director of Public Prosecutions (DPP) and the Australian Federal Police (AFP) continue to provide assistance to the Tax Office and this is carried out in accordance with the Commonwealth Prosecution Policy.

Typical Phoenix Arrangement Using Labour Supply Entities

Building and Construction Business (for example, a formwork group)



1. Liquidation of labour supply entity does not affect liabilities or assets within the rest of the business. The labour supply entity is the only entity within the business group that 'phoenixes', which enables the business to survive.
2. The labour supply entity does not ordinarily provide services outside of the business to third parties

This entity supplies workers to the business until it is placed into liquidation resulting from non-payment of taxes deducted from workers wages and/or non payment of other taxes.

This entity becomes active once the first entity has transferred all workers into it, and/or first entity has gone into liquidation.

This entity becomes active once second entity has transferred all workers into it and/or second entity has gone into liquidation.

The extent of phoenix companies in the building and construction industry in NSW

It is not possible to estimate the number of phoenix companies in NSW because the principals take deliberate steps to disguise themselves and their practices from creditors and the Tax Office. The person controlling the business is not always registered as a director, making it difficult to identify the principal.

Sometimes phoenix companies change their names when going into voluntary administration, often using their Australian Business Number (ABN). This in itself is not an offence against the Corporations Law although it is a device that can easily mislead creditors.

Since 1998 the Tax Office has maintained a planned and coordinated focus on individuals who use, or promote the use of, successive company structures to intentionally evade payment of taxes. In NSW the Tax Office has 20 staff working full time on phoenix activities, mainly in respect of the building and construction industry and a further 23 staff working on other 'high risk' building and construction industry projects. We intend to increase our staffing for phoenix and other building and construction compliance activities during 2002-2003.

The Tax Office Phoenix Project has confirmed that most large-scale phoenix activity occurs in the SME sector of our client base, that is, enterprises with a turnover in the range $2 million - $10 million pa. The tax most at risk was PAYE until replaced by PAYG(W)[2] after the introduction of the New Tax System. Non-payment of GST and suspect claims for GST input tax credits are emerging risks associated with phoenix activity.

The Tax Office has raised over $140 million in taxes and penalties since it commenced focussing on these types of activities in 1997. Around $126 million has been raised in NSW with $110 million attributed to the building and construction industry. Our assessment is that this industry participates in phoenix activities to a greater extent than any other industry. About 85% of the Phoenix Project casework since 1997 has involved the building and construction industry.

Phoenix operators take calculated risks they will not be detected by the Tax Office. Some have been able to evade payment of taxes for some years. Over time, our intelligence capability has developed and the Tax Office has been able to identify and address these practices more quickly and more effectively. The tax debts of new cases involving serial offenders are typically smaller on average than one or two years ago. This may indicate that the Tax Office is identifying and actioning these type of arrangements sooner and more effectively than in the past.

The Tax Office has also identified a number of tax agent 'promoters', predominantly in NSW, and they are currently under investigation. We are unable to confirm exactly how many clients of these tax agents may be involved in phoenix activities as our research has not been completed.

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[2] Further revenue at risk includes State payroll taxes, Superannuation, Long Service Leave contributions

Over the past two years some high profile prosecutions have led to some significant gaol terms. A director of a bricklaying business was gaoled for 7 years 8 months for defrauding over $7.5 million in PAYE tax through a series of phoenix companies. A financial administrator of a formwork business was gaoled for 5 years 4 months for defrauding over $7 million in PAYE tax.

Fraudulent claims for GST Input Tax Credits

The introduction of the Goods and Services Tax has led to a form of phoenix activity which may operate along the following lines. The example again is a formwork group:

> Company A accumulates a tax debt. Company B is formed in anticipation of A being unable (or unwilling) to pay its debts and using the voluntary administration process as a safe refuge from its creditors.
>
> Company A sells its fixed assets to Company B at a reasonable market price. Tax invoices are provided. In this example the transferred assets would be formwork.
>
> Company B claims the GST paid on the purchase price of the formwork as an input tax credit in the next BAS that it lodges with the ATO. This would ordinarily result in a refund of GST being paid to Company B, unless this amount was offset against some other tax liability of Company B.
>
> Company A may or may not lodge a BAS. In any event it simply adds the GST debt to the already growing list of debts it owes the Tax Office.
>
> Company B may not actually pay for the assets despite what tax invoices and other relevant documentation held by Company A and Company B may indicate. If the assets are not paid for in full by Company B, and Company A goes into liquidation it is up to the liquidator to either recover the assets from Company B or chase the debt owed by B to A. The assets and/or debt may not be recoverable by the administrator or liquidator if the transaction took place beyond the statutory six month period prior to administration or liquidation.
>
> Should the ATO confirm that Company B has received a GST refund inappropriately, as a result of fraudulent intent, then action will be taken to recover the tax refunded and the matter referred for prosecution investigation.
>
> The obvious scenario may well be that Company B will have, or will claim to have, suffered some economic misfortune and will not be able to pay its debt to Company A or to the Tax Office.
>
> In time, Company B will fail and Company C will rise from the ashes to continue the cycle.

