



Incorporated Victoria No A0050004U
ABN: 54 403 453 626
www.independentcontractors.net.au
PO Box 13103 Law Courts 8010 Vic

**Submission to
Inspector General of Taxation
Review into the ATO's Employer Obligations Audits
December 2015**

Accompanying this submission is

1. ICA submission to Board of Taxation review, May 2014.
2. Case Study Results Test. **ICA requests that this be kept confidential.**
3. ICA PSI Ready Reckoner.
4. ICA queries to Tax Commissioner on ABN process and his reply

1. Background and reiteration of points made earlier in 2014

This submission is an update of the submission ICA made to the Board of Taxation (BOT) *Review of Tax System Impediments Facing Small Business* in May 2014. That submission is supplied as part of this submission.

In our BOT submission we included real-life case studies of the experiences of individual self-employed people in their dealings with the Australian Taxation Office. Those experiences were all negative and highlighted inefficiencies and, we believe, even malpractice, on the part of the ATO. The nature of the ATO's action towards the smallest of small business people—the self-employed in particular—is one of aggression with the effect (and perhaps even intent) to suppress the numbers of self-employed people in Australia. That is the conclusion that we are forced to adopt after years of dealing with the ATO and assisting self-employed people in dispute with the ATO.

In our BOT submission we criticized the ATO for:

- Its processes for allocating and/or refusing to allocate Australian Business Numbers.
- Its failures in relation to basic, core administrative functions.
- Failing to ensure that ATO officers comply with the ATO's own rules.
- Having a dispute-resolution system that is not seen to be open and fair and which allows the ATO to win its claims by financial intimidation. (That is, small business people cannot afford to challenge the ATO because of the costs of litigation.)
- Incoherent application of policy in relation to Personal Services Income Tax laws.

Specifically, we asked for:

- Rapid introduction of a genuine, independent disputes-mediation mechanism.
- Cessation of the ATO's denying individuals ABNs.
- The closure of the ATO employee-contractor online 'decision-making' tool.
- Repair of the poor ATO administration of small taxpayers' issues.
- Proper, correct and consistent application of the ATO's own rules on PSI by its officers.

The BOT itself made many recommendations, including:

- Fixing (in their words 'relaxing') the ABN requirements.
- Fixing the employee-contractor tool (again, in the BOT's words, "The Board endorses the ATO review of the tool").
- Rationalising and simplifying the PSI rules (this is really linked to contractor-employee distinctions).

We supported and endorsed these recommendations.

<http://www.independentcontractors.net.au/Current-Issues/Taxation/digging-out-the-ato-board-of-taxation-review-recommendations>

In January 2015 the Inspector-General of Taxation (IGT) issued a parallel report on *Managing Tax Disputes*. We also supported and endorsed those recommendations.

<http://www.independentcontractors.net.au/Current-Issues/Taxation/inspector-generals-report-slams-the-ato>

2. Situation after the BOT and IGT reports

Subsequent to the BOT and IGT reports and recommendations, the Commissioner of Taxation has made a number of public claims about how the ATO is undergoing a reform process—one where the ATO is more understanding and is working with small business people. In particular, it was claimed that:

- The employee decision-making tool is/has been reviewed and reformed.
- Decisions on ABN allocation are/have been improved.
- The ATO has introduced an Alternative Dispute Resolution process.
- PSI rules are being reviewed.

Independent Contractors Australia's experience and observation is that, rather than improving the situation, it has become worse since early this year. Specifically:

- The Alternative Dispute Resolution (ADR) process is not genuine. It is a 'talkfest' process in which the only resolution open to the taxpayer is to concede to the ATO's predetermined position/s.
- ABN allocation/withdrawal continues to be illogical and/or inconsistent.
- The employee decision-making tool continues to operate as before.
- The PSI rules may be subject to review, but the process is conducted at a snail's pace with no change 'on the ground'.

3. Australian Business Numbers

We can confirm that, at the moment, the ATO is engaged in a process of sending form letters to ABN holders announcing the cancellation of the holders' ABNs. When holders ring the ATO call centre, invariably they are informed that the letters are just form letters. The individual's ABN is invariably reallocated over the phone on the spot.

This demonstrates that the ATO is not undertaking genuine ABN reviews. Instead, it is undertaking a sweeping ‘catch all’ strategy to see how many people do not object to their ABN being cancelled. However, such an aggressive strategy causes endless concern and angst for the people receiving them.

New ABN applications continue to be rejected on grounds that are either not explained or inconsistent.

In ICA’s view, by continuing to deny and withdraw ABNs (seemingly on the basis of a collective bureaucratic ‘whim’), the ATO is following an aggressive anti-self-employed program. ICA has no confidence in the integrity or openness of the ATO process in this regard.

