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Payroll Tax Review
NSW Treasury
GPO Box 5469
SYDNEY NSW 2001

Dear Sir / Madam

Call for Submissions – Review of Payroll Tax Administration

The crunch test for how well any tax is administered can be measured by the results of compliance audits of taxpayers. A high level of adjustments and penalties is a fairly reliable indication of fundamental flaws in the administration of the tax and/or, in many cases, overly complex legislation. If taxpayers are continually getting compliance wrong, this begs the question as to whether there should be a better and more constant process of continually identifying the barriers to better administration and taking decisive and prompt action to address and resolve those problems. This review is a very good reminder of that and hopefully will lead to a fresh look at how things are being done.

We are a firm of tax consultants and I personally have had 20 years' experience in dealing with payroll tax matters. A lot of that time has been spent advising and assisting clients dealing with a payroll tax audit by Revenue NSW (RNSW).

Most of the 8 topic points listed in the Call for Submissions Fact Sheet are related to ways of improving the mechanical compliance process. Whilst the taxpaying community will welcome any streamlining of administration in these areas, it is the big picture issues, such as uncertainty as to the outcome of a payroll tax audit, which keeps taxpayers awake at night.

My comments don't fit squarely into the 8 topic points, so I have not tried to set out my comments under those headings. Rather, I have set out below what my experience has led me to believe are 8 of the big picture issues which should be addressed to make dramatic improvements to the administration of payroll tax.

In fairness to RNSW and its officers, the administration of payroll tax runs smoothly in many areas and there have been many commendable improvements over the years and the organisation has many dedicated professionals. However, given the nature of this review, my comments are obviously directed at areas which are creating significant issues for taxpayers.

1. Overly complex legislation

Although this review is directed at administration of payroll tax, everything starts with the legislation. I would contend that you can't have perfect administration if you have imperfect legislation. In my experience there are a handful of key areas in the legislation that have created huge compliance issues which affect both taxpayers and RNSW staff.

In my view there needs to be a will to improve the legislation in these areas and a mechanism to achieve that within an acceptable timeframe. Some of these issues have been in the "too hard basket" for years or decades.

The key areas that in my view require a rethink are:

(a) The contractor provisions (Division 7, Part 3 of the *Payroll Tax Act 2007*);

(b) The employment agent provisions (Division 8, Part 3 of the Act)

(c) The grouping provisions (Part 5 of the Act)

(d) The "de-grouping" provisions (s 79 of the Act)

The bulk of disputes, audit adjustments and objections arise from these areas. Any review of these areas would ideally involve input from a range of interested stakeholders.

I am happy to provide more detailed comments about these areas of the legislation and the practical compliance problems arising therefrom at a later point in time. However, some key points are as follows.

Contractor Provisions: Some exclusions work well because they can be easily determined by the taxpayer (e.g., the contractor provides services for 90 days or less) but others rely on commercially confidential information held by the contractor which it is not obliged to provide to the taxpayer (in relation to whether it renders services to the public generally) or require the satisfaction of the Commissioner, which doesn't really work in real world time.

Employment Agent Provisions: RNSW and taxpayers appeared to be in agreement that these provisions only applied to traditional employment agent arrangements until 2014 when, following Supreme Court cases in NSW and Victoria (Freelance Global and CXC Consulting), RNSW expanded its view as to how the provisions operated and that they could be applied to arrangements well beyond traditional employment agents, creating a disaster for those taxpayers who were then audited and assessed retrospectively. Four years later the uncertainty for taxpayers as to how this part of the law works lives on – to the point where the tax obligations of a cleaning business may be dependent on the time of day or night that the cleaners work (JP Property Services case).

Grouping Provisions: Even RNSW staff have acknowledged that the grouping provisions cast the net so wide that potentially all or most business in NSW/Australia could technically be grouped with each other. The provisions covering common employees (where there is no de minimus test) and discretionary trusts (where every potential beneficiary of the trust is deemed to have a controlling interest in the business of the trust) are particularly burdensome and have led in my view to inequitable outcomes.

In 2003 the NSW Government made a commendable decision to insert a "mainly" test in the common employee provision which meant that businesses were not grouped purely on the basis of the employees of one business doing occasional work for another business. This totally simplified that whole grouping issue. Unfortunately during the harmonisation process the common employee provision reverted back to the pre-2003 model to line up with the model in Victoria. The NSW Commissioner at that time indicated that he would be pushing for all States to incorporate a "mainly" test in the harmonised grouping provisions but this never eventuated. It would be very good for simplifying administration if this issue could be looked at again.

De-Grouping Provisions: I would say as a general comment that s 79 sets the bar too high and too many businesses remain grouped notwithstanding that they are by and large completely separate businesses.

2. **Taxpayers Want Certainty**

All businesses want certainty, they want to be able to rely on a particular position and not find out down the track that RNSW has shifted the goal posts.

In recent years, the biggest area of uncertainty by far has been the application of the employment agent ("EA") provisions.

