

Taxable payments reporting – Effectiveness measurement

Analysis of the impacts of the taxable payments reporting system in improving compliance in the building and construction industry

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Australian Government
Australian Taxation Office

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Executive summary

The taxable payments reporting system introduced in the 2012–13 tax year, requires businesses in the building and construction industry to report to the ATO payments they make to contractors within the industry. The ATO has analysed the reported information and reviewed the compliance behaviour of contractors whose incomes were reported under the system. This report details a number of observations that demonstrate improvements in voluntary compliance in response to the system.

Additional income tax and GST liabilities of \$2.3 billion for 2012–13 have been voluntarily reported to the ATO by businesses whose incomes were reported under the taxable payments reporting system. This amount is comprised of:

- Lodgment of returns \$265 million
- Goods and services tax \$506 million
- Pay as you go withholding \$1,128 million
- Pay as you go instalments \$357 million

The figure of \$2.3 billion reflects an increase in liabilities reported by businesses in the building and construction industry that:

- received taxable payments that were reported, and/or
- reported taxable payments to the Tax Office.

Specific increases cannot be attributed solely to the impact of the taxable payments reporting system. However, it is likely that the majority of the increase flows from the introduction of the reporting system, the communications and education program together with acceptance of the system by reporting businesses.

We have also identified a number of apparent compliance risks where additional liabilities could be secured through direct compliance activity:

Tax return lodgment – 76,000 contractors with reported payments still have not lodged a 2012–13 tax return and 21,000 have one or more 2012–13 activity statements unlogged

Omitted income – 53,000 contractors have lodged 2012–13 tax returns but appear to have reported less income in their tax returns than they have been reported to have received

GST compliance – 84,000 contractors, without an active GST registration have been reported to have received payments that include GST totalling \$426 million.

Invalid or missing ABN – 53,000 transactions (3.4%) did not include an ABN or the quoted ABN was invalid. The value of these transactions is \$1.3 billion and this amount is unlikely to have been included in contractor tax returns.

Further analysis of this information is needed to identify amounts that may relate to incorrect reporting but where the underlying tax has been accounted for.

Building and construction industry businesses with reporting obligations have responded well to the system, approximately 76% of businesses that need to lodge have done so. They have reported 1.58 million transactions valued at \$163 billion. The availability to the ATO of this valuable information has driven significant improvements in compliance by contractors. This has had a positive impact on levelling the playing field across the building and construction industry, reducing unfair competition from businesses that do not pay their fair share of tax.

To assist with compliance, the ATO has made information on 97,700 reported payments available through our pre-filling service for individual contractors and their tax agents to review when completing their 2012–13 returns, making it easier for these contractors to correctly report their incomes.



97,700

reported payments
available through prefilling

Background

The taxable payments reporting system was introduced in the building and construction industry for payments made on after 1 July 2012. Businesses in the industry are required to report payments they make to other businesses (including contractors) for building and construction services.

The taxable payments reporting system is aimed at:

- assisting contractors to meet their income tax obligations,
- improving compliance with tax obligations by contractors in the building and construction industry, and
- creating a level playing field for businesses and improving tax fairness within the industry, by ensuring compliant businesses are not disadvantaged by those who can undercut prices because they do not pay the correct amount of tax.

Specifically, the system addresses the following compliance problems identified as prevalent in this industry:

- non-lodgment of tax returns
- omitted contractor income
- not complying with GST obligations.

