

# BLACK ECONOMY TASKFORCE

Final Report – October 2017

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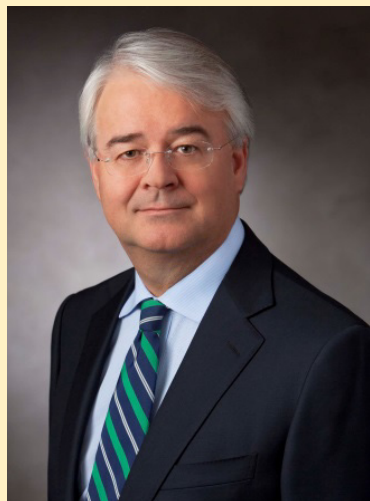
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# CHAIR'S LETTER



Dear Minister,

It is with a great sense of public responsibility that I present to you the Final Report of the Black Economy Taskforce.

The report presents our findings on the black economy, the drivers and risks underpinning it, and an innovative, forward-looking blueprint for tackling it. The recommendations are practical and address the underlying causes of the black economy rather than its symptoms. They include near-term, urgent measures the Government could implement, as well as medium and longer-term actions.

There is a strong sense of community outrage at the inequality and unfair disadvantage created by the black economy. I hope that by creating an efficient, level playing field we can lower taxes, treat all businesses and workers fairly, increase community services or reduce debt if all Australians operate within the rules. If implemented as intended, these recommendations should deliver a red-tape reduction to the community.

I partnered with 20 Commonwealth agencies and 14 private sector representatives, meeting monthly to share information, test ideas, hear their views and build consensus. I am very grateful for their crucial insights and expertise and pay tribute to their commitment of time and effort.

I held an extensive series of bilateral meetings with leaders of business, professional and community organisations. I also engaged with hundreds of people in public hearings and industry round-table discussions around the country, made several speeches and engaged openly with journalists and talk-back radio. We received 149 submissions from businesses, unions, community organisations, state and territory governments and members of the public.

I would like to thank all those who so openly engaged with us. We learned a great deal from them.

Through the Taskforce's activities, we have begun to raise awareness in the community of the societal cost of the black economy. My hope is that the content of this report contributes further to that awareness and lays the foundation for changing community attitudes.

Finally, I wish to record my appreciation for the excellent support provided by the Taskforce Secretariat.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Michael Andrew AO'. The signature is fluid and cursive, with a prominent initial 'M'.

**Michael Andrew AO**

Chair

Black Economy Taskforce



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# FINAL REPORT: EXECUTIVE SUMMARY

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Following an initial investigation by the Board of Taxation, supported by Treasury and the ATO, the Government (in December 2016) established this Taskforce to develop an innovative, forward-looking and genuinely whole-of-government strategy to combat the black economy.

The black economy is a significant, complex and growing economic and social problem. In our opinion, it could have increased in size by up to 50 per cent since 2012.

The costs it entails are not only financial in nature (lower tax revenues and higher welfare costs), but also societal. The black economy is manifestly unfair, allowing some to play by their own rules and penalising businesses, employees and consumers who do the right thing. Under cover of the black economy, vulnerable workers are exploited, criminal groups flourish and social capital and trust are undermined.

The black economy is not standing still, but rapidly shifting and evolving in step with wider economic, technological and social changes. It is a growing problem which, if not dealt with, can develop a dangerous momentum of its own: a 'race-to-the-bottom' which we are already seeing in particular areas.

In 2012, the Australian Bureau of Statistics estimated that the black economy equated to 1.5 per cent of GDP, with the illicit drug industry adding a further 0.4 per cent of GDP. This estimate is now outdated. We consider that the black economy could be as large as 3 per cent of GDP (roughly \$50 billion) today, given the trends we identify in this Report.

A sense of urgency is needed from policymakers, leaving behind business-as-usual approaches from the past. A new strategy and commitment is required: one which addresses underlying causes, not symptoms, while keeping regulatory burdens low; one which goes beyond tax; and one which breaks down agency silos and embraces joint action and the intelligent use of data and analytics. This Taskforce was a genuinely whole-of-government undertaking, bringing together 20 Commonwealth agencies.

This agenda has a clear purpose and objective: to make our society both fairer and more equitable by creating a level playing field. To the extent that this yields a revenue dividend, the Government's capacity to fund needed services (or provide tax relief or lower deficits) will be greater.

Combatting the black economy is not just a matter for governments. We all need to be part of the solution. We need a new social contract: a renewed commitment from the business community and wider public to fight the black economy. Our hope is that our work, including our public hearings and consultations, has helped start an overdue national conversation.

In the time since the Interim Report in March, the Government announced the adoption of two of our key recommendations in the 2017-18 Budget.

In late May and throughout June, we conducted a national roadshow, holding public hearings and industry roundtables in every state capital city and the regional centres of Bathurst, Mildura and the Gold Coast. We have received 149 submissions from businesses, unions, community organisations, state and territory governments and members of the public. The Taskforce Chairman has held over 140 bilateral meetings with stakeholder representatives. In August, we released a detailed consultation paper containing over 50 ideas.

Perhaps as a result of this review, we have been told by tax and law enforcement authorities that public reporting and enforcement of black economy offences has increased.

## ***What we have learned***

Our engagement with the public has deepened our understanding of the black economy, the factors that drive it and, critically, the wider societal damage it causes. We have benefitted enormously from the insights and expertise of our private sector Reference Group and Inter-Departmental Committee of Commonwealth officials.

In particular, we have learned the following:

- The **black economy is more diverse, more complex and influenced by a wider range of factors than we first realised**. While the black economy has always been with us, it is constantly changing form and focus as the commercial, economic, technological and social landscape shifts. A decade ago, the sharing economy was in its infancy, phoenixing was not as prominent as it is today, supply chains were under less pressure, Australian Business Number fraud and identity fraud were less of a concern and the criminal face of the black economy was very different. There has been a noticeable increase in white collar crime.
- The black economy is an **endemic cultural problem**. It is supported by values and assumptions that participation in the black economy is a 'victimless crime', that 'everyone does it'. We are seeing it become more entrenched with such views spreading through families and communities including through social media.
- The **adoption, up-take and spread of new business models in the economy**, while a positive development, facilitates black economy activities when our policy and regulatory frameworks fail to keep pace. The shift of contracting into new sectors (including human services), the sharing or gig economy, the expansion of domestic services, the fragmentation and growing complexity of supply chains, the growing sophistication and cross-border nature of criminal activity and financial innovations (including the use of cryptocurrencies) are all cases in point.
- That **the traditional view** which placed the 'cash' and 'black' (or criminal) parts of the problem in different categories, leaving the former to tax authorities and the latter to law enforcement, **is outmoded**. Modern criminal networks are more sophisticated and business-savvy than ever, pursuing opportunities wherever they arise, including the legal economy. Indeed, this is a factor behind the growth of the black economy in recent years. Criminal activities **do not respect the**

**silos of government organisation** so any government response needs to be flexible and coordinated.

- **More regulation is not the answer.** Business after business has told us that regulations tie legitimate operators up in complexity and red-tape, while being completely evaded by hardened black economy operators. Our responses must be more intelligent and targeted than this, including **employing the smart technologies** we are seeing in the private sector. It is not beyond us to reduce red-tape for 'low-risk' businesses while focussing our enforcement efforts on the minority doing the wrong thing. In our consultations, the value of visible enforcement has been a consistent message.
- The **exploitation of vulnerable employees is widespread and may be growing.** This manifests itself in the underpayment of labour, the denial of basic conditions and in some cases modern slavery.
- There is **anger in the community about the unfairness of the black economy.** Honest small businesses are sick of being undercut by competitors who have an unfair advantage, whether it is paying cash wages to employees, using illegal migrant workers or engaging in sham contracting. Honest employees suffer as well. While community frustration toward multinational firms has been acknowledged by the policy community, in part because it has a natural focus, the black economy's injustices and unfairnesses, while no less real, lack the same profile.
- It is wrong to tar the entire small business community with the black economy brush. The **majority of small businesses and tradespeople do the right thing.** Equally, we should avoid the temptation to paint consumers and employees as innocent victims in all cases. Some employees, including high-end hospitality staff, will not work for anything other than cash wages. Some consumers demand discounts from tradespeople. This is not to deny, of course, the situation of vulnerable employees in particular, who are, in many cases, subject to mistreatment.

## *Our strategy*

In this Report, we outline a clear strategy for dealing with the black economy. We recognise that this must:

- Address the drivers rather than the symptoms of the black economy. We must focus on incentives, deterrents and measures which will limit opportunities for participation in the black economy across the board. Strengthening identity regimes (for individuals and businesses), transparency (for contractors and sharing economy operators), moving to a near non-cash world, visible enforcement, education and 'hardwiring' government all have a role to play.
- Be practical and implementable, while avoiding increasing regulatory burdens, and tailored and targeted. We need to recognise different degrees of culpability: there are many who innocently participate in the black economy (for example, occasionally paying cash for childcare); others



deliberately flout the law; and still others find themselves trapped (for example, exploited employees).

- Include short-term, urgent measures, addressing the most pressing concerns, but also early actions which provide a foundation for later interventions. We set out an indicative timetable for implementation of our key recommendations.
- Our efforts need to be sustained. We need to leave a lasting institutional legacy, to ensure this problem receives the attention it deserves in future years. This will require changes to the machinery of government, but also new patterns of cooperation with the states and territories and other countries.

Our strategy, at the highest level, is to:

1. **Move people and businesses out of cash and into the banking system**, which makes economic activity more visible, auditable and efficient (Chapter 3 in this Report).
2. **Strengthen the identity underpinnings** of the banking system by introducing a more reliable, safe and modern individual identity credential (initially for interactions with the Commonwealth Government) and reforming the Australian Business Number system (Chapter 4).
3. **Improve agencies' ability to enforce existing laws** by promoting **better sharing of data and more modern data analytics** (Chapter 5). At the same time, closing data gaps by **extending our tax reporting systems** and promoting more data sharing with state governments (Chapters 6 and 15).
4. Improving Commonwealth agencies' effectiveness by **working more closely with other governments** (state, local and international) and **business organisations, community groups and unions** (Chapters 11 and 15).
5. **Tackling behaviours directly by strengthening incentives for consumers and small businesses** including an amnesty and benefits for small businesses which adopt non-cash business models (Chapters 3 and 7).
6. Supporting this with a **dedicated social norms agenda**, including education, public awareness and new-business strategies (Chapter 11).
7. **Making enforcement more visible, better tailored to the offence and more effective** (graduated penalties, greater use of civil law and multi-agency action). Targeting particular problem areas, including phoenixing, sham contracting, visa abuses and vulnerable workers. In the criminal area, **adopting a more strategic approach on illegal tobacco and gambling** (Chapters 8, 10, 12, 13 and 14) and disrupting the proceeds of crime.
8. **Pursuing a new responsible supply chain agenda**, which is an emerging integrity issue, in both the public and private sectors (Chapter 9).

9. **Disrupt crime and illegality**, the sharp end of the black economy, including illegal tobacco and unregulated gambling (Chapters 12, 13 and 14).
10. **Institutional changes** to strengthen, modernise and better marshal our future efforts on the black economy (Chapter 16).

In our Interim Report, we pointed out that, in many areas, relevant work is being done by other reviews. These are looking at the treatment of migrant workers, phoenixing, individual identity, modernisation of business registers, under-payment of superannuation, money laundering and beneficial ownership. We have worked closely with these reviews, contributing ideas to them and seeking their views on matters we have examined.

Any effective response to the black economy must be genuinely whole-of-government in nature. In addition to tax, it must involve workplace relations, human services, immigration (and home affairs, when that department is established), education, our financial regulatory community and our law enforcement and intelligence communities. We also recognise the transformation the ATO is undergoing and its willingness to embrace new technologies, processes and methods of operation which can better deliver efficient outcomes. This is necessary, as its traditional enforcement and audit approaches are unable to deal, in all cases, with the trends we identify in this Report. We also note that the ATO is significantly bound by resource constraints.

### **High priority recommendations**

We recommend that consideration be given to the following.

1. *A time-limited amnesty* with a bias for people in the cash economy rather than those engaged in criminal conduct. This should be followed by an enforcement blitz.
2. *Australian Business Number (ABN) integrity reforms*. The Government should adopt a number of measures to strengthen the ABN system, including: banning people on certain visas and apprentices from getting ABNs; requiring periodic renewal of ABNs (which would be conditional on meeting tax obligations); and providing for real-time verification of ABNs.
3. *Individual identity*. To counter the risk of identity fraud, we recommend that the Government introduce a plan that allows individuals to use a digital credential, biometrically secured to an individual's own smartphone or connected device, for people to use in all their interactions with public agencies. Individuals would 'own' this credential, which should not be used to create government databases or to collect individual biometric data.
4. *Taxable Payment Reporting System extension*. Apply the Taxable Payments Reporting System to additional high-risk sectors, including security contractors, road freight transport, IT contractors, owner-builders and home improvements from 1 July 2018 (reporting to start 1 July 2019).
5. *Sharing Economy*. A reporting system for sharing or gig economy operators should be put in place.

6. *Tougher and more visible enforcement.* New and strengthened penalties for phoenixing, ABN fraud, sham contracting and illegal tobacco, making more use of civil law provisions. There should be more high-profile prosecutions, more visible and efficient prosecutions and fewer confidential settlements.
7. *Small business incentive.* In addition to the current instant asset write-off, small businesses that adopt (or have already adopted) entirely non-cash business models should receive tax instalment timing relief, benefitting their cash-flows. Further, small businesses that fulfil a set of core compliance activities should benefit from a regulatory safe-harbour, which means they will be treated as low-risk. We also recommend that further downward pressure be put on card interchange fees, which will benefit both small businesses and consumers.
8. *Moving to a near cash free economy.* A \$10,000 economy-wide cash limit should be introduced.
9. *Payment of wages* into bank accounts to increase transparency.
10. *Non-deductibility of undocumented contractor payments and cash wages.*
11. *Hardwiring government.* Better sharing of data across agencies and the application of leading-edge analytics to more effectively enforce existing laws. Further funding for the National Criminal Database.
12. *Changing social norms and education.* An initial, focussed public awareness campaign designed to raise consumer awareness of the costs and risks associated with the black economy, including the reminder that this is not a victimless crime. Education must also play a role.
13. *Commonwealth Procurement.* We recommend that the Government limit procurement opportunities to firms with a good tax record. Bidders for contracts over a certain size would obtain a certificate of tax compliance from the ATO and issue a tax transparency report.
14. *Tackling illegal tobacco.* An enforcement blitz following the passage of the *Tobacco Control Act* which consolidates offence provisions. Co-locating enforcement officers from a number of Commonwealth agencies and giving them new powers to provide a one-stop shop and single point of accountability with a stronger focus on the retail and distribution parts of the problem.
15. *Illegal gambling.* Better use of existing enforcement tools and information exchange to disrupt illegal gambling and other actions including blocking offshore websites offering services to Australians and prosecuting providers and participants.
16. *Phoenixing.* Tougher and better targeted promoter penalties, better early detection and asset clawbacks.

## *Institutional legacy*

Our Review has highlighted the scope to strengthen, streamline and better focus our institutional arrangements for countering the black economy.

At present, we do not have a single policy and strategic home for the black economy within government; no central body examines emerging trends and vulnerabilities from a whole-of-economy perspective. On the operational front, we need to develop our capacity to tackle high-value, complex and cross-cutting black economy abuses, including criminal involvement in labour exploitation. Third, there is no obvious focal point for public complaints, concerns and allegations about the black economy.

In light of this, we recommend that the Government consider the following:

1. *A central agency-led advisory board, including both public and private sector representatives, to monitor trends and risks in the black economy and prepare a five yearly report on these.* The board would meet twice a year. It would consider evidence on the overall size of the problem and the factors which may be contributing to its growth (or reduction). The reports would be made public as part of the Intergenerational Report.
2. *Establishment of a standing Taskforce (modelled on the Serious Financial Crime Taskforce) to identify, respond to and prosecute serious, complex black economy fraud.* The taskforce model, which has proven successful in Australia, brings agencies together for a specific, mutually-agreed purpose, allowing them to ‘pool’ data, staff, powers and operational capabilities. After consulting with the law enforcement community, we have opted against recommending a new agency (like the United Kingdom’s Serious Fraud Office), which could further silo and fragment our efforts.
3. *A dedicated program of cooperation with the states and territories.* This would focus, in the first instance, on better data sharing, small business red-tape reduction and joint enforcement efforts. While cooperation takes place in some areas, we are a long way short of fully exploiting the variety of tools and resources (licencing, tax information and enforcement) governments, separately, possess.
4. *Establishment of a Black Economy Ombudsman’s Office and hotline.* The Ombudsman would be the public face for this issue and play a proactive role both within government and in the community. The black economy hotline should replace the plethora of existing agency hotlines with the exception of the National Security Hotline. It would triage incoming calls, referring them to the right agency and, where possible, publicly report on follow-up actions taken.





# CHAPTER 1

## UNDERSTANDING THE BLACK ECONOMY

**'WE CANNOT SOLVE OUR PROBLEMS WITH THE SAME THINKING WE USED WHEN WE CREATED THEM.'**

**ALBERT EINSTEIN**



# CHAPTER 1: UNDERSTANDING THE BLACK ECONOMY

---

## AN URGENT, PERVASIVE AND DAMAGING PROBLEM

When the Government established the Black Economy Taskforce in December 2016, it did so with a sense of urgency. It recognised that while the black economy has always been with us, new threats and vulnerabilities were emerging. These stem from fundamental economic, technological and social changes, extending well beyond the tax and regulatory system. The Government understood a whole-of-government response was required rather than a continuation of business-as-usual approaches. It asked the Taskforce to develop an innovative, forward-looking and practical plan of action, addressing root causes as well as consequences. The urgency of this undertaking was reflected in the Taskforce's timelines. An Interim Report was delivered in March 2017 which informed key Budget measures announced in May.

Over the course of our work, this sense of urgency has been vindicated. In our opinion the black economy could be as large as 3 per cent of Gross Domestic Product (GDP) today, up to 50 per cent larger than the Australian Bureau of Statistics' (ABS) 2012 estimates. Our public meetings and industry roundtables in every state, bilateral meetings and public submissions have sent a clear message: the black economy is a significant, pervasive, damaging and growing economic and social phenomenon. A common refrain was that determined action was long-overdue.

For our part, we have learned a great deal about the black economy.

- If anything, we did not fully appreciate, at the outset, the diversity of the black economy, the very real economic and social harm these activities are causing and the demoralising effect they are having on businesses, employees and consumers who do the right thing. There is a visceral sense of unfairness about this which we have picked up.
- When we started our work, our focus was mainly on the cash economy (under-reporting of otherwise legal incomes), but it soon became apparent that certain illegal activities demanded attention. We came to appreciate that it was wrong to place these in neatly separated categories, with one left to the tax authorities and the other to traditional law enforcement. In key respects, we saw the same regulatory gaps, commercial drivers and indeed technological and other tools in play. We heard many credible reports of criminal-based firms underbidding legitimate competitors, in both public sector and private procurement, especially in the supply of unskilled labour.
- A third lesson we have learned is the speed and scale of change in the black economy. The sharing or gig economy, and with it the rise of freelancing, explosion in home based services, the emergence of new sectors (including under the National Disability Insurance Scheme (NDIS)) and technological innovation are outpacing, in some areas, our policy and regulatory



frameworks. It is true that the black economy has always been with us, but it is constantly evolving and taking on new forms. Too often, our policy, regulatory and enforcement frameworks are a step behind.

- Enforcement resources are under pressure from counter-terrorism and growth in financial crime and identity fraud.

While the risks and vulnerabilities are greater than we first assumed, such as the sophistication of organised crime and phoenixing and the exploitation of migrant communities, so are the opportunities for effective responses. Emerging technologies, including the use of data, analytics, distributed ledger, and biometrics, but also in the payment system, if properly harnessed, promise a great deal. Policy-makers and regulators, for their part, recognise that they must work more closely than before, rejecting the sometimes siloed and reactive approaches of the past. They understand that less red-tape and better enforcement are not mutually exclusive; intelligent responses can and must achieve both.

### ***Black economy activities***

The black economy covers activities which take place outside the tax and regulatory systems. While Organisation of Economic Cooperation and Development (OECD) countries apply different labels and definitions, they typically include both legal and illegal activities.<sup>1</sup> Set out below are examples of black economy activity we discuss in the Report.

- **Not reporting or under-reporting income:** The most common black economy activity is not reporting or under-reporting taxable income. This includes income from cash jobs, whether that job is a person's main employment or a small job on the side, not declaring rental income or income from sharing economy activities, shop keepers skimming transactions, or selling goods and services for cash without a receipt. While the work or payments themselves are perfectly legal, hiding the income is illegal, regardless of whether it is done to reduce taxes such as Goods and Services Tax (GST), avoid the compliance burden, retain welfare payments, or avoid child support or other obligations.
- **Paying for work cash-in-hand:** Employers paying their employees in cash without complying with relevant reporting, documentation and withholding requirements. Mostly this is done to avoid paying minimum wages, avoid paying taxes, reduce compliance costs and allow under-reporting of income by the recipient of the payment. An employee can be entirely off the books, or work in part cash-in-hand, for example student visa holders who have exceeded their permitted hours of work. This is not always driven by the employer: in certain sectors it is common for employees to demand cash-in-hand payments. Providers of domestic-based services (such as nannies and cleaning) are also often paid cash-in-hand.

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<sup>1</sup> Shadow economy and cash economy are other common terms used, while the OECD and ABS refer to black economy activities as underground and illegal production.

- **Underpayment of wages:** Underpayment has emerged as a key aspect of black economy activities. Mostly this is done through cash-in-hand payments but other methods are also used, for example employees paying back part of their salary or temporary migrants having significant portions of their salary deducted. Superannuation guarantee (SG) and payroll taxes are not normally paid on these wages.
- **Sham contracting:** This occurs when a standard employment relationship is wrongly presented as an independent contracting arrangement. This can be employer initiated, where the motivation is to avoid having to pay award wages, pay as you go withholding (PAYGW) and payroll taxes and superannuation contributions. Vulnerable workers can sometimes be pressured into these arrangements, which at their worst can amount to blatant exploitation. Employees may sometimes propose or support sham contracting arrangements to avoid or lower their tax and other obligations.
- **Phoenixing:** Phoenixing involves a firm deliberately going out of business in order to avoid meeting its employee, creditor, customer and tax obligations, only to reappear soon after in another guise. There has been a massive increase in phoenixing, and the costs of this are absorbed by taxpayers.
- **Bypassing visa restrictions and visa fraud:** Black economy participation by temporary residents occurs when they opt to exceed their allowable work limits (such as the 40 hour per fortnight cap for students) or work when they are not allowed too, such as tourists, and therefore violate their visa conditions.<sup>2</sup> These people are vulnerable to blackmail and exploitation. Some are involved in organised crime. Those who exceed their work limits by large margins are effectively economic immigrants.
- **Identity fraud:** Individuals and businesses use identity related fraud and identity theft to pose as legitimate operators by hiding behind fraudulent business or personal credentials. In the 2015-16 financial year there was an 80 per cent increase in identity theft over the previous year. Identity fraud has been made easier by the failure of authentication and verification processes to keep pace as the economy has digitised.
- **Australian Business Number (ABN) fraud:** Black economy operators hide behind their ABN, which is treated by their counterparties as proof that they are fully compliant with tax, workplace relations and visa laws. In some cases contractors intentionally misquote ABNs to avoid detection by the tax authorities.
- **GST fraud.** This takes a number of forms, including business-to-business arrangements which result in double-claims for input credits but no GST remittance. Selling goods online from one country to another without registration is another example. GST fraud occurs where GST is collected but not remitted to the Australian Taxation Office (ATO), including through organised cross-jurisdictional fraud.

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<sup>2</sup> The Taskforce has also heard of black economy activities, including exploitation of working holiday makers, because of the so-called 88 day rule.

- **Origin of goods and duty fraud:** Customs duty can be avoided by not declaring goods, misstating the country of origin, or undervaluing imported goods, for example jewellery, antiques and vintage cars.
- **Duty evasion and illicit tobacco:** The most prevalent example of excise evasion is tobacco. Cigarettes that cost \$3 in China or South Korea can be smuggled into Australia and sold here for about \$23.
- **Tobacco excise evasion:** Excise can also be evaded by selling tobacco crops that have been illegally planted and harvested in Australia. This tobacco is most commonly sold as ‘chop-chop’.
- **Money laundering:** Money laundering occurs where money from illegal activities is brought into the formal economy. It is closely linked to tax evasion and is a threat to revenue. This can happen through businesses that transact with customers, such as car parts dealers or money agents existing solely as a front for money laundering activities. At other times money laundering is undertaken by transacting in high-value goods, especially where they can be purchased and sold anonymously using large sums of cash.
- **Unregulated gambling:** Illegal offshore gambling is growing rapidly. Unlike regulated gambling, it does not contribute to the community and undermines the racing and sports entertainment industry. It also creates money laundering opportunities and enables the shifting of profits into tax havens.
- **Illegal and criminal activities:** Over the course of the Taskforce’s work, it has also become evident that the black economy cannot be divorced from illegal and criminal acts. In the Interim Report we pointed out that where there are linkages between the black economy and criminal acts and activities these should not be ignored. These linkages are stronger and more prevalent than the Taskforce had initially assumed.
- **Counterfeit goods:** Counterfeit goods that are being brought into Australia include car parts and luxury items. The category also includes digital piracy. Trade in counterfeit goods is growing.
- **Motor vehicle fraud:** The Taskforce has heard of a growing trend of motor vehicle fraud whereby cars are leased using fraudulent identification. The car is then sold and the previous owner disappears with the money.
- **Illegal drugs:** The illegal drugs trade is pervasive and closely connected to other black economy activities and criminal gangs.

We appreciate this list is a long and diverse one. It is intended to serve an illustrative purpose, reminding us that the modern black economy assumes a wide variety of forms.

We recognise, however, that our responses to the black economy must be strategic, targeted and cost effective. We must address root causes and drivers, rather than only symptoms. Policy and regulatory efforts must focus on the most urgent and costly problems, avoiding over-reach, which we acknowledge is a risk in this area. And we must recognise that, in many areas, existing policy processes and reviews are already in place.

## ***Activities not examined by the Taskforce***

The following activities were excluded from the scope of the Taskforce:

- **Own-use:** The production of own-use goods and services, for example individuals repairing or cleaning their own homes or growing their own fruit and vegetables.
- **Genuine domestic or hobby activity.**
- **Deductions:** Over-claiming of work related-expenses and rental deductions.
- **Tax avoidance:** Tax avoidance through exploiting gaps and loopholes in tax law.
- **Multinational profit shifting:** This is already a high priority area for Government.
- **Intellectual property theft, including digital piracy:** We touch on this subject in passing, but do not devote detailed attention to it.
- **Cybercrime:** We address identity theft but do not cover other aspects of cybercrime.

## ***What drives black economy behaviour?***

In our Interim Report, we detailed the drivers of black economy behaviour, including high tax and regulatory burdens and low profit margins which place pressure on supply chain practices. We highlighted how these drivers do not act in isolation; it is often multiple drivers which lead to the decision to participate in the black economy.

Our extensive consultations with small businesses, members of the public, industry and professional associations, and unions have confirmed much of what we said, but also enriched and deepened our perspectives.

The following five causal factors stand out. These are discussed briefly below, but will be explored in greater depth in later parts of the Report.

### ***1. Commercial opportunities and pressures where transparency is lacking***

A consistent theme in our consultations has been that black economy participation is fuelled by a combination of commercial opportunity and poor transparency. We have observed how, in these circumstances, a vacuum is created which is quickly filled by black economy operators. This is apparent in a number of areas we have examined.

- Procurement officers in both the public and private sector under pressure to cut costs may opt for the cheapest bid, even if it seems suspiciously low. Where supply chains are long and complex, they are difficult to police at sub-contractor level. Poor supply chain practices can more easily flourish when transparency is lacking.

- Commercial pressures at the top of supply chains will often result in squeezed margins downstream, increasing the incentive for some suppliers to move into the black economy to cut costs.
- Firms supplying illegal labour ‘hide’ behind their ABN credential, undercutting their competitors who pay the award wage. This is particularly the case for those supplying labour for unskilled jobs. Some do not use ABNs.
- A similar dynamic can be found in the sharing economy, where regulatory frameworks are still being developed. The sharing economy is growing strongly, challenging traditional business models and the regulatory frameworks that accompany them. While some platforms have agreed to provide payment information to the ATO, this is a voluntary arrangement. Other platforms do not report, which increases the risk that incomes will not be declared. This is not limited to the sharing economy, but is a problem in all sectors where basic reporting arrangements are not in place, including many contracting arrangements.
- Criminal groups take particular advantage of these transparency gaps and regulatory blind-spots. White collar criminals are playing a larger role, are increasingly sophisticated and are able to mobilise capital, labour and business expertise to exploit commercial opportunities they see. In addition to traditional illegal activities (like drug dealing and illegal tobacco), we are seeing criminals involved in new areas, including the provision of under-priced labour to both governments and private sector purchasers.

Developments in our payment system should also be mentioned. As we discuss in more detail in Chapter 3, the use of cash in our economy has been falling in recent years. Non-cash payment methods, including debit and credit cards, direct transfers and contactless payment options, are increasing in use. While cash offers anonymity and no audit trail for black economy participants, these non-cash options can be traced and monitored. They leave an invaluable audit trail. As the role of cash diminishes, the transparency of economic activity is likely to increase, as is our capacity to limit the black economy.