The application of these provisions beyond traditional employment agents has literally created a mine field for taxpayers who use contractors and subcontractors. With each new Tribunal or Court case the goal posts shift and there is no certainty for many taxpayers as to what their legislative liability is. For other taxpayers they are blissfully unaware of the extended approach taken by RNSW and the Tribunal/Court to the EA provisions. I personally made a submission to RNSW in 2014 (via the Tax Liaison Committee) requesting that the Commissioner issue a public advice setting out the RNSW changed position on the EA provisions and to take a decision to not apply new interpretation policy retrospectively. No action was taken in relation to that request that I am aware of. To my knowledge, RNSW has still not produced a public document clearly setting out its approach to the EA provisions or written to all taxpayers alerting them the potential implications of recent Tribunal and Court decisions. Meanwhile, those taxpayers being audited are bearing the brunt of this confusion.

3. Client Education

As mentioned earlier, the contractor and grouping provisions are responsible for the bulk of audit adjustments. Why is this so, when these provisions have been around for decades?

Obviously RNSW has a suite of measures in place to educate taxpayers, such as information seminars and online information. But even with that, the current system of client education is not working as optimally as it should be and some supplementary measures seem necessary.

So a re-think of education strategy is suggested.

I'm not sure what the optimum solution is but:

- For those businesses already registered for payroll tax, it may be necessary to have some form of periodic education to break the cycle of taxpayers just robotically lodging monthly and annual returns, without a reconsideration of the law at regular intervals, e.g., by way of a self-audit tool which taxpayers have to work through before lodging their annual return;
- For unregistered businesses, to identify some method of contacting those businesses approaching the exemption threshold, and those businesses where the heavy use of contractors is traditional to their industry;
- Perhaps all new payroll tax registrants should have a training officer (rather than an auditor) visit them in the first 3-6 months of registration to talk through the areas where the most errors arise.

4. Penalties and Interest

This topic follows on from the previous one. In my experience, payroll tax adjustments made by RNSW auditors arise from taxpayers' lack of knowledge of the more complex provisions of the payroll tax legislation. As businesses need to have wages above the exemption threshold to be subject to payroll tax, these taxpayers are normally substantial businesses which do not set out to deliberately avoid payroll tax. Rather, they have to deal with a complex spectrum of legislation across a range of areas of which State and Federal taxes form just a component. Particularly for businesses at the smaller end of the payroll tax-paying spectrum, it is difficult to be 100% informed across this vast range of issues.

A typical scenario is where a business has an audit, is advised that it is technically grouped with another entity (for which it was unaware) and one or other of the businesses is hit with a four year assessment (average tax per year $40K x 4 years = $160K plus 25% penalty of $40,000 (non-tax deductible). This is an unbudgeted cost and can often be a business breaker.

Which leads to the question – What responsibility does RNSW take for not educating the taxpayer sufficiently to identify the problem or otherwise having a system in place to identify the issue at an earlier point in time when the tax adjustment may have been more manageable?

A $40,000 penalty may be just a number to an RNSW auditor, but it is a critical amount to an SME that is struggling to deal with an unbudgeted tax adjustment going back 4 years.

In my view there needs to be a review of the penalty regime, if not the actual legislation then at least to the Commissioner's policy guidelines under which remissions are made. If a taxpayer has got their compliance correct in all aspects but say one (e.g., a contractor adjustment or a grouping adjustment) and it is clear that the shortfall resulted from innocent error, then perhaps a 5-10% penalty may be more appropriate.

5. Culture of the Organisation

In my view there has definitely been a more aggressive position taken by RNSW to the administration of payroll tax in the last 5 years (e.g., refer my earlier comments about the EA provisions). Good for the Government in that it has brought additional revenue, but at the cost of totally and permanently damaging relationships between many taxpayers and RNSW and in many cases significantly damaged or even destroyed businesses, apart from creating huge stress for business owners.

It was the decision of RNSW to call taxpayers "clients". A good idea if you want to work collaboratively with taxpayers, but the mind-set of the organisation as a whole has to match up to what the term "client" infers.

6. Unhelpful RNSW Practices/Strategies

There are a number of practices/strategies used by RNSW staff from time to time that are very frustrating for taxpayers and their advisers looking to resolve disputes. From the RNSW perspective, they are probably viewed as legitimate strategies to maximise revenue but from the other side of the fence they alienate taxpayers who just want to resolve disputes in a fair, transparent and accountable way.

The ones I have experienced:

(a) Onus of Proof: Section 88 of the *Taxation Administration Act 1996* provides that "*On an objection, the objector has the onus of proving the objector's case"*. Unfortunately this can be taken advantage of by RNSW officers where they know that the taxpayer cannot produce physical evidence (e.g., a contractor may refuse to provide information necessary to prove an exemption or documents may have been lost, etc.) and RNSW wins their case by default rather than taking an objective approach which may take into account a range of other factors.