Tax Instalment Deduction (TID) claims by directors of phoenix companies

Directors of phoenix companies typically lodge personal income tax returns and declare income by way of salary and wages paid to them by their company. They also lodge claims for TID credits. The ensuing tax assessments usually deliver a refund of TID credits - even though the phoenix company never remitted the TIDs to the Tax Office.

Therefore, the directors receive substantial refunds on payments that the Tax Office may never be able to recover from the company. The Tax Office is considering advice from the Director of Public Prosecutions and the Australian Government Solicitor about TIDs and will refer suspected cases of fraud for prosecution.

The Tax Office conducts a High Risk Refund program which systematically reviews cases where excessive tax credits are claimed by taxpayers.

Estimates of revenue lost to the Commonwealth by tax evasion schemes in the NSW building and construction industry

An accurate assessment of the impact on taxation revenue from tax evasion schemes is difficult to make due to the fact that the people behind such schemes take deliberate steps to avoid detection. This in turn makes it difficult to estimate the revenue lost to the Commonwealth through such schemes. We are not always able to determine how many participants there are in a particular scheme.

Notwithstanding, the Tax Office takes the view that tax evasion within the building and construction industry is significant and in need of a targeted, coordinated strategy to improve voluntary compliance. The national Property, Building and Construction Project that is currently in progress represents a significant part of our response to assessing and addressing compliance within this industry.

The Tax Office raised over $26 million in tax and penalties from its work with the NCA in addressing the bogus labour hire schemes in NSW. A further $94 million was raised as a result of our leveraging and it is significant that the revenue raised from our leverage activities is more than <u>three times</u> the revenue raised from actual audits.

Some employers have been known to generate false invoices and create 'ghost' workers on their payroll to disguise the payment of cash to workers or to themselves. This has occurred across a range of trades and building related activities can be difficult to detect during the audit process. Ratio analysis can identify these types of cases but only when businesses lodge returns and report appropriately and accurately in accordance with their monthly, quarterly or annual obligations under the ITAA.

The Tax Office uses the ANZSIC[3] industry coding system to identify businesses within and across industries. It is sometimes difficult to identify businesses within an occupation or trade when the businesses quote the wrong ANZSIC code to describe their activities. This then leads to difficulty in accurately determining the

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[3] Australian and New Zealand Standard Industrial Classification

number of businesses within certain trades or occupations and the risk to revenue posed by certain sub-industries and individuals.

It is clear from our work in the building and construction industry that the level of non-compliance in this industry is significant, and if left unaddressed would pose a risk to ongoing revenue collections. A number of high risk trade services are currently subject to targeted audit activity and the results provide some idea of the revenue at risk. The sub-industries that were audited include formworkers, steelfixers, scaffolders and plasterers.

- Thirteen audits of formwork and steelfixing companies or groups in NSW have raised $20.6 million in additional tax and penalties. A further 27 cases are in progress and involve $18.5 million in suspect transaction as reported by AUSTRAC.

- Audits on 15 NSW scaffolding companies has raised a further $8 million, with audit and analysis work currently being undertaken on a further 72 NSW scaffolding entities. Suspect transactions exceeding $13 million have been reported by AUSTRAC in respect of these businesses over the past few years.

- There are 15 audits of plasterers currently in progress in NSW. Cash payments identified by AUSTRAC for these cases also exceed $13 million.

Difficulties in identifying tax evasion schemes

The ANZSIC industry code numbering system is the national system by which industries and sub-industries are collectively identified. The Australian Bureau of Statistics (ABS) is responsible for the management of ANZSIC and collects and reports on data gathered on an industry-wide basis. This data assists in a range of activities at all levels of the community, including forward planning and economic forecasting by governments and industry.

The Tax Office uses ANZSIC codes for all businesses that lodge income tax returns. We also cross-references information held by ABS against our databases for a range of reasons including risk assessment and risk monitoring.

The current ANZSIC code classification does not make a clear distinction between the different classes or types of construction within each building and construction sub-industry. For example, business to business and business to consumer trades are included under the same ANZSIC code. This makes it difficult to isolate the businesses involved in commercial construction.

One example is in respect of formworkers which may fall under carpenters, concreters or non-residential construction. Should we identify non-residential construction as a particular risk area for formworkers, we could not rely upon the ANZSIC system to accurately confirm the names or numbers of all the businesses involved in this activity. A formworker could use any one of three or more ANZSIC numbers. Therefore we would have to rely upon other means to identify them.