This conclusion comes with important caveats. First, some non-cash payment methods, including the many cryptocurrencies which are being traded, are just as anonymous as cash. While cryptocurrencies play a niche role today, this needs to be monitored. Second, and more important, is that incentives matter. People participate in the black economy for the potential payoffs it offers. Cash is a means for them, not an end in itself. If dealing in cash becomes more risky, other types of transacting allowing fraud will become more attractive. Those who engage in identity fraud, for example, can operate entirely through digital channels. It is wrong, therefore, for commentators to assert that as we move away from cash, the black economy problem will solve itself.

## ***2. Tax and compliance burdens***

High tax and compliance burdens provide a strong incentive for participation in the black economy. The high effective marginal tax rates faced by people moving from welfare into work are a clear case in point, as is the differential between the company and personal income tax rates. Workplace relations, including the complexity of the award system, visa and other regulatory restrictions may also have this effect. Each has a strong rationale, but if compliance cannot be enforced, black economy ‘leakage’ will occur. Employers and employees, tradespeople and consumers, procurement officers and suppliers will strike cash bargains outside the tax system. Regulatory ‘noise’ can also result in black economy participation. By this we mean overly complex, difficult-to-understand or little-known compliance burdens. In a number of cases, businesses complain that regulatory burdens have perverse effects. They tie well-behaved firms in red-tape, but they are evaded by operators prepared to flout the rules. When this occurs, respect for the rule of law is undermined, as are notions of basic fairness.

## ***3. Perceptions of risk***

The perception of being caught can determine how willing people are to engage in black economy activities. This can be influenced by a range of factors, including the experiences of colleagues, others in the community and family members, and the level of visible enforcement. The type of sanction can also have an effect. Research shows that the risk of a court or tribunal conviction can be a stronger deterrent than a financial penalty or charge. Under the current enforcement approach few matters go to court as they are treated as criminal matters and therefore difficult to prosecute. The decision to settle cases rather than prosecute also has consequences. This contributes to a perception that it is difficult to get caught. There is a behavioural dynamic as well. Where perceptions of risk are low, people can easily fall into a pattern of non-compliant behaviour, which eventually becomes habitual. This can be reinforced by rationalisations, including that ‘everyone does it’. We touch on these under social norms, below.

## ***4. Perceptions of fairness***

Perceptions of fairness have a powerful influence on taxpayer behaviour. If a tax system is viewed as unfair (either in its basic policy settings or the way it is administered), voluntary compliance may be adversely affected. Unfairness will mean different things to different people, but two dimensions stand out: the horizontal and vertical. The former arises when people see those in similar circumstances, and perhaps earning similar incomes, paying less tax than them. The latter occurs when those who are better off are perceived to be under-paying their tax.

Community concern about the tax practices of multinationals is well known. This is an OECD-wide phenomenon and, in Australia, has become a major political and policy issue. Vertical unfairness, therefore, is highly salient.

There is less publicity about horizontal fairness, which arguably the black economy undermines most directly. After all, black economy practices involve a minority of small businesses, tradespeople, consumers and employees enjoying a ‘free kick’ that the majority of their peers do not have access

to. It is even worse than this, if we take the competitive advantage they obtain into account, and the serious obligations they avoid, such as child maintenance. There is a real anger about this in the community which, as mentioned before, is yet to be fully recognised in policy circles. In part, this is a by-product of the diffuse nature of the black economy, which lacks an obvious focal point of attention (in contrast to criticism of multinationals).

When unfairness, or the perception of unfairness, is allowed to fester, public attitudes can harden, resulting in a deterioration of support for the tax system (sometimes called tax morale). For any system based on voluntary compliance, this can have a corrosive effect.

## **5. Social norms**

Social norms are also a factor behind black economy participation. This term refers to the values, assumptions and behaviours that groups of people demonstrate. The black economy is fertile ground for these, reflected in the following, widely-held views: that participation in it is a ‘victimless crime’, that ‘everyone does it’ and that ‘if multinationals do not pay tax, why should I’? These are transmitted through a variety of channels, including families, ethnic and community groups, friends and peers and, more recently, social media. Different communities have different social norms: businesses within one industry often behave similarly, while migrant communities may retain views based on their experiences with other tax cultures. We discuss social norms in detail in Chapter 11.

### ***A common dynamic***

These drivers interact in a variety of ways. For some individuals or groups, in some particular settings, they may work at cross purposes. In other contexts, they will reinforce each other.

- If tax and regulatory burdens are reduced in ways which are perceived as unfair by some, participation in the black economy may not necessarily decline. In this case, one driver (tax incentive) is weakened, while another (unfairness) gains strength. In a self-assessment regime like ours, these motivations matter.
- Similarly, if perceptions of risk are heightened (by more effective enforcement and education), people will be more reluctant to exploit weaknesses or gaps in regulatory systems. Or to put it differently, there may be less need to ratchet up regulatory burdens.
- Social norms, including the natural tendency of people to ‘do the right thing’, have always played a critical role in this regard. If people have internalised habits of good conduct, auditing, enforcement and other interventions can be better targeted. Our self-assessment tax system has always relied on this.
- Fairness is not just a function of tax and other policy settings, but how the tax and regulatory system is administered and enforced. This should not be taken to imply that high tax and regulatory burdens are not a problem. If, in practice, it is easy for individuals and firms to evade these burdens (either through participation in the black economy or in other ways, for example, by re-characterising their income), perceptions of fairness will suffer.

These examples illustrate how drivers can offset or counter-balance each other. To the extent that this occurs, the black economy will be more stable and predictable than it may be otherwise. A kind of equilibrium can be maintained.

When the drivers work in the same direction, however, they can start to feed off each other. Put differently, either virtuous or indeed vicious cycles can emerge. In the course of our work, we have seen a disturbing pattern in this regard.

This pattern is seen in many areas of public policy, including financial regulation, law and order and product market regulation. In public policy terms, three distinct phases can be identified.

- **In phase 1, we have an inherited policy, regulatory and enforcement architecture which does not keep pace with economic, social or technological change.** This architecture will typically have been designed to meet past challenges. It will have evolved in piecemeal ways. External change opens up opportunities to exploit gaps and flaws in this architecture, but these may not be immediately exploited, in part because of the force of habit or custom on existing behaviour.
- **In phase 2, some people exploit the regulatory gaps.** For the purposes of our study, they move into the black economy (in one of its many manifestations) and start profiting from it. They take advantage, often in innovative ways, of the combination of economic opportunity and regulatory blind spots. When they are seen by others, including their competitors and peer groups, to be 'getting away with it', more people join their ranks.
- **In phase 3, we see an economic and social race to the bottom.** As more people move into the black economy, this shift can build further momentum as the new behaviours and practices are normalised. At this stage, social norms can develop which legitimise the trend. When this stage is reached, enforcement of existing rules becomes far harder.

We appreciate that this may sound abstract, but this pattern lies behind many of the problems we have seen, including: cash takings and wages in the hospitality sector, the use of illegal migrant labour, ABN fraud, phoenixing, sham contracting, the exploitation of vulnerable workers and the changing presence and threat posed by criminal groups. Put simply, once a problem emerges, it can grow more quickly than many expect and develop a momentum of its own.



## **Concluding Observations**

We have argued that the black economy, in all its manifestations, is more diverse, more dynamic and poses greater risks for the policy and regulatory community than is widely recognised. We have highlighted the nature of the tight economic environment, technology trends and social attitudes. We have highlighted the complex interactions between the cash economy and criminal activities, rejecting the notion that each should be confined to a separate box. On the other side, however, we have identified a small number of drivers which, based on our extensive consultations, lie behind the problem. If it is true that the black economy shows itself in multiple and constantly shifting ways, the incentives, opportunities, transparency gaps and social norms that underpin it provide a framework to guide, and discipline, our thinking and policy responses.

*‘Digitalisation and globalisation of the economy is resulting in new ways of conducting business and obtaining goods and services. Just as traditional business models have been disrupted so too have traditional governance models.’ Chartered Accountants Australia and New Zealand*



# CHAPTER 2

## THE SIZE AND TRAJECTORY OF THE BLACK ECONOMY

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# CHAPTER 2: THE SIZE AND TRAJECTORY OF THE BLACK ECONOMY

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## THE BLACK ECONOMY IS GROWING AND CHANGING

### *Key points*

The black economy is and will always be difficult to measure. We have made a qualitative assessment of the size of the black economy, based on consideration of relevant data sources and extensive consultations.

In 2012, the ABS estimated that the black economy ('underground production' in its terms) was 1.5 per cent of GDP. It found the illicit drug economy to be 0.4 per cent of GDP.

**However, this estimate, which relied in part on data going back to 2001, is now outdated. Based on our work, we consider that the black economy could be as large as 3 per cent of GDP today (or approximately \$50 billion per year), including both cash and criminal or illegal components. This is up to 50 per cent larger than the ABS' 2012 estimates.**

Measurement is critical. Without understanding how big the black economy is, and how its elements interact with each other and with the legitimate economy, we can neither form effective strategies to combat it nor assess the effectiveness of our responses. We are recommending a black economy data strategy to develop this evidence base and track it over time.

### *Measuring the black economy is difficult, but necessary*

Measuring the black economy will always be difficult and contested. This is because black economy activities are not directly visible or trackable. Black economy participants are at pains, moreover, to cover their tracks. Complicating matters is that the black economy, at least in part, sits outside (or in the gaps between) established regulatory perimeters. Tax authorities may have a good idea of the 'tax gap' in the restaurant sector, for example, but the sharing economy will be a different matter.

For these reasons, measurement of the black economy is controversial. National accounts officials, tax administrators, econometricians, and specialised subject matter experts employ a range of estimation techniques. As we noted in the Interim Report, estimates typically employ one of two approaches.

- Direct methods, which use detailed data from surveys and administrative data sources such as audits and tax returns.
- Indirect methods, which rely on macroeconomic and statistical estimation techniques. Attempts to infer the size of the black economy from the demand for cash fall into this category.

OECD tax administrators and national accounts officials rely on direct methods. They discount the reliability of indirect methods, which produce highly variable numbers and tend to be sensitive to the particular model used. We discuss a number of direct estimates, both economy-wide and for components of the black economy, in this chapter.

Why measure the black economy? The answer will depend on who is doing the measuring.

- Official statisticians want to make sure their estimates of GDP (and its key components) are accurate. Adjustments will be made for the black economy (and other parts of the non-observed economy).<sup>1</sup> Audit information from tax authorities is typically used in this context. GDP estimates and trends, of course, are a key influence in economic policy-making.
- Tax administrators conduct tax gap analysis. The tax gap is the difference between actual collections (for the particular tax base examined) and what would be raised if taxpayers were fully compliant. Tax authorities draw on these estimates when framing their audit, compliance and public engagement strategies.
- Others seek to measure specific elements of the black economy. Later in this chapter, we have attempted to reconcile some of these estimates, including for illicit tobacco, illicit drugs, money laundering and phoenixing. These studies are conducted by public sector agencies, academics, industry groups, unions and private sector businesses. They employ a range of methodologies and techniques, vary widely in degrees of rigour and, in any given area, can produce widely different results.

A larger point needs to be made. Measuring the black economy, however difficult this is, and being able to monitor its trends is critical to framing strategies and allocating resources to respond to it.

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1 The non-observed economy includes: (i) underground production, which covers activities that are productive and legal, but are deliberately concealed to avoid payment of taxes and/or compliance with regulations; (ii) illegal production, which is production of goods and services that are illegal or for which the production itself is illegal if it is unauthorised; (iii) production in the informal sector, for example by unincorporated enterprises or unregistered producers (the ABS does not consider this category to be material in Australia); (iv) the consumption of domestically-produced goods ('backyard production') (v) the 'statistical underground', or the statistical discrepancies that are the result of deficiencies in statistical collection. In Chapter 1, we made clear that our focus is on the first two categories mentioned here.

### Experts workshop on the size of the black economy

The Taskforce recognised that the size of the black economy is controversial issue and an expert workshop, bringing together representatives from the Treasury, ABS, ATO and the Australian Criminal Intelligence Commission (ACIC), was convened to discuss this issue in September 2017. Workshop participants made the following points:

- The system of national accounts is the best framework to allow consistent, rigorous measurement and analysis of the black economy, but the currently-available estimates are outdated. Without compiling estimates in a consistent framework, double counting and overestimation is a significant risk.
- The range of measures of black economy activity reflects the priorities of those compiling them. For example, tax gap estimates are intended to guide allocation of resources to compliance enforcement.
- While the black economy is not large enough to ‘move the needle’ on key components of GDP, activities can have a significant impact on estimates that are derived as residuals, for example, the national accounts measure of saving.
- Measuring illegal activity is very difficult, but necessary. Greater cooperation between relevant agencies would contribute to better, more timely, estimates.
- There is not a direct relationship between revenue lost and the estimated underlying black economy activity. Some tax revenue will be collected (for example GST will be collected when a worker spends money they have earned cash-in-hand). Money laundered through legitimate businesses may reflected in income earned and taxes paid by those businesses.
- The cost of collecting taxes on black economy activity can be high, but such policies might be pursued for broader reasons, such as addressing distortions in markets or countering perceptions of unfairness which corrode social capital.

#### *The 2012 ABS study*

In our Interim Report, we cited the 2012 ABS study which estimated the black economy to be approximately 1.5 per cent of GDP (or \$25 billion in today’s dollars), up slightly from 1.3 per cent in 2001.<sup>2</sup>

To be precise, this figure refers to ‘underground production’, which covers activities which are legal but deliberately concealed to avoid payment of taxes and compliance with regulations. It does not pick up illegal activities, such as proceeds of criminal behaviour. It is also important to note that much has changed since 2012, for example, the price of tobacco and changes in the way we work. Additionally, the estimate was based, in part, on the same ATO audit data that underpinned the 2001 estimates. These estimates are now outdated.

<sup>2</sup> Australian Bureau of Statistics, 5204.0.55.008 — Information Paper: The Non-Observed Economy and Australia’s GDP, 2012.

Important elements of the 2012 ABS estimate were:

- Under-reporting of income and over-claiming of expenses by unincorporated small business, small corporations and wages paid by small businesses.
- Factor incomes were adjusted by \$20.7 billion to reflect these understatements, or about 1.5 per cent of GDP.
- It is worth noting that the ABS, in its 2012 study, did not make an adjustment to employees' compensation data for cash-in-hand wages, pointing to the lack of sufficient reliable data.
- On the expenditure side, the ABS considered that black economy activities were largely concentrated in some forms of final consumption expenditure of households and in alterations and additions to dwellings — for example paying tradespersons 'off the books'.

The ABS estimated that the construction sector accounted for just over half of underground production, with other sectors, including mining, manufacturing, accommodation, retail and restaurants accounting for smaller shares. We consider that the composition is likely to be different today. For example, the introduction of the Taxable Payments Reporting System (TPRS) for payments to contractors in building and construction is likely to have reduced the level of under-reporting of income in that sector, which, in the 2012 study accounted for about 50 per cent of the adjustments to gross value added.

### *The ABS experimental estimates of the illegal drug economy*

In its 2012 study, the ABS prepared what it called experimental estimates of the size of the illegal drug economy. It focussed on the following substances: cannabis, amphetamines, MDMA, heroin and cocaine.<sup>3</sup> Production of these drugs was estimated at 0.4 per cent of GDP in 2009-10 (or approximately \$7 billion in today's dollars).

If this figure is added to the ABS underground production (legal black economy) estimate, cited earlier, we get an overall figure of 1.9 per cent of GDP or \$31 billion in 2015-16 terms.

### *Statistical methods are rigorous and in a consistent framework*

Statistical methods for estimating the black economy are in a consistent framework that is part of the system of national accounts. Adjustments take place at various stages of production of the national accounts, for example, with correcting biases in reporting or scope, and using data confrontation techniques to identify discrepancies. Different jurisdictions use a range of approaches to measuring particular items, suitable to their circumstances.

The rigorous consistent framework of the national accounts means that different countries' estimates can be compared like-for-like. In 2012, the OECD compiled the estimates prepared for 19 countries. While Australia was not included in this survey of estimates, the (ABS estimated)

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3 Ibid.

1.5 per cent of GDP for Australia falls at the bottom end of the range, comparable with the United Kingdom (UK) and Canada.

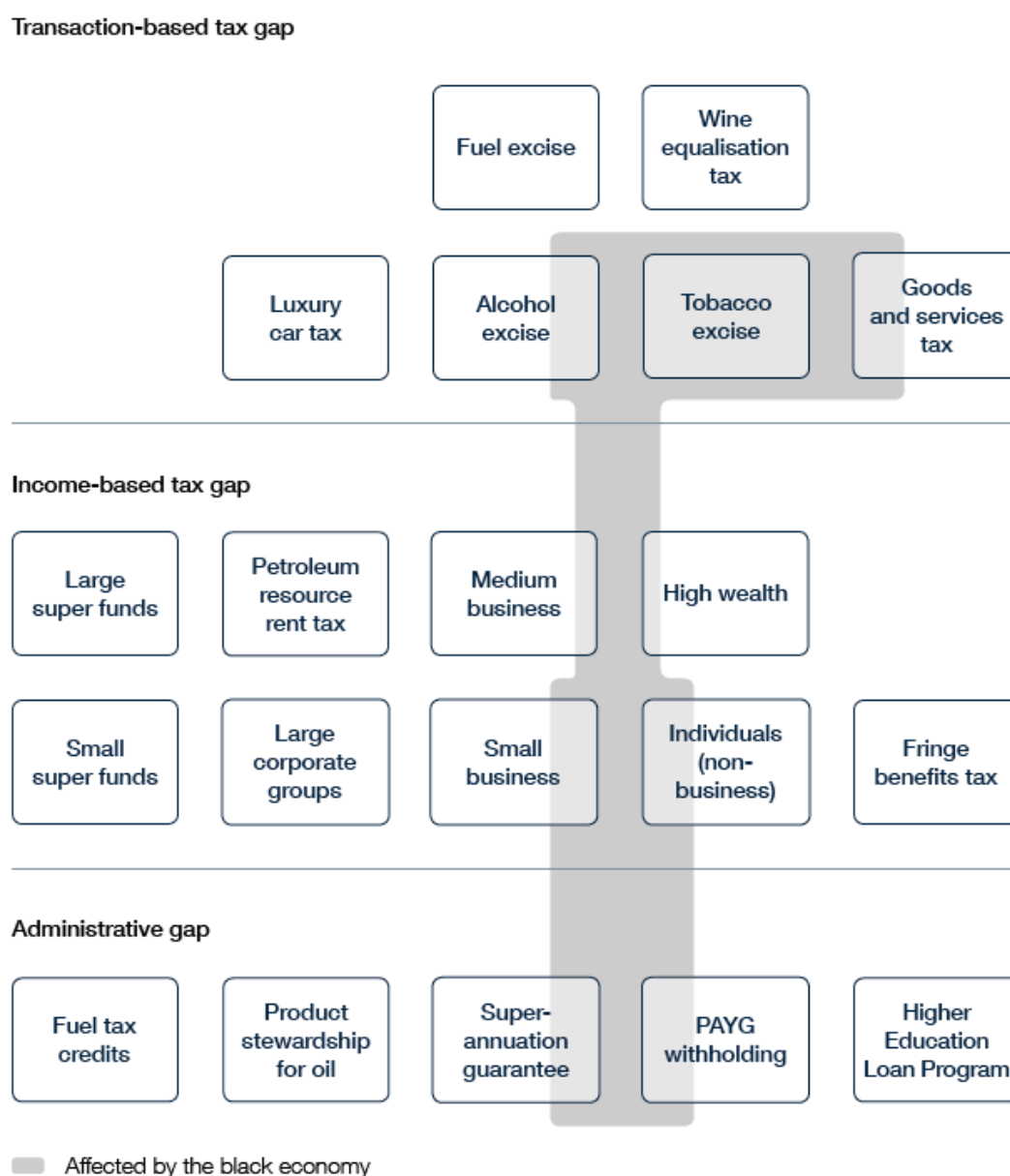
### *The ATO's tax gap study: early results*

The ATO's tax gap project commenced in 2015. Internationally, tax gap estimates are published in the UK, USA (both federally and by some States), Denmark, Sweden, Finland, Italy, Mexico, Chile, Estonia and Canada. Many other countries prepare but do not release such estimates. The tax gap measures the difference between the estimated amount of tax theoretically payable assuming full compliance by all taxpayers, and the amount actually reported to (or collected by) tax administrators for a defined period.

The ATO groups the tax gap analysis into three broad programs: transaction based tax gaps, for taxes collected and paid by an entity higher up the supply chain; income based tax gaps, including income tax for individuals and business, superannuation funds and fringe benefits tax; and administrative gaps, which include items such as PAYGW, the SG and administered programs. This is shown in Figure 2.1 (see next page).



**FIGURE 2.1: TAX GAPS**



SOURCE: AUSTRALIAN TAXATION OFFICE, WHY WE MEASURE THE TAX GAP, ACCESSED 5 OCTOBER 2017, [HTTPS://WWW.ATO.GOV.AU/ABOUT-ATO/RESEARCH-AND-STATISTICS/IN-DETAIL/TAX-GAP/AUSTRALIAN-TAX-GAPS-OVERVIEW/?PAGE=2](https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/tax-gap/australian-tax-gaps-overview/?page=2)

While not all under-reporting or under-collection is the result of the black economy, it nonetheless manifests in a number of gap estimates. So far, the ATO has published tax gaps for selected indirect taxes, PAYGW, large business and the SG gap. Estimates for the personal and business tax gaps are still being prepared.

The net tax gap for selected indirect taxes (GST, luxury car tax, wine equalisation tax and petrol and diesel excise and duty) is estimated at to be \$4 billion, with a net tax gap for GST of \$3.8 billion.<sup>4</sup> This was equivalent to about 0.2 per cent of 2014-15 GDP, and compares with revenue from those taxes of just under \$73 billion, or approximately 5 per cent of GDP. These taxes are generally more difficult to avoid than, say, income taxes.

The SG gap is estimated to be \$3.3 billion in 2014-15, which includes both cash payments in lieu of superannuation and underpayment of super.<sup>5</sup> This compares with a total amount voluntarily paid to superannuation funds of \$51.5 billion.<sup>6</sup>

### *Other estimates of significant black economy sectors*

Official statistical estimates of the black economy are, by necessity, conservative. The size of the black economy may be likely to be larger than official estimates suggest. This is why we have examined other data sources. In some cases, estimates are based on the Taskforce's discussions with a wide range of government agencies and private sector businesses and other organisations as part of the extensive nation-wide consultation process.

The estimates described below are not necessarily directly comparable with official statistical measures. They are derived from a range of sources, and are neither necessarily additive nor mutually exclusive. They also reflect underlying activity such as the value of expenditure or income. They do not reflect revenue lost.

### *Cash wages — easy to evade obligations, difficult to measure*

There is a range of estimates of cash wages in the economy—that is, those accepting cash wages on which tax and other obligations are not met. The ATO's SG gap estimates are derived from a separate ATO estimate of cash wages and activities such as sham contracting, which assumes a 1.2 per cent uplift to estimated aggregate salary and wages. This equates to \$8.5 billion in 2015-16 terms (approximately 0.5 per cent of GDP).<sup>7</sup> The estimate of salary and wages in the black economy includes superannuation entitlements that should be paid, although it is not possible to discern from the ATO's SG gap study whether these entitlements are paid as cash in lieu of superannuation or simply not paid at all.<sup>8</sup>

4 Australian Taxation Office, Australian Tax Gaps overview, viewed 2 October 2017, [https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Australian-tax-gaps-overview/?page=2#Summary\\_findings](https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Australian-tax-gaps-overview/?page=2#Summary_findings), data is latest available: all 2014-15 except for the wine equalisation tax which is 2013-14.

5 Ibid.

6 This is the gross gap. Adjustments from compliance activity of \$414 million result in a net gap of \$2.85 billion.

7 Australian Taxation Office, Superannuation Guarantee gap, viewed 2 October 2017, <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Superannuation-guarantee-gap/?page=2#Methodology>.

8 The ATO uses ABS compensation of employees data as to generate the base for estimates of the superannuation gap. Compensation of employees comprises wages and salaries (in cash and in kind) and employers' social contributions. Employers' social contributions include contributions to superannuation funds and incomes taxes that are withheld by the employer for administrative convenience. For further information see ABS Cat No 5216.0, Australian System of National Accounts: Concepts, Sources and Methods, 2015, pp. 289-90.

Survey data is also of some assistance. For example, in 2000, 6 per cent of Australians reported working in the cash economy, with an average amount earned in the vicinity of \$2,000.<sup>9</sup> More recently, the Australia Institute estimated that 5 per cent of Australian employees had worked cash-in-hand in their current job, with aggregate earnings of approximately \$12.8 billion.<sup>10</sup>

### *Illicit tobacco*

We discuss illicit tobacco in detail later in Chapter 13. While some illicit tobacco may be captured in official statistics (for example as part of household consumption or retail trade), it is likely largely unreported. In 2015-16, total household consumption expenditure on cigarettes and tobacco amounted to \$16.3 billion. Tobacco excise collected in that year was \$9.8 billion.

There is a range of estimates of illicit consumption and production. According to the Department of Immigration and Border Protection (DIBP) the size of the market is unknown, but could range from 3 to 14 per cent of total consumption. In 2015-16 terms this would suggest expenditure of \$0.5 billion to \$2.3 billion. In a 2015 study that focused on consumption, or demand, KPMG concluded that excise revenues foregone could be \$16 billion.<sup>11</sup> Assuming an average excise rate, this would suggest expenditure in the order \$2.5 billion. Other estimates are higher, including those submitted to the 2016 Joint Law Enforcement Committee Inquiry into Illicit Tobacco, which estimated lost excise of about \$4 billion<sup>12</sup>, which could imply expenditure in the order of \$6 billion.

### *Illicit drugs*

The ABS experimental estimate referred to earlier is broadly consistent with the mid-point estimate quoted by a 2011 United Nations (UN) study of 0.3 per cent in 2003.<sup>13</sup> This equates to about \$7 billion in today's dollars. The UN report, and the work underpinning it, focused on the proceeds generated by illicit drugs trafficking.

Other studies examine the consumption of illicit drugs, without necessarily assessing the value of that consumption. The National Wastewater Drug Monitoring program, conducted under the auspices of the ACIC, measures the consumption of a wide range of licit and illicit substances.<sup>14</sup> Two public reports have been released to date, of a series of nine up to the end of 2019.<sup>15</sup> This complements and enhances survey results, for example, the National Drug Household Survey. Over time, the wastewater analysis will help to expand understanding of the demand and supply sides of the illicit drugs market, and the wider range of drugs surveyed, including monitoring use of new drugs, may suggest higher consumption compared with the earlier estimates.

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9 L Nelms, P Nicholson & T Wheatley, *Employees earning below the Federal Minimum Wage: Review of data, characteristics and potential explanatory factors*, Fair Work Australia Research Report 3/2011, 2011, pp. 39-40.

10 D Richardson & R Denniss, *Cash-in-hand means less for the states — the impact of tax evasion of public finances*, The Australia Institute Technical Brief No. 17, October 2012, p. 2.

11 KPMG, *Illicit Tobacco in Australia: 2016 Full Year Report*, p. 6.

12 Rohan Pike Consulting, *Submission to Parliamentary Joint Committee into Illicit Tobacco*, 2017, p. 18.

13 United Nations Office on Drugs and Crime, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organised Crimes*, 2011, p. 23.

14 See, for example, Australian Criminal Intelligence Commission, *National Wastewater Drug Monitoring Program, Report 2*, July 2017.

15 *Ibid*, p. 4.

Our assessment, based in part on these studies and on our consultations with relevant agencies, is that the illicit drugs sector could be between \$7 and \$10 billion (per year) and indeed could be higher.

### *Money laundering*

Money laundering is common in all serious and organised criminal activity and is intrinsic to serious tax fraud and tax evasion and therefore a threat to Commonwealth revenue.<sup>16</sup> Major channels for money laundering are the banking system, money transfer and remittance services, including hawala, as well as gaming and high-value goods, and movement of funds through cash intensive industries.<sup>17</sup> Money laundering can also contribute to terrorism financing.

There is a range of estimates of the value of organised crime and resultant money laundering in Australia. In its 2011 report mentioned above, the UN estimated total criminal proceeds in Australia to be 1.5 per cent of GDP. In 2015-16 terms, this equates to approximately \$25 billion. Two-thirds of this money was assumed to be laundered, based on an expert survey. In today's dollars, assuming no change in the GDP share of proceeds of crime, this would equate to \$16 billion.

To the extent that laundered money is passed through legitimate businesses, it will be captured in official estimates of GDP. This would be reflected in higher deposits and incomes earned by banks, other financial institutions and high-value goods retailers who, unknowingly, are targeted by money launderers.

### *Phoenix activity*

Phoenix activity is a pervasive part of the black economy. Phoenixing is a practice in which companies intentionally go out of business, to reappear in another guise, with the purpose of avoiding tax and obligations such as meeting employee entitlements. There is also an active industry in pre-insolvency advice that facilitates phoenixing.

As we noted in our Interim Report, the Fair Work Ombudsman (FWO) and PricewaterhouseCoopers (PwC) have estimated that phoenix activity resulted in losses between \$1.8 to \$3.3 billion per year to employees, businesses and government revenue. These losses include unpaid employee entitlements such as unpaid wages and salaries and redundancy pay; unpaid debts to other businesses such as suppliers; and unpaid taxes.

### *Unregulated offshore gambling*

Unregulated offshore gambling refers to gambling operators outside local regulatory arrangements, and gives users access to activities that would be prohibited by Australian regulations, or provides Australian users with higher returns that reflect Australian taxes not paid.

Sports betting, that is, wagering on local, national or international sporting activities other than established horse and greyhound racing, is a growing market. In the ten years to 2014-15, annual

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<sup>16</sup> Australian Transaction Reports and Analysis Centre, Money Laundering in Australia 2011, 2011, p. 8.