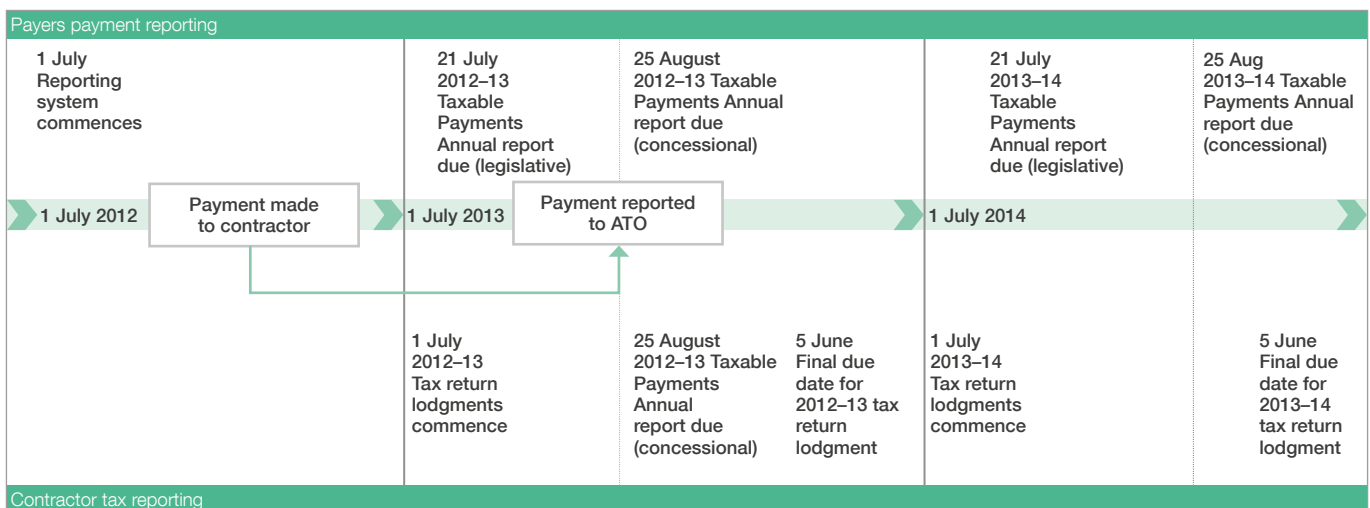
Taxable payments annual reports for 2012–13 were due for lodgment on 21 July 2013 with an extension granted for businesses using an agent to prepare their report until August. As of 31 December 2014, approximately 102,000 annual report lodgments have been received for 2012–13. This report focuses on analysis of the information contained in the 102,000 taxable payments annual reports and the taxpayers whose income is reported in them.



102,000

taxable payments
annual reports lodged

Timeline – Taxable Payments Reporting



Improvements in compliance by contractors

The system was designed to improve compliance by contractors specifically in relation to:

- lodgment of tax returns
- correctly reporting business income
- GST obligations.

The following analysis looks at the income tax and GST compliance of contractors in the taxable payments industries that have been identified as having received a payment reported in a taxable payments annual report.

Contractor lodgment compliance

We have compared 2011–12 and 2012–13 income tax returns and business activity statements lodged by businesses in the taxable payments industries that have had their incomes reported under the taxable payments reporting system. There has been an improvement in both activity statement and income tax return lodgment.

We have contacted 249,000 contractors where taxable payments reporting information has shown they have received income and they have outstanding lodgments. This work is continuing and so far \$265 million in liabilities has been raised from lodgments received.

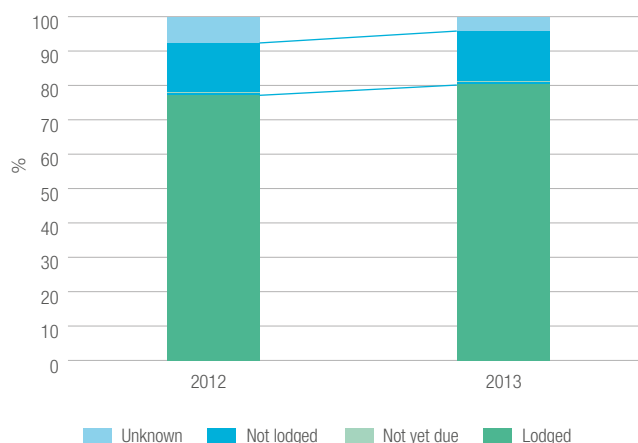
Income tax return lodgment

Overall levels of compliance with income tax return lodgment have increased. While 76.9% of contractors have lodged their 2011–12 tax return, this has improved to 80.0% of 2012–13 tax returns.