Employers dealing in cash are more difficult for the Tax Office to detect and monitor. Many employers seem to be aware that AUSTRAC reports payments and withdrawals of cash in excess of $10,000. There is evidence that some employers have structured their deposits and withdrawals to remain below this threshold, regardless of this being an offence under the Financial Transactions Reporting legislation. Banking and financial agencies are required to report any cash transaction they consider to be suspect. The bogus labour hire scheme was first detected following reports from a bank that a scheme promoter was trying to structure his withdrawals so that they fell below the $10,000 threshold.

Prosecution of tax evaders

In the past two years over 100 individuals or entities involved in the building and construction industry (39 in NSW) have been or are being investigated for fraud. One of the main aims of these investigations is to gather sufficient information to lay charges and prosecute the worst offenders. The total amount of tax is over $70 million with $60 million relating to NSW.

Our investigations target offences such as payment of untaxed 'cash in hand' monies, defraud, money laundering and provision of false and misleading statements in tax returns. In the more serious cases charges are typically laid under s.29D of the Commonwealth Crimes Act.

Since January 2001 the Tax Office has been involved with several successful prosecutions including four promoters of a bogus labour hire scheme, two directors and a financial administrator of (two) formwork companies, and one director of a bricklaying business. All were charged with s.29D defraud offences under the Crimes Act and all cases were in NSW.

Details of sentences imposed since January 2001 include:

Offence	Activity	Amount	Sentence
Defraud (s.29D)	Formwork	\$7.0m	Company financial administrator sentenced to 5 years 4 months gaol.
Defraud (s.29D)	Formwork	\$8.8m	Principal director sentenced to 18 months gaol. Second director received a suspended sentence and good behaviour bond.
Defraud (s.29D)	Bricklayer	\$7.5m	Director sentenced to 7 years 8 months gaol.
Defraud (s.29D) and Money Laundering[4]	Bogus Labour Hire	\$6.0m	Promoter sentenced to 18 months gaol.
Defraud (s.29D) and Structuring (s.31 FTR Act)	Bogus Labour Hire	\$15.3m	Promoter sentenced to 7 years 6 months gaol.
Defraud (s.29D)[5]	Bogus Labour Hire	\$13.0m	Promoter sentenced to 3 years 4 months gaol.

Geographic distribution

The majority of commercial construction occurs in the Sydney metropolitan area and this is where the major tax evasion practices have been detected. Cash payments have been detected in regional areas including Wollongong and Newcastle. Bogus labour hire schemes were mainly in the Sydney region.

Summary

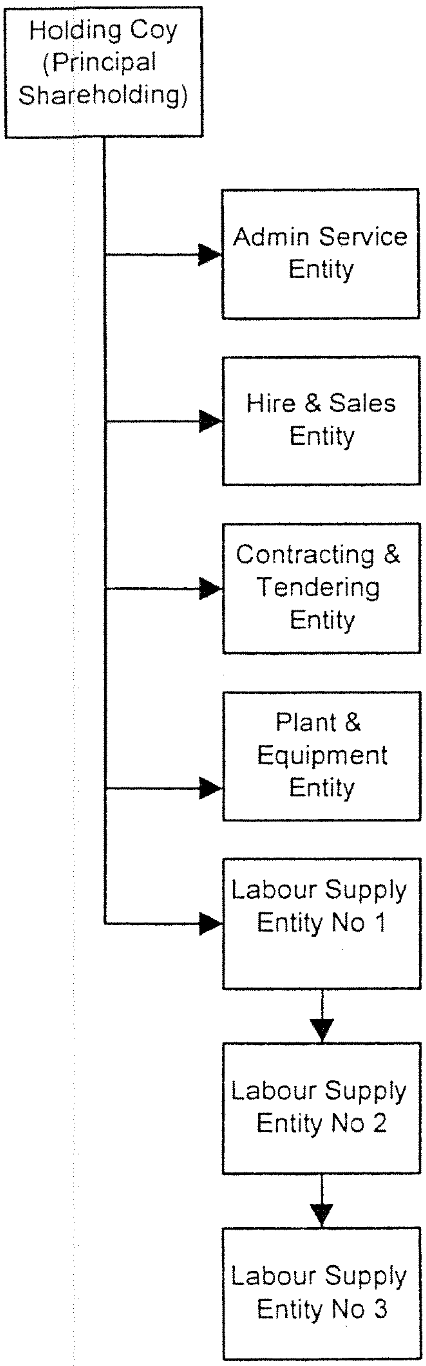
The Tax Office has a long history of involvement with the building and construction industry and has identified practices that indicate a high risk of non-compliance and significant threats to the revenue. Lost revenue affects all Australians and the Tax Office has a range of strategies in place to promote voluntary compliance in the industry.