<sup>17</sup> Ibid., p.10.

turnover grew by an average of 16 per cent per year, and expenditure by an average of 22 per cent per year. In 2014-15, turnover was estimated at about \$7 billion, and expenditure of \$0.8 billion.<sup>18</sup> This estimate is for operators in Australia only, and does not include sports betting on Australian fixtures in foreign jurisdictions.

According to the Department of Social Services (DSS), evidence suggests that between 5 and 26 per cent of all gambling expenditure occurs through illegal offshore gambling sites.<sup>19</sup> In 2014-15, total gambling expenditure, across racing, sports betting, casinos, gaming machines and lotteries was an estimated \$22.7 billion.<sup>20</sup>

As with all measures of black economy activity, estimates of the size or scale of this market vary. The 2015 Review of Illegal Offshore Wagering reported an estimated an expenditure of \$400 million with unregulated offshore providers.<sup>21</sup> In 2012, the then Department of Broadband, Communications and the Digital Economy (DBCDE) reported KPMG estimates of online gambling activity of approximately \$1.6 billion in 2010.<sup>22</sup> Estimates from submissions to the DBCDE review suggested that about 60 per cent of this activity was with unregulated overseas services, or \$1 billion.<sup>23</sup> This would be close to \$1.3 billion in 2015-16 terms. Based on the earlier studies and the Taskforce's consultations with relevant agencies, illegal gambling activity could be between \$1.3 and \$2 billion today, with about 60 per cent relating to the racing industry.<sup>24</sup>

### *Other fraudulent activity*

A wide range of fraudulent activity can be considered part of the illegal black economy. This includes:

- People deliberately evading duties at the border through fraudulent activities such as the creation of false documents. Other techniques may include incorrect description of goods, undervaluation or tariff misclassification. Based on the Taskforce's consultations with relevant agencies and the private sector, our estimate is that this could be up to \$1 billion.
- Underpayment of GST, including fraudulent activities. Underpayment can result from simple mistakes, but can also involve the creation of false invoices, business-to-business arrangements

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18 Queensland Government Statistician's Office, Australian Gambling Statistics 32nd edition, 2016, Sportsbetting tables 1 and 5.

19 Department of Social Services, A National Consumer Protection Framework for online wagering in Australia: Regulation Impact Statement for consultation, 2017, pp. 8-9.

20 Queensland Government Statistician's Office, Australian Gambling Statistics 32nd edition, 2016, p. 60. Note that the ABS sources net losses from gambling from Australian Gambling Statistics for their current price estimates of net losses from gambling — see Australian Bureau of Statistics, Australian System of National Accounts: Concepts Sources and Methods, 2015, p. 202.

21 Department of Social Services, Review of Illegal Offshore Wagering Report, 2015, p. 52.

22 Department of Broadband, Communications and the Digital Economy, Review of the *Interactive Gambling Act 2001*: Final Report, 2012, pp. 28-29, also quoted in Review of Illegal Offshore Wagering, p. 52

23 Ibid, p. 29. bet365 estimated an annual spend of approximately \$1.5 billion on online gambling, with about \$922 million with prohibited services based overseas such as in-play wagering, casino, poker and bingo, and \$574 million with Australian licenced services such as pre-game wagering, including horse racing.

24 Lower bound, *ibid*. Upper bound estimate and proportion attributable to racing based on Taskforce's consultations.

involving double-claims for input credits but no GST collection, or GST that is collected but not remitted to the ATO. The GST tax gap was estimated at \$3.8 billion for 2014-15.

- Equipment finance fraud, in which false or stolen identities are used to acquire motor vehicles, heavy vehicle and agricultural equipment on credit which are then on-sold. The Australian Equipment Finance Fraud Action Group estimates that this activity could be currently up to \$250 million per year.<sup>25</sup>
- Identity fraud, where identities are stolen or false identities are created and then sold. Identity fraud also enables other criminal activities. The value of identity fraud has been estimated at \$2.2 billion per year.<sup>26</sup>
- Intellectual property fraud and counterfeiting. A wide range of counterfeit goods can be bought or sold, purporting to be genuine or otherwise. This helps to avoid taxes and duties that might otherwise be payable and reduces incomes such as royalties that might otherwise be payable as a result of consuming genuine goods. The value of such activities has been estimated at about \$2 billion per year.<sup>27</sup>

### The costs of serious and organised crime in Australia

Measuring the profits from crime and the amount spent on illicit goods and services is important to a complete understanding of the black economy. However, this is not the only measurement. The ACIC takes the approach of measuring some of the financial costs of harms, preventative measures and law enforcement responses.

The ACIC estimated that serious and organised crime cost Australia at least \$36 billion a year<sup>28</sup> — equivalent to 2 per cent of GDP. These costs include direct and indirect financial harms. Direct financial harms include property losses, and health and welfare costs. Indirect costs include, for example, the competitive advantage enjoyed by businesses when the profits of serious and organised crime are re-invested in legitimate activities.

### *Changes in composition and trajectory*

Is the black economy larger than it was in 2012, at the time the ABS study was published? Has its nature changed? Before offering a judgement, it is worth making a few observations.

- As we made clear in Chapter 1, there is no single black economy, but rather multiple black economies. Any analysis of trends needs to acknowledge this.
- We also need to keep the underlying drivers discussed in Chapter 1 in mind. Measurement without an understanding of what is influencing the numbers will not tell us much. This is where

25 Australian Equipment Finance Fraud Action Group, consultation with Taskforce, 5 September 2017.

26 Commonwealth of Australia, Identity crime and misuse in Australia 2016, p. 61. Assumes that the direct cost to individuals of identity crime is equivalent to the gain to the perpetrator.

27 Australian Retailers Association, consultations with Taskforce.

28 Australian Criminal Intelligence Commission, Organised Crime in Australia 2017, p.1.

the drivers are useful. Together with statistical measurement frameworks, they give us the beginnings of a framework for thinking more deeply about the problem and its evolution.

With these points in mind, a number of developments can be discerned which suggest a growing and shifting black economy.

- Economic pressures, reflected in margin pressure and low wages growth, even more important today than they were in 2012. In particular, Australia has experienced an extended period of low wages growth.
- Social norms play an important part. Many in the community accept black economy behaviour. It is thought a 'victimless crime', 'everyone does it' and 'if multinationals do not pay tax, why should I'? In the context of competitive pressures, black economy behaviour might be thought necessary and these views can become self-perpetuating.
- The sharing or gig economy is growing, including, in particular, home-based services. For example, Deloitte estimated an increase in revenue generated by the collaborative economy in New South Wales of approximately 68 per cent between 2014-15 and 2015-16, with an increase in users of 108 per cent.<sup>29</sup>
- Exploitation of vulnerable integrity arrangements, including ABN fraud, visa violations, sham contracting and supply chain problems are increasing. One reason for this is the dynamic we discussed in Chapter 1. When some get away with this conduct, others are encouraged to follow suit. Our consultations have shown these to be prevalent in construction, horticulture, security, personal services and cleaning. In the 2012 ABS study, black economy activity in agriculture was estimated to be \$100 million, or less than one per cent of the total.
- There are factors that are working in the opposite direction. These include the declining use of cash and increasing role of electronic means of payment in the economy. The introduction of the TPRS, a transparency initiative, in the building and construction sector, appears to have reduced non-compliance in this part of the economy. However, our assessment is that these are not sufficient to offset the pressures that are contributing to its growth.

All that said, over the past decade or so, there have been fundamental developments in the Australian economy. For example, the mining boom saw a substantial increase in the allocation of resources to the mining sector. As commodity prices stabilised and in some cases declined, and projects moved into the peak-production phase, that source of support to Australian economic and wages growth unwound. While Australia's passage through the global financial crisis was relatively smooth, almost all major advanced economies experienced recession, weakening Australia's economic performance.

The way Australians are working is changing. Contracting arrangements appear to be shifting. Concerns were raised with us about the prevalence of sham contracting and exploitation of

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<sup>29</sup> Deloitte Access Economics, *Developments in the Collaborative Economy in New South Wales*: NSW Department of Finance, Services and Innovation, 2017, p. 4.

vulnerable workers such as those with visa restrictions. Growth in the sharing economy appears to be outstripping the development of a comprehensive regulatory framework. This change is happening now.

We continue to use the 2012 ABS estimate as a benchmark, complemented by a range of partial indicators. In light of the fundamental developments in the economy over the past decade or so a new, comprehensive assessment should be made.

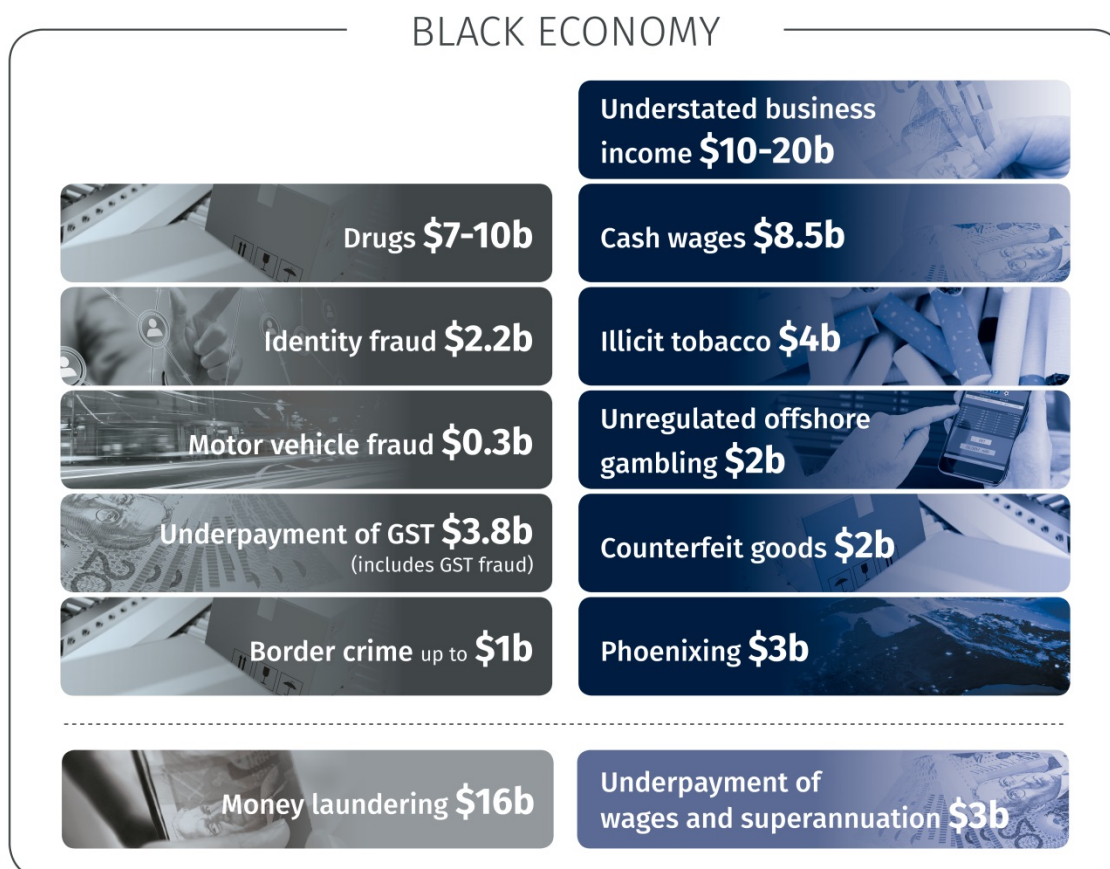
Our assessment is that if it were measured today, the black economy would be larger than it was estimated at the time of the ABS' 2012 study, taking into account new information that is available as well as the pressures we have observed. We consider that the black economy (including both cash and criminal components) could be as large as 3 per cent of GDP today, equating to \$50 billion in 2015-16 terms.

Our judgement is that important components of the black economy are increasing, owing to a combination of strong incentives, poor transparency and limited enforcement. Phoenixing, visa abuse and illegal tobacco stand out in this regard. We have been told that other parts of the black economy, including the non-declaration of business income and cash wages, are expanding. We do not believe that countervailing factors, including the falling use of cash, and the fact that black economy participants spend money in the legitimate economy, are offsetting this negative trend.

We acknowledge that this conclusion is a qualitative one. The figures we present in this chapter should be taken as indicative only. They come from various sources, employing different methodologies. Some measure turnover, or activity, and others net profits or expenditure. They are therefore not additive. However, they are based on extensive consultations and analysis of the pressures and incentives for black economy behaviour.



**FIGURE 2.2: PARTIAL INDICATORS OF BLACK ECONOMY RELATED ACTIVITY<sup>30</sup>**



SOURCES: **UNDER-REPORTED PROFITS/BUSINESS INCOME**—ABS, MEASURING THE NON-OBSERVED ECONOMY IN THE NATIONAL ACCOUNTS AND ESTIMATE BASED ON TASKFORCE'S CONSULTATIONS; **CASH WAGES (INCLUDING SUPERANNUATION ENTITLEMENTS NOT PAID)**—ATO, SUPERANNUATION GUARANTEE GAP, BLACK ECONOMY WAGES AND SALARIES; **ILLICIT TOBACCO**—MID-POINT OF RANGE DERIVED FROM KPMG AND ROHAN PIKE, SUBMISSION TO THE JOINT LAW ENFORCEMENT COMMITTEE INQUIRY INTO ILLICIT TOBACCO; **UNREGULATED OFFSHORE GAMBLING**—LOWER BOUND: DEPARTMENT OF BROADBAND, COMMUNICATIONS AND THE DIGITAL ECONOMY, UPPER BOUND: ESTIMATE BASED ON THE TASKFORCE'S CONSULTATIONS; **PHOENIXING**—FAIR WORK OMBUDSMAN AND PWC; **MONEY LAUNDERING**—UN OFFICE ON DRUGS AND CRIME, ILLICIT FINANCIAL FLOWS 2011; **BORDER CRIME**— ESTIMATE BASED ON THE TASKFORCE'S CONSULTATIONS; **GST FRAUD**—ATO GST GAP; **EQUIPMENT FINANCE FRAUD**— AUSTRALIAN EQUIPMENT FINANCE FRAUD PROTECTION ACTION GROUP; **IDENTITY FRAUD**—ATTORNEY GENERAL'S DEPARTMENT, IDENTITY CRIME AND MISUSE IN AUSTRALIA; **DRUGS**—LOWER BOUND: ABS, MEASURING THE NON-OBSERVED ECONOMY IN THE NATIONAL ACCOUNTS AND UPPER BOUND: ESTIMATE BASED ON THE TASKFORCE'S CONSULTATIONS; **COUNTERFEIT GOODS** — AUSTRALIAN RETAILERS ASSOCIATION, CONSULTATION WITH TASKFORCE; **UNDERPAYMENT OF WAGES AND SUPERANNUATION** — ESTIMATE BASED ON THE TASKFORCE'S CONSULTATIONS. REFLECTS UNDERPAYMENT OF EMPLOYEES IN THE BLACK ECONOMY AND SUPERANNUATION ENTITLEMENTS NOT PAID.

30 Money laundering and underpayment of wages are presented as 'under the line' given that they will also be reflected in the activities listed 'above the line'. Caution needs to be used when interpreting spending (GST) and income leakages, since a proportion of understated income will be spent (recouping some of the initial 'loss').

There is a need for further work to be done on measuring and understanding the black economy. Current efforts are fragmented, looking at the issue from particular tax, national accounts or law enforcement perspectives. A single body, within government, should be responsible for tracking, analysing and developing strategies to address this problem, which knows no departmental or jurisdictional boundaries.

A good first step would be the inclusion of a special section in the next Intergenerational Report which looks at potential black economy risks. This could be part of a broader discussion of coming revenue risks.

### *Possible costs: taxation and other*

Any assessment of the black economy must take all costs into account. These costs are both direct, affecting tax revenues and welfare costs, and indirect. We consider each in turn.

The taxation impacts, in particular, will always be difficult to estimate given the complexity of the tax system, the wide variety of individual circumstances and the necessarily simplistic behavioural assumptions that any revenue and other estimates need to rest on.

A further point should be made. Regardless of the assessed budgetary costs, it will not be realistic or cost effective to try to eliminate this cost entirely. A number of black economy incentives stem from basic design features of our tax and other systems. Our relatively (by OECD standards) heavy reliance on income tax and tightly means-tested transfer systems are the two standout cases in point. In any case, there will always be a degree of tax leakage. The aim should be to reduce it as much as possible, while being mindful of the costs of doing so.

That said, well-designed measures to counter the black economy can be expected to yield meaningful budgetary dividends over time. We point out, however, that while some measures will be able to be costed using standard methodologies, others will not. Critical reforms, including moving people into the banking system and strengthening the integrity of individual and business identification systems, fall into the second category. Other measures will take some time to have any affect, perhaps even decades, including efforts to change social norms.

While we must always be conscious of the direct tax and welfare costs associated with the black economy, indirect costs and consequences should not be ignored. While these will also be difficult to measure, they arguably do more damage than the former. This is because each of them can gain a momentum of their own, once initial problems have emerged.

Indirect costs include:

- The harm done to individuals concerned and others when they fail to comply with other regulatory requirements. Workplace relations, immigration, occupational health and safety (OH&S) and driving and other state-based licencing regimes are all affected. This can be corrosive, resulting in the declining respect for laws which are not being enforced.
- The distortion of product and labour markets associated with black economy activity, which results in competitors, fellow employees and consumers who abide by the law being underbid

by others. As we point out later, this can result in a race to the bottom and the progressive erosion of established standards. Competition, flexibility and innovation, of course, are positive economic forces, but not when they are being stimulated by black economy operators.

- The weakening of public confidence in the fairness of our tax, welfare and wider regulatory systems. This can, in turn, undermine community support for existing institutions and policy settings.

In a real sense countering these indirect costs, and in particular the manifest unfairness of the black economy, should be our aim. Any revenue that is saved (or welfare costs avoided) should be seen as a welcome dividend, or by-product of this program, not its motivation.

## RECOMMENDATION

### ***Recommendation 2.1: A project to measure and track the black economy***

Implement an ongoing black economy research program.

#### ***Description***

We recommend that the ABS lead a black economy data project to update the most recent estimates, develop measurement techniques and establish arrangements for ongoing monitoring of the black economy. Over time, monitoring would assist with identifying emerging risks and measuring the effectiveness of existing responses. The project would be expected to involve the academic and business community and would need to be funded appropriately. It would also involve close consultation with the ATO's tax gap project.

#### ***Objective***

- To develop a better understanding of the size, trajectory and emerging trends in the black economy.

#### ***Discussion***

##### *Problem this recommendation seeks to address*

Black economy research efforts have been irregular, at least in part because they are not necessarily seen to form core business of revenue or statistical agencies. Available estimates are not necessarily in a consistent statistical framework which means comparison across time and between estimates is difficult.

The ABS has periodically prepared estimates of the underground or non-observed economy. These estimates are used to make regular adjustments to GDP to take into account under-reporting of income, and to further develop statistical estimation techniques in areas such as valuing illegal production. However, preparing these estimates is resource intensive and it is not regularly completed. We consider that the frequency of the estimates should be increased, and the research program augmented with the latest academic development in this area.

##### *Rationale*

Better understanding of the size and trajectory of the black economy is important for a number of reasons. Without this information policy-makers will be unable to identify risks and emerging vulnerabilities. For example, if we were to see a significant increase in under-reporting of income in a particular sector, this could point to the need for a regulatory or enforcement response. A better understanding of the size of black economy activity can also help governments to make decisions about how resources should be targeted and appropriate responses.

## ***International Experience***

A number of jurisdictions have recognised the importance of measuring the black economy and incorporating such information into the national accounts. This is done in many European jurisdictions and in the UK. A wide range of sectors and activities may be included, depending on local circumstances. In the UK, for example, the 2014 national accounts were adjusted to reflect updated estimates of under-reporting of small business income using new tax gap analysis from Her Majesty's Revenue and Customs (HMRC).<sup>31</sup>


Similar to Australia, however, this data tends to be non-timely and sparse and often allows only historical analysis. It does not readily support assessment of more detailed developments over time, or more timely analysis.

## ***Implementation considerations***

A black economy research program would need resources. In an environment of fiscal constraint, this could mean crowding out other activities. However, over time, consideration could be given to funding a research program from revenues that are generated by enhanced compliance or regulatory activities that are guided by the programs results.

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31 Office for National Statistics (UK), Methodological Improvements to National Accounts for Blue Book 2015: Exhaustiveness, 19 May 2015.



# CHAPTER 3

## MOVING TO A NEAR NON-CASH WORLD

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# CHAPTER 3: MOVING TO A NEAR NON-CASH WORLD

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## HOW WE TRANSACT IS EVOLVING

### *Key points*

As a result of social, commercial and technological changes, we are witnessing a move away from cash as a means of payment in the economy. This is a worldwide trend that could help limit the scope for the black economy and bring other economic efficiencies and social benefits, including red-tape reductions and reduced business costs.

As people rely more on the financial system for everyday payments, transactions become more transparent and secure, efficiency is improved (given the increasing cost of cash relative to other means of payment) and the integrity of individual identity can be better verified. Small business leaders, including the Council of Small Business Australia (COSBOA), are calling for the digitisation of the economy. This is in recognition that transacting via cash is expensive. It imposes costs on small businesses that electronic transactions do not. These costs are not always clearly evident and can manifest in unforeseen ways. For example, we have heard from some smaller supermarket operators that they are net purchasers of cash due to demands from consumer for cash withdrawals.

Banks and other financial system participants have led this process, pioneering a range of payment system innovations. As cash is used less in the future, banks will benefit from lower funding costs.<sup>1</sup> Over time, this should be reflected in further reductions in transaction fees for their customers and merchants as the cost per customer is reduced and cross selling opportunities expand.

Given the changes in consumer preferences and the increasing relative prices of cash transactions governments should be embracing rather than resisting the prospect of a near cash-free world. This will ensure that those who seek to use cash as a means to operate in the black economy, in part because of the anonymity it provides due to the lack of a clear audit trail, will find it more expensive and difficult to do so. The move away from cash will also capture the efficiency and integrity improvements provided by non-cash transactions. Government should remain open to what shape this will take (we should be neutral between competing non-cash offerings).

However, cash will still have a role to play. It has near-universal acceptance, facilitates simultaneous exchange and instantaneous settlement, is convenient for person-to-person payments and can still be used at times when electronic payment methods are unavailable. During our roadshows we

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<sup>1</sup> To the extent that the costs of retail deposits are lower than other funding sources, for example wholesale funding from offshore.



received information on cash payments for homes and apartments, luxury cars, jewellery, school fees, boats and other high-end goods.

While it is clear that electronic payment options provided through services such as BPAY and PayPal have significantly changed the payment landscape, policy settings must seek to make the implicit costs of cash clear to consumers, particularly where they are relatively high, remove unwarranted impediments to greater use of non-cash payment methods and be prepared to support small firms adopting non-cash business models.

We recommend the introduction of an economy-wide \$10,000 cash payment limit and a requirement that wages be paid into bank accounts. We also make recommendations on the need to lower card interchange fees and debit card costs further, including by giving merchants greater 'optionality' on which network to route debit card payments through. The New Payments Platform (NPP) will take time to bed down and develop, but is a potential game changer. When operational it will replicate some of the features of cash, including the capacity for peer-to-peer transfer of value and instantaneous settlement. Depending on how it is used, it could also put downward pressure on card interchange fees and other card costs.

#### **OBSERVATION: REAL-TIME SETTLEMENT UNDER THE NPP — THE FUTURE**

The following scenario illustrates the promise of the NPP.

1. A tradesperson gives a householder a quote on his or her iPhone.
2. If accepted, the quote is converted to an invoice with the tradesperson's ABN.
3. The householder transfers funds into the tradesperson's account through the NPP.
4. The tradesperson issues a receipt.
5. The tradesperson gets an updated revenue statement from the bank.

This transaction costs 40 cents.

### ***A near non-cash world***

The use of cash as a means of payment is falling. This is a worldwide trend, but is also apparent in Australia. A number of factors explain this. As a result of technological advances and financial innovation, the range, accessibility and cost of non-cash payment methods are improving all the time. The growth and expansion of e-commerce has accelerated this process. Digital wallets and cryptocurrencies are also becoming increasingly popular (although currently they only play a small role in the payment system). However, for the foreseeable future we will always need some cash. We recognise that not everyone is willing to go electronic, and even though social resistance to electronic payments continues to fall, it is on business and government to lead the way.

**OBSERVATION: POINT OF SALE (POS) TECHNOLOGY ADVANCEMENTS**

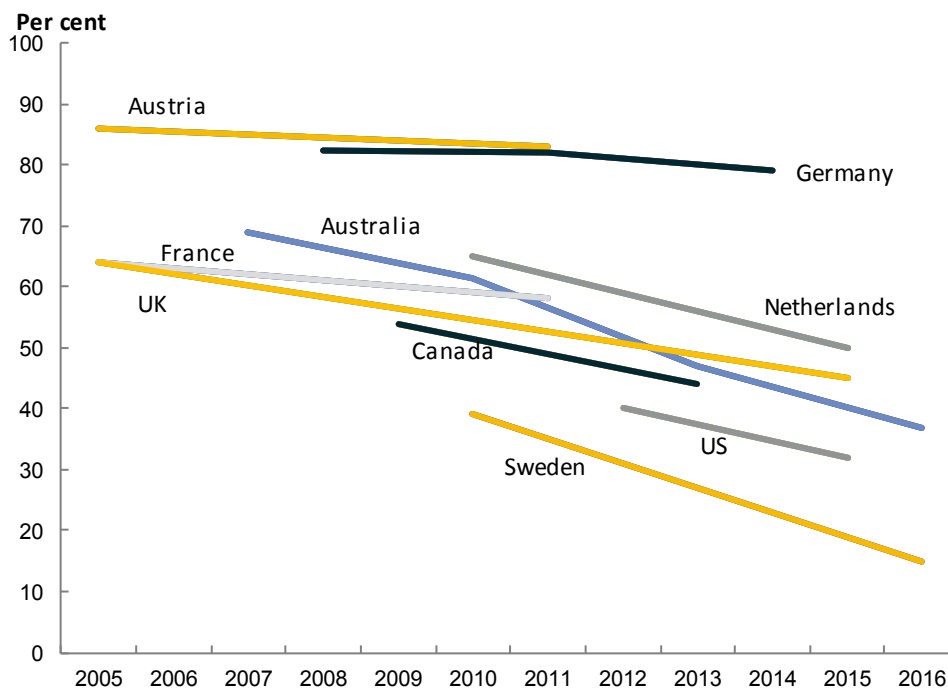
A number of companies have developed card readers that can accept payments made by contactless cards, mobiles and chip cards. They are wireless and pocket-sized — small enough to be attached to a mobile phone.

Additionally, the increasing prevalence of touchscreen devices has allowed for the development of portable devices that accept contactless payments which can split bills, add tips, print and email receipts.

In both cases these can also be used to assist businesses by prefilling transaction data to assist with invoicing, inventory management, accounting and reporting.

Changing social norms and consumer preferences have also played a role. People, by and large, are more comfortable, and in many cases prefer, using non-cash payment alternatives than they have been in the past. The move away from cash, in most economies, has been led by the private sector and consumers rather than governments. Sweden and other Scandinavian countries have been the main exception to this.

**CHART 3.1: CASH USE ACROSS COUNTRIES**  
(PER CENT OF TRANSACTIONS)



SOURCE: RESERVE BANK OF AUSTRALIA

### OBSERVATION: MOBILE PAYMENTS IN CHINA

Apps like WeChat, which incorporate social media and mobile payment technology, have revolutionised the way people transact in China.

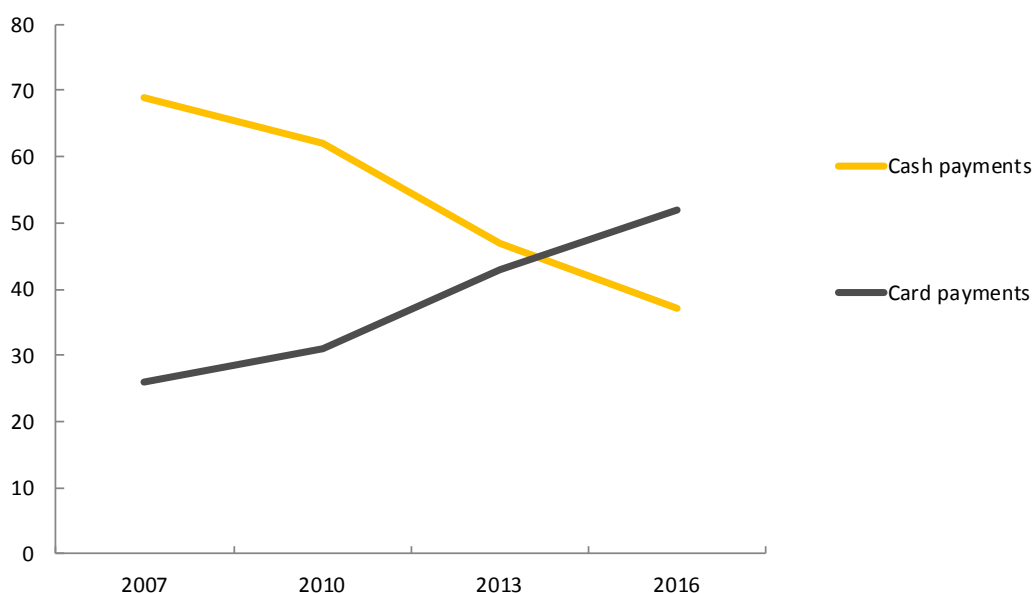
People do not need to carry cash or wallets. They can use WeChat to easily and quickly pay using their mobile phone at restaurants, for street food at roadside stalls, at local fruit and vegetable markets, for petrol (without even leaving the car), to pay bills, to send mail or for a cab.