There has also been a marked improvement in the category of 'unknown' lodgment status. Unknown lodgment status relates to where an obligation to lodge is not recorded on ATO systems. About half as many 2012–13 tax returns have 'unknown' status as compared to 2011–12 returns because we have now identified a requirement for them to lodge.

As outlined later in this report, 51,000 taxpayers in the taxable payments reporting industries that were not known to be in business, and therefore did not have a lodgment obligation recorded on ATO systems have now lodged a 2012–13 tax return. It is likely that the existence of the reporting system has prompted these taxpayers to re-join the tax system ahead of possible detection through data matching.

Chart 1: Income tax return lodgment status. All contractors in the taxable payments reporting system whose incomes have been reported.



Unknown include 'further return not necessary', 'not on calendar' or no record of an obligation to lodge on ATO systems.



2012 – 76.9% contractors lodged

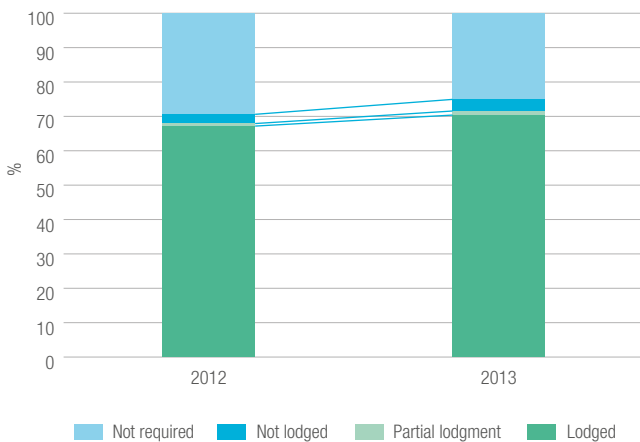
2013 – 80.0% lodged

Activity statement lodgment

Analysis of activity statement lodgments by contractors that have had their incomes reported under the taxable payments reporting system shows that there has been a small increase in the number that have lodged all their activity statements for 2012–13 as compared to 2011–12. Similarly the number that have lodged at least some of their 2012–13 activity statements has also risen from 2011–12.

The increase in the number of contractors that have an obligation to lodge an activity statement may be a reflection of over 50,000 that were brought into the PAYG Instalments system through lodging tax returns containing business income for the 2012–13 year. Entering the PAYGI system will in many cases have meant that these contractors now have activity statement obligations. More detail about PAYGI follows later in this report.

Chart 2: Activity statement lodgment. All contractors in the taxable payments reporting industries that had their incomes reported under the system



Obligations reported on activity statements

The total value of obligations reported on these activity statements has also increased. Net GST increased 6.1% and PAYG withholding has grown by 7.9% from 2011–12 to 2012–13.

Table 1: Amounts reported on activity statements. All contractors in the building and construction industry that had their incomes reported under taxable payments reporting.

	2012 (\$ billion)	2013 (\$ billion)	% change
Total Net GST	\$7.8	\$8.3	6.1%
Total PAYGW*	\$13.1	\$14.2	7.9%

*Includes amounts reported through large withholder system

Taxpayers brought into the system

As a consequence of lodging tax returns, 50,306 taxpayers identified as payees through the taxable payments reporting system, entered the Pay as you go instalments (PAYGI) system since the commencement of taxable payments reporting. After entering PAYGI, these taxpayers receive regular activity statements including a PAYG instalment amount to cover their current year tax liability. It will consequently be harder for them not to comply. These 50,306 taxpayers have had nearly \$358 million in PAYG Instalments included on their activity statements as follows:

Table 2: Increase in Net PAYG instalments reported on activity statements

Financial Year	Net PAYGI (\$ million)
2012–13	\$142.8
2013–14	\$214.8
Total	\$357.6

Changes to PAYGI thresholds may result in some of these contractors exiting from the PAYGI system in future years.