Further, ICA maintains that the ATO does not have the legislative authority to impose its bureaucratic views on who is entitled to an ABN. The law is in fact quite clear, leaving no discretion to the ATO.

Under law, the ATO is required to allocate ABNs to individuals/entities that conduct an ‘enterprise’. However, an ABN cannot be allocated to an employee. This is the only distinction. The appropriate legislation states:

A NEW TAX SYSTEM (GOODS AND SERVICES TAX) ACT 1999 - SECT 9.20

Enterprises

- (1) An *enterprise* is an activity, or series of activities, done:
 - (a) in the form of a * business; or
 - (b) in the form of an adventure or concern in the nature of trade; or ...
- (2) However, *enterprise* does not include an activity, or series of activities, done:
 - (a) by a person as an employee or in connection with earning * withholding payments covered by subsection (4...

A NEW TAX SYSTEM (GOODS AND SERVICES TAX) ACT 1999 - SECT 195.1

Dictionary

"business " includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee.

The legislation makes it clear that the idea of ‘enterprise’ as a ‘business’ or ‘adventure’ is very broad. However, the legal fact of being an ‘employee’ is tightly defined under common law. And, under common law, the process of finding who is or is not an employee is also clearly established— it is conducted through the courts using clear and known tests.

However, the ATO itself has taken on the power to define an ‘enterprise’ quite narrowly within what can only be described as the ATO’s ‘smell test’. That is, if the ATO thinks or suspects that someone is not conducting what the ATO would consider to be an ‘enterprise’, then the ATO will reject an ABN. For example, it declares that a ‘labourer’ cannot be conducting an ‘enterprise’. In other words, it has determined that a certain job status (labourer) must be employment and not an enterprise. It is therefore denied an ABN. This is in defiance of all common law processes as required under the law.

In August 2014 ICA put a number of questions to the Tax Commissioner or the ATO's processes and policies in relation to ABNs. The Commissioner responded in September 2014. The response is attached to the submission (Attachment 4) for the purposes of background information.

4. Employee 'decision-making tool'

The ATO's defiant attitude is evidenced by the use of its online 'decision-making tool'. The ATO has created an online questionnaire which, using only a few short generalized questions, is supposed to determine if the respondent is an employee. The decision of the 'tool' is then determinative of whether an individual is granted an ABN.

This defies the common law process. Only a court can decide who is an employee. When the courts undertake such an investigative exercise they spend considerable time making sure they understand precisely what is occurring in the work between the parties. To do this they use up to some 20 sub-tests in the investigation. The courts then make a decision based on the balance of evidence arising from those tests.

The ATO has completely ignored this long-established common law requirement, instead utilizing a short question-and-answer process that is entirely unreliable in terms both of process and outcomes.

5. Personal Services Income Tax laws

The same situation applies, in parallel, with the PSI laws. The ATO has made a confusing mess of the application of these laws—laws that should establish a clear process.

In 2004 (updated in 2006) ICA negotiated with the ATO over the design of a simple four-page summary of how the PSI laws apply. (See attachment 3.) In summary, the PSI laws only really need to be applied to a small/micro business that is structured as a company or a trust. The task is to see if the income earned through the efforts of the owner/controller of the company/trust is allowed as income of the company/trust.

These particular tax laws have significant implications for the 700,000 or more small/micro business people in Australia who are structured as companies/trusts.

What must be discovered is if the company/trust and owner/controller pass, at first instance, the 'results' test. The 'results' test is established under statute and restated under Taxation Ruling TR 2001/8 <http://law.ato.gov.au/atolaw/view.htm?DocID=TXR/TR20018/NAT/ATO/00001> that states at clause 110

- *"the results test is based on the traditional criteria for distinguishing independent contractors from employees. Guidance on this distinction is provided in Taxation Ruling TR 2000/14. In summary, the following factors are relevant to this distinction.*

The 'traditional criteria' referred to is in fact is common law and the common law process. The results test requires consideration of 11 of the (around) 20 possible common law subtests. But these 11 are the most important.