In China's largest cities, approximately 93 per cent of the population use WeChat.<sup>2</sup>

### We are seeing cash use decline in Australia

Australians' use of cash has been declining. As recently as 2007, cash accounted for approximately 40 per cent of all transactions by value. By 2016, this share had fallen to 20 per cent. Cash has traditionally dominated the number (if not the value) of transactions, but in 2016 credit and debit cards became, for the first time, the most commonly used means of payment (52 per cent against cash's 37 per cent).

**CHART 3.2: PAYMENTS MADE BY CASH AND CARD**  
(PER CENT OF TRANSACTIONS)



SOURCE: RESERVE BANK OF AUSTRALIA, HOW AUSTRALIANS PAY: EVIDENCE FROM THE 2016 CONSUMER PAYMENTS SURVEY, RESEARCH DISCUSSION PAPER 2017-04

The shift away from cash is likely to continue in this country. In part, this will be a by-product of demographic change, as the attachment to cash is strongest among older people.

The digital payment revolution remains at an early stage. A large field of competitors, including traditional financial institutions, IT companies, internet businesses and start-ups are competing for

<sup>2</sup> Nielsen Norman Group, WeChat: China's Integrated User Experience, accessed 5th October 2017, <https://www.nngroup.com/articles/wechat-integrated-ux/>.

the digital payment dollar. Contactless payment, including the use of smart phones, is growing strongly. In 2016, smartphones accounted for only 1 of every 100 transactions<sup>3</sup>, yet in that year close to 90 per cent of Australians had one of these devices<sup>4</sup>, underlining the untapped potential from this technology alone.

### **Potential ‘game changers’**

The payment system landscape will be changed by a number of developments in coming years. The NPP, an initiative of Australian banks and supported by the Reserve Bank of Australia (RBA), has the potential to be a game changer. The NPP, which is expected to commence operations by the end of this year, with broader functionality being rolled out to users in 2018, will allow for near immediate person-to-person bank transfers. In addition to its cost and speed benefits, it promises greater security for users, however there are fraud risks associated with real-time payments which will need to be addressed. This broader functionality has the potential, when further developed, to use the enhanced data message attached to each NPP payment to allow them to verify their counterparty’s ABN details, limiting the scope for ABN fraud. Future applications for businesses might link the NPP’s payment services to other business processes, including preparation of accounts.

#### **OBSERVATION: OSKO — A NEW WAY FOR AUSTRALIANS TO PAY USING THE NPP**

Osko by BPAY is the first product to leverage the capabilities of the NPP, and will be rolled out as the NPP is made available to consumers. Osko will allow people to pay others in real-time, with funds available in less than a minute. It will not matter if different banks are involved or what time of the day or night the payment is made.<sup>5</sup>

Banks and other financial institutions are developing distributed ledger products, including fiat-backed digital currencies. This is a response to the emergence and growth of bitcoin and hundreds of other cryptocurrencies. The aim is to replicate the benefits of the latter, while avoiding their costs.

As is well known, cryptocurrencies are largely anonymous, making them attractive for criminals, however increasingly they are being used as an investment vehicle and for other legitimate purposes. They are highly volatile, and in some cases, including bitcoin, they can sometimes be relatively inefficient, as has been evident in the intermittent processing delays that have occurred recently in bitcoin transactions. The fiat-backed alternative to cryptocurrencies, in contrast, would be stable (linked to a regulated, highly traded currency), offer fast processing speeds and, critically, offer built-in integrity protections.<sup>6</sup>

3 Reserve Bank of Australia, How Australians Pay: Evidence from the 2016 consumer payments survey, Research Discussion paper 2017-04

4 Australian Payments Network, Milestones Report: The Digital Economy, Seventh Report, May 2017, p. 7.

5 BPay, A new way for Australians to pay, accessed 5 October 2017, <http://www.bpay.com.au/Member-Financial-Institutions/Osko-by-BPAY.aspx>.

6 These would include identity verification and also conditional payment rules (for example, a contractor payment could be made conditional on a third-party attesting that the work was completed).

Central banks, for their part, are also examining the feasibility of official digital currencies. For many, these are still some way off, but are likely to appear in coming decades. Singapore, for example, has completed preliminary testing of a tokenised version of the Singapore dollar using a blockchain. The Government should keep an eye on these developments and examine the feasibility of Australia moving to a central bank issued digital currency over the longer-term.

### ***Why the move away from cash is a good thing***

The market-led move away from cash is a positive development. It has made our payment system more competitive and innovative, improving the cost, quality and range of alternatives on offer. Indeed, it has brought into sharper focus the costs of cash, which until recently were typically internalised by users. Businesses dealing in cash incur a range of expenses, including storage, transportation and monitoring costs (given the heightened risk of employee fraud). As the use of cash falls, the per-transaction cost associated with cash (bank branch and Automatic Teller Machine (ATM) networks, for example) has risen.<sup>7</sup>

#### **OBSERVATION: THE BENEFITS TO BUSINESS OF GOING DIGITAL**

Transacting in cash imposes a range of direct and indirect costs on businesses which are becoming more transparent. These include security, storage, transport, fraud and theft.

For example, *The Canberra Times* reported that one café had gone cashless to avoid the estimated additional \$270 per week transacting in cash was costing them.<sup>8</sup>

The owner also said that by accepting card payments only, they expect to save money in insurance premiums, POS systems and the cost of employing staff to manage cash. They will have also lowered their risk of theft or robbery.

In addition in their submission COSBOA noted that the development of digital solutions can deliver processes that are more modern, efficient and simple to use. These can also reduce costs for business and reduce incidences of fraud and loss.

The reduced use of cash brings other possible benefits, including potentially lowering financing costs for banks and other financial institutions (from higher deposit rates than might otherwise be the case). As the trend away from cash continues banks should be monitored to ensure they pass on the benefits they receive from this change to consumers.

Some economists, including Ken Rogoff (former Chief Economist of the International Monetary Fund (IMF)), argue that financial stability and the effectiveness of monetary policy may also benefit.

7 See C Stewart, I Chan, C Ossolinski, D Halperin & P Ryan, *The Evolution of Payment Costs in Australia*, Reserve Bank of Australia Research Discussion Paper, No 2014-14, 2014.

8 K Jones, "It was the nail in the coffin for me": Pope Joan café bans cash after three robberies', *Canberra Times*, 28 July 2017.

**OBSERVATION: SUPPLY CHAIN EFFECTS**

A business participating in the black economy by operating in whole or in part in cash will also generally be paying its suppliers in cash, in whole or in part. For example, a café paying its fruit and vegetable supplier in cash. That supplier may also be participating in the black economy. This can flow through multiple steps down the supply chain. Pulling the café, or any other of the businesses along that supply chain, out of the cash world can have flow on effects along the whole supply chain, moving all the businesses in the chain increasingly out of the shadows.

For our purposes, an economy less reliant on cash could help counter the black economy. Electronic payments leave a footprint that cash transactions do not. That is why the latter are so attractive to criminals and those operating in the black economy. Not only is cash anonymous, but it can be used without leaving an obvious audit trail. In contrast, the more we move people into the digital payment world, the more visible, traceable and reportable their transactions can be. Digital payment can also be linked to identity, both individuals and businesses, which cash cannot. Digital payments also allow for the provision of smarter and more detailed e-invoices. As these become more prevalent, there will be a need to determine how much standardisation is required to ensure these have interoperability across both accounting solutions and regulatory reporting requirements.

We are not saying that digital payment methods are risk or fraud free. Payment system fraud will always be a risk, regardless of the means selected. The vulnerabilities will still be there, but change in nature. While physical robberies or muggings may be less likely, identity theft and credit card fraud — which have risen considerably over recent years — could become an even greater risk. This risk can be mitigated by improving individual identity verification, as discussed in Chapter 4.

***The \$100 note***

The RBA has supported our recommendation for a study into the use and disposition of the \$100 note. This reflects the fact relatively little is known about this subject. During our consultations, a wide range of hypotheses were offered. Some believed that pensioners had stocked up on \$100 notes to avoid being hit by the pension assets test. Others claimed a large volume of notes are held offshore, including by people with little confidence in local banking systems, or as a currency hedge. Others argued they were mainly used at wholesale markets and in casinos. None of these explanations completely satisfied us.

**OBSERVATION: BANKNOTES STATISTICS**

\$100 banknotes represent:

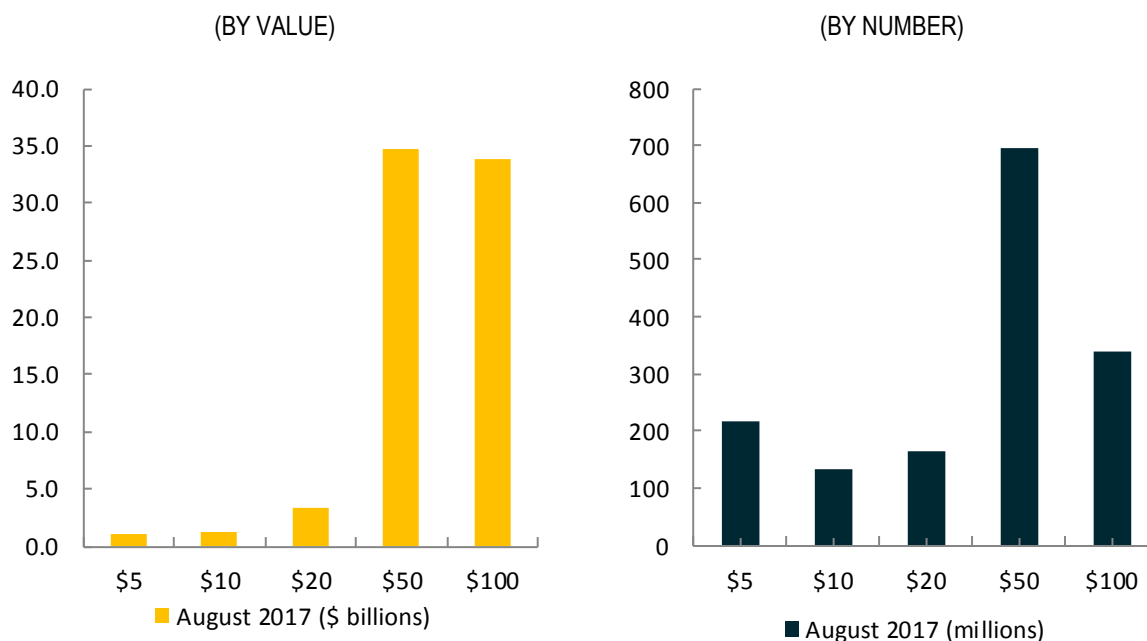
- 22 per cent of the number of banknotes in circulation.
- 46 per cent of the value of banknotes in circulation.<sup>9</sup>

There are approximately fourteen \$100 notes in circulation for every person in Australia.

9 Reserve Bank of Australia, Statistical Tables, Table A6: Banknotes on issue by denomination.

We are not yet calling for the abolition of cash or the banning, reissuing or restriction of \$100 notes. Cash will remain a part of our payment system for the foreseeable future, albeit a declining one. Given the societal trends in cash usage and preference, and the emerging innovations in payment systems there may not be a need to take action on the \$100 note in the future, indeed there may not be a need for the note itself. It is worth noting that the Australian \$100 note is relatively low-value compared to other high-value banknotes that have been subject to demonetisation processes internationally — for example the \$10,000 SGD, \$1,000 CAD and the €500 EUR.

**CHART 3.3: BANKNOTES IN CIRCULATION**



SOURCE: RESERVE BANK OF AUSTRALIA, STATISTICAL TABLES, TABLE A6: BANKNOTES ON ISSUE BY DENOMINATION.

Despite being the second most common banknote in circulation — approximately fourteen \$100 notes in circulation for every Australian — with average growth of about 8 per cent per year since 2011, the \$100 note is not widely used by Australians for everyday transactions; rather it is the \$50 note, the most common note in circulation, which is preferred for daily transactions. Suggestions have been made that the \$100 note primarily serves as a store of value, both domestically, including by individuals seeking to avoid asset and welfare tests, by tourists intending to visit Australia and by international banks and investors seeking to hedge against other currencies. These views have been supported by anecdotal evidence presented to us.

It has also been suggested that the \$100 note is used primarily to facilitate illegal transactions. While there is no doubt that the existence of the \$100 note does facilitate some amount of illegal activity it is not clear the extent to which it does so or to what extent action against the \$100 note would curtail these activities. Evidence presented by law enforcement agencies suggests that criminals are more likely to transact using the \$50 note given its wide acceptance and ubiquitous use in legitimate transactions. It is also the \$50 note that is most often counterfeited. This widely available near perfect substitute illustrates that potential action against the \$100 note would need to take account for other stores of wealth and likely behavioural responses.

Regardless, because of public concern and lack of clarity regarding the \$100 note, we have examined closely a range of possible reforms to high-value banknotes, including options to ban, restrict or trace these notes. What became evident in trying to evaluate the likely effect of any specific action against the \$100 note is that there is little hard information on the role that high-value notes, in particular the \$100 note, play in the modern Australian economy. This makes it difficult to be definitive about the likely effects, economic, commercial and social, of any action on the \$100.

This leads to an obvious question, how is the \$100 used in the modern Australian economy and to what extent does it facilitate black economy activity?

To determine if there is justification for any specific policy action in the future there will need to be an understanding of these issues. To address this, we are recommending, with the support of the RBA, that a research study be undertaken to determine the use and disposition of high-value banknotes in the economy and their specific role in facilitating black economy activity. This will better inform policy makers in the future to make effective policy in this space without imposing significant unintended consequences on the operation of the Australian economy.

#### **OBSERVATION: A CONTINUING ROLE FOR CASH**

While cash facilitates under-reporting income and facilitates criminal transactions, getting rid of cash would not get rid of crime or of under-reporting of income: illicit operators would move to some other form of payment, probably more than one form.

Rather than ban cash, which after all is a key part of our payment system and convenient and accessible for many, it is more important to constrain the use of cash in the areas where it is most abused, such as high-value transactions.

This narrows the scope for dishonest people to hide transactions and to hide what their real income is.

### ***What policy settings should governments adopt?***

In our view, governments should be embracing rather than resisting the prospect of a near cash-free world. Our current payment system policy settings, which emphasise competition, innovation and stability, have played a constructive role. In this area at least, regulation is not standing in the way of market-led change and disruption. We think the Government could be doing more to encourage the move away from cash. This agenda should include the following:

- The introduction of cash payment restrictions, including a \$10,000 economy-wide limit on cash transactions.
- A requirement that payment of salary and wages be made electronically to an Authorised Deposit-taking Institution (ADI).
- The continued encouragement of competition and innovation in the payment system, while remaining neutral between competing non-cash initiatives. We make specific recommendations on consumer choice in relation to emerging payment methods and welcome the RBA's move to lower card interchange fees.



- A specific incentive for small businesses to adopt entirely non-cash business models, together with a benefit for those who have already taken this step.
- Specific strategies for sectors where cash remains commonly used. Casinos and clubs, for example, are required by their governing legislation to accept wagers and make payouts in cash. We think this should be reviewed, but we appreciate that any change must come with protections to limit problem gambling. Produce markets still use cash in some cases.
- Further efforts to identify large, undeclared amounts cash being brought into and taken out of the country, including polymer scanning.
- Recognition that some in our community, including those living in remote communities and the disadvantaged, may not be able to adopt non-cash payment methods. Specific programs might have to be developed for them, if the trend away from cash continues and our recommendations are adopted.

#### **OBSERVATION: COST OF CASH FOR FINANCIAL INSTITUTIONS AND RETAILERS**

There is a view that cash is 'free'. Cash is costly for financial institutions and retailers. For example; banks incur the cost of secure cash transportation, ATMs and ATM maintenance, and security costs of cash at branches, all of which, as for any business, are part of the price consumers pay for their services. Retailers incur fees, insurance and security costs.

## RECOMMENDATIONS

### ***Recommendation 3.1: An economy-wide cash payment limit***

Introduce an economy-wide cash payment limit of \$10,000. Payments above this amount would be required to be made through the banking system.

#### ***Description***

The Government should introduce a cash payment limit that removes the ability of any individual or business to make a single transaction in cash in excess of \$10,000. The limit should apply to all payments made to businesses for goods and services. Transactions in excess of this amount would need to be made through the banking system.

#### ***Objective***

- Remove the ability for cash to be used to make large value transactions to reduce the ease with which black economy transactions may be made.

#### ***Discussion***

##### ***Problem this recommendation seeks to address***

Cash can be anonymous and untraceable. Making payments in cash makes it easier for businesses to underreport income, and to offer consumers discounts for transactions that reflect avoided obligations, gaining a competitive advantage over businesses that either cannot or will not offer such discounts. These practices perpetuate black economy activities and allow unfair practices to continue. The limit will also help to change social norms which legitimise participation in the black economy. We have heard examples of large undocumented cash payments being made for houses, cars, yachts, agricultural crops and commodities.

An example of a large cash transaction which falls within the black economy is a householder paying a discounted cash price for home renovations, with the tradesperson charging a lower price reflecting their avoided tax obligations. We have heard through consultation a number of legitimate payments people make in excess of \$10,000 including payment of school fees, motor vehicles, final payment upon settlement of building works and purchases of jewellery. Regardless, it is our view that if the cost is \$10,000 or more, transactions should no longer be allowed to be completed using physical currency but rather must be made via the banking system.

Our recommendation would not affect transactions with financial institutions—that is, people dealing in their own money. For example, a business would not be prevented from depositing takings in excess of \$10,000 into their financial institution. In such cases, large deposits do not represent a payment to the financial institution for providing a service. These however would still be

subject to existing Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) reporting requirements.

### *Rationale*

Introducing a cash payment limit will send a strong signal to the community that it is not acceptable to avoid tax and other obligations by using cash as a means of payment.

A cash payment limit will make it more difficult to under-report income or charge lower prices and not remit GST. This would therefore be expected to result in an increase in income reported and have a positive impact on the revenue.

### *Costs and benefits*

A cash payment limit is consistent with broader trends in the economy, reflecting a broad-based trend away from cash. This was evident in the overwhelming support for this proposal in submissions made to us. While some consumers will retain a preference for cash, consultations suggest that the majority of legitimate transactions would be unaffected by the recommendation. The \$10,000 threshold aligns with, and supports, the Government's efforts in other areas such as AML/CTF.

Currently, the market provides a wide range of solutions for electronic transactions. Internet banking is a widely used, fast and simple way to pay electronically. The market is continuing to evolve: the NPP will give Australian customers, businesses and government access to a fast, versatile and data-rich payments system for making their everyday payments.

A cash payment limit would also support businesses to decline high-volume cash payments: currently, honest business may find it difficult to decline large cash payments even where they suspect such payments are being made in the course of money laundering. This emerged as a concern for some traders in high-value goods in our consultations.

Depending on how it is implemented, a cash payment limit may involve some increase in government expenditure, for example, establishing systems relating to enforcement and penalties.

### *Other options considered*

#### **\$2,000 limit for tradespeople**

We considered whether a lower limit should apply for payments to tradespeople. The lower limit would recognise that the black economy is prevalent in the home maintenance and renovation sector. While business-to-business payments in the building and construction sector are captured by the TPRS, and we recommend that owner-builders should have to report payments to contractors (see Recommendation 6.1), neither of these capture payments made by consumers to businesses.

The idea attracted a lot of support from stakeholders, but due to the difficulty of enforcement and the potential complexity of two cash payment limits we are not recommending a second lower limit. Rather, we consider that improving the integrity of business transaction data (such as receipts),

recordkeeping and enhanced reporting obligations are more appropriate ways to address these issues at this time.

The Government could consider lowering the cash payment limit of \$10,000 once it has been in operation for a while to ensure that smaller cash payments are also restricted.

### ***International experience***

Several countries in Europe have implemented limits on cash transactions, including Spain, France and Italy. Typically these only apply to transactions that involve businesses. For example, people who live in France are not allowed to make payments of more than €1,000 in cash (previously €3,000). There are some exceptions to this rule for non-residents and those without access to banking.<sup>10</sup>

The European Commission is currently exploring whether to implement a limit on cash transactions across the European Union (EU). A recent survey indicated some resistance to cash limits, with 95 per cent of 30,000 respondents against the introduction of restrictions in cash payments at the EU level. Some 70 per cent of respondents indicated that if a limit were set, it should be above €9,500.

### ***Stakeholder views***

A cash payment limit was broadly supported in consultations and submissions. Stakeholders noted the difficulties of enforcing such rules, and some commented that such a move could be difficult for groups with strong preferences for cash, for example, older Australians.

Businesses that are required to operate in cash noted that such limits could affect their businesses, however some, such as casinos and gambling providers have expressed support for this measure.

Others have supported the concept of a limit but argued that \$10,000 is too high.

### ***Implementation considerations***

#### ***Cash payment limit amount***

For reasons of simplicity and interoperability, and to reduce the impact on groups with a strong legitimate preference for cash like older Australians, the threshold for the economy-wide cash payment limit should be aligned to the threshold used for the AML/CTF framework. Given that, the \$10,000 limit should be reviewed and adjusted as appropriate in line with any review of the AML/CTF threshold.

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<sup>10</sup> For example, in France, non-residents and tourists can make payments up to EUR15,000; salaries can be paid in cash up to EUR1,500; people who do not have any other means of payment (that is, they can show that they do not have a bank account in their name) are exempted. In Spain, the limit applies to any payments where one of the parties of the transaction is a business or a sole trader. It does not apply to payments between individuals.

### *How 'payment' would be defined*

Consideration would need to be given as to how to define 'payment' for the purposes of this measure, to ensure that there are no unintended consequences. For example, it would be undesirable for a limit to interfere with the distribution of cash and foreign exchange processes.

### *Enforcement*

Consideration would also need to be given to how the application of the limit is enforced, which agency is best placed to administer and enforce the limit and how information about the new rules is conveyed to the public. Depending on design, this may involve costs to government.

An appropriate penalty regime would also need to be implemented. Incentives to encourage reporting of banned transactions could also be considered. An appropriate penalty regime could include escalating penalties for second and subsequent transactions. Careful consideration would also need to be given to which party to the transaction is held liable for the transaction and subject to the relevant penalty.

### *Application*

The cash transaction limits would apply to payments made to a business for goods or services. In these cases, POS technologies are generally available and electronic transactions can be more easily facilitated. The vast majority of Australians have the ability to transact via a bank account.<sup>11</sup>

The application of the payment limit is likely to have the largest effect in those industries which remain largely cash based such as markets and casinos.

At this stage, we do not recommend that infrequent consumer-to-consumer non-business transactions — such as those in second-hand markets like Gumtree — be included in the limit where the selling party is not running a business. Consideration could be given to requiring the operators of the trading platforms to report advertised transactions above the limit. However, all of these matters could be given further consideration in the future, for example, subject to the take-up of the NPP.

### *Possible extension of AML/CTF framework*

The Government is currently considering extending the AML/CTF framework to designated non-financial businesses and professions, which includes real estate agents, jewellers, other high-value dealers, and trust and company service providers. We support this extension.

This extension would expand the scope of the AML/CTF framework to approximately 93,000 entities. This could represent a significant increase in the compliance burden, however, if the Government proceeds with both the extension of the AML/CTF framework and a cash payment limit, any resulting increase in the compliance burden would be lower than if the AML/CTF framework were extended without a cash payment limit.

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<sup>11</sup> World Bank, Global Financial Development Database, 2017. Latest available data for Australia is that 98.86 per cent of Australians aged 15 and over have an account at a formal financial institution.

The effect of imposing a cash limit, even with a broader net of industries and businesses being brought into the AML/CTF framework, would likely mean some of the existing reporting requirements would no longer be required. Other requirements would still apply to these entities, including reporting suspicious transactions. In implementing the cash payment limit consideration will need to be given to how this interacts with the AML/CTF framework to determine how the compliance burden imposed can be minimised.

### *Other considerations*

The design of the measure will need to ensure that payments are not broken-up or artificially structured to circumvent this threshold; the existing reporting regime could provide guidance here. Consideration should be given to the application of a time threshold as has been applied in Europe. These considerations would need to strike a balance with avoiding imposing additional compliance costs on businesses, particularly small businesses.

### **Recommendation 3.2: Mandating the payment of salary and wages into bank accounts**

Mandate that salaries and wages are paid into an ADI.

#### **Description**

The Government should mandate that all salaries and wages are paid into an ADI. Employers should transfer salaries and wages directly into the employee's financial institution account.

Requiring payment into an account with an ADI will mean that the vast majority of salary and wages will be paid electronically, but should allow for circumstances where that may not be possible.

*'There is no benefit for a retail system to see these practices continue where wages are paid off-the-books, as it impacts not only on brand perception but also turnover... Many systems now operate in a virtually cashless environment which reduces the impact of a wide range of financial issues, from theft and increased insurance costs...'*

Australian Retailers Association

#### **Objective**

- Improve transparency and data matching by generating a transaction record for the payment of all salaries and wages.
- Create protections for vulnerable workers.
- Give a clear message that cash-in-hand wages are not allowed.
- Better identify businesses which pay wages in cash and may be avoiding their obligations (including SG, payroll tax and WorkCover) to ensure appropriate compliance action can be undertaken.

#### **Discussion**

##### *Problem this recommendation seeks to address*

Payment of cash-in-hand wages is a key feature of the black economy. A common scenario is businesses taking cash paid for their goods or services and using this cash to pay employees 'under the table', thereby enabling them and their employees to avoid their obligations.<sup>12</sup>

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<sup>12</sup> For example, for the business: avoiding income tax and GST, PAYGW and superannuation, payroll tax and workers' compensation premiums and award wages. For the employee: welfare and child support obligations, and personal income tax.

Cash transactions also do not automatically generate a record which makes it much harder to track and audit these undertakings.

It is not uncommon for employees to demand cash wages; a requirement for the employer to pay wages into an account with an ADI reduces the pressure on business to do so and assists in creating a level playing field for honest business.

### *Rationale*

The convenience, ease of handling and anonymity of cash facilitates black economy and illegal activity. Mandating the electronic payment of wages will reduce the use of cash in the economy, especially those cash payments which are more likely to be associated with black economy activity.

The recommendation raises the bar for cash-in-hand payments by making them unlawful, even if accompanied by documentation. The change will send a strong and simple message that cash wages are facilitating the black economy, helping to change social norms which legitimise participation in the black economy. It will also give employers who might be asked by their employees to pay in cash a further reason to refuse.

This will also enhance transparency for employees and create clear audit trails. Electronic payments and other payments into an ADI generate evidence of transactions which can be used to track and verify business operations, and employee's income. Information can also be included with the electronic payment. For example, and particularly under the NPP which allows for more information to be attached to transactions, it might be possible to include some information identifying under which award the employee is being paid, providing a data point from which regulators can easily ensure entitlements are being met without needing to intrude in a more time consuming way on the business. This change aligns with the intentions of the Single Touch Payroll (STP) initiative in driving down business costs and increasing transparency.

This recommendation aligns processes whereby employers are already required to pay superannuation contributions electronically through the SuperStream system.<sup>13</sup>

It should also provide efficiency savings to employers and employees through improved record keeping and transparency and security of payments.

#### **OBSERVATION: ELECTRONIC PAYMENT ISSUES OUTSIDE METRO AREAS**

It has been reported to us that internet connectivity in some regional and remote areas is patchy to non-existent. Cash still has a role to play where electronic payment is not yet convenient (or possible) due to a lack of the required infrastructure.

<sup>13</sup> We note however that SuperStream is a closed-system, while this may have been necessitated by its design, a single process allowing for electronic payment and transmission of data across all payments a business makes, while complex, may deliver significant cost savings.



## ***International experience***

In Austria, wages in the construction sector must be paid electronically (unless the employee is not eligible for a bank account).

## ***Implementation considerations***

Further consultation with small businesses will be required to ensure the change can be implemented according to reasonable timelines and exceptions if and where necessary. Businesses will have to be informed of the change and adequate lead times provided.

The introduction of this measure should align with the introduction of the STP rollout to encourage desired behaviour and minimise change and complexity.

The ATO already captures significant information about electronic transactions and individuals' bank accounts. Examination of how the ATO can better use this data to assist in enforcement of the tax and superannuation laws may be warranted. Examination of how other agencies, both Commonwealth and State, can better use this data to enforce other laws to address the black economy may also be warranted.

While in the vast majority of cases it is expected these payments will be made between domestic banking institutions, the scale of use and issues relating to the payment to offshore bank accounts will need to be explored. This should include exploring liability for any unpaid tax relating to the offshore account holder.

### **OBSERVATION: WAGES — 'CASH-BACKS'**

While requiring electronic payment of wages goes a long way to assist in addressing black economy behaviours associated with cash wages, it will not entirely fix the problem. Some employers have already been caught paying the correct wages into employees' bank accounts, and then demanding the employees withdraw a portion of the wages in cash to pay back to the employer. This usually involves bullying and other unacceptable threatening behaviours. The recent passage of the *Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017* through the Parliament now expressly prohibits employers from unreasonably requiring their employees to make payments. Significant penalties apply for breaching these provisions.

A number of other recommendations in the report specifically deal with sham contracting arrangements. Consideration could be given to mandating that payments to contractors engaged in the provision of labour be made electronically or into an account with an ADI. The Government should remain vigilant on sham contracting to ensure the electronic payment of salary and wages does not unintentionally result in an increase in the number of individuals engaging in these behaviours.

### **Recommendation 3.3: The future direction of interchange fees**

In its next review of card payments regulation, RBA should consider whether there are further actions it could take to put downward pressure on interchange fees that would be in the public interest.

This consideration should take account of the effect of its recent decision on fee benchmarks, along with the lower regulatory caps for consumer cards applied in the EU and other jurisdictions. The option of moving away from weighted-benchmark averages to hard interchange fee caps for credit and debit cards should also be explored.