Businesses operating outside the system

Taxable payments valued at \$2 billion have been reported as paid to 59,098 contractors (mostly individuals) that were not previously identified on ATO systems as being actively engaged in a business operation. While these contractors had an ABN, they were not classified as being business taxpayers on ATO systems and had not reported business income in 2011–12.

Just over 86% of these contractors have now lodged a 2012–13 tax return and a further 11% are overdue and will be subject to compliance activity. The validity of indicators such as ‘return not necessary’ is being reviewed, given that these contractors are reported to be in receipt of business income.



Table 3: Tax return lodgments by contractors not previously known to be in business

Client Type	Lodged	Not Lodged	Not Yet Due	Unknown *	Total	Payments Reported (\$ million)
Individuals	47,423	6,106	–	769	54,298	\$1,211
Non Individuals	3,819	347	1	633	4,800	\$784
Total	51,242	6,453	1	1,402	59,098	\$1,995

*Unknown include ‘further return not necessary’, ‘not on calendar’ or no record of an obligation to lodge on ATO systems.

Omitted income

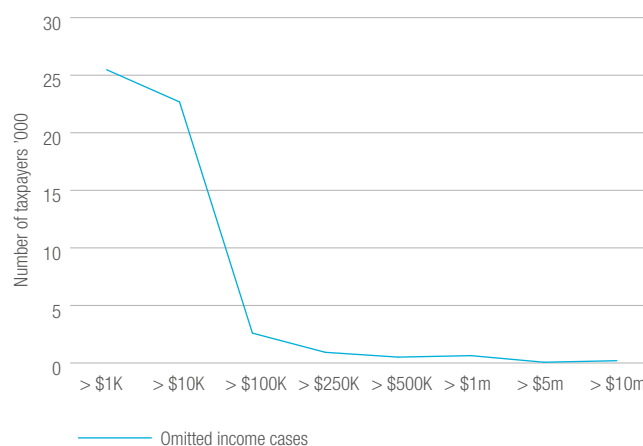
Matching of taxable payments amounts reported with incomes declared in tax returns identifies contractors that on the surface appear to have omitted income from their tax returns. These mismatches need to be investigated to establish that there is an actual omission of income rather than a misreporting, for example where another related entity has reported the income. Work has commenced on a small scale, but it is not yet possible to provide an estimate of the overall likelihood of identified mismatches being misreporting rather than omission of income. The following analysis needs to be read in this context.

Information about reported payments made to individual contractors is available to the contractor or their tax agent through the ATO's prefilling service. Contractors or their tax agents can access the prefilled information and use it to complete the tax return. Information on 97,773 payments was made available for 2012–13 tax returns. This service is planned to be extended to non-individual entities in future years.

Allowing for GST included in payments, and discounting mismatches with a value below \$1000, 53,089 contractors appear to have reported less business income in their tax returns than the amount they are reported to have been paid. The total amount reported to have been paid to these contractors is \$41.6 billion. No business income at all was declared by 33,312 (63%) of these contractors in their 2012–13 tax returns.

The chart below shows that the great majority of taxpayers appear to have omitted a moderately low value amount (between \$1000 and \$10,000). However, there are significant potential omitted income amounts at the higher value end of the discrepancy ranges.

CHART 3: Numbers of contractors that have potential omitted income (over \$1000) by value of omission.



Case study – omitted income

A home renovation company in Western NSW was reported to have received \$2,027,495 in taxable payments. The company's tax return showed business income of \$77,213 had been omitted. A letter was sent to the company seeking explanation. The company's tax agent agreed that an amount had been omitted from

the tax return. The ATO amended the company's tax assessment to include the omitted income, raising an additional \$23,415.30 in tax liabilities, which the company paid by the due date. The agent and the company will be careful to include all its income in the future.