[4] Referred by NCA
[5] Referred by NCA

ANNEXURE 2

Typical Phoenix Arrangement Using Labour Supply Entities

B & C Business eg Formworker



NB:

1. Liquidation of Labour Supply entities does not affect liabilities or assets within the rest of the business. The labour suply entity is the only entity within the business group that "phoenixes" to survive.

2. The labour supply entities do not ordinarily provide services outside of the business to 3rd parties

This entity supplies workers to the business until it is placed into liquidation resulting from non-payment of taxes deducted from workers wages and/or non payment of other taxes

This entity becomes active once the 1st entity has transferred all workers into it, and/or 1st entity has gone into liquidation

This entity becomes active once 2nd entity has transferred all workers into it and/or 2nd entity has gone into liquidation

49. A top down approach is adopted, commencing with the major contractors and moving through the tiers of contractors and subcontractors at various stages of construction.

50. Major projects provide opportunities to generate large amounts of cash.

The Olympics

51. The Olympic Games was approached in this comprehensive way. A compliance risk was identified in relation to formworkers/steelfixers associated with the Olympic Games in Sydney. This risk predominantly related to the commercial segment of the non-residential building and construction industry. Information provided by a source within the industry led to the identification of a large formwork business working on one of the Olympic Games construction sites. It was subsequently proven in court that the business had made undeclared cash payments totalling $8.8 million to its workers and had sought to disguise the payments via the creation of false invoices, supposedly for material purchases. The principal director was prosecuted for defrauding the revenue, and on appeal, was gaoled for 18 months.

52. The audit of this company led to further research into the formwork and steelfixing sub-industries.

The Alice Springs to Darwin Rail Link

53. Work has commenced on the Alice Springs to Darwin rail link, which the Tax Office is treating as a major infrastructure project. This $1.3 billion project involves a number of different trades and market segments. We will adopt the top down approach across various trades at various stages of construction to ensure compliance with the tax laws.

54. This project will be conducted in two phases. The first phase will involve relationship building, intelligence gathering, risk identification and education and support for entities involved in the project. The second phase will be focused on addressing identified compliance issues.

PHOENIX PROJECT

55. Since 1998 the Phoenix Project has provided a planned and coordinated focus on individuals who use, or promote the use of, successive company structures to intentionally evade payment of taxes.

56. This fraud typically occurs when individuals use limited liability companies to accumulate debts (usually to the Tax Office), liquidate the companies concerned and then carry on their business via a newly formed company. In almost all cases the entities placed into liquidation have no assets.

57. The major focus of the Project has been on serial offenders who use deliberate and fraudulent methods to avoid their obligations.

58. The Project currently has 32 staff located in four Tax Office sites in the eastern States where phoenix risk is at its highest. Phoenix activity has been found to be more common in NSW, particularly in the building and construction industry.

Table 6 - Phoenix Project Results to Date[2]

Cases finalised	400
Tax and penalties raised	$140m
Tax and penalties collected	$60m
Cases in progress	150

59. Tax Office collection processes have been reasonably effective to date. Experience has shown that when audit and debt collection activities are integrated the chance of success in collecting taxes owed by phoenix companies is significantly increased. Working with other law enforcement agencies has strengthened our efforts to address harmful phoenix practices in the community. The fact that limited liability companies are treated as entities separate from the controllers of the company means that the forensic process of gathering evidence can be difficult, time consuming and expensive. The use of 'puppet' directors by individuals who would otherwise be disqualified from holding a position of company director has also been observed.

60. In recent years it has become more prevalent for businesses involved in phoenix practices to structure themselves so that they do not place at risk the entire assets of the business. Should an entity within the group become unable to meet its tax obligations, such as PAYG(W) taxes, then this entity can be placed into liquidation without affecting other entities within the group or the business as a whole. Typically the entity that falls behind in meeting its tax obligations is the labour supply entity for the group. The bulk of the workforce is usually administered by one labour supply entity in each phoenix group. When that (labour supply) entity is placed into voluntary administration and liquidation the workers are moved into a new labour supply entity. The pattern repeats itself when the next entity becomes unable to pay its taxes. (Refer to Annexure 2 for a diagram of a typical phoenix arrangement involving labour supply entities).

61. The Phoenix Project has confirmed that most large-scale phoenix activity occurs in connection with enterprises with a turnover in the range $2 to $10 million per annum and usually involves non-payment of PAYG(W)[3]. Non-payment of GST and suspect claims for GST input tax credits have been found to be emerging risks associated with phoenix activity. The risk originates from assets purportedly sold by one phoenix entity to another.

62. The tax debts of new cases involving serial offenders are typically smaller on average than one or two years ago. This may indicate that the Tax Office is identifying and actioning these type of arrangements sooner and more effectively than in the past.

63. The Tax Office has also identified a number of tax agent 'promoters', predominantly in NSW, and they are currently under investigation.