(b) Failure to provide full and detailed reasons for decisions.

(c) Seeking to apply a PTA ruling to a taxpayer on a "one size fits all" basis rather than considering the application of the legislation to the taxpayer's specific circumstances.

7. Ombudsman

In my view there is a need for a Taxation Ombudsman Office, similar to that set up at Federal level, to give taxpayers access to an independent "referee".

It is acknowledged that in many cases the existing avenues provide a suitable review process, such as the formal objection process. However, there are also instances where interactions between RNSW and taxpayers reach a stalemate or dead-end and an independent Ombudsman would help in resolving matters. For example:

- RNSW decisions may sometimes be legislatively correct (e.g., RNSW issues retrospective assessments going back say 4 years with or without penalties) but be unethical or unfair due to circumstances (e.g., the taxpayer was given a clean bill of health on the same issues at a previous audit and relied on the outcome of that audit). The taxpayer cannot win at Objection or Tribunal level from a legislative viewpoint but still seeks some respite and fairness.

- Where RNSW is being discriminatory in its treatment of taxpayers, as has been happening with its changed position on the interpretation of the EA provisions, and during which the judicial interpretation of that legislation is still in a state of flux. During the period 2014 to date, RNSW has targeted specific taxpayers who were operating on the premise that the contractor provisions applied to them, but RNSW then applied the EA provisions retrospectively (4 years) to assess a much greater liability. The problem is that the taxpayer's competitors in the same industries were not all identified and assessed retrospectively and continue accounting for their liability under the contractor provisions, oblivious of the treatment of the taxpayers who have been retrospectively assessed.
- Many taxpayers are forced to accept RNSW decisions because they simply cannot afford the resources and cost of challenging the Commissioner in the Tribunal or Supreme Court. Having an independent referee such as an Ombudsman can often bring some logic and reasonableness to the dispute between a taxing body and taxpayer.

8. Options for ongoing consultation

I am aware there are currently Taxation Liaison Groups set up with members from the relevant Institutes, but the matters discussed and any output from those meetings is to my knowledge not made publicly available.

If the Government and RNSW have the will to work collaboratively on an ongoing basis with external stakeholders, for ongoing and constant improvement to the administration of payroll tax, then a regular forum to do so would be a good idea. In my view however, it would have to be a formal undertaking where input from external parties is in documentary form (as well as being presented orally where applicable), minutes are publicly available, and there is transparency and accountability to progress matters raised and time frames set so that issues do not linger on for months, years or decades.

Calls for Submissions – Fact Sheet Questions

In addition to my above comments, my summarised response to the 8 questions in the Call for Submissions Fact Sheet are:

1. *How can payroll tax administration processes in NSW be streamlined, noting that thresholds and rates are outside the scope of this Review?*

   As set out in all of the points above.

2. *What is the single change to the way payroll tax is administered in NSW which would be of greatest benefit?*

   Resolution of the issue with the EA provisions would be my highest priority.

3. *Is there a simple, short term change that should be considered to make an immediate improvement to tax administration?*

   Resolution of RNSW policy on the EA provisions

4. *Are there practices that NSW should adapt from other jurisdictions, and what would their impact be if taken up in NSW?*

   I would say the opposite and not take up the phasing threshold introduced in some other States as this is a move to more complicated administration process.

5. *Are there additional guidance /materials/tools that could be provided by Revenue NSW to improve an employer's user experience?*

Some form of self-audit tool could be useful.

6. *What is the administrative burden (time, cost) on your business associated with the audit process undertaken by Revenue NSW and how might this burden be reduced?*

   The experience with the audit process for most clients is that the administrative burden is significant to huge. Because auditors are conducting many audits at once, the audit is a constant pick up and put down process as each tranche of documents provided results in a new set of queries and requests for further documentation, often taking months for an audit to be completed and often without the taxpayer knowing if there are any additional liabilities until the very end of the audit. So quite stressful for most taxpayers.

7. *Are there any areas where further harmonisation or co-ordination with other jurisdictions would be beneficial?*

   A big concern is that the 8 States/Territories put a fairly significant effort into harmonising as much as possible from 2007 to 2009 but seem to be creating more points of distinction in individual States/Territories as time goes on.

8. *How might the performance of the NSW payroll tax administration process be measured to keep track of the efficiency and effectiveness of the system, and to benchmark with other tax administration systems?*

   I notice that the ACT has taxpayer surveys – this might be something worth considering.

Other Matters

I am unaware of how widely this review was advertised but I'm sure there are many stakeholders who would appreciate the opportunity to express their views. If they haven't already done so, ideally RNSW should be contacting all payroll tax taxpayers by email to invite them to make submissions as they are the ones dealing at the coalface with the monthly lodgement/process and associated activities and could offer very practical suggestions for improving and streamlining that part of the compliance process.

Please call or email me if you would like to discuss any of the matters raised in this submission.

Yours sincerely

Shane Peters
Director