These are stated in the table reproduced below taken from Taxation Ruling TR 2001/8 <http://law.ato.gov.au/atolaw/view.htm?DocID=TXR/TR20018/NAT/ATO/00001>

1. The contractual obligations	An independent contractor enters into a contract for a specific task or series of tasks.
2. How the work is performed	The independent contractor maintains a high level of discretion and flexibility as to how the work is to be performed. However, the contract may contain precise terms as to materials used and methods of performance and still be one of result.
3. Risk	An independent contractor stands to make a profit or loss on the task. They bear the commercial risk. The independent contractor bears the responsibility and the liability for any poor workmanship or injury sustained in performance of the task. Often an independent contractor would carry their own insurance and indemnity policies.
4. Tools and Equipment	An independent contractor provides the assets, equipment and tools, if any, necessary for the work.
5. Hours of work and place of work	An independent contractor may set their own hours of work, or place of work, depending on the contract or the nature of the work.
6. Leave and other entitlements	A contract for a result usually does not contain leave provisions or allowances.
7. Payment	Payment to an independent contractor is often based upon performance of the contract rather than being paid a hourly rate, piece rates or award rates.
8. Expenses	An independent contractor usually incurs their own expenses.
9. Appointment	An independent contractor is likely to advertise their services to the public at large, and the contract for a result is often the direct result of this activity.
10. Termination	An independent contractor is contracted to complete a set task. The payer may only terminate the contract without penalty where the worker has not fulfilled the conditions of the contract. The contract usually contains terms dealing with defaults made by either party.
11. Delegation	An independent contractor may delegate all or some of the tasks to another person, and may employ other persons.

In undertaking a PSI results test assessment, the law is quite clear that the requirement on the ATO is to consider the ‘business’ operation of the small/micro business person being investigated and apply each of the 11 tests to that business and make an assessment based on the balance of the evidence. That is, the ATO is required to apply a similar process to that which a court would apply. The ATO should then, we argue, make and provide to the party being investigated it’s reasoning as to why the party has passed or failed each of the 11 sub-tests. This would be a correct process at law.

Is the ATO doing this? No.

Since 2006 at least, ICA has looked at around 40-or-so PSI cases brought to us by small/micro businesspeople. These are all cases where the ATO has claimed that the party has failed the ‘results’ test. In a significant number of these cases, the business people have shared with us all their correspondence with the ATO. During 2015, ICA has looked at around 9 cases. We cannot and will not provide the details of the cases, as the parties are all concerned about maltreatment by the ATO. Most of the cases involve information technology, engineering and other similar consultancies.

ICA has read the PSI assessments by the ATO case officers that allege failure of the results test. In not one case we have examined has the ATO conducted a proper or even near-proper assessment based against each of the 11 sub-tests required under the results test. The correspondence and explanations are written in ATO legalese, they are confusing, circular in argument, frequently quoting tax rulings that are marginal or seemingly irrelevant to the substance of the results test, and float diversionary 'red herrings'.

Attached to this submission is a case study (attachment 2) that we have prepared based on a typical information technology consultant's work situation. **Please note that we ask that this case study not be published, but be for the IGT officers' eyes only.** The reason for requesting confidentiality is that the case study is modelled on several cases with which we have been dealing.

We have detailed in the case study how we believe a proper results test process should occur. There needs to be a full description of how the business operates against each of the 11 criteria. This needs to be followed by an opinion/assessment of how the facts of the work situation apply against each sub-test. A summary and overall assessment should also be provided.

If this process is not followed, the ATO is denying the small/micro business person the natural justice to which they are entitled and which the ATO should apply.

(Note that ICA is not in this submission querying specifically the likely outcome/s of cases but arguing for proper process as required, we say, under the law.)

Instead, what we have read of the ATO case officers' assessments does not even remotely resemble a proper process or an attempt at a proper process. In fact a distinct pattern is evident where the only sub-test of substance that the ATO frequently raises is the alleged failure of the results test because the small/micro business person has not 'advertised'. The ATO seems mired on this point and when it has been debated with them it is as if the ATO holds the view that if a consultant does not place an advertisement in a daily newspaper, then the consultant fails the results test. (Has not the ATO heard of the Internet, Facebook, LinkedIn and other social media processes for professional self-promotion?!)

6. There is a pattern

There is a pattern to the processes and behaviour of the ATO on the issues we have raised. The ATO is not following required processes as established under common law and, we argue, as required under legislation, namely:

ABN: The rejection or cancellation of an ABN can only (on a fair reading of the Act) be clearly undertaken if an applicant is an employee. Such an assessment requires a process modelled on the common law process. The ATO is on very dubious ground in rejecting or cancelling an ABN on its allegation that the applicant is not an 'enterprise'. This is particularly so because of the very wide meaning of 'enterprise' under the Act.

‘Decision-making tool’: In creating and using the online ‘decision-making tool’, the ATO attempts to condense the common law process into a few brief, broad steps and questions. This is entirely illegitimate and misleading

PSI results test: Given the evidence from the many cases upon which we have made active and detailed investigation, the ATO is not even attempting to apply a proper assessment process based on the 11 sub-tests of the ‘results’ test as required under legislation.