The benefits of lower merchant service fees for small businesses and of encouraging a further move towards non-cash payment methods should also be taken into account.

### **Description**

An interchange fee is a fee charged by the financial institution on one side of a payment transaction to the financial institution on the other side of the transaction. They are most commonly seen in card transactions, although can arise in other payment methods.<sup>14</sup> In card transactions, interchange fees are typically paid by the merchant's financial institution to the cardholder's financial institution. These fees are set by card schemes (such as EFTPOS, MasterCard and Visa), subject to regulatory benchmarks established by the RBA.

#### **INTERCHANGE FEES — AN EXAMPLE**

A consumer makes an in-store purchase using their debit card. The transaction is sent via the card scheme to the cardholder's financial institution which will provide authorisation for the transaction, and the merchant will provide the goods or services purchased. The merchant's financial institution will subsequently make payment into the merchant's account, and the cardholder's financial institution will debit the cardholder's account. The merchant's financial institution pays a fee to the cardholder's financial institution — this is the interchange fee. This is determined by the card scheme and factored into the net settlement of obligations between financial institutions. Because the interchange fee is paid by the merchant's financial institution, it effectively sets a floor under the 'merchant service fee' that is charged to the merchant.

The RBA has made a number of interventions into the card payments market, including initial reforms to interchange fee arrangements that approximately halved the level of credit card interchange rates and subsequent reforms to debit card interchange arrangements. The RBA should continue to monitor the impact of the recent changes to the interchange benchmarks.

We observe that there are a number of debit card systems in the world where interchange fees are set at zero.

<sup>14</sup> Reserve Bank of Australia, Review of Card Payments Regulation: Issues Paper, March 2015.

## Objective

- To ensure that interchange fees remain low and efficient as the payments system continues to mature.

## Discussion

### *Problem this recommendation seeks to address*

In May 2016, the RBA completed a review of regulation that established maximum caps on interchange of 0.80 per cent for credit cards and 15 cents or 0.20 per cent for debit cards, as well as reducing the weighted-average benchmark for debit cards from 12 cents to 8 cents. It retained the weighted-average benchmark for credit cards at 0.50 per cent, but established quarterly compliance arrangements to minimise the extent to which credit card interchange fees may drift above the benchmark between reset periods.

The RBA has noted that interchange fees can be appropriate in some circumstances, particularly in the establishment of new systems where they may be necessary to rebalance costs and ensure that both sides of the market have an incentive to participate.

However, there is little justification for the imposition of significant interchange fees in mature card systems. We support the work of the RBA to date and agree with the idea that as schemes mature there is little to support the imposition of significant interchange fees.

### *Rationale*

The payments system is continually evolving. The rise of electronic payment methods and peer-to-peer payment options has meant individuals and businesses have more choice in how they choose to transact. Increased moves to non-cash payment should not be undermined by inappropriate or inefficient fees in the electronic payment environment. While it is justifiable for providers to recover the costs of developing and operating these systems, these fees should be explicit, and should not be used to cross-subsidise benefits or incentives aimed at encouraging use of one system over another. This kind of pricing structure hides from consumers the true costs of a particular payment type and may lead to the overuse of particular payment methods; this introduces inefficiency into the payments system.

In considering the case for further changes to the regulatory regime, the RBA should consider overseas experience, particularly the EU.

#### **THE EUROPEAN EXPERIENCE**

In the EU, hard interchange caps apply to both credit and debit transactions, for all consumer cards. The credit card caps are lower than those in Australia. For credit cards, the weighted-average interchange fee cap in Australia is 0.50 per cent and the maximum interchange fee is 0.80 per cent. By comparison, the EU maximum is 0.30 per cent (in practice all consumer card fees have tended to be set at this rate). However in the EU commercial cards are excluded from regulation, and interchange rates on these can be much higher (for example 1.88 per cent in Germany).

### **Recommendation 3.4: Bringing down the cost of debit card transactions for businesses**

The RBA's Payments System Board should consider regulating to ensure downward pressure on the cost of debit card payments. In particular, where debit cards allow for the authorisation of the transaction to occur via two different networks, merchants should be given the ability to send the transaction via the lower-cost network.

By reducing the cost of card payments, there will be an additional impetus for businesses to accept cards and move away from cash. It will also contribute to holding down business costs, which can lead to lower prices of goods and services for consumers.

The RBA should also seek to ensure that effective price competition among payment networks is maintained for dual-network debit card usage in the context of mobile wallet technology.

#### **Description**

While the number of card transactions has risen significantly in recent years, many merchants report that this growth has not flowed through into a significant reduction in the average cost of card payments for businesses. One particular focus of merchants has been that as transactions have migrated from PIN entry to contactless or 'tap and go' there has been an increase in the fees they pay to their banks. This reflects a shift in the routing of debit card transactions from the domestic eftpos network to the higher-cost MasterCard and Visa networks.

Fostering greater use of non-cash payments, including the use of debit and credit cards, requires that these payments are relatively inexpensive for merchants (or for consumers where merchants choose to pass on the cost of some payment methods by surcharging).

The RBA's Payments System Board is the primary regulator of the payments system and has undertaken various regulatory measures over the past 15 years which have had the effect of bringing down the cost of card payments relative both to many other countries and to the levels that existed in Australia prior to the reforms. However, regulators in some other countries have taken steps in this area recently which go further than the RBA's measures. In addition, some recent developments in the Australian marketplace have had the effect of driving up payment costs to merchants, despite the strong growth in card transactions.

Following consultation with stakeholders, we recommend that the RBA consider introducing regulatory measures to ensure that:

- Where debit cards provide access to a customer's transaction account via two different networks, banks providing card acquiring services to merchants enable merchants to ensure that their contactless transactions use the lower-cost network.
- Cardholders retain the ability to send the transaction via their own preferred network by dipping the card and pressing the relevant terminal button.

- Card-issuing banks and card schemes do not take any steps to prevent or discourage acquiring banks or merchants from implementing such network choice.

The RBA should consult with stakeholders on such measures and in its consideration of the public interest should take account of the Government's aim of reducing the size of the black economy.

#### **OBSERVATION: PAYMENT ACCEPTANCE OPTIONS FOR MERCHANTS**

Merchants in Australia have significant choice in terms of which payment methods they accept and can use this flexibility to reduce their payment costs:

For example, many merchants no longer accept cheques. Merchants also have the freedom to accept (or not accept) payment methods such as BPAY, POLi and PayPal. In addition, merchants are also able to decline to receive payment in cash providing this is disclosed appropriately to customers.

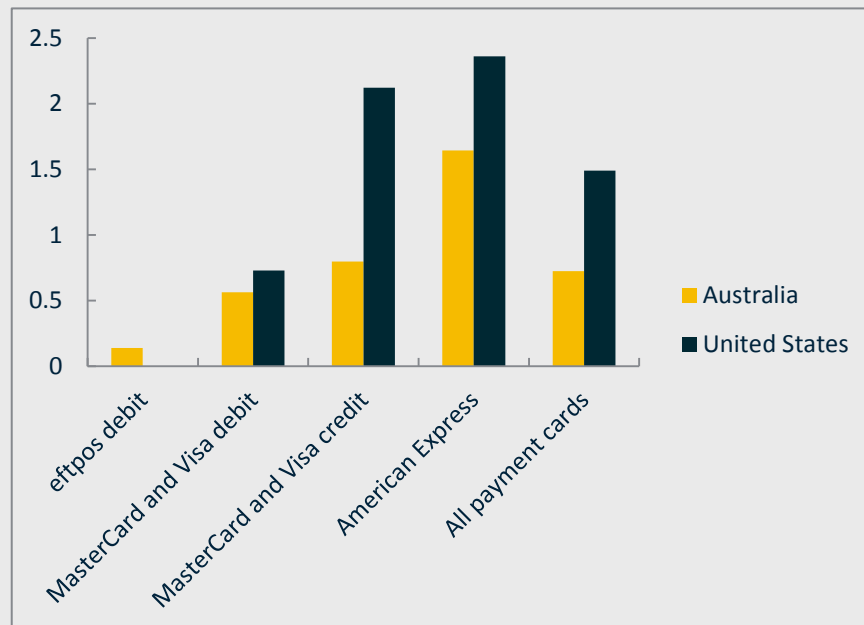
As regards cards, merchants can choose to accept credit cards from some schemes but not others; for example, many merchants choose not to accept Diners Club, and some choose not to accept American Express—both of these cards have traditionally been relatively expensive payment methods. Also, MasterCard and Visa previously had rules that required merchants that accepted one type of card (for example, debit) from that brand to accept all types of cards (for example, also credit and prepaid), but following the RBA's reforms in the early 2000s, these two schemes were required to remove their 'Honour all cards' rules, and make different types of cards identifiable. Hence, merchants have the right to not accept the more expensive cards of these brands (typically credit cards are more expensive) and only accept less expensive cards (typically debit and prepaid). In addition, since the removal of the international schemes' 'No steering' rules, merchants also have the right to indicate to consumers that they prefer particular cards over others.

Merchants also have the ability to accept a particular type of card but to surcharge the cardholder to recover the merchant's cost of accepting that card. However, any surcharge must not be greater than the average cost of that card to the merchant. In addition, merchants may not surcharge all payment methods—they must offer at least one payment method that is not surcharged. The framework for surcharging in Australia reflects the interaction of the RBA's surcharging standard, the Australian Consumer Law, and a recent amendment to the *Competition and Consumer Act*. The Australian Competition and Consumer Commission (ACCC) have enforcement powers for cases where merchants are surcharging above their cost of acceptance.

The changes to the regulatory framework that have occurred since the early 2000s have contributed to the cost of card payments being significantly lower than in some other countries, including the US.

## OBSERVATION: PAYMENT ACCEPTANCE OPTIONS FOR MERCHANTS (CONTINUED)

**CHART 3.4: MERCHANT SERVICE FEES**  
(PER CENT OF VALUE ACQUIRED, 2016)



SOURCE: RESERVE BANK OF AUSTRALIA, THE NILSON REPORT

### Objective

- Ensure card acceptance services provided by banks better meet the needs of businesses.
- For businesses to reduce the costs associated with accepting cards and increase the incentives for businesses to take cards as opposed to cash.
- Introduce greater competitive pressure on merchant payment costs.
- Contribute to downward pressure on the cost of goods and services bought by consumers.

### Discussion

#### *Problem this recommendation seeks to address<sup>15</sup>*

Merchants frequently express a desire to move to greater use of electronic payments, including cards. However, electronic payments are sometimes quite expensive. Different types of cards have different costs for merchants, with debit cards usually having lower merchant service fees than credit cards. In addition, debit transactions that are processed through the domestic eftpos system are on average less expensive than transactions processed through the international MasterCard

<sup>15</sup> This description of the technical aspects of the routing of debit card transactions draws on pp. 36-37 of the Reserve Bank of Australia submission to the Productivity Commission inquiry into competition in the financial sector.

and Visa systems, reflecting both lower interchange fees and lower scheme fees (the fee that the merchant's bank pays to the payment network).

Merchants have reported a significant increase in the cost of their debit card payments as payments have shifted away from 'contact' or 'dip and PIN' transactions to contactless or 'tap and go' transactions. The majority of debit cards in Australia are dual-network debit cards, which allow contact transactions to go via the eftpos network (if the cardholder pushes CHQ or SAV) or the international network (if they push CR); the different networks can largely be thought of as different sets of pipes for the authorisation messages from the merchant's bank to the cardholder's bank and back again. However, with the introduction of contactless cards, the cardholder and merchant no longer influence the routing of the transaction — it is determined by the network priority that is pre-set by the card issuing bank when it sends the card out. Initially, the international schemes were the only networks with contactless functionality, so a contactless debit transaction could only go via their networks. However, eftpos has now rolled out contactless functionality on almost all debit cards and almost all terminals are now enabled for eftpos contactless transactions.

With international scheme transactions typically being more expensive for merchants, merchants report that the shift from contact to contactless transactions has resulted in a significant increase in payment costs for debit transactions and many merchants are now increasingly interested in their banks providing them with the ability to send debit transactions via the lower-cost network even if that network is not the first-priority contactless network on the card. However, banks have not yet begun to offer least-cost transaction routing to their merchant customers. As a result, some merchants express a reluctance to move away from cash to greater use of card payments.

Some merchants have indicated that their existing banks (the merchant's bank is called the 'acquirer') have indicated that they are unable or unwilling to provide least-cost routing. In some cases merchants attribute this unwillingness to the fact that most acquirers are also card issuers and may be looking to protect the higher interchange revenues that they earn from transactions that are routed via the international schemes as opposed to eftpos. In other cases merchants attribute the unwillingness of banks to policies of the international schemes to discourage least-cost routing. Accordingly, merchants have expressed a desire for regulatory intervention to ensure the provision of least-cost routing, which would help hold down the cost of non-cash payments.

### *Rationale*

Our recommendations should result in a continuation of the shift that is occurring from cash to non-cash payments. The banking sector will be a primary beneficiary of this shift. We consider that it is reasonable to expect that as the volume of card payments rises, there is scope for reductions in the average cost of payments. At the same time there is a need to better educate consumers about the real cost of card and other non-cash alternatives.

*'It's really unfair that consumer spending patterns have changed but the banks are not adapting with those changes. It's just another hit that a small business takes.'*

Member of Restaurant & Catering Australia, as reported in their submission

We note that other jurisdictions (the EU, Malaysia and the US) have taken various regulatory actions to encourage the use of lower-cost payment networks for debit card transactions. For example, the recent reforms in Malaysia require that acquiring banks must provide merchants with the ability to route transactions via their preferred network. These interventions in other jurisdictions have typically been directed at taking decisions about network routing away from entities such as banks and card schemes, which may have no incentive to reduce the cost of payments, and empowering those end-users of the payments system who have the greatest incentive to reduce payment costs.

### EDUCATING CONSUMERS

Consumers need to be better informed about the real costs of the different cards available when they are choosing what product is right for them.

Often the cards which provide the most 'bells and whistles' in terms non-cash benefits are ultimately more expensive to the consumer over the longer-term. Consumers should be encouraged to choose lower cost cards.

### *Implementation considerations*

The Taskforce recognises that there are sometimes small differences in the cardholder experience or terms and conditions depending on whether transactions are routed via the eftpos network or the MasterCard or Visa networks. If so, it would seem appropriate that the merchant should disclose it is using least-cost routing and that consumers should be able to 'override' a merchant's network preference. Accordingly, where a merchant chooses to exercise least-cost routing for contactless transactions on dual-network cards it may be appropriate for them to display a sign along the following lines:

'At [Merchant Name] we care about holding down our costs so that we can hold down prices for our customers. Accordingly, we prefer to send contactless debit card transactions to customers' banks via Network X as opposed to Network Y or Z. If customers prefer that their debit transactions are instead sent via another network, they can insert/dip their cards and push the button or keypad for their preferred network.'

We consider that such a framework would be a reasonable balance between the rights of merchants and consumers, and that consumers would quickly become used to the concept that their transactions could be sent via different networks at different merchants. Furthermore, we stress that this recommendation relates only to debit cards with two networks enabled, and that our recommendation does not in any way mean that a consumer could find that a transaction they intended to fund from their debit account has instead been funded from their credit account, or vice versa. Nevertheless, it will be important that the RBA consult with consumer organisations before deciding on any new regulation in this area.

We understand that some banks argue that it would be costly or take time for them to provide least-cost routing to merchants. However, the RBA has indicated that a number of acquirers are currently considering providing this functionality to merchants. While it is recommended that the RBA commence a regulatory consultation process, in the event that least-cost routing was being



brought to market and provided a realistic and competitive alternative to more established acquirers, there might be a case for the RBA to hold off from implementing a regulation, not least because such a regulation could have the effect of removing a point of competitive differentiation for any acquirers that are planning on implementing least-cost routing without being required to do so.

We understand that there may be opposition to the provision of least-cost routing from two other groups of stakeholders. First, banks that are card issuers may prefer the status quo where contactless transactions default to either Visa or MasterCard and the banks earn higher interchange revenues. Second, the international schemes could potentially lose a significant share of their debit transactions. Ideally, they might respond by competing to be lower-cost schemes by reducing interchange or scheme fees. However, they could also seek to respond in ways that might be anti-competitive. Given this potential opposition to least-cost routing from these two groups, we recommend that the RBA, ACCC and Government monitor, and respond to, any anti-competitive behaviour in this regard.

The ACCC has the power to investigate and take action in relation to anti-competitive or cartel conduct that contravenes the *Competition and Consumer Act 2010* (Commonwealth). In particular, the amendment of the misuse of market power provision<sup>16</sup> will provide the ACCC with additional scope to investigate unilateral conduct by a firm with substantial market power that has the purpose, effect or likely effect of substantially lessening competition, for example, by raising barriers to entry or hindering competitive conduct by a lower-cost provider. While such a contravention would depend on the particular facts at issue, the amendment is likely to improve the capacity of the ACCC to tackle anti-competitive conduct in this area.

## ***Other options considered***

### ***Increasing tap-and-go limits***

Given that Australia has one of the highest thresholds for PIN-less tap-and-go transactions at \$100 (for most of Europe it is closer to \$30) and the fact that transacting above this level via contactless methods only requires the entering of a PIN there does not seem to be any benefit in seeking to encourage card schemes and financial institutions to raise this limit. The risks associated with tap-and-go fraud both from a law enforcement perspective and the risk proposition for the card issuer appear to outweigh any benefit for the consumer transaction experience. We consider that the real opportunity provided by tap-and-go transactions in reducing the use of cash will occur mostly in regards to lower value (that is, under \$20) transactions.

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<sup>16</sup> *Competition and Consumer Amendment (Misuse of Market Power) Act 2017*. At the time of writing, the amendment is not yet in force.

### *A no-frills Australian debit card*

Low-cost debit cards for small, everyday transactions have been introduced in a number of overseas jurisdictions. These have often also acted as transport cards; for example the Octopus card in Hong Kong can be used for payment on transport networks and in convenience stores, fast food restaurants, vending machines and more.

We have found that in the Australian market there are currently sufficient options, including free banking products and stored-value cards available to consumers. A lack of a single national transport network also reduces the benefit of any single combined card.

We have also seen that some state governments are running trials<sup>17</sup> whereby general-purpose credit and debit cards can be used in place of dedicated transport cards to purchase public transport tickets. If this trend continues there will likely be less use and reliance on dedicated transport cards.

Given this, no government intervention is required at this stage. However, this should be closely monitored to ensure that no barriers emerge to prevent people from moving away from cash for low-value transactions.

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17 NSW Government, Contactless payments on Sydney Manly Ferries service, viewed 4 October 2017, <[https://www.opal.com.au/en/news/opalnews/news\\_6july2017.html](https://www.opal.com.au/en/news/opalnews/news_6july2017.html)>.

### ***Recommendation 3.5: Incentives to move to a non-cash business model***

Offer incentives to small businesses to adopt entirely non-cash business models, including tax instalment timing relief and preferential treatment as trusted taxpayers.

#### ***Description***

The Government should introduce an incentive to encourage small businesses to adopt entirely non-cash business models. The suite of incentives could include:

##### ***Tax instalment relief***

Small businesses which move to non-cash business models should benefit from a more favourable tax instalment schedule. This would give them a cash flow benefit. We note that the Government already offers a \$20,000 immediate write off for equipment, which many businesses have used to digitise their operations (for example, through the purchase of accounting software).

##### ***Trusted taxpayer***

Businesses which operate entirely cash-free could apply to become a 'trusted taxpayer'. Trusted taxpayers would be rated as a lower-risk by regulators. The trusted taxpayer program would afford participating businesses with distinct advantages, including:

- Pre-filled, and eventually, no tax returns for eligible businesses (for businesses sufficiently electronically linked to the ATO).
- A lower instalment rate.
- Dedicated and preferential treatment by the ATO and other regulators.

The program would recognise that electronic-only businesses are at lower-risk of operating in the black economy and create lower administrative costs for the ATO. It would also prepare business for the introduction of STP. COSBOA told us that about 250,000 businesses do not use accounting software; instead they are using paper systems or excel or other means of accounting. The Government should incentivise businesses to take up accounting software by clearly demonstrating the regulatory burden reductions and other back-office efficiencies that can be gained by its take up.

#### ***Objective***

- Support businesses going completely cash-free. This will reduce their risk of black economy activities and signal the Government's support for a near cash-free economy.

*‘Businesses prefer to spend time on productivity and growth activities as opposed to investing significant amounts of time on compliance related activities. Digital transformation enabled by today’s technology advancement has matured significantly enough for systems to be designed so that compliance can be seamlessly embedded in everyday business activity as a convenience or operational efficiency as opposed to a regulatory imposition.’ COSBOA*

## Discussion

### *Problem this recommendation seeks to address*

Cash facilitates the black economy as it does not generate a paper-trail in the same way as digital transactions. This makes reporting less credible and also poses difficulties for conducting accurate audits. As the costs of electronic payments have decreased cash has become increasingly a relatively more expensive way for businesses to operate. Moving businesses to non-cash models — in combination with measures to further lower the cost of electronic payments — will reduce business costs.

*‘Some of the strongest leaders in the move to cashless fully automated payment and control systems within the retail sector have been small business. There are multiple cases of retailers who see automation, non-handling reduction in costs, removal of cash theft and stock control, along with prefill employment and tax keeping as being a massive advantage to them at a competitive level.’ Australian Retailers Association*

### *Rationale*

Many businesses have already adopted electronic systems and some have gone even further and no longer accept cash. There is no legal requirement to accept cash as a payment method<sup>18</sup> and there are distinct advantages of businesses moving away from cash, including:

- Lower costs.
- Easier reconciliations and lower-risk of theft and fraud.
- Combatting the black economy.
- Improving (and automating) record keeping and reporting.
- Improved data reliability for the ATO and other regulators.

Small businesses already have access to the \$20,000 instant asset write-off and can claim deductions for business software purchased. This has encouraged many to become partially electronic.

However, a specific incentive to move to an entirely non-cash business models would provide further encouragement to completely remove cash from businesses. This will increase the number

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<sup>18</sup> Australian Government, Cash payments, viewed 4 October 2017, <https://www.business.gov.au/info/run/finance-and-accounting/accounting/payments-and-invoicing/cash-payments>.

of businesses considered low-risk for black economy activities. Incentives will also form an important part of promoting a general move away from cash in the Australian economy.

### *Costs and benefits*

Any instalment tax relief will impact on the timing of revenues collected by the ATO. To the extent that entirely non-cash businesses are less able to operate in the black economy, compliance will be improved.

### *Other options considered*

#### *Tax rebate*

We considered recommending a tax rebate for businesses that adopt entirely cash-less business models. This idea was raised in our Interim Report. However, an instant asset write-off is already available to small businesses. Combined with instalment relief, a 'trusted taxpayer' scheme and safe harbour which is recommended in Chapter 7, we do not consider that an additional financial incentive is necessary, especially in light of the significant costs associated with a tax rebate.

### *Stakeholder views*

Incentives to digitise businesses and encourage greater transparency and reduce business costs are strongly supported by small business representatives. This approach would support broad adoption and not single out particular business types. They do not support restricting to businesses already in operation to capture new businesses and encourage them to be within the system.

### *Implementation considerations*

The incentives will have to be carefully designed and may only be possible if other recommendations, such as anti-phoenixing measures are implemented at the same time. Sanctions or penalties may need to be introduced to deal specifically with businesses which receive the instalment relief or participate in the program but continue to operate in cash.

The instalment timing relief will shift a larger proportion of the payment to the end of the year. While this gives a cash flow benefit to business through the year, it does mean that there will likely be a larger tax payment due after the end of the year. This may create cash flow problems for some business and thereby increase outstanding debt levels. Design of this initiative would need to carefully consider the level of instalment relief with this in mind. Business should also be able to vary their instalment so that this does not occur should they choose to do so.

Consideration should also be given to only offering the incentive to businesses that have generally met their reporting and payment obligations as this may be an indicator of good cash flow management. As should, removing the instalment relief from business that generally fail to meet their reporting and payment obligations after receiving the relief.

In addition, to further support this measure and the move away from cash this measure could be coupled with a targeted program aimed at cash-only businesses.

### **Recommendation 3.6: Gaining a better understanding of the use and role of high-value banknotes**

The RBA should undertake research, in conjunction with government agencies, financial intermediaries and others, to develop a better understanding of the use, role and location of the \$50 and \$100 notes.

#### **Description**

The Government should have a better understanding of the use and role of high-value banknotes. The RBA should work with:

- government agencies, particularly the Australian Transaction Reports and Analysis Centre (AUSTRAC), regarding sharing of information about banknotes being taken overseas;
- financial intermediaries regarding offshore demand for banknotes; and
- high users of banknotes domestically, such as casinos and post offices.

#### **Objective**

- Develop a robust understanding of the use of large value Australian banknotes in both the domestic and international economy.

#### **Discussion**

The \$100 note is relatively infrequently used for day to day transactions, but at the same time represents a large proportion of currency in circulation by value and number.<sup>19</sup> However, there is relatively little reliable information available about how the \$100 is used.

The use of cash, particularly high-denomination banknotes, has attracted attention as a way to avoid reporting income to the authorities, or to finance illicit activities. It is speculated that high-denomination banknotes are also a useful vehicle for black economy activities such as making payments in cash to avoid tax or the loss of pensions or welfare benefits. Some use the \$100 note as an anonymous store of wealth to avoid asset and other means-based tests. Particular criminal operations (for example money laundering) also prefer cash, owing to its anonymity and its ease to store and transport.

However there are also many legitimate uses of the \$100 note. For example, it is believed that some high-value banknotes are used as a store of value, including by people located overseas who are seeking to hedge against their local currency or within particular migrant communities where trust in banks and government may be low. Macroeconomic factors such as low inflation and low interest rates can increase the relative attractiveness of Australian currency as a store of value. This has been

<sup>19</sup> Reserve Bank of Australia, Statistical Tables, Table A6: Banknotes on issue by denomination.

particularly evident in times of economic and financial uncertainty, such as the 2008 Global Financial Crisis. However the extent to which this accounts for the relatively low level of use of the \$100 note as a means of everyday transacting is unknown.

Given the clear knowledge gap, developing a better understanding of how high-value Australian banknotes are being used will support the Government's economic and monetary policy objectives. A stronger understanding will also assist regulatory and law enforcement agencies to mitigate risks posed by the use of high-value banknotes to facilitate illegal or black economy activity.

### ***Other options considered***

#### *Remove the \$100 note from circulation*

While a number of jurisdictions have taken the approach of decommissioning high-value banknotes they have tended to involve a variety of country-specific factors — hyperinflation or involve denominations that have been of considerably higher value than the Australian \$100 banknote. In the case of India, the banknotes were replaced with even higher denominations.

In this context, we note that in Australia, \$100 is considered to be a small enough value for credit card payments without PIN or signature verification (for example, tap-and-go payments).

Arrangements would need to be made for individuals holding old series banknotes to exchange them for alternative denominations. This would imply significant additional compliance and transportation costs for legitimate holders.

While this may temporarily disrupt some black economy activities, this would be unlikely to have a permanent impact. Substitutes are readily available (such as the \$50 note or foreign currency).

#### *Implement technology to track \$100 banknotes*

Currently available radio frequency identification technologies are not suitable for use in currency. Simply put, they are thicker than Australian polymer banknotes and may not be sufficiently robust. Considerable research would be needed to develop a suitable mechanism. This could be at some cost and may have extensive lead times. Given the likelihood that black economy participants would turn to lower value banknotes, use of similar technologies in other Australian banknotes may also need to be considered.

Given the anonymity of cash, for tracking to be effective, there would be a need to connect the user of the banknote with its identifier, through POS technologies. This does not currently exist and would also need to be developed. This would involve considerable expenditure.

#### *Include expiry dates on \$100 banknotes*

Under this option, the \$100 banknote would have an expiry date, after which it would no longer be able to be used and would need to be exchanged. However, the potential costs of such a proposal would likely outweigh its benefits in curbing black economy activities. For example, it would imply a

need for expiry dates for all Australian banknotes, as black economy participants would substitute \$100 for other denominations.

Expiry dates would also increase the compliance cost for currency holders, who would need to monitor them and make arrangements to redeem them at a future point. This would be compounded should the range of banknotes including expiry dates be expanded. As highlighted in the previous options, the logistical and financial impost on the community would be considerable.

Introducing an expiry date for any Australian banknote would be an unorthodox approach for an advanced industrial economy with a stable monetary system and central bank that commands the confidence of the community. Such an option has only been considered in extreme circumstances such as during the period of hyperinflation in the 2000s where the Zimbabwean dollar currency took the form of a time-limited bearer cheque.

### *International experience*

Internationally, there have been some moves to change the mix of banknote denominations. The motivations for these changes have differed between countries; to eliminate counterfeiting problems, to address issues associated with high inflation, to making it more difficult to use cash for black economy purposes. Notable examples include:

- Canada's \$1,000 banknote was decommissioned in 2000.
- Singapore stopped issuing a \$10,000 banknote in 2014.
- In late 2016 India announced it would demonetise its highest denomination and would replace them with a banknote of higher value (the INR 1,000 was replaced with the INR 2,000). By necessity, the demonetisation in India occurred over a very short time period, which was reported to have resulted in considerable hardship.
- The European Central Bank (ECB) announced it would end production and issuance of its EUR 500 at the end of 2018 (although these banknotes would remain legal tender).

At the same time:

- The ECB announced that it will continue to issue EUR 200 banknotes.
- The Swiss indicated that they had no plans to demonetise their highest denomination, the CHF 1,000.

### *Stakeholder views*

On balance, submissions and consultations did not support action against any specific banknotes.



### ***Implementation considerations***

If it is deemed to be useful, this research could occur on a regular basis. The Next Generation Banknote program also provides an opportunity to gather information about the use and store of high-value banknotes. The RBA should consider how best to capture information throughout this process.