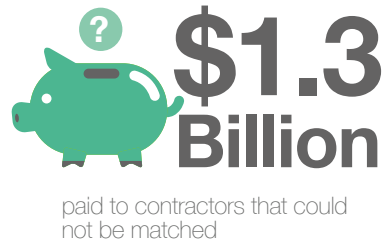
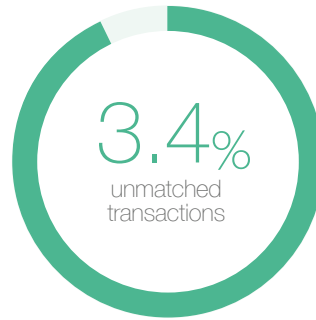
Missing or invalid ABN

Analysis to match reported payments to contractors on ATO systems showed:

- 91.6% of transactions were matched to a known taxpayer in the initial process,
- 5.0% were subsequently matched to a known taxpayer after further work,
- 3.4% remain unmatched.

The unmatched reports either do not contain an ABN or contain one that is invalid because it does not have 11 digits, conform to the ABN algorithm or does not belong to the named entity. \$1.3 billion was reported to have been paid to contractors that could not be matched. It is unlikely this income has been included in tax returns. We are following up with the reporting businesses to see whether they have additional information that may help identify the contractors. In some cases the reporting business has incorrectly recorded the contractor's ABN.

Although this level of non-compliance is concerning, it is an improvement over earlier sampling and analysis conducted before the introduction of the reporting system, when over 7 per cent of invoices could not be matched to a contractor on ATO systems. The need to report payments is likely to have encouraged businesses to take greater care in correctly recording their contractors' names and ABN.



GST and unregistered contractors

Over \$426 million in GST is reported to have been paid to 83,770 contractors that do not have an active GST role. It is likely that the businesses making the payments have claimed a GST input tax credit, but the \$426 million in GST amount has not been paid to the ATO.

Analysis is being undertaken to determine the extent of possible related entities reporting the GST and other data integrity issues.

Table 4: Contractors with no GST role or role is cancelled or inactive

GST Role Status	contractors	Charged GST	GST Amount (\$ million)
Cancelled/Inactive Role	87,975	60,287	\$366.9
No GST Role	85,507	23,483	\$59.4
Total	173,482	83,770	\$426.3

Taxable payments annual report lodgments

Nearly 102,000 businesses have lodged taxable payments annual reports including 1.58 million transactions valued at \$163 billion. 1.45 million transactions with a reported value of \$157 billion have been matched to 479,000 contractors.

Included in the 102,000 reporters are 29,000 that were not identified as having a reporting obligation, because they were not recorded as being within the taxable payments reporting industries. Nevertheless, they have self-assessed a need to lodge and done so.

Reporter lodgment compliance

The original estimate of the population of 160,000 businesses that were identified as possibly having a lodgment obligation has been adjusted to account for the removal of 24,000 businesses that have advised they do not have a lodgment obligation and the addition of 29,000 self-initiated lodgments. This leaves a possible population of 165,000 reporters. Of these, 102,000 have now lodged.

We are contacting businesses in the remaining 63,000 that appear to have a lodgment obligation. Of nearly 1700 successful contacts, about 48% are claiming that they do not have a lodgment obligation because they did not engage contractors in 2012-13 (32%), have ceased business (8%), or are not in the taxable payments reporting industries (8%).

We are conducting some assurance work around these results. If these findings can be extrapolated across the remaining non-lodger population, there would be 32,827 reporters yet to lodge, or 24%. In the first year of a new obligation, 76% lodgment compliance is a good result in an industry with a longstanding history of poor compliance.



Summary

The introduction of the taxable payments reporting system in the building and construction industry has resulted in measureable improvements in compliance by contractors and has exposed areas of non-compliance that the ATO is developing or implementing new approaches to address.

In an industry where non-compliance is long-standing and entrenched, continual pressure will need to be applied to lock in the compliance gains made and persuade reluctant contractors to engage with the tax system in a positive way.

The information provided through the system will help the ATO to improve service delivery and make it easier for those that want to comply, but we will also need to make it harder for those that choose not to. The taxable payments reporting system is an effective tool for identifying and targeting these contractors and also for channelling services to those who are willing participants in the tax and super systems.

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