In other words, tax law and common law require the ATO to apply the known common law process of investigation to the ABN issue, the ‘results’ test and any determination of employee status. The ATO does not do this and instead applies its own processes.

Why is this so?

After close to two decades of close involvement with the ATO and with small/micro business people having to deal with the ATO, we come to the unfortunate conclusion that the ATO has adopted an aggressive stance against allowing people to be self-employed. Whether this is by intent, gross incompetence or incapacity to understand common law is not relevant. It is the outcome of the ATO’s processes and behaviours on which we reach our conclusion. We judge the results and they are not good.

We suspect that the most logical reason is as follows.

The ATO has a cultural bias against self-employed people because it is administratively complex and difficult to collect tax and ensure tax compliance from hundreds of thousands of small/micro, self-employed business people. It is administratively easier for the ATO if people are ‘employed’ through large businesses, because the businesses do the administration for the ATO. Auditing of large businesses is much more efficient than auditing micro, self-employed business people.

Further, micro, self-employed business people are easy-to-pick, low-hanging fruit in the tax collection game when they are targeted. The ATO knows, for example, that if it makes a claim for, say, \$20,000 against a micro business individual based on an allegation that he or she failed PSI, then the cost to the individual in legal and accounting fees for defending their position will easily exceed the \$20,000. If a micro, self-employed small business person disagrees with an ATO determination, their only course of action is to go to the courts. This is always expensive.

In addition, the individual doesn’t know or understand the law which they are alleged to have broken and therefore do not know how to defend themselves. In effect the ATO is able to conduct financial intimidation and harassment of micro, self-employed people. Based on ICA’s observations, studies and experiences over many years, we conclude and allege that this is the case. Whether there is a hidden policy agenda and/or culture within the ATO to conduct such intimidation and harassment we cannot know. However, the application of the ATO’s policies and practices certainly has this outcome.

7. ATO Alternative Dispute Resolution (ADR)

During 2015 the ATO started a process of internal ADR to which a taxpayer can apply if they feel aggrieved with a case officer's decision. The ATO has publicly trumpeted the process as a success.

We have directly been involved in the ATO's ADR processes and have had many people report to us on the process. We can say that, from the micro, self-employed business person's perspective, the process is not Alternative Dispute Resolution but rather the re-putting of the ATO's position and the rejection of any position different from the ATO's. In fact the ATO has stopped calling the process ADR and now refers to it as 'facilitation'. The ATO 'facilitator' is invariably from lower management and has a task of 'facilitating' discussion, not assisting resolution. Invariably a senior manager is bought in who dominates the process and calls the shots. We do not consider the ATO's ADR process for micro, small business self-employed people to be a genuine process of ADR.

8. What to do. Recommendations

We are most pleased that the IGT is conducting this review. Australia has a problem. The ATO is acting, intentionally or otherwise, to suppress the ability of people in the community to be self-employed micro/small business people. This impedes innovation and economic development. We have no confidence that, left to their own devices, the ATO will change its approach. Our observation is that the culture and the processes within the ATO that work against the self-employed are so entrenched as to be immovable from the inside. Correct processes need to be imposed on the ATO from the outside.

This is not only an issue of economic development, it is also one of justice. All self-employed people have a right to a fair and correct process under law applied by the ATO without intimidation and harassment.

Since May 2015 the Inspector-General of Taxation has the authority to review ATO processes on an individual case basis and, we understand, to require correct processes to be imposed on the ATO. We may be mistaken on the latter point, but we hope we are not.

In essence what is required is that the ATO apply a proper process of common law assessment of employment status when

- Rejecting an application for, or removing, an ABN.
- Considering the 'results' test under PSI.

Further, the online decision-making tool should be disbanded or clearly made subservient to the common law process. If it is to be retained, it should be re-named the online 'indicator tool' and it should be substantially modified if retained.

However, we have no faith in the willingness of the ATO to do any of this and based on the history of the ATO on this issue, it would probably resist it vigorously.

We therefore ask the IGT to step in and consider doing the following:

- Establish a template process based on common law for ABN, PSI results test and to override the online ‘decision-making tool’. (Our case study attachment 2 provides a starting point for development.)
- Publish the template and provide lay language explanation about the processes on the IGT website.
- Make it clear to self-employed people that if they are confronted with an ATO assessment on an ABN, the ‘results’ test or the decision-making tool, and if the ATO does not apply the common law processes as recommended by the IGT, the individual can appeal to the IGT on the grounds of failure of due process.

The emphasis in this submission and recommendation is to see a process outcome that complies with the law as required under statute and common law. We do not seek to prejudge the outcome of due process.

However, if the tax collection system is to have integrity and to be one in which people can have confidence, due process at law must apply. A just tax system relies on this.