### ***Recommendation 3.7: ABN verification in electronic payments***

Verified ABNs should be included in the data attached to all electronic payments.

#### ***Description***

The data attached to all electronic payments made should include verified ABNs for business transactions. We consider this should start with the NPP.

#### ***Objective***

- Ensure businesses receiving electronic payments provide correct ABNs to the consumers they deal with.

#### ***Discussion***

##### *Problem this recommendation seeks to address*

Consumers do not currently have easy access to a real-time ABN authentication process when completing payments to business for goods or services.

Misquoting of ABNs is a method some businesses use to give the impression they are legitimate businesses to consumers while also avoiding tax obligations on income received. Using the extended transactional data attached many electronic payments to include verified ABNs will ensure payments made to these businesses are reported and taxed correctly. Additionally, it will provide consumers with certainty that they are dealing with legitimate businesses.

##### *Rationale*

Incorporating ABN verification into electronic payments will enhance the integrity of the ABN system and make it harder for businesses to use the ABN of others to indicate a false legitimacy.

#### ***Implementation considerations***

Payment system changes are generally large scale and rolled out progressively. The extended data element attached to payments serves a number of purposes which increase transparency about the nature of payments being made. Implementing ABN verification using the extended data capability will need to account for the other data elements required to deliver this enhanced transparency.

Additionally, consideration will need to be made to as to the best way to allow for the real-time verification of ABNs with transactions which will likely involve the development of an interface with the ABR. Advancements in distributed ledger technology in the future may allow for the real-time verification of ABN and other identifying information.

## SUPPLEMENTAL RECOMMENDATION

### *Non-cash wagering reform*

Clubs and casinos have highlighted that, in some Australian jurisdictions, they are required by their governing legislation to accept and pay out bets in cash. This is more a legacy of the time in which the legislation was developed which was heavily based on the Las Vegas experience. They told us that this is expensive, inconvenient and potentially unsafe for their customers.

We consider that, where possible, barriers to businesses adopting electronic payment methods should be removed, including for gambling venues. Such a move would be consistent with broader trends across the economy that has facilitated cost reductions for business and convenience for consumers. It may also reduce problem gambling and limit the scope for money laundering. It may also be necessary for high-value transactions, should the Government accept our recommendation for an economy-wide \$10,000 cash payment limit (see Recommendation 3.1).

In the case of gambling, we are aware that these arrangements are a matter for the states and territories, and that there must be a balance between reducing barriers to modern payment mechanisms and the social harms associated with problem gambling.

*‘Clubs Australia welcomes the suggestion of introducing non-cash wagering alongside traditional cash wagering. We believe that this will not only allow clubs to align themselves with and be responsive to shifts in consumer behaviour, but will also serve to improve AML/CTF efforts, venue security and increase our ability to implement and monitor problem gambling.’ Clubs Australia*



# CHAPTER 4 IDENTITY VERIFICATION

## LIST OF RECOMMENDATIONS

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# CHAPTER 4: IDENTITY VERIFICATION

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## IDENTITY IS THE NEW CURRENCY

### *Key points*

Every day Australians are required to prove their identity as they work, buy, sell, consume and invest. The digitisation of our lives has brought with it enormous benefits and will continue to do so. We have more choice than ever before and more information. Many markets are more competitive. Our economy is more efficient and dynamic. An individual's ability to prove their identity is the 'currency' which grants access to this digital revolution.

However, as the economy has increasingly digitised — encompassing among other things most retail, banking and Government services — our identity arrangements have remained stuck in the past. In many cases identity is still proved using multiple sources of physical documentation. This is not a natural fit in our online world. This entails costs and inconvenience for the public, who must repeatedly produce the required paper documents. This is holding Australia back from realising the efficiency gains and red-tape reductions available through further digitisation of the economy.

The existing processes also expose us to identity fraud. It has arguably never been easier for criminals to obtain false identity papers or 'steal' another person's digital identity. In the 2015-16 financial year there was an 80 per cent increase in identity theft over the previous year.<sup>1</sup> One in five Australians has been a victim at some point in their lives — this is more common than robbery, motor vehicle theft, household break-ins or assault. Indeed, we are seeing new crimes are being perpetrated because of the issues in our current system.

*'The single biggest obstacle faced when trying to carry out law enforcement activities is multiple identities'. Australian law enforcement official*

As we move toward a near non-cash world without strengthening our identity regimes, banks and their customers will increasingly be exposed to the costs incurred due to the lack of integrity found in existing paper-based processes — including, importantly, costs associated with a significant uplift in identity fraud and theft. The recommendations in this Chapter, which focus on both individual and business identity, should therefore be seen as supporting the integrity of the payment system changes we advocate in Chapter 3.

Business identity is also a concern. The Australian business registration system is being misused by a range of black economy operators. They are hiding behind fraudulent business credentials to evade tax and regulatory obligations, and in some cases engage in criminal activities.

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<sup>1</sup> Veda, Cybercrime and Fraud Report, 2016, p. 3.

Identity fraud and the misuse of business credentials impose a range of direct and indirect costs on the economy. In addition to the immediate victims, which in many cases include the most vulnerable in our community, social capital and trust is undermined (which comes with an economic cost), revenue bases are eroded and legitimate businesses and employees are short changed. If identity documents are undermined, businesses must spend more money and time on 'know your customer' (KYC) requirements. These broader costs are not well understood and are likely to be far greater than the immediate financial costs most commonly identified.

We recommend the introduction of a single individual identity to allow individuals to instantly and securely prove their identity using a digital identity credential, secured biometrically, when dealing with Government. This **does not** involve an identity card. It **does not** involve a government database of biometric information. If such an identity credential were adopted, a wide range of private sector businesses would start recognising it as well, allowing them to move away from their expensive, paper-based and easily compromised KYC processes. Banks and other financial institutions would particularly benefit given the size of their client bases and volume of transactions they intermediate. To the extent that credit card and lease fraud is made more difficult with a secure individual identifier, banks' exposure to these costs would be lessened. Improved identity would also help assist law enforcement agencies to mitigate significant threats including terrorism.

We also recommend a number of reforms to strengthen the integrity of the ABN system. Too many people have ABNs although they are not entitled, including tourist visa holders and apprentices, criminal groups hide behind them (when offering illegal labour hire services, for example) and too often they are misquoted.

#### **OBSERVATION: BUNNINGS ABN**

We have heard many instances of tradesmen who intentionally include the Bunnings' ABN when issuing invoices to customers for the work they complete.

This allows these tradesmen to appear legitimate to the person procuring work from them, but ultimately the inability to identify the entity that has completed the work allows them to avoid their tax obligations.

These measures, when implemented, would reduce red-tape burdens for businesses, individuals and governments.

### ***Identity fraud***

The failure of identity authentication and verification processes to keep pace as the economy has digitised has meant consumers and businesses are faced with frustrating processes which impose significant costs and burden. Perhaps more importantly, the real failure of the current identity verification processes is that they have allowed identity related fraud and identity theft to proliferate throughout the economy. We have seen examples of this across all facets of the economy including financing and motor vehicle fraud.

The reliance on physical documentation in identity verification processes has meant a black market in fraudulent documents has emerged in Australia. The prices charged for purchase of false documentation range from \$6 for a bank or utility statement, \$40 for a drivers' licence, \$250 for a birth certificate and only \$5,000 for an Australian Passport. These items, among many others that can be used to pass the 100-point identity check, including student identification and Medicare cards, can be easily and freely purchased on the 'dark-web'.<sup>2</sup> To cite a specific examples: we were told of the risks people run when they present drivers' licences at nightclubs which might be owned by criminal groups; we are aware of reports that thieves are using master keys to break into apartment letter boxes and obtain credit cards and identity information.

The existence of these markets highlights the failings of current processes. They also illustrate that our current KYC process is broken as the integrity of the system has been undermined. This has occurred because current KYC processes are fragmented across agencies and, due to their current reliance on paper based documentation, can be easily circumvented in some cases. The forthcoming introduction of the NPP which facilitates the real-time settlement of domestic payments enhances these risks within the banking and retail sectors.

They also result in risks that extend far beyond our tax avoidance and fraud. The ability to procure fake drivers licences has the ability to create clear road safety and public health issues. For example, individuals using fake licences to frequent nightclubs and gambling establishments.

The annual economic cost of identity crime in Australia is \$2.2 billion. In 2014-15 there were close to 100,000 incidents of identity fraud identified by Commonwealth agencies alone.<sup>3</sup> Identity crime is a key enabler of broader serious and organised criminal activities, which has been estimated to cost Australia at least \$36 billion annually.<sup>4</sup>

The growing incidence of identity theft, the lack of trust it fosters and the corruption of markets it leads to imposes large economic and social costs. These include:

- The direct costs borne by the immediate victims of this activity. The loss of property, the need to replace identity documentation and steps taken to rectify fraudulent transactions. These are well recognised.
- The adverse social and economic costs. Identity fraud undermines the trust and confidence of all market participants. If some identities are suspect, all identities will be subject to increased scepticism. In other words, we witness a debasement of identity where the value of all identities is undermined. This results in costly efforts to strengthen further compromised identity arrangements, imposing additional burdens on individuals and businesses that do the right thing while often having little impact on criminal behaviour.
- The corruption of markets, with poor practices gaining an unfair advantage. Those engaging in ABN fraud, whether it be sham contractors or firms employing illegal immigrants, are able to

<sup>2</sup> See chapter 12 for more on the dark web.

<sup>3</sup> Attorney-General's Department, *Identity Crime and Misuse in Australia*, 2016, p. 40.

<sup>4</sup> Australian Criminal Intelligence Commission, *Organised Crime in Australia 2017*, p. 1.



underbid legitimate employees and businesses. This results in the erosion of wages and conditions and, if the practices spread, risks creating a race to the bottom. This results in a phenomenon similar to Gresham's Law<sup>5</sup> where good businesses are driven out of the market by illegitimate operators who are able to undercut prices by not complying with tax, employment and other obligations and by defaulting on creditors. These costs are borne across the economy.

We do note that some progress is being made at the state level to address the integrity of identification materials. We encourage all states to continue follow the lead set by NSW and SA with regard to digital drivers licences. Additionally, student cards can play a similar role to drivers' licences for some identity interactions. Tertiary education institutions should seek to ensure the integrity of these is robust.

#### **OBSERVATION: DIGITAL DRIVERS' LICENCES**

Some state governments have begun to pilot digital drivers' licences.

These digital licences will be accessible via a smartphones and can be used in all ways that traditional card based licences can be. The digital licence offers additional security and increased protection against fraud and counterfeiting.

Other licences and cards, including proof-of-age, boat licence, land agents and land sales representatives, will also be trialled digitally.

While these processes are a good step forward into digital solutions, **they need to meet the requirements of the National Identity Proofing Guidelines** if they are to be effective in combatting identity fraud and theft.

There are also a range of private sector institutions that have begun to utilise biometrics and other technological advancements to improve identity verification processes.

#### **OBSERVATION: BIOMETRIC USE IN MODERN SOCIETY**

The use of biometrics to secure and verify identity is already evident in a range of everyday interactions; from unlocking smartphones using fingerprints and now face prints, voiceprint identification with the ATO, and the capture of face and fingerprint data as a part of border control procedures.

Other processes, including the use of social media interactions to identify criminal networks have also had success in combating undesired activities.

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5 Gresham's law is a monetary principle proposition that 'bad money drives out good money'. That is, if there are two forms of accepted money in circulation with a similar face value the more valuable commodity will disappear from circulation.

## ***Business identification***

Employees, customers and investors must have confidence in the identity and legitimacy of the businesses they deal with.

The critical business credential in our system is the ABN. There are over 7 million active ABN holders. Holding an ABN is essentially a licence to do business, allowing businesses to register a business name, allowing for an exemption from (no-tax file number (TFN) and no-ABN) withholding and access to commercial business discounts. When an ABN is quoted, the firm's counterparty will often assume it is a legitimate operation as real-time verification of the ABN is difficult.

When the ABN system was introduced, the goal was to ensure that ABNs could be obtained as easily and quickly as possible. This was a reasonable aspiration, but the evidence is that this has been taken too far. In the absence of proper identity checks, there are many fraudulent and inappropriate ABN holders, including those on tourist visas and apprentices, who may not be entitled to use them. There are significant numbers of ABN holders who have never lodged a tax return. The perception among some in the community is that holders view the ABN as something they own rather than something as carrying both rights and responsibilities.

The ability to easily obtain an ABN with few identity or integrity checks is an important enabler for a range of fraudulent purposes, including sham contracting and phoenixing. Estimates of the number of phoenix companies operating in Australia per year range from 2,000 to 6,000.<sup>6</sup> The costs of phoenix activity are estimated to be between \$1.8 billion and \$3.3 billion per year.<sup>7</sup> The number of contractors has also been increasing. Law enforcement agencies have told us that criminal groups obtain multiple ABNs, using different aliases, to cover their tracks. We have been told of examples where individuals have used false documentation to register multiple companies. Greater ABN integrity would make this more difficult.

Emerging developments will make it easier to verify, in real-time, ABNs. The NPP, which will allow fast person-to-person money transfers, when it is launched later this year, could over the longer-term develop functionality that allows for the real-time verification of ABNs. Distributed ledger technologies, while still at an early stage, are being developed for digital currency and supply chain management purposes. In both applications, integrity protections (including, for example, real-time verifying of business identity and authorisations) can be hard-wired into the system.

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6 Productivity Commission, *Business Set-up, Transfer and Closure: Productivity Commission Inquiry Report No. 75*, September 2015, p. 423.

7 *Ibid.*

### **OBSERVATION: BUSINESS REGISTERS**

- There are more than 2.2 million companies on the Companies Register.
- There are more than 90 million searches per year on Australian Securities and Investments Commission (ASIC) registry services.
- There are over 7 million active ABNs.
- Almost all Companies and ABNs are now registered online.
- The ABR is used by over 500 agencies, and its public data is searched over 900 million times per year, forming an integral part of many business processes.<sup>8</sup>
- A fake 'Jane Citizen' passport was used to register 50 companies.

For smaller businesses in particular, business identity is linked intimately to individual identity. There is scope to strengthen the ABN system in its own right, but ultimately it must be anchored in any individual identity system which is adopted. In the short-term, this might include the Director Identification Number, although this does not deal with straw directors or non-company business structures. Beneficial ownership information and other changes will also be needed. There is also a need to review ABNs issued to ineligible individuals, those holding multiple ABNs and the lack of real-time ABN validation.

#### *Recommended actions*

Our recommendations are designed to strengthen the integrity of both personal and business identities throughout Australia. They will also result in significant red-tape reductions, enhance public safety and deliver other efficiency improvements.

We recommend the introduction of framework that allows individuals to use a robust, credible and safe individual identity credential across all interactions with Government.

We also propose a number of changes to the ABN system, including not allowing those on tourist visas to access them.

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<sup>8</sup> Australian Government, Modernising Business Registry Services Discussion Paper, 2017.

## RECOMMENDATIONS

### *Recommendation 4.1: An identity solution for the modern economy*

To counter the rising risk of identity theft, the Government should introduce a standardised identity framework that enables businesses and individuals to prove their digital identity quickly and securely.

This will allow individuals, through the use of a biometrically secured digital credential, to use their proven digital identity in all interactions with the Commonwealth Government and the private sector.

### *What we are not recommending*

We **are not** recommending the introduction of a national identity card.

We **are not** recommending a government database of biometric or personal information.

### *Description*

The development of a common identity framework across the whole of the Commonwealth is required to allow individuals to quickly and securely prove who they are and then, through the use of a biometrically secured digital credential, use their proven identity. The use of this credential should only require individuals to prove who they are once and be reusable across all interactions with government departments and agencies. The framework should have the following features:

- **A set of credentials uniquely and securely linked to an individual:** The identity should be uniquely and securely linked to an individual using **multiple factors** such as face and finger **biometrics**, pin numbers, message tokens and other emerging techniques (including social media). This will make it harder for individuals to engage in identity fraud and better protect the identity of individuals as they transact through the economy.
- **Mandatory across government:** Use of a digital identity, through a biometrically secured digital credential, should be mandatory in all dealings with Commonwealth agencies where identity verification is required, including online, in-person and over the phone. This will remove the need for individuals to establish multiple profiles across different agencies and no longer require the repeated provision of identifying information or the maintenance of usernames, passwords and profiles to engage with the Government.
- **One identity across government:** All Government interactions and services which require identity verification must be accessible using the established identity. Maintaining separate identity verification processes for ubiquitous interactions such as lodging a tax return or making a Medicare claim will not result in wide acceptance of the platform. More importantly, it will not address identity fraud risk.
- **Open framework:** Use of the identity, through a biometrically secured digital credential, and the underlying framework should be open to other jurisdictions in Australia and the private

sector (especially banks and insurance companies), allowing the individual to prove identity beyond simply Government interactions, but more widely when engaging with businesses and other individuals. Broad acceptance of the platform and its use throughout the economy for identity verification should be encouraged and supported. We have been told by a number of private sector representatives that wider uptake of any Commonwealth credential would be rapid.

- **Expanded use:** The identity, through a biometrically secured digital credential, should allow individuals to verify other delegations and credentials, for example, authorisation to act on behalf of another, responsibility for an ABN, directorships, professional accreditations and company roles (such as Chief Executive Officer (CEO) and Chief Executive Officer (CFO)). It should also allow for easy real-time checking of banned, stolen or deceased identities, disqualified company directors and ‘high-risk’ companies and individuals — for example, cases of bankruptcy and liquidation.

Once introduced, individuals will establish a credential through the one-time verification of identity through the platform. Additionally, updating personal information, for example a change of name or address, should also update the information held by institutions, removing the need for individuals to provide updated information multiple times to multiple institutions.

Going forward, an individual will be able to begin to build their identity profile as their parents and carers interact with Government services on their behalf. For these individuals an identity will grow and be reused when they begin to work, pay tax and interact with other Government services.

The Commonwealth has already taken a number of steps in developing a digital identity solution. Specifically, the Digital Transformation Agency (DTA) has undertaken significant work in developing the underlying trusted digital identity framework that would support the operation of a digital credential.

## How you would use a digital identity

Establishing the credential:

1. An individual downloads the identity app onto their connected device.
2. The individual enters into the app, one time only, key identification details (for example: name, date of birth, passport number, etc.) and captures a 'selfie'.
3. The identifying details are checked against data held by issuing Government agencies through the Document Verification Service.<sup>9</sup> The 'selfie' is verified against the Face Verification Service.<sup>10</sup>
4. The identity is created and secured to the individual within the device using pin, fingerprint and face biometrics.

Using the credential:

Individuals use the secured credential to prove who they are in all dealings with Government seamlessly providing information through their device either through automated background processes, on command, through a scannable code, or potentially via near-field communication technology.

### Objective

- Allow individuals to use a single secure identity, through a biometrically secured digital credential, to prove their identity in all interactions throughout the economy.
- Make it difficult to steal or otherwise access another person's identity for the purposes of committing fraud or obtaining a benefit by deception.
- Enhance privacy and security and reduce the costs of compliance and red-tape inherent in current identity verification process.
- Deliver more efficient streamlined services which remove points of friction and improve the quality of data held by institutions.

### Discussion

#### *Is this just a digital rehash of the Australia Card?*

No.

Given the changes in societal values regarding identity and privacy and the capability offered by modern technology some have suggested that the time is right to re-prosecute the case, at least conceptually, for an 'Australia Card'.

<sup>9</sup> The Document Verification Service is an online system that allows organisations to compare a customer's identifying information back to a verified government record.

<sup>10</sup> The Face Verification Service is a service that can match a person's photo against an image on one of their government records, such as a passport photo, to verify their identity.

It is from our perspective that any solution that relies on a physical card or document for enduring identity verification is already outdated, inherently less secure and is less convenient. There are a number of advantages that a digital credential has over a card based identity.

- Unlike a physical card a digital credential cannot be lost or easily stolen — making it more secure.
- An enduring biometric marker that is verified upon each use ensures identity cannot be falsified or used by someone else the way point in time data stored on a card can be.
- A physical solution, such as a card, does not translate into an online environment.
- Technology advancements allow for identity verification solutions across a broad range of interactions (both private and public) without the need for a centrally administered database or unique individual identifier. This provides clear privacy and data integrity protections.

### *Problems the recommendation seeks to address*

#### **Existing identity verification has failed to keep pace**

Current identity verification processes are not sustainable, secure or efficient. Individual identity is arguably less secure than it has ever been but at the same time we have to spend more time than ever completing processes to prove who we are.

As the economy has digitised and goods and services have increasingly been delivered or supported through a range of online services — both in the private and public sectors — the process of verifying identity to assist the delivery of these services has failed to similarly digitise. Identity verification has remained largely paper based. The development of individual identity verification has been a fragmented process where new iterations and improvements have been built upon the ideas and infrastructure of what has come before.

Individuals are required to prove their identity dozens of times throughout the year, be it making an enquiry about their bank account, purchasing a mobile phone or engaging with Government services. Across the economy this translates into hundreds of millions of interactions completed by Australians each year.

*‘Authentication of identity is a whole of government issue, as is the sharing and effective utilisation of data. The attack on the Black Economy requires inter-agency collaboration on an enormous scale.’* Chartered Accountants Australia and New Zealand

Individuals have multiple identity profiles across institutions requiring the maintenance of multiple accounts, usernames and passwords. Establishing these accounts often requires the provision of the same (or similar) sets of information often either provided in person or as a certified original. Additionally, individuals can establish an identity within a single registry or system multiple times, either intentionally if the individual is trying to hide their identity, or inadvertently where identity matching processes fail to link multiple interactions to a single person. In some cases the registration of identity does not adequately verify that the person providing information is the person that owns

the information. This imposes inefficiencies on the operations of Government departments and commercial institutions. It also imposes significant burden on individuals and the broader economy. Australia Post has estimated that the inefficiencies imposed by current identity processes cost the Australian economy \$11 billion a year.<sup>11</sup>

Once established, it is often only a username and password that are required to access services (sometimes coupled with a SMS or email confirmation). This does little to ensure the individual using the service is who they say they are. It also means individuals have to remember multiple logins and passwords. Removing these inefficient processes and replacing them with a single reusable digital identity will significantly reduce compliance costs and reduce red-tape for individuals and businesses.

Community attitudes towards the use of biometrics have changed as technology has advanced; indeed we use biometrics in many daily interactions such as unlocking our phones by fingerprint, using voiceprints with the ATO and facial recognition as a part of crossing international borders. These advancements should be harnessed to strengthen identity processes.

### **Identity fraud is a key facilitator of the black economy**

The reliance on outdated physical methods of identity verification and the requirement to maintain multiple separate profiles could be justified if it had eliminated the ability of individuals to game the system and either disguise their identity or impersonate the identity of others. This has not been the case. The ability of individuals to circumvent current processes and exploit the system has created mistrust, has resulted in poor service delivery and allows those with false identities to proliferate in the black economy.

The more payments are digitised — be they salary and wages or payments to a business — the greater the transparency that is built into the system. This ultimately helps to combat the black economy. For the most part this will mean shifting cash payments into the banking system. However, this change itself will not address the problem if we do not have confidence in the integrity of bank account owners.

The existence of markets for stolen and fraudulent identity documentation shows that this risk is real. It is estimated that every 20 seconds an Australian is a victim of identity crime.<sup>12</sup> This shows that our existing KYC and related processes have been undermined. While not all identity crime is directly linked to the black economy, this is not an issue that can be addressed in a piecemeal fashion.

In discussions with various police and law enforcement agencies it was noted that a robust digital identity solution would be a ‘game changer’ in fighting organised crime. AUSTRAC has also noted that compliance with customer due diligences and KYC requirements constitute the single most expensive compliance costs incurred by reporting entities under the AML/CTF regime. The implementation of this proposal would significantly reduce these costs.

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<sup>11</sup> Australia Post, A frictionless future for identity management: White Paper, December 2016, p. 7.

<sup>12</sup> Attorney-General’s Department, Identity Crime and Misuse in Australia, 2016, p. 5.



Without a way for individuals to prove who they are and to have certainty in the identities and credentials of those who they deal with it is difficult for individuals, business or governments to have trust that individuals in the system are doing the right thing.

Identity fraud is also a significant concern in the national security, money laundering and counter-terrorism fields. It is also used to deceptively obtain a benefit by defrauding tax and welfare systems.

### *Rationale*

The OECD has noted that:

*'To combat identity theft, many are now using enhanced authentication, including biometrics such as fingerprint, iris, face and voice recognition, including at a whole of government level.'*<sup>13</sup>

The rise of the digital age and changing consumer attitudes towards privacy and online interactions provides an opportunity to streamline and improve the use of individual identity processes to remove these inefficiencies and benefit the economy, consumers and the institutions they deal with. A widely accepted single source identity verification framework that operates across the economy (encompassing private, business and government interactions) and is secured through biometric means will reduce the proliferation of false identities, correct issues of poor-quality data and reduce the significant inefficiencies inherent in many current identity verification processes.

A digital identity verification service that allows individuals to easily prove their identity and provide validated credentials to government and private institutions will reduce the costs of engagement for individuals by reducing points of repetition or friction as well as improve the data integrity of registries and data bases across both the private and public sector. This would also significantly reduce the back-office costs associated with traditional identity verification processes for business and government.

For government, there are many other benefits: enhanced service delivery, reduction in the time and cost of verifying identity, reduction in identity fraud, scalable whole-of-government infrastructure and increased trust in identity.

#### **OBSERVATION: RBA SUBMISSION TO OPEN BANKING REVIEW**

In its submission to the Open Banking review the RBA noted;

'A framework for trusted digital identity is a related initiative that has the potential to make online interactions more convenient and secure, including in the context of open banking. A trusted digital identity could help mitigate the scope for identity fraud, while providing convenient authentication, as part of an open banking regime.'

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13 OECD, Shining Light on the Shadow Economy: Opportunities and Threats, 2017, p. 35.

By developing the infrastructure supporting digital identity and rapidly scaling it for use across jurisdictions, the Australian Government can deliver a key piece of enabling public infrastructure, which will bring productivity gains to the whole Australian economy. Solving the significant problem of a fragmented and uncoordinated digital identity will reduce individual identity fraud.

### *Costs and benefits*

The recommended proposal is a significant paradigm shift in the way identity is managed. It is a long-term goal, with significant benefits to the Australian economy and should be viewed as such.

It will require a change in the operation of many Government agencies and their attitudes to verification processes and identity risk management. Government agencies have invested significant time, resources and effort into their respective identity verification processes. The solution we propose would render some of these ‘legacy’ systems redundant and may be opposed for that reason. However, government agencies and private institutions have developed digital identity databases in isolation from each other, often with different standards and identity requirements. As discussed above, this has made them inefficient and open to fraud. While a lot of effort has gone into their development, as ‘sunk costs’ they should not be seen as a reason not to develop a better solution.

#### **OBSERVATION: REPORT OF THE ICT TASKFORCE**

In August 2017, the DTA released the report of the ICT Taskforce which noted the following in regard to government agency attitude towards risk as it relates to the development of innovative ICT solutions.<sup>14</sup>

‘Industry stakeholders observed a tendency for agencies to be risk averse and conservative, making it difficult for government to adopt new and innovative solutions.

Most agencies agreed, stating that a fear of external scrutiny of decisions (such as through Senate estimates and audits) leads to a low-risk appetite and a culture where it is “not okay to fail”. This means that old and familiar ICT solutions are preferred to newer and more innovative, but perceivably riskier, solutions.

Industry and government stakeholders noted that APS personnel can have a tendency to maintain the status quo, which results in favouring the incumbent, defaulting to the same technology and solutions previously used, and repeating the same processes from previous procurements, rather than seeking out new and innovative suppliers and solutions.’

### ***Implementation considerations***

While the implementation of the service should span multiple platforms, the proliferation of smartphone ownership and the increasingly central role they play in the delivery of services make these devices ideal for facilitating a new identity paradigm.

A properly delivered identity solution should improve services by streamlining interactions for the public, improving quality of data held by institutions and hence their ability to tailor services to the

<sup>14</sup> Digital Transformation Agency, Report of the ICT Procurement Taskforce, 2017, pp. 26-27.

individual, and increasing certainty of client identity. Private/public partnerships which deliver these outcomes are starting to be implemented across the world, in particular in airport departure processes.

Institutional trust will play a significant role in the successful delivery of any identity verification system. In selecting a preferred provider, the Government will need to assure individuals that the organisation providing the service and holding the data will not expose or otherwise share their information (intentionally or otherwise) beyond what the user has agreed to or authorised. Beyond this, a provider who is not inherently tied to either the private or public sector could better facilitate broad take-up of the identity credential as a verification process.

Similarly, it is likely perceptions and concerns of privacy risks will be raised. However, a properly designed and implemented proposal in line with what is presented here will reduce risks to individual privacy by better securing and enhancing control individuals have over their information. The solution proposed here will also be able to operate without requiring that individuals provide any additional information to Government or private sector firms beyond what they currently do. It is the existing system that has failed to protect individual privacy; this proposal will correct those faults.

To put beyond doubt issues of privacy, the Government could consider implementing a set of data-protection principles similar to the General Data Protection Regulation that has been adopted in Europe which provides individuals with certain rights and imposes certain obligations on entities in relation to personal data. Any use of this data requires explicit consent from the owner.

This should be considered in light of the existing provisions within the *Privacy Act* which class biometric information as 'sensitive information', meaning it attracts greater protections than other personal information. Most notably, this includes a default rule in Australian Privacy Principle 3.3 that entities can only use sensitive information with consent, and in the case of agencies, for a purpose that is reasonably necessary for the agency's functions and activities.

#### **Delivery of the framework — single provider or open framework standard**

Once a single identity framework is established there is a need to determine the method by which the individual accesses and uses the identity through a biometrically secured digital credential supported by the framework.