BUILDING AND CONSTRUCTION OUTLIERS PROJECT

64. The introduction of the GST and the increased frequency of reporting for PAYG purposes has substantially increased the timeliness, range and quality of business ratios available. This means the Tax Office can now identify businesses operating outside the norm much more easily than in the past.

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[2] Around 85% of the Phoenix Project cases and results are in the building and construction industry.

[3] Further revenue at risk includes State payroll taxes, Superannuation, Long Service Leave contributions and Workers Compensation (eg. NSW WorkCover).

65. The Tax Office uses real-time BAS information to identify taxpayers and businesses that fall outside the industry norms. All monthly and quarterly BAS data is analysed to establish industry benchmarks for each quarter which are then used to identify those with an unacceptable tolerance.

66. The concept of an outlier is based on the assumption that businesses that are similar in characteristics (e.g. same specific industry and turnover ranges) should have similar business performance, especially if the performance is measured in the form of ratios rather than absolute values. Identified cases are followed up as appropriate.

DISPLAY HOMES PROJECT

67. A Display Homes Project is underway in order to remedy issues around the GST treatment of display homes.

68. Issues of concern relate to the construction or selling of new residential premises and leasing those premises from the investor for use as a display home.

69. It is the view of the Tax Office that the purchase or building of a house to be used as a display home constitutes an input taxed supply. Under the GST legislation there is no entitlement for the purchaser or investor to claim input tax credits if the acquisition relates to making an input taxed supply. The investor is accordingly not entitled to input tax credits either on the construction or purchase cost, and the subsequent lease payments by the builder do not attract GST.

70. Early results from a pilot project being conducted in South Australia have indicated that there is confusion in the market place. Some display home investors are incorrectly claiming an input tax credit.

71. Our approach will focus on leverage products and encouragement of voluntary compliance through raising community awareness of the issue, providing customised information for industry associations and project home builders, and conducting follow up reviews.

SERIOUS NON-COMPLIANCE - PROSECUTIONS

72. In the past two years over 100 individuals or entities involved in the building and construction industry have been or are being investigated for fraud. The investigations have as one of their aims, the gathering of sufficient information to lay charges and prosecute the worst offenders. The total amount of tax involved is calculated to be $70 million.

73. The majority of offences being investigated involve payment of untaxed 'cash in hand' monies, defraud, money laundering and provision of false and misleading statements. In the more serious cases charges are typically laid under section 29D of the Commonwealth Crimes Act.

Table 7 - Examples of some finalised prosecutions since January 2001

Offence	Activity	Amount	Result
Defraud (s.29D)	Formwork	$7.0m	Company financial administrator sentenced to 5 years 4 months gaol.
Defraud (s.29D)	Formwork	$8.8m	Principal director sentenced to 18 months gaol. Second director received a suspended sentence and good behaviour bond.
Defraud (s.29D)	Bricklayer	$7.5m	Director sentenced to 7 years 8 months gaol.
Defraud (s.29D) and Money Laundering[4]	Bogus Labour Hire	$6.0m	Promoter sentenced to 18 months gaol.
Defraud (s.29D)[5]	Bogus Labour Hire	$13.0m	Promoter sentenced to 3 years 4 months gaol.

74. In addition, audit action has continued against serious non-compliers, especially property developers. Since 1998 five such cases have been finalised resulting in detection of non-declared income of almost $1 million. Additional tax and penalties raised was another $500,000.

75. A further example of serious non-compliance casework concerns bogus labour hire businesses, which is reported in more detail above.

Inter-agency Relationships

76. A number of agencies have regulatory responsibilities that impact on this industry. The Tax Office works co-operatively with each.

77. Where serious fraud issues are encountered, and particularly where criminal charges are likely, there are specialist staff within the Tax Office who deal with each case. In such cases, the Australian Federal Police (AFP) and the Commonwealth Director of Public Prosecutions (DPP) are involved.

78. The Tax Office works co-operatively with Centrelink, the National Crime Authority (NCA), AUSTRAC and various Offices of State Revenue and each agency benefits from ongoing exchanges of information.

79. AUSTRAC data is particularly valuable for operational and strategic intelligence for this industry.

CLARIFYING THE LAW

80. The process of clarifying the Tax Office's views about the correct application of the law is an important compliance strategy. It is particularly important at the more 'sophisticated' end of the industry, where 'grey' areas may be exploited. Over recent years, the more significant rulings issued include:

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[4] Referred by NCA
[5] Referred by NCA

- Taxation Ruling TR 2000/D5 - Income Tax: Taxation of retirement village operators.

- Taxation Ruling TR 97/25 - Income Tax: Property development: Deduction for capital expenditure on construction of income producing capital works, including buildings and structural improvements.