One option would be for the Government to keep the framework standard closed and only allow a single provider to deliver the identity service. This has clear benefits including control over access and the potential to mitigate perceptions of security issues. However, it creates a single point of failure, potentially limits innovation and creates privacy issues.

Alternatively, allowing the underlying identity framework to be open to allow other trusted entities to develop identity services will encourage the convergence of private and public sector approaches to identity, support consumer choice and facilitate ongoing innovation in the sector.

Any providers who enter the market will need to have a high level of trust among governments, business and the community. International experiences have shown that a single provider is often

less successful than an open market solution; the latter usually results in a small number of dominant providers capturing the majority of the market.

The DTA has developed certification processes that establish the requirements a potential provider must meet if they are to be certified to deliver the identity credential. This process will ensure only legitimate identity providers are able to provide platforms to the market.

Once a provider had been certified, individuals would be able to choose the provider they want to use, and have this provider prove their identity as they move across the economy. Individuals would only need to use one provider for all interactions, but would not be limited to only one; however it is not easy to identify reasons why one individual would want to use multiple providers.

### Preferred providers

To encourage broad take up of the new platform there is a role for the government to play in assisting people to enter and engage with the platform. In delivery it needs to be very clear to people not only the benefits of the system but the steps people go through to acquire a digital identity credential. To make this process easy the Government could nominate or highlight a small number of preferred providers for initial delivery of this service.

The Australia Post 'Digital ID' product could be considered for this role because of the extent to which this work has already progressed, the wide physical presence and reach across Australia that Australia Post has, and the existing trust the Australian public has in them, including in regard to identity services. However, other viable solutions should be explored.

#### **OBSERVATION: AIRTASKER AND AUSPOST DIGITAL ID**

Airtasker, the Sydney-based online marketplace which allows users to outsource everyday tasks, has incorporated the Australia Post's Digital ID service into its platform allowing individuals using the site to securely verify their identity and the identity of those they transact with.

The intent of this is to build trust and transparency between job posters and users. Users on the platform will be able to verify other accreditations such as degree or working with children licences.

### *International experiences*

Countries like New Zealand, the UK, Canada, Sweden, Norway, and others have delivered or are working towards improved identity verification frameworks. The Australian model should learn from these experiences.

The UK's VERIFY service launched in May 2016 with similar aims to what is proposed here. To date, the service has failed to achieve wide uptake. This has been attributed to the opt-in nature of the service (both for the Government and individual) which has failed to incentivise both sides to make full use of the services. Some commentary has suggested its continued operation is a result of the Government being a 'prisoner to the sunk-costs' already incurred. There is a general view that there needs to be a complete re-think of how the UK government delivers these services.

Singapore Personal Access (or SingPass), which launched in 2003, is a gateway to hundreds of digital services offered by more than 60 government agencies, enabling users to only have to remember one password when connecting and transacting with the Government. Recently the Singapore Government announced it would enhance this service through the incorporation of biometric identification and an open identity interface which will allow the private sector to integrate the SingPass digital identity into their services.

In Norway, an identity verification system that started in the banking sector is now used across the private and public sector and has resulted in improved identity verification and delivered strong efficiency gains. The system is now used by 8 in 10 adults in Norway.

## Recommendation 4.2: ABN reforms

Strengthen the integrity of the ABN system to provide confidence in the identity and legitimacy of Australian businesses.

### Description

The Government should implement a number of immediate measures to improve the integrity of the current ABN system. These changes include:

- **Provision of TFN:** Applicants for an ABN should be required to quote their TFN if they want to apply for an ABN.
- **Remove entitlement from specific groups:** A number of groups are currently able to obtain an ABN even though they are not entitled to carry on an enterprise (as required for eligibility). To clarify entitlement, apprentices and individuals on a tourist visa should be explicitly banned from holding an ABN. Additionally, there may be scope to stop workers in certain industries from getting an ABN, which would be a useful tool in tackling sham-contracting arrangements. Currently, in some inappropriate cases, workers are too readily able to obtain an ABN. When combined with the self-assessed tax rules governing personal services income, these workers can easily alienate their income and avoid tax.
- **Periodic renewal:** Require the periodic renewal of an ABN at the same time as business name and/or Australian Company Number (ACN) annual renewal or at the longest, every three years. This renewal should be conditional on having met key tax obligations and not having been identified with a phoenix operation.
- **More timely cancellations:** Companies that have ceased to operate should be deregistered and have their ABN cancelled in a timelier manner.
- **Better data matching:** To assist the pre-filling of tax returns.

In addition, improvements currently being undertaken by the Australian Business Registrar (ABR) to identify visa holders applying for ABNs and, if needed, confirm entitlement before issuing an ABN should be expedited.

The ABR should also do more to publicise the work it has completed to date aimed at improving the integrity of the ABN, including illustrating the number of ABNs that have been cancelled.

Consideration could also be given to introducing an ABN renewal fee. Options include aligning the fee with the company renewal fee, or charging a single fee covering ABN, ACN (if relevant) and business name renewal (if relevant).

Ultimately, there should be one issuer of ABNs and one, consolidated, business registry which allows for easy, real-time ABN verification.

### **OBSERVATION: DIRECTOR IDENTITY**

The ASIC company/director database has the same individual recorded multiple times under slightly different names, or with different dates of birth, which means it is currently not possible to identify if that person is associated with multiple companies. There are similar issues with mismatches between the ASIC registry and the ABN registry. Addressing this would require director identity to link to a robust, verified individual identity.

### **Objective**

- Make it harder for businesses and individuals to deceptively use existing registration processes to imply legitimacy and regulatory compliance.
- Improve compliance of businesses operating within Australia with their regulatory obligations.
- Better align the registration and renewal system for an ABN with ACN and business names.

### **Discussion**

#### *Problem this recommendation seeks to address*

Behind every commercial entity (and straw director) is an individual or group of people. Identity fraud (including hiding behind ABNs or false director details) undermines trust, creates uncertainty, distorts economic activity and is unfair.

One of the strongest messages conveyed to us is that the current ABN system makes it too easy for those seeking to do the wrong thing to avoid their obligations yet still present as legitimate and compliant businesses.

### **OBSERVATION: ABNS AND LODGMENT**

The ATO has cancelled over 2 million ABNs over the last three years because individuals either did not lodge a tax return or activity statements at any point over the last 2 years despite being required to do so; or they lodged but recorded no business or personal services income.

The current system does not incentivise or require businesses to be compliant with their obligations and many holders view the ABN as something they are entitled to rather than something that carries both rights and responsibilities. As a key identifier of business legitimacy, the current disconnect between the perceptions of what an ABN allows and how it actually operates has created opportunities for fraudulent operators to prosper.

**OBSERVATION: APPRENTICES WITH ABNS**

One form of sham contracting is employers requiring apprentices to obtain an ABN. An apprentice cannot operate a business in their trade until they have completed their apprenticeship, for example, until they have become a licenced plumber. Apprentices should not be able to obtain ABNs and the on-line tool for obtaining an ABN automatically excludes apprentices from obtaining one — if they answer the questions honestly.

We have been advised by stakeholders of a range of ABN fraud scenarios. These include ABNs being gained fraudulently (where the applicant was not entitled as they were not carrying on an enterprise such as sham contracting or apprentices) and businesses fraudulently misquoting ABNs to facilitate under-reporting of their income.

A weakness of the current ABN system is that it operates largely as a ‘set and forget’ system. An ABN remains active until the Australian Business Registrar or ABN holder cancels it. This is in stark contrast to the operation of the ASIC company registration system which has ongoing obligations following registration including an annual renewal process, where companies must check and update company details, pass a solvency resolution and pay an annual fee. Similarly, for business names, there is a regular renewal process with confirmation of details and payment of a fee (one or three years). These processes help to ensure that the information held on the Companies Register and Business Names registers are up-to-date. For the ABN there is no periodic renewal process. The system relies on the registrar undertaking a review program under which ABNs are cancelled.

**OBSERVATION: BUSINESS REGISTRATION — STRAW DIRECTORS**

Straw directors are used to hide the true controlling mind of a company. They are used in phoenixing situations, as well as other situations where companies are being used for dishonest purposes, such as carrying on fraudulent activity. Examples of straw directors include:

- Paying unemployed people on welfare or homeless people to be directors of companies.
- Using elderly relatives, often unknowingly, as straw directors.
- Professional straw directors who are directors of many companies.

The company, and other business registers, are not currently set up to identify this sort of behaviour. Company registrations, director registrations, and other business registers like the ABN register do not sufficiently link to a personal identity, or information currently held elsewhere in government about the applicant directors that would assist in identify such behaviour. There are no automated checks built in to the registration process covering various risk indicators that would assist in identifying this behaviour, such as employment/welfare status, number of current or previous directorships or visa status.

*Rationale*

The ABN system is the backbone of business registration. Just because a person or entity has obtained an ABN does not change their tax identity. The ABN system needs strengthening, supported by a robust individual identity system. The recommended actions address the most vulnerable aspects of the current ABN system without imposing greater compliance costs on ABN holders or making it more difficult or lengthy to start an enterprise.



## ***Other options considered***

### *The Australian Business Licence (ABL)*

We considered a recommendation that the Government should seek to replace the current ABN system with a new ABL. The licence system would reflect how the ABN is being used in practice, as a ‘business licence’.

An ABL would be provisionally issued to all new business the same way the ABN currently is, but would require a basic tax competency test to be passed to gain a full ABL. Failure to complete key obligations (such as lodging a tax return or Business Activity Statement (BAS)) would result in a suspension or withdrawal of the licence (which would have meant the business became subject to ‘no-ABN withholding’). An alternate to the suspension or withdrawal system, a points system, similar to that used for drivers licences, was also considered which could have allowed for weighting of different obligations.

The option for an ABL was not supported by small business groups and was seen as potentially imposing significant additional regulatory burden on businesses. In addition, the ability to suspend or withdraw the licence was seen as a significant penalty which could impact on financing of businesses.

### *‘Fit and proper’ person test*

We also explored the concept of requiring ABN holders, or the directors, partners and other key associates of ABN holders, to be ‘fit and proper’ persons. This type of test applies to trustees of self-managed superannuation funds. While we note there was some support from stakeholders for this concept on the basis that it could assist to tackle phoenixing, we do not consider that a reform of this nature is needed at this time. Concerns about those people who have been involved in previous phoenixing exercises who operate as directors of new entities, could be tackled by strengthening ASIC’s ability to ban or disqualify people from being a director. Down the track, it may be appropriate for Government to further consider this proposal as a way to further improve ABN integrity.

## ***Implementation considerations***

The design of the proposal to remove entitlement for certain groups, such as apprentices, will need to be able to cater for situations where an ABN applicant acts in multiple capacities (for example, a carpentry apprentice who also runs a part-time lawn-mowing business may be entitled to an ABN). Under the current law an entity can only ever hold one ABN, no matter how many businesses or other enterprises. This may need to be reviewed.

The introduction of the periodic ABN renewal process would impose an additional regulatory burden on ABN holders and also require additional resourcing of the Australian Business Registrar. An annual renewal process is in place for companies and business names can be renewed annually or every three years. There is a risk that the renewal requirements may create an incentive for some

people to operate out of the system. The ATO will need to carefully monitor what is occurring and take active steps where it becomes apparent that people are moving outside of the system.

A transition period for the changes will be necessary to educate the community of the changes.

The timing of the implementation of this recommendation should have regard to the modernisation of business registers work. As renewal will be dependent on the ABN holder meeting key tax obligations, it will be important to ensure that minor cases of non-compliance or those in dispute with the ATO are not captured.

### **Recommendation 4.3: Creation of a single business register**

The Government should integrate the Companies Register, Australian Business Register (ABR) and Business Names Register into a single register maintained by a single agency.

In the interim agencies must continue their efforts to improve the integrity of the separate registers. Other business registers should be progressively integrated over time.

#### **Description**

The Companies Register, ABR and Business Names Register must work in harmony to support the real-time, robust identification and verification of businesses. The current fragmented registration process, while online, needs to be integrated and further streamlined. By integrating (or at least greatly improving their ability to talk to each other and cross-check information held in other registers) business identity will be significantly improved.

The initial focus should be on these three registers. Given their criticality to business identification and verification this action must be given high priority and expedited. Other business registers should be progressively added over time, with a prioritisation process settled through consultation with businesses.

The single register should be administered by a single agency. This approach is preferable to the current fragmentation of registers administered by multiple agencies.

*‘The current registration requirements place an unacceptable burden on businesses (particularly new businesses). Any improvements that lead to better coordination and information sharing between agencies is a positive step provided it does not place too great a compliance burden on businesses and agents who are responsible for ensuring the real-time reporting requirements are satisfied.’* The Tax Institute

The register should be underpinned by a robust modern digital identity.

#### **Objective**

- Reduce fragmentation by integrating business registers
- Real-time, robust identification and verification of businesses
- Reduce regulatory burden for businesses

#### **Discussion**

##### *Problem this recommendation seeks to address*

There are over **250 registers** across government with business related information (including registration, licensing and permits). This fragmentation contributes to higher compliance costs for

business, in registering and updating information, and mismatches between the information held in the registers.

Strategic consolidation of registers is needed within an agreed platform and an immediate focus on the critical business registers, including, the ABR, Companies Register and Business Names Register. Other registers can be added over time.

Of the hundreds of registers across government, ASIC administers 31 registers and the ABR is run by the ATO. This subset of 32 registers relate to business registration and business permits, licences and accreditations.

When setting up a new business, a person registers with at least one of the three registers — Companies Register, Business Names Register or ABR. Some businesses will have to register with all three and do not need any further registrations to operate. Others will have further registrations (such as GST registration) that they will need to complete.

We have heard in consultation that the fragmentation of business registers has created opportunity for unscrupulous businesses to either register multiple entities to avoid obligations or for those who have been involved in multiple phoenixing entities, for example, to start afresh with a new business untainted by the tarnished reputation of their earlier entities.

While the new Business Registration Service is helping to make it easier for businesses by allowing businesses to apply for multiple business and tax registrations at the same time online (including registering as a company and obtaining an ABN) Government must go much further and the registers need to be integrated. We strongly support this first step forward in streamlining the initial registration process for ACN and ABN and reducing compliance costs for new businesses. However, this is only a bridging effort for initial registration and businesses still need to engage with the ABR and ASIC to maintain their registration and meet ongoing compliance requirements. Businesses that wish to verify their counterparties are not assisted by this improvement either.

### *Rationale*

A robust, real-time business identification and verification system requires government business registers to either be integrated or talk to each other and cross validate in real-time.

Instead, we currently have separate registers that do not talk to each other in real-time. This supports neither identification nor verification, nor service delivery to businesses. It also compromises the valuable data that should be available to government and businesses to verify counterparties. The registers have been established at different times and operate on different IT platforms of different ages. This fragmentation of registers means that similar information, such as business name and address and director names, is required multiple times. This creates scope for simple inputting errors but also, for those that want to, some gaming of the system. A single business register would reduce the errors and also remove the opportunity for gaming.

The Government has recently commenced consultation<sup>15</sup> on ways to modernise business registers to make it simpler for business to get on with business. We support the intent as modernising business registers will remove barriers to new business creation. The Treasury Discussion Paper on Modernising Business Registry Services notes that, as a first step, the Government is considering options to improve the ABR and the 31 registers managed by ASIC.

Stakeholders supported the Government's announcement.

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15 The Hon Kelly O'Dwyer (Minister for Revenue and Financial Services) & Craig Laundy (Assistant Minister for Industry, Innovation and Science), Modernising business registers to make business simpler, media release, 9 August 2017.



# CHAPTER 5 HARDWIRING GOVERNMENT

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# CHAPTER 5: HARDWIRING GOVERNMENT

## THE GOVERNMENT NEEDS TO BENEFIT FROM NEW TECHNOLOGY

### *Key points*

Governments already possess a significant amount of information that can be used to combat the black economy. Governments can make much better use of the data, information and intelligence they already have access to. It is not possible to audit your way out of the black economy by traditional means. Governments must get their own houses in order and utilise existing data sources before imposing further regulations and reporting requirements on the public.

Too often, agencies are siloed and operate at cross purposes, fragmenting effort. Potentially rich data sets are underutilised, in part because of outdated secrecy laws, in part because of poor analytical capabilities or disparate networks. Indeed, the public assume data is exchanged between agencies already. Privacy and better data use are not mutually exclusive. As the Productivity Commission has pointed out, there is a cultural problem here, a mindset that data must be hidden away rather than seen as an asset.

The private sector has made large steps in this area and is probably 3-5 years ahead of the public sector. It is no exaggeration to say that we are witnessing a data revolution in business. The same thing needs to happen in government. Two reform priorities stand out. First, there needs to be far more data sharing and collaboration across agencies, mirroring what we have seen in national security since 9/11. Second, data analytics need to be brought up to 21st century standards, in line with the data revolution we are seeing outside government.

Work underway to modernise and consolidate business registers will also help. As noted in Chapter 4, there are over 250 registers run across various government agencies. The culture of data sharing within government needs to be changed so that these systems can talk to each other. Ultimately ABNs should be issued by one body only.

### **OBSERVATION: LESSONS FROM 9/11**

As a result of the 9/11 Commission recommendations, the USA set up the Information Sharing Environment (ISE) which facilitates the sharing and safeguarding of terrorism-related information. This brings together federal, state, local and private sector partners.

The Northwest Joint Analytical Center/ Washington Joint Analytical Center (NWJAC/WAJAC) which was set up as part of the ISE uses an 'all-crimes approach'. This includes collecting and analysing both criminal and non-criminal information to improve the depth, speed and coordination of analysing terrorism and other threats.



## ***Why hardwire government?***

During the course of our consultations, the message from the public and small businesses has been clear. Before imposing new regulations and reporting requirements on taxpayers, **the government should make better use of the resources, regulatory tools and information it has at its disposal.** Information, of course, is critical. In the absence of sound data and an ability to analyse it, intelligent action is literally impossible. An individual, firm or government department can have access to all the powers and resources it may desire, but will be singularly ineffective if it is deprived of data, unable to make sense of it, or unable to translate it into action. Data matching across agencies, when done well, promises to exponentially increase our capacity to pinpoint risks and vulnerabilities, but also to better tailor services. The data agenda also requires more standardisation of data, the collection and storage of data in usable ways and better data analytics.

It is no generalisation to say that the public see government as a single entity. They expect agencies to share data and insights as a matter of course. This is particularly the case for cross-cutting policy and regulatory problems. It is true that in some areas, including counter terrorism, agencies are ‘talking to each other’ more than ever before. With some exceptions, however, this has not been the case for the black economy. Whether it is phoenixing, visa or welfare abuse, sham contracting or the perennial problems of undeclared takings or wages, existing data sets, if intelligently used, can pinpoint risks and vulnerabilities.

Better use of data across government will allow red-tape burdens to be reduced, obviating the need for citizens to provide the same details to different agencies.

For any policy problem, data is of foundational importance.

*‘Successfully hardwiring government has the potential to reap significant administrative savings for citizens, businesses and government alike. It can also level the playing field for businesses who are doing the right thing.’* Chartered Accountants Australia and New Zealand

## ***The information revolution***

There is a broader point to make. As we are all aware, an information revolution has been underway in recent decades. The internet, an exponential increase in computing power and acceleration in scientific and commercial innovation are underpinning this. We are only starting to appreciate how this revolution will change our lives. There is no doubt that it promises lasting benefits, but it also presents challenges. In a world awash with information, individuals, firms and indeed governments must learn how to harness it for their ends. In this decentralised eco-system, misinformation becomes a greater threat. The starkest example of this is identity fraud, which we discussed in Chapter 4.

At the vanguard of the information revolution are a select group of firms, researchers and government agencies. They recognise the potential for data, widely defined, to identify commercial opportunities (whether in finance or understanding consumer behaviour), achieve medical

breakthroughs or fight terrorism (in the case of our intelligence agencies). In our Interim Report we highlighted the use of internet scraping technology by German authorities. During our consultations, we saw evidence of how social media resources can be used by investigators to identify links among a large number of individuals, piecing together networks that otherwise would be hard to detect.

Leading edge organisations are developing an impressive range of analytical tools including specialised algorithms to deal with big data which enables predictive modelling and undertakes a range of other functions. They recognise that data is not just about hardware. Data scientists are being appointed. Data is increasingly being seen as central to value creation rather than an add-on. Organisational cultures are being examined from this perspective.

#### **OBSERVATION: THE ATO NEAREST NEIGHBOUR MODEL**

More sophisticated use of data is transforming the way the ATO assesses work-related expenses. The Nearest Neighbour model allows the ATO to risk-assess all taxpayers that make a work-related expense claim. The model compares a taxpayer's claims with those of their peers (earning similar income, in similar jobs) to determine how far they differ from the norm. Where taxpayers claim larger than usual claims the ATO will ask further questions.

### ***Where improvement is needed***

Commonwealth agencies share data today, but in a limited way which lacks sophistication and in some cases is clumsy or cumbersome. Data is exchanged between the ATO, the DIBP, the Department of Human Services (DHS), the Australian Federal Police (AFP), AUSTRAC and others. Some data is shared with the states and territories. But this is suboptimal. In the area of law enforcement, including counter terrorism, agencies work more closely together than in other areas. We have a prototype National Criminal Database, for example, which allows investigators from participating agencies to immediately access all agencies' reports. Prescribed taskforces, including the Serious Financial Crime Taskforce (SFCT), share data. Putting these to one side, data sharing has been limited, piecemeal and episodic across agencies. The ATO has significantly upgraded its data analytics capabilities in recent years, but remains behind the private sector leaders in this field.

Why is this the case? After all, governments are spending more on information technology than ever before. Agencies, for their part, have access to far more data. The two main reasons are legislative impediments, including outdated privacy and secrecy laws, and cultural attitudes.

#### **OBSERVATION: OUTDATED SECRECY PROVISIONS**

'Legislation restricting access to data was formulated up to a century ago, and much of it is no longer fit for purpose. The primary legal impediment to more effective use of data is typically not the *Privacy Act*, but regulations and guidelines specific to the field in which the data is collected'.

- Productivity Commission Inquiry into Data Availability and Use, 2017

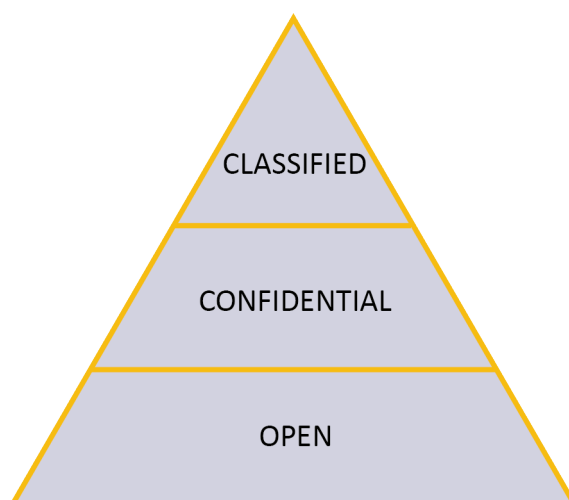
Government agencies' use of data is limited by a complex range of secrecy and other legislative restrictions. These are set out each agency's enabling legislation, the multiple laws governing the

programs and policies they administer and other provisions. As the Productivity Commission has observed,<sup>1</sup> much of this legislation is outdated, reflecting the concerns of a bygone age, and not more restrictive than the *Privacy Act*, which should be the main guarantor of this privacy. A holistic renewal is required.

We should not ignore the cultural barriers to data sharing. If legal reform took place, these would continue to frustrate efforts to better connect government. Within the public service, data has traditionally been viewed as a potential risk, a resource to be hidden away and protected, allowing only the selected few to see and study. While government data, and in particular information provided by the public, should always be used lawfully and prudently, the traditional cultural attitude, at least in some cases, goes beyond this. Agencies collect more information than ever, but there is still an instinctive reluctance to make use of it, even where the current law allows it. This mindset needs to change.

In the information age, data must be seen in a fundamentally different way. As the Productivity Commission has pointed out, it is a powerful, yet underutilised, asset. Making better use of it within government is not incompatible with fundamental privacy concerns. While we are advocating for better data sharing, and the legal and cultural change required to enable it, we are not advocating blanket access to data within government. There should be tiered levels of access across and within government agencies. For instance, all or near all data should be available for sharing to agencies for national security purposes, most data should be available for sharing to agencies for law enforcement purposes, and less data should be available for sharing for administrative purposes. Staff access to data within each agency should be tailored to suit the needs of their job. Some users may need access to classified data whereas others may not need access at all.

**FIGURE 5.1: TIERED LEVELS OF ACCESS**



Our law enforcement agencies have made important strides in the area of counter-terrorism and organised crime. Since its establishment in 2006, Project Wickenby, a cross agency taskforce, has

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1 Productivity Commission, Data availability and use: Productivity Commission Inquiry Report, No. 82, March 2017.

raised \$2.3 billion, prosecuted 76 people and convicted 46.<sup>2</sup> The over 10 million documents leaked from the law firm Mossack Fonseca in 2016 have been a treasure trove for tax authorities across the world.

#### **OBSERVATION: PANAMA PAPERS — THE MOSSACK FONSECA LEAK**

Various Australian law enforcement agencies, through the SFCT, have investigated the data in a joint and coordinated way, using modern data analytics techniques, building a profile of over 1300 Australian taxpayers identified through the Panama Papers, and identifying taxpayers and advisers linked to tax evasion, money laundering and corruption.

As part of the international response to the release of the Papers, Australian agencies have also been working with counterparts overseas to build a fuller picture of the activities of taxpayers and advisers alike.

Through its enforcement activities involving the Panama Papers the SFCT has raised over \$12 million in liabilities and there are two criminal investigations underway. In addition through direct engagement, 53 taxpayers have either made or have indicated they want to come forward and make a disclosure. These disclosures are expected to be in excess of \$40 million.

The ability to share data, apply modern analytical techniques and work jointly in a coordinated fashion across agencies and across borders underpins the successful response to the release of the Panama Papers.

### ***Our strategy***

We recommend the adoption of a black economy data strategy. In the short-term, opportunities to share data more broadly within current legislative constraints should be identified. This would take place within the Commonwealth and between the Commonwealth and the states and territories. The initial focus should be the most serious black economy abuses, including phoenixing, visa and ABN fraud, sham contracting and illegal activity. The standing Taskforce we propose in Chapter 16 will be the main vehicle for this, at least initially.

Other short-term actions should include revising the secrecy provisions applying to the ATO and other key Commonwealth agencies (to eliminate outdated restrictions), developing a central register of data holdings by agencies, and pursuit of a data sharing agenda with the states and territories (discussed in Chapter 15). In the longer-term consideration should be given including a single *Data Sharing Act* to promote this within government, but also to include necessary protections against abuse.

Distributed ledger technology, while still at an early stage, offers enormous potential for data sharing. An early example of this is the National Criminal Database. With a distributed ledger, data can be shared instantaneously among a large population of users. There is no need for a central register or database doing away with the risk, inefficiency and costs that this entails. Privacy and other protections can be ‘engineered’ into the way the ledger works. Any data strategy, therefore, must not be set in stone. In a few years, technological change may make it redundant. For that

<sup>2</sup> Project Wickenby finished on 30 June 2015 when the Serious Financial Crime Taskforce began operating.

reason, the focus should be on priority concerns, specific, purpose-directed initiatives and cultural attitudes.

Our data strategy forms part of our wider suite of recommendations. Reforms in the area of individual and business identity, moving people into the banking system and contractor reporting will, if implemented, significantly improve both the quality and range of data at the disposal of agencies.

Public support for greater data sharing within government will be greatest if the focus is on better enforcement of existing laws. Progress on this front pays an immediate revenue dividend, restores confidence in government administration and improves fairness. But data can also be used to make government more efficient, responsive and also to lower red-tape burdens. Small business, in particular, must benefit from more connected government. Our Report includes specific recommendations in this area.

#### **OBSERVATION: WORKING HOLIDAY MAKERS ACT**

The original *Working Holiday Makers Act* in late 2016 allowed the ATO to share details of registered employers with the FWO for the broader purpose of ensuring their compliance with the *Fair Work Act*. However, it is proposed to amend the Act to restrict the ATO's ability to share working holiday maker related data with the FWO to circumstances where an entity is actually non-compliant, or is reasonably suspected of non-compliance with a tax law and is for the purpose of ensuring the employer's compliance with the *Fair Work Act*.

This prevents sharing data for the purposes of identifying those who may be non-compliant, and significantly hampers the ability of the agencies to undertake efficient joint agency work.

## RECOMMENDATIONS

### **Recommendation 5.1: Development of a black economy data strategy**

The Government should implement a black economy data strategy which includes:

*In the short-term:*

1. Modernising the secrecy provisions of relevant agencies.
2. Developing a central list of which agency collects which data.
3. Commonwealth and state and territory governments working together to identify specific areas where policy harmonisation or simplification would lead to an alignment of data definitions.

*In the medium-term:*

4. Improving data and information sharing between states and territories and the Commonwealth.

*In the long-term:*

5. Introducing a whole-of-government *Data Sharing Act*.
6. Consider migrating government records onto blockchain technology as the technology matures.

### **Description**

#### **Short-term**

##### *1. Modernise secrecy provisions*

The secrecy provisions of key agencies that deal with the black economy should be modernised to allow more data and information sharing within Government.<sup>3</sup> These agencies could include ATO, DHS (including Centrelink, Medicare and Child Support agencies), DIBP, ASIC, AUSTRAC<sup>4</sup>, ACCC, and ACIC.

The secrecy provisions of the legislation governing the FWO provide a good model to follow. The FWO has broad information sharing powers which allows it to share data and information liberally with other agencies if the FWO reasonably believes that it is likely to assist in the administration or enforcement of law.

Reform of the secrecy provisions would allow increased data sharing with state and territory government agencies, such as state revenue offices and workers' compensation authorities.