LARGE CLIENTS

A 'Personalised' Approach

81. In respect of Large Clients there is a structured compliance process which entails using industry and fine industry tax performance measures. The measures may include effective tax rates, other financial indicators, level of losses, international related party dealings, previous audit history and events, and may be used for intensive review such as a Client Risk Review.

82. One of the major processes used in risk assessment for the Large Client Program is the Client Risk Review. This process ensures a consistent approach to risk assessment for large business. The review looks at the economic performance of the corporate group as a whole. It includes financial analysis and qualitative profiling information from a variety of sources, both internal and external to identify risks for further enquiries with taxpayers. Following the review, issues identified are prioritised and collated for systemic treatment.

83. The approach has been initially to conduct a Client Risk Review on the Top 200 groups - 17 clients in the Top 200 groups are in the property and construction industry.

Some Specific Activities

84. A range of recent specific projects covering Large Clients include major construction projects, infrastructure, and loss utilisation.

85. As noted above, the behaviour of Large Clients in this industry is consistent with the behaviour of Large Clients in other industries. In very broad terms, particular risk issues in connection with Large Clients include Division 10D write back, capital and revenue losses, and financing arrangements.

The Future

86. In respect of Large Clients the Tax Office will continue to:

- Enhance client coverage (Client Risk Reviews and audits) and ensure leverage within the industry;

- Engage in further project-based approaches to compliance;

- Issue further rulings to cover risk areas and provide the Tax Office view; and

- Establish closer relationships with industry representative groups and major players.

Australian Taxation Office

Submission

to the

Royal Commission

into the

Building and Construction

Industry

June 2002

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Chapter 3 Specific Compliance Strategies

OVERVIEW

32. Significant issues the Tax Office encounters in the commercial trade services sector include:

- Payment of cash wages which are not disclosed on payment summaries. This involves the evasion of PAYG(W). In some cases, invoices are fabricated by employers to ensure a deduction is available for the expense;

- Cash and other payments to contractors and sub-contractors, which are not returned as income;

- Fraudulent claims for GST input tax credits;

- Use of bogus labour hire arrangements ('bodgies') which generate cash in hand for employers and facilitate the payment of undisclosed cash to employees; and

- Phoenix arrangements used to evade payment of tax liabilities through deliberate and systematic liquidation of trading entities. These harmful practices can be compounded by directors generating payment summaries for themselves to claim PAYG(W) credits on tax that has never been paid.

33. This part of the submission provides some detail about the use and structure of a number of the arrangements mentioned above and the responses taken by the Tax Office. Specific outcomes and intelligence findings are also noted where appropriate.

34. A number of successful outcomes in actively addressing high-risk clients in the building and construction industry have been achieved in co-operation with other Commonwealth law enforcement agencies.

NATIONAL PROPERTY, BUILDING & CONSTRUCTION COORDINATION

35. A group of senior executives from across the Tax Office oversee the risk management and compliance activities underway in the building and construction industry. This recognises the size and diversity of the Tax Office and of the industry.

36. Broad objectives of this steering group are to:

- Effectively deal with non-compliance by adopting a balanced and proportional approach;

- Develop integrated compliance approaches, utilising risk management approaches and shifting to real-time intervention to leverage the impact of the Tax Office across the range of tax obligations;

- Continue to improve and build on relationships with industry leaders, associations and government and semi-government organisations through ongoing consultation and co-operation; and

- Expand the Tax Office's understanding of the industry and its practices, particularly in respect of new provisions. A greater understanding of the reasons for non-compliance will assist in the development of a long-term compliance strategy.

37. There are currently over 220 field staff associated with this industry and an increase of at least 50 staff are expected over the course of the 2002/03 financial year. In addition, over 30 staff from the Tax Office's Phoenix Project will continue to undertake casework specific to the building and construction industry.

HIGH RISK SUB-INDUSTRIES

38. A number of high risk trade services are currently subject to targeted audit activity. These cover formworkers, steelfixers, scaffolders, and plasterers.

39. The practice of payment of a base salary to workers supplemented by cash for overtime and bonuses appears widespread throughout the formwork and steelfixing sub-industries. Some employers have been known to generate false invoices and/or create 'ghost' workers on their payroll, to disguise the payment of cash to workers or to themselves. This can be difficult to detect during the audit processes.

40. Additionally, Phoenix practices are quite commonly employed to evade payment of tax, especially in respect of the formwork sub-industry.

Table 3 - Formworkers / Steelfixers Results to date

Cases finalised	13
Tax and penalties raised	$20.6m
Cases in progress	27

41. Since 1998 fifteen entities in the NSW scaffolding sub-industry have been reviewed and/or audited and $8 million in tax and penalties raised. Further cases are underway in this sub-industry.

Table 4 - Scaffolders Results to date

Cases finalised	15
Tax and penalties raised	$8m
Cases in progress/under review	72

42. The Tax Office continues to expand its focus to include projects covering other high-risk building and construction sub-industries, with action underway in relation to plasterers.

BOGUS LABOUR HIRE

43. This scheme came to the attention of the Tax Office through our involvement in a taskforce with the National Crime Authority (NCA). The project undertaken by the Tax Office commenced in February 2000 and is nearing completion.

44. The NCA identified approximately 400 companies as having paid $86 million to known bogus labour hire businesses.

45. Broadly the scheme operates as follows:

> A construction business agrees to interpose a bogus labour hire firm (known as a Bodgie company) that acts as a commission agent to cash cheques that are allegedly for payments for the supply of labour. The bogus labour hire firm retains a 7% commission from the total monies paid by the construction company, returning the balance (ie 93%) of the original cheque value in cash. Invoices for the supply of (non-existent) labour by the bogus labour hire firm are also supplied to the construction business to facilitate a full business deduction for taxation purposes. Workers employed by the construction business are paid their usual net payments, typically tax free. The construction business keeps the cash that formerly would have been remitted as PAYE had tax instalment deductions been made from the gross wages paid to its employees.
>
> Refer to Annexure 1 for a simple diagram of the 'Bodgie' scheme.

Table 5 - Tax Office results since the Bodgie Project commenced in February 2000

Cases finalised	209
Tax and penalties raised	$26.2m
Tax and penalties collected	$5.9m
Additional revenue raised (via leverage)[1]	$94.0m

46. The Tax Office is currently finalising a small number of cases and continuing to assist the NCA with the prosecution of several scheme promoters. Payment arrangements to collect outstanding taxes are either in place or being put in place. Monitoring of the industry and previous scheme participants is continuing and any resurgence will be quickly addressed.

47. Intelligence gathered during the course of this Project confirmed that this practice was mainly confined to the NSW building and construction industry especially in sub-industries such as excavation, earth moving and pipe laying.

MAJOR INFRASTRUCTURE/CONSTRUCTION PROJECTS

48. These active compliance projects involve the monitoring of compliance levels of entities involved in major infrastructure or construction projects in all States. The Tax Office seeks to influence the compliance levels of these entities through developing partnerships with project managers and contractors they engage, monitoring their compliance levels and addressing issues that may impact on their ability to meet their tax obligations.

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[1] The $94m in leveraged revenue was ascertained by calculating the increase in both PAYE and PPS remittances that occurred after businesses ceased involvement in bodgie schemes.

SUPPLEMENTARY BUDGET ESTIMATES BRIEFINGS
NOVEMBER 2003

Possible Estimates Issue – Building and Construction Industry

Brief Description:

The Cole Royal Commission report raised a range of tax policy and compliance issues, which include:

- Tax evasion within the industry is widespread - including non-declaration of income; money laundering; and false invoicing to disguise payments;
- The practice of phoenix companies being used to defeat creditors such as the Tax Office, suppliers and workers, is commonplace;
- ABNs are being abused and their entitlement needs to be reviewed;
- The definition of "employee" is not consistently applied across the industry;
- The exchange of information across state and federal agencies needs to be enhanced so as to better target tax evasion and phoenix practices;
- Amendments to the Superannuation Guarantee legislation that directly impact on the building and construction industry need to be reviewed within twelve months of operation;
- The impact of the Alienation of Personal Services Income legislation needs to be reviewed within twelve months of operation;
- Income tax legislation concerning Director Penalty Notices needs to be amended;
- The Tax Office should establish a Building and Construction Industry Forum which would examine taxation issues of significance for this industry. Membership of this forum would include major industry participants, including unions and employer organisations.

The Tax Office was closely involved in supporting the Commission through secondment of staff and assessing information raised before the Commission.

The Government is currently considering the final report. Earlier public announcements included a media release on 27 March 2003 from the Hon Tony Abbott MP. During the *Construction Beyond Cole* construction industry conference on 20 – 21 October 2003, the Hon Kevin Andrews MP announced that he would be tabling the *Building Industry and Construction Industry Improvement Bill 2003* in parliament before the end of the year.

The Tax Office has undertaken the following activities as a result of the Royal Commission:

- A national Steering Committee has been established which oversees all work conducted by the Tax Office within the building and construction industry;
- Around 250 staff are currently engaged by the Tax Office on compliance work specific to the building and construction industry as part of a national focus on this industry;

SUPPLEMENTARY BUDGET ESTIMATES BRIEFINGS NOVEMBER 2003

- The Tax Office is currently addressing a number of concerns in this industry, including phoenix companies; undeclared income; inadequate record keeping; non-lodgement of Business Activity Statements and Income Tax Returns; non payment of tax; abuse of ABN; fraudulent GST claims; understated GST on property sales and the incorrect application of the margin scheme; and the incorrect classification of sales and expenses in Business Activity Statements;
- The Tax Office maintains an "Issues Register" which contains a catalogue of taxation-related issues which the Tax Office identified while monitoring the formal hearings conducted by the Royal Commission. Many hundreds of witness statements were examined as part of this process. All taxation issues have been risk assessed and audit action has been undertaken where appropriate;
- The Tax Office continues to work with other agencies such as the Australian Federal Police and Director of Public Prosecutions in the prosecution of the worst offenders;
- The Tax Office is establishing a new Building and Construction Industry Forum to discuss taxation issues specific to this industry. The first meeting will be held in Sydney on 28 November and about 50 participants representing major industry players, unions and employer organisations are expected to attend;
- A new ASIC/Tax Office Memorandum of Understanding designed to facilitate the more effective exchange of information has been drafted and is expected to be in place by 30 November 2003. Discussions with other agencies, including NSW Office of State Revenue and DIMIA also occur regularly in order to identify/promote whole-of-government solutions;
- The Tax Office is continuing to provide support in respect of the Alienation of Personal Services Income measures through a variety of strategies including seminars and one-to-one visits with clients and tax agents.

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Sources used: ***Includes documentation provided by the Tax Office to the Royal Commission into the Building and Construction Industry***

Tax dodge companies resurface

Mark Fenton-Jones

Phoenix companies are rising again as unscrupulous business owners look for ways to wriggle out of their GST liabilities and burn unsuspecting creditors at the same time.

These companies have been around for years. Typically, the assets of a company which owes money to various creditors are shifted to another company, for a nominal fee. The new company has the assets but not the creditors, who are left with the older company. Often, the new company's name bears a striking resemblance to its predecessors. Hence, the tag, "phoenix".

Schon Condon of insolvency practitioners Jones Condon reported an increase in phoenix activity across the board in recent months. He attributed this to the Australian Taxation Office's pursuit of outstanding GST payments.

Historically, the biggest losers with phoenix companies are the ATO and various workers' compensation schemes.

Often a phoenix company trades for a period of time and relies on unpaid tax to heavily discount prices to consumers. Having built up a sizeable tax debt before going into liquidation, the operator of the business transfers those assets that exist to a second, "clean" company.

Next would be the liquidation of the old company at little or no value.

"The new company then starts operating again at the latest days or even weeks after the old company folds – and sometimes even before the other company is liquidated," Mr Condon said.

But small to medium companies are also victims of this activity. Not only are they owed money as suppliers, but if they compete with the phoenix, they might have to offer discounts themselves.

As a phoenix company has to re-emerge elsewhere, its owners still need suppliers and will pick those creditors it can afford to burn.

For example, a company buys office equipment from one of 10 suppliers in its operating area. But there is only one transport company and it will need its services later, no matter what guise it works under. Guess which one is likely to be the unpaid creditor?

"A number of people have not paid GST from the start," Mr Condon said, adding that some were even brazen, or foolish enough, to say that they didn't know they had to.

He divided these rip-off merchants between those who orchestrate a planned phoenix, and the ones who suddenly "discover" they have a large GST bill that they can't pay.

Ironically, the ATO's decision to leave businesses alone for two years had exacerbated the problem, Mr Condon argued. If the ATO had people out visiting late payers, rather than adding a penalty tax to the outstanding GST, the impact of on reputable business might have been reduced.

Other warnings about phoenix companies are emanating from business advisers, who are cautioning smaller companies to watch out for phoenix companies that emerge should interest rates start to move up over the next six months.

The strong economy has enabled many businesses to borrow heavily as interest rates are at low levels. But the warnings by both the Reserve Bank governor and the Treasurer directed at home loan borrowers, should also signal to SMEs that they should maintain strict credit controls.

The Insolvency & Trustee Service figures for September showed that business-related bankruptcies, increased by a small number – 931 compared with 914 in 2002. While not suggesting these are phoenix companies, at a time when money is cheap, it's a timely reminder that some small businesses have over-extended themselves. It could be a worse picture if rates shoot up.

"When the economy is quite healthy, we still find we get a bit of work because people expand badly," said an insolvency practitioner, Peter Marsden of accountants RSM Bird Cameron. "They don't fund it properly and they still end up in financial problems.

"The key thing for creditors is to be vigilant; to make sure they know specifically which entity they are dealing with and if they see a change to make sure they take action quickly. Because the quicker you get onto it, the more chance you have of getting a better result," Mr Marsden said.

Horwath insolvency partner Paul Weston advised SMEs to ensure their customers complied with the credit terms. "Don't extend credit without the proper guarantee," he said.

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KEY POINTS

- The ATO is typically the big loser with phoenix companies.
- The rise in activity could be due to the ATO chasing outstanding GST.

Phoenix companies, which shift assets to avoid paying GST and creditors, are once again increasing.