<sup>3</sup> Data refers to raw, unorganised material such as characters, text, words or numbers. Information refers to the meaning derived from data after it has been processed and presented in some context (Productivity Commission, *Data Availability and Use*, Issues Paper, April 2016). Unless otherwise specified the Report will use data for shorthand where both data and information are referred to.

<sup>4</sup> We support the implementation of the 'AML/CTF statutory review implementation' recommendation relating to the simplified model for sharing information collected under the AML/CTF Act.

More data and information sharing is essential for joint agency work, and more joint agency work is required, as discussed in Chapter 8 on enforcement.

*'Tackling the black economy does not necessarily require new laws or more red-tape, rather it requires better detection and enforcement of breaches of existing laws in both existing and emerging areas of Australia's economy. Better sharing of existing data between government entities and greater integration of existing government processes are essential in driving the incentives and deterrents for behavioural change.'*

Chartered Accountants Australia and New Zealand

## 2. Central list

A central list should be established showing what type of data is held by different government agencies. The intention would be to improve the discoverability of data within government. Most government agencies have limited knowledge of what data is collected by other agencies. The list would help close that knowledge gap.

There should be tiered levels of access within government to maintain appropriate security restrictions. Only the national security and more serious criminal law enforcement agencies such as ASIO, ACIC, AFP should have complete access. Law enforcement agencies and regulators such as ATO, ASIC, ACCC, DHS, AUSTRAC, DIBP and FWO should have the next level of access, to the majority of information. Agencies needing information for purposes of administration rather than law enforcement may only need a lesser degree of access.

This is not a centralised database. The list would not include the personal data of citizens, but indicate which agencies hold it.

## 3. Cooperation between Commonwealth and state and territory governments

Commonwealth and state and territory governments should work together to identify specific areas where policy harmonisation or simplification would lead to an alignment of data definitions. This is discussed later in the Report.

## Medium-term

### 4. State secrecy provisions

While some data is already shared between states and territories and the Commonwealth, there is scope to expand this further. This could include further sharing of state and territory payroll tax data, licencing and workers' compensation data, and sharing of new third-party data being obtained by the ATO (for example from TPRS and Government agencies).

For example, we recommend that information relevant to identifying unexplained wealth is shared further. Currently, the ATO collects a range of state data which allows it to identify taxpayers who may be accumulating assets but not including sufficient income in their income tax returns to show the financial means to pay for them. In order to build a comprehensive view of a taxpayer's wealth, the ATO data matches motor vehicle registry data, land title registry data, and information relating to insurance policies for high-wealth lifestyle assets including enthusiast motor vehicles. Such

indicators of unexplained wealth should be shared more broadly as they would be useful for other agencies that address black economy behaviours, such as state and territory revenue agencies. Such information would allow those agencies to construct a more holistic picture of an entity's wealth and also assist in ensuring effective and efficient joint action. There may also be data that other agencies or entities hold, either Commonwealth or state and territory, which would be useful in identifying unexplained wealth.

## Long-term

### 5. Data Sharing Act

We recommend the creation of a *Data Sharing Act (the Act)*. This would create a positive obligation on officials to share data, subject to protections, where this might help in administering or enforcing the law. It would replace the current arrangements, which include a patchwork of specific data sharing agreements, outdated secrecy provisions and a strong cultural bias against using data more intelligently. We recommend that the following features are factored into the design of the Act:

- **When can data be shared:** The Act should empower the agency that holds the data to share data if it believes that the data or information is likely to assist the receiving agency to administer or enforce Commonwealth, state or territory laws. The Act should, where reasonable, override existing secrecy provisions that prevent agencies from gaining access to other agencies' data or providing their data to other agencies.

Data should not be provided to an agency if the data is unlikely to assist it to administer or enforce a law. For example, this principle in the Act should disallow the disclosure of an individual's sensitive personal health records to an agency that administers business grants.

- **What should this Act apply to:** The Act should apply to both data and information. The Act should also apply to connected datasets which may consist of datasets from multiple agencies.
- **Who should be able to receive this data:** Agencies should be allowed to share data and information with other government agencies. Further consideration could be given to sharing de-identified data more broadly, as per the Productivity Commission's proposed '*Data Sharing and Release Act*' (see below).

Privacy would need to be maintained. We are not recommending that there be wholesale sharing of information for the sake of it. As noted above, sharing would only be within government, to assist in administering and enforcing laws. The Act would not alter the application of the current secrecy or privacy provisions as far as they relate to releasing information outside of government. Those stringent protections of privacy would be maintained.

### 6. Distributed Ledger

As distributed ledger technology matures the Governments should be alert to the potential it offers for record storage and data sharing. The Chief Government Scientist of the UK describes distributed



ledgers as a ‘database that can securely record financial, physical or electronic assets for sharing across a network through entirely transparent updates of information’.<sup>5</sup>

In contrast to centralised registry functions, distributed ledgers are very efficient because there is no need for a central authority to authorise changes to a record. The ledger could be programmed so that everyone can make changes to the ledger as long as they stick to a mutually agreed set of algorithmic protocols. Alternatively, the ledger could also be programmed so that only one person can make changes to records. Regardless of who makes changes to records on a ledger, all updates to records can then be broadcast to the other entities on the ledger in real-time.

The ability for distributed ledgers to maintain a consensus of replicated, shared, and synchronized digital data geographically spread across multiple sites allows for a single unique record of a state of affairs relating to an entity.

These features of distributed ledgers make it an ideal candidate to host a single record of an entity’s records across federal, state and local government agencies. The entity could choose to share their details with trusted government agencies so that they do not have to provide the same information repeatedly. This reduces the current inefficiencies associated with the cost of maintaining multiple databases across various agencies.

Distributed ledger technology also offers the entity enhanced control and privacy over their data. The ledger could be programmed so that the entity can choose to share certain aspects of its records with trusted entities. For instance, the individual may authorise only the health-related state and federal agencies to view its health records.

Data 61 argues that blockchain technology, which is a subset of distributed ledger technology, can be used as a common reference point to bring together different levels of government (local, state and federal) to host government registries of open data.<sup>6</sup>

The Government’s data sharing strategy should therefore remain flexible such that where and when possible, the Government can adopt such technology.

## Objective

- Make better use of existing data across Government without imposing additional reporting requirements on the public.
- Allow better information sharing to identify and address black economy risks.

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5 UK Government, Distributed ledger technology: beyond block chain, accessed 5 October 2017, <https://www.gov.uk/government/news/distributed-ledger-technology-beyond-block-chain>.

6 Data61, Blockchain: What does the future hold for blockchain in Australia?, accessed 5 October 2017, <http://www.data61.csiro.au/en/Our-Work/Safety-and-security/Secure-Systems-and-Platforms/Blockchain>.

## Discussion

### *Problem this recommendation seeks to address*

Government collects a lot of data, but current secrecy laws are complex and strongly restrict sharing of data for the purpose of government administration and law enforcement. This is inefficient, reduces the information available to comprehensively address the black economy, and is contrary to the community's expectations about efficient data and information sharing.

### *Rationale*

A broad legislative framework governing data sharing has the potential to remove needless barriers to improved government service delivery, lower regulatory burdens, better enforcement by regulatory and law enforcement agencies and better data analytics. A *Data Sharing Act* is the preferred long-term solution. It covers the operation of all government agencies and enables the flexibility to share data for the purpose of better administration and law enforcement. It also aligns with the community's expectation that government use data efficiently to ensure the community does not have to have unnecessary multiple interactions with government, receives better services and is better protected by enforcement action.

While some costs may be involved, we are of the view that the benefits from the improved service delivery and law enforcement are likely to outweigh these.

The Act should include a number of protections against the misuse of data, violation of privacy rights and the risk of inappropriate access. At present, these protections are scattered across multiple laws and regulations, with overlaps and duplication. Many of these laws are outmoded.

Given the development of a *Data Sharing Act* may take considerable time, action also needs to be taken in the short-term by modernising the secrecy provisions of select agencies which are likely to have large amounts of relevant black economy data.

## *Other options considered*

### *Productivity Commission's 'Data Sharing and Release Act'*

This proposal focuses primarily on providing researchers, private sector and government departments with access to data for the purpose of evidence based policy and service design. It would support the provision of de-identified data for this purpose. Our proposed Act, in contrast, would promote data sharing within government. It would allow for identified data to be shared, subject to the protections against abuse it would build in.

## *Implementation considerations*

### *Legislative change*

Our proposed Act will require further consultation to inform the more detailed aspects of the law, including how long data should be collected and retained for and the formulation of offence provisions that punish secrecy breaches.

### *Operational impacts*

Data sharing and the systems that support it will entail costs, including the establishment of secure bulk data transmission channels, increased storage capacity, changes to IT infrastructure and recruiting skilled personnel. Additional expenses may have to be incurred, but these could be offset, in part, by savings in other areas.

Agencies that provide data to other agencies may not trust the accuracy of data they receive from another agency. Some administrative agencies may not have the legislative ability to act directly on the basis of on-disclosed data either. These are valid concerns that need further consideration.<sup>7</sup>

These costs will fall disproportionately on the agencies that collect large volumes of data and are required to share it for the benefit of other agencies. Government may consider some sort of compensation mechanism for agencies that share large volumes of data.

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7 For example, if agency A passed data onto agency B, and agency B then on-disclosed that data to agency C, C may not have the legislative ability to make an administrative decision that negatively affects a citizen. C may not want to take the risk of acting on potentially inaccurate data they had no control over. B may not vouch for the accuracy of A's data either.

## ***Recommendation 5.2: Improving government data analytics***

Improve the data analytics capability of the regulatory and law enforcement agencies.

### ***Description***

The Government should continue to prioritise improvements to the data analytics capability of the regulatory and law enforcement agencies that deal with black economy activity, especially the ATO.

The data analytics functions of regulatory and law enforcement agencies responsible for policing black economy activities are at various levels of maturity.

Government should ensure that these agencies are adequately funded so that they can procure and leverage cutting-edge data analytics technology, develop smart algorithms and train or acquire staff with the right data literacy skills.

### ***Objective***

- Ensure that data the Commonwealth can access is used to its full extent to identify risks, trends and vulnerabilities.
- Allow effective and efficient targeting of auditing and law enforcement resources. It is not possible to ‘audit our way out of the problem’. Discrete public sector databases need to be combined with smart algorithms to ensure that auditing and law enforcement resources are used efficiently.

### ***Discussion***

#### ***Problems this recommendation seeks to address***

The public sector, including the ATO and other regulatory agencies, have not sufficiently developed and adopted leading edge data analytics techniques used in commercial or research settings.

Insufficient IT infrastructure investment, capability and access and use of data sources have meant that agencies may have a lot of data, but are unable to harness its full potential.

### **OBSERVATION: HORTICULTURAL EXPORTS**

We have been told there are increasing numbers of offshore buyers on tourist visas going directly to farms and buying whole crops for cash, then exporting it themselves. Such buyers are even buying crops on the vine or tree, which means they then arrange all the harvesting and transport themselves as well. When they do so, they usually use illegal labour hire operatives who underpay illegally working pickers. Concerns were also raised about whether in these circumstances there would be sufficiently sanitary treatment of the crop from harvest through transport, because if not that would damage the current good international reputation for Australian farm produce. Australia exports in excess of \$1.1 billion in fresh horticultural products.

There is scope to use data analytics to discover such freight by matching data between freight consignments and industry levies.

Existing IT infrastructure can often restrict new ways of sourcing, storing and analysing data. Some traditional IT systems which were not designed with the existing data revolution in mind actively prevent the integration of siloed information and matching unstructured data forms. Updating these legacy IT systems will take time and resources.

Some agencies may also not have sufficient staff with appropriate data analytics expertise. A well-developed data analytics team requires data analysts, data scientists, data infrastructure engineers and data architects.

In addition, incompatibilities between systems, technological constraints and secrecy provisions (addressed in Recommendation 5.1) prevent the smart use of data across government.

### *Rationale*

Sustaining high levels of investment in data analytics capability will help government agencies improve their service delivery and enforcement activity despite reductions in staffing levels.

Whilst individual agencies already use data analytics to inform their service delivery and black economy enforcement strategy at a macro level, more can be done to inform service delivery and enforcement strategies at a micro level.

Empowering agencies with the ability to fuse separate datasets of entity's interactions across various government agencies will go a long way in informing strategy at the micro level. Once these datasets have been fused, agencies can use computational methods to discover data patterns, map relationships between entities and even prevent or predict non-compliance with obligations. Government agencies should be encouraged to use advanced private sector applications where appropriate.

### **OBSERVATION: SMART ALGORITHMS**

The ATO has developed an algorithm to determine how much fish is stored on the basis of power bills related to freezing a certain tonnage of fish. Such data can then be used to determine likely business turnover and evaluate compliance.

### ***Implementation considerations***

In addition to the upfront investment required to deliver improvements in data analytics capability across government agencies, improvements in intra-government data analytics capability will require consideration of the *Australian Privacy Principles*.

Consideration should also be given to the relative costs and benefits of agencies developing these tools in-house compared to using or adapting solutions developed internationally or in the private sector.

## SUPPLEMENTAL RECOMMENDATIONS

### *Internet scraping*

Internet scraping should be explored as a tool to identify black economy activities on the internet and social media platforms. Scraping could be used to better monitor transactions and identify individuals that are offering products or services to the public on a repeated basis, for example a person that has been selling many items on eBay or Gumtree over an extended period (including the sale of contraband such as drugs) and may therefore be conducting a business which generates taxable income rather than hobby. We also have heard examples of international students selling particular items, like infant formula and vitamins, back in their home countries through online marketplaces. This information could be matched with tax returns and income reported to DHS to check whether income has been reported to authorities. Web scraping is used by a number of countries on a systematic basis already, including by German and Dutch tax authorities.

The provision of API access to allow regulators to use data held by social media providers to identify black economy activities would also be desirable.

### *Further opportunities from third-party data such as escrow*

The Government should also keep a continual look out for other opportunities to access and make use of data held by third-parties. As technology changes and new systems are adopted by businesses and consumers, tax and other regulatory authorities may be able to tap into them, where appropriate, to ensure that information is reported where the transactions are considered high-risk for the black economy. Escrow services (which are third-parties that hold money on behalf of transacting parties and used by some e-commerce business such as carsales.com.au) are becoming more accessible for ordinary but large and high-risk transactions and could increase as more and more transactions go digital. There may be opportunities to access such transactions data which can then be used to match data on GST payments, or even use such services to pay and remit tax, for example for car sales.



# CHAPTER 6

## A REPORTING ARCHITECTURE FOR THE NEW ECONOMY

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# CHAPTER 6: A REPORTING ARCHITECTURE FOR THE NEW ECONOMY

## OUR REPORTING SYSTEMS NEED TO BE BETTER

### Key Points

The bed-rock of any tax system must be reporting arrangements which capture, efficiently and seamlessly, all taxable economic activities. Reporting should not stifle activity and entrepreneurship; just relate the payments that have been made. The STP initiative, which will take effect in 2018, will streamline and improve the transparency of PAYG reporting.

In the new economy, labour, goods and services are being delivered in new ways often outside the PAYG reporting net. The sharing economy is one such area. Innovation in business models should be supported, but regulation needs to adapt. Home-based services (such as nannies and dog walking services) and independent contractors are other examples of this.

This transparency gap allows the black economy to proliferate, creating an uneven playing field for those (including traditional employees) who are subject to current reporting requirements.

A modern, comprehensive and low compliance reporting architecture is a better approach than options like withholding, which introduce greater compliance burdens and substantially affect cash-flows. Withholding should not be ruled out as a last resort for particularly problematic sectors.

### OBSERVATION: BUILDING A HOT-HOUSE

Master Builders Australia informed us that the building and construction industry:

- Is the second largest in the country, after the financial sector, with revenues of over \$300 billion in 2016-17.
- Accounts for approximately 9.4 per cent of total economic growth (Gross Value Added) on average per year since 1996.
- Employs more than 1.1 million people.
- Includes more business entities than any other industry (approximately 360,000 as at June 2016).

They also told us, 'The size and nature of the building and construction industry, as well as the nature of how construction projects are delivered, creates an inherent expansion of circumstances in which opportunities to display avoidance are present. This is a risk to the sector, the economy, and Master Builders' members. It is a circumstance where those who do the right thing are undermined and disadvantaged.'

### **OBSERVATION: BUILDING A HOT-HOUSE (CONTINUED)**

The Construction, Forestry, Mining and Energy Union (CFMEU) told us that black economy behaviours like the below have long been a part of the building and construction industry, noting that ‘On one view, the construction industry is less a microcosm of, and more a hot-house for, the ‘black economy’:

- Cash-in-hand payments
- Non or under-reporting of income
- Poor or false records
- Phoenixing
- Sham contracting
- Underpayment and exploitation of workers
- ABN fraud and abuse
- Using interposed entities to avoid tax

CFMEU also noted that ‘One of the few measures that appears to have had some impact on cash-in-hand payments and other black economy practices in the construction industry is the introduction of the taxable payments reporting system...’.

### ***The economy is changing...***

The face of the Australian economy has fundamentally changed in recent decades. We have seen a shift away from traditional employment towards contracting, self-employment and use of labour hire firms. We have become a more services-based economy, parts of which are dominated by contractors. And in recent years, the so-called sharing economy has risen to prominence and alongside a rise in freelancing. These changes are set to continue. Independent contracting and the sharing economy are attractive to many. They offer flexibility, independence and the prospect of rewards which traditional employment may lack. Contracting is spreading to new parts of the economy, including a range of personal and domestic services.<sup>1</sup> Sharing economy platforms have established a foothold. As governments remove or scale back regulatory barriers which limit them, they will continue to grow. Technology, including the rise of labour market matching sites, is giving these changes greater impetus.

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1 There are roughly one million independent contractors in Australia: Australian Bureau of Statistics, 6333.0 — Characteristics of Employment, Australia, August 2016.

**OBSERVATION: SHARING ECONOMY PARTICIPANTS**

People participate in the sharing economy for a range of reasons. For some, the sharing economy can be a pathway to transition from unemployment and underemployment into the full-time workforce. For others, it is a stepping stone from receiving welfare payments to regaining financial independence.

Splend provides people with a rental car so they can earn a flexible income with sharing economy platforms such as Uber. Additionally, Splend provides members with ongoing coaching, training and mentoring to ensure they become a successful small business owner.

Splend's platform has been supporting people involved in the Government's New Enterprise Incentive Scheme (NEIS) and Job Active Pathways. The flexible working hours of the sharing economy are attractive to a wide range of individuals, including the increasing number of over 40-year-old job seekers who are finding it hard to re-enter the workforce.

**... but our tax reporting arrangements are not**

Our tax reporting systems are based on the old economy. The PAYG reporting and withholding regime was designed for traditional wage labour and bricks and mortar businesses. While it continues to capture a large proportion of the workforce, its coverage has been falling. In the contracting economy, by contrast, services are delivered outside this reporting net.

This transparency gap is not desirable for a number of reasons. It denies the tax authorities basic information which they can use when checking tax returns. Their ability to focus their audit and compliance efforts is limited. When transparency is lacking, some taxpayers will be tempted not to declare or fully disclose their earnings. Indeed, in a self-assessment tax system like ours, the absence of a comprehensive reporting framework poses serious risks.

*'Third-party reporting has proven to be an effective measure of ensuring taxpayer compliance with their taxpayer obligations.'* The Tax Institute

Sham contracting, which we discuss in Chapter 10, becomes more attractive in these circumstances. When employers fail to report wage and salary payments, they are in clear breach of their obligations. At present, few such obligations apply to payments to contractors.

Tax reporting arrangements can obviate the need for more stringent responses to tax evasion, including tax withholding. Tax withholding is a reliable way to improve compliance, but imposes compliance costs and adversely affects the payee's cash flows. If applied across the tax paying population, regardless of compliance risk, withholding would be seen by many as excessive.

Any tax reporting arrangements must be easy and inexpensive for businesses to comply with. The information asked for must be clear and limited to key data. Where possible, systems should be automated and able to be integrated into business software products.

## What should a new reporting system look like?

Australia already has a contractor payment reporting system in place (the TPRS), but it only covers a small number of high-risk sectors. It initially applied only to the building and construction industry, where it has had promising results. In the 2017-18 Budget, the Government announced it would be extended to contractors in the couriers and cleaning industries. Other reporting schemes include third-party reporting for major government entities and reporting of business transactions through payment systems.

We think the TPRS should be extended to other high-risk sectors of the economy. Security providers, road freight transport, and IT contractors should be covered, as well as owner-builders and home improvements. Reporting exemptions provided to some public sector agencies should also be removed.

### OBSERVATION: SUCCESS OF TPRS IN THE CONSTRUCTION INDUSTRY

When TPRS was introduced in the building and construction industry it raised an additional **\$2.3 billion** in tax liabilities in its first year alone (the 2012-13 year).<sup>2</sup>

- \$265 million from outstanding returns being lodged — 249,000 contractors were found to have outstanding returns
- \$506 million GST — a 6.1 per cent increase in net GST from the industry in a single year
- \$1,128 million PAYGW — demonstrates significant under-reporting of wages and concomitant underpayment of personal income tax
- \$357 million pay as you go (PAYG) instalments — an additional 50,306 taxpayers were identified as payees

This will not be the total increase as at the time the ATO report these results there were 76,000 contractors who had not lodged returns for that year, 53,000 who had lodged but TPRS reports indicated they had underreported, and 84,000 contractors without an active GST registration that TPRS reports indicated had received payments likely subject to GST.

The ATO notes that while increases cannot be attributed solely to the impact of the TPRS, it is likely that the majority of the increase flows from the introduction of the system, the communication and education program together with acceptance of the system by reporting businesses.

As at the time of writing, the ATO was analysing the data in preparation for publishing figures for the 2013-2014 and 2014-2015 years. The additional liabilities for future years are expected to reduce because the first year of operation has an element of 'catching-up' with past years, not least from bringing some people into the system.

The success of TPRS could be magnified by using the data it generates to identify those contractors who receive all or vast majority of income from a single source, which is an indicator of sham contracting.

<sup>2</sup> Australian Taxation Office, Taxable payments reporting — Effectiveness measurement, May 2015.

In our consultations we have been told that TPRS reporting, although only required annually, can be time consuming. Many businesses lodge paper-based forms. The modernisation of the TPRS should emulate the STP initiative, which while still in its early stages, promises benefits for taxpayers (simpler compliance) and the ATO (real-time and more accurate information).

We also recommend the adoption of a reporting regime for sharing or gig economy platforms. This could be linked to the TPRS or undertaken on a stand-alone basis or possibly aligned with STP.

Any changes to reporting arrangements, including the introduction of new ones, should avoid imposing overlapping burdens on taxpayers. If a firm is already reporting under the TPRS, it should not have to duplicate this under a sharing economy or other reporting initiative. Consideration will need to be given to how duplication can be avoided.

We are not recommending the introduction of tax withholding for contractors. However, Governments should not rule out withholding in cases of serious and persistent non-compliance.

*We also note that overseas experience indicates that withholding systems are more effective than reporting regimes in improving compliance in cash industries.’ BDO*

#### **OBSERVATION: POTENTIAL HIGH-RISK INDUSTRIES**

Stakeholders told us that non-compliance is a significant problem in other industries including traffic management, nail salons, scaffolding, removalists, car repair, milk bars and car washes. We encourage the ATO to review these industries and if they are found to be high-risk, advise government of options to tackle the problem, including potentially extending reporting to these industries.

## RECOMMENDATIONS

### ***Recommendation 6.1: Expansion of reporting systems***

To reduce the transparency gap in our reporting arrangements, the Government should:

- Progressively expand the TPRS to further high-risk industries and sectors.
- Extend the third-party reporting regime applying to some government entities to all government entities.
- Allow for the removal of TPRS reporting obligations from industries which have increased their compliance and are meeting benchmarks.

### ***Description***

#### *Expanding TPRS*

The Government should apply the TPRS to improve third-party reporting information available to the ATO to further high-risk industries. The TPRS already applies in the building and construction industry and in the 2017-18 Budget the Government expanded it to the cleaning and courier industries, as recommended in our Interim Report.

Information provided by the ATO, together with our consultations, indicates that the following industries and activities are at higher-risk of not reporting or under-reporting income:

- Security services.
- Information technology (computer system design and related services).
- Road freight transport.
- Owner-builders.
- Home improvements.

At the same time the ATO should look to modernise the TPRS system to streamline and automate reporting in order to simplify compliance for taxpayers and provide the ATO with more accessible and accurate information.

#### **OBSERVATION: TPRS — SOFTWARE PRODUCERS**

4 out of 5 of the largest software producers in the SME sector already have TPRS functionality in their systems because of the construction industry.

### *Security services, IT and road freight transport industries*

We heard from stakeholders that a number of industries posed a significant compliance risk. We sought advice from the ATO of the highest risk industries based on ATO data and analysis. The ATO advised that in the security services, information technology and road freight transport industries, non-lodgment and/or under-reporting of income by contractors is high. On the basis of this advice we recommend the expansion of TPRS to those industries.

#### **OBSERVATION: COMPLIANCE RISK IN THE IT INDUSTRY**

ATO analysis of contractor data for the IT (computer system design and related services) industry for the last three financial years has found that non-lodgment by contractors in the IT industry has increased to about 30 per cent. In addition, incomes reported by contractors to the ATO are significantly lower than average wages reported by industry market researchers. From this significant unlawful income splitting is evident. It also suggests that contractors in the IT industry are making errors in classifying their income and in their business deductions. Expansion of TPRS to the IT industry will improve the visibility of payments and enable the ATO to provide support to contractors to ensure income is reported accurately.

### *Owner-builders*

The TPRS is already in place in the building and construction industry, but it applies to business-to-business transactions only. Owner-builders, who are not in the business of building and construction, are not covered. Government should consider including owner-builders in the TPRS to address this exploitation.<sup>3</sup> The lack of reporting by owner-builders creates an opportunity in the residential construction and renovation sector for non or under-reporting being exploited by black economy operators. There are also insurance benefits flowing from this reporting as the owner-builders reporting can also be supplied to insurance companies by the owner-builder.

### *Home improvements industry*

Some stakeholders suggested that reporting obligations should also apply to payments made by homeowners for home improvements to ensure there is a more level playing field with TPRS applying in the building and construction industry. Any extension of the TPRS to this sector will not apply to payments from the householder to home renovation firms. It will only cover payments from the latter to their sub-contractors, consistent with the TPRS's business-to-business focus. In this case, the renovation firm would have to report through the TPRS applying in the building and construction industry. We recommend that the Government consider applying TPRS to sub-contractor payments in the home improvement sector.

### *Extend third-party reporting to all government entities*

The Government has a leadership role to play in procurement. All Government contractor payments should be reported. Accordingly, we recommend the removal of the current exemption applying to

<sup>3</sup> Australian National Audit Office, Prescribed Payments System, Australian Taxation Office Audit Report No. 14, 1998, p. 22. Owner-builders were covered under the Prescribed Payments System (PPS) which operated before 2000, for contracts in excess of \$10,000.



‘non-core’ public entities, including public schools, public art galleries and hospitals. The reporting requirement commenced on 1 July 2017 with reporting due in mid-2018. The extension to all government entities should apply from 1 July 2019, with reporting due in mid-2020.

#### **OBSERVATION: CLEANING CONTRACTS AND GOVERNMENT-RELATED ENTITIES**

United Voice told us that government-related entities award significant cleaning contracts and underpayment of the cleaners is a common problem.<sup>4</sup> Independent initiatives such as the Cleaning Accountability Framework (CAF) aim to improve this industry (see also Chapter 9).

#### *Remove TPRS where compliance has increased*

We recommend that TPRS reporting obligations be removed from sectors which improve their compliance rates to an acceptable benchmark. This would provide a strong incentive for industry associations to encourage improved tax behaviour among their members. Conditional removal of the TPRS in these circumstances is an example of a smarter, risk-based approach to regulation that we should see across all parts of government. Of course, if an industry’s compliance rates fall below the set threshold, the TPRS would be reimposed.

#### **Objective**

- Improve the ATO’s visibility of the income of contractors in high-risk industries through progressively expanding the TPRS system to those industries.
- Create greater parity in reporting of payments to employees and contractors.

#### **Discussion**

##### *Problem this recommendation seeks to address*

There are obvious gaps in our tax reporting system. As it primarily captures payments to employees, there is little visibility of the significant proportion of payments that are not made to employees. This means tax authorities lack key data required to verify the accuracy of tax returns. They are also limited in their ability to focus their audit and compliance efforts. Lastly, if taxpayers know that tax authorities do not have visibility, they may be tempted not to declare or fully disclose their income. In a self-assessment tax system this poses serious risks.

##### *Rationale*

As we noted in our Interim Report, transparency is an underutilised, yet potentially powerful tool for combatting the black economy. Transparency, when applied to businesses (and individuals), provides a strong motivation to do the right thing.

The TPRS provides visibility to the ATO of payments to businesses. This reporting is akin to the reporting by employers of payments to employees. The information is used by the ATO to: check

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<sup>4</sup> United Voice, Submission to the Black Economy Taskforce, July 2017.

that payees have lodged the required tax returns; included payments as income in their returns; and paid GST on these payments.

Extending the TPRS to further high-risk industry expands this visibility further. With an additional \$2.3 billion in tax receipts raised in its first year TPRS applied in the building and construction industry, it is an effective method for improving compliance in a high-risk sector. The suite of short-term and medium-term recommendations seeks to balance increased transparency to the ATO of payments to contractors, and consequent increased level playing field for business, with the additional compliance burden imposed by from the expansion of TPRS on businesses.

On third-party reporting for government agencies, the exemption in place for some government entities seeks to reduce the compliance burden for entities on the basis that payments were to recipients with low compliance risks and that payments they made were low-value and low-volume. We have, however, heard through submissions that government-related entities, such as government schools, are major recipients of contracted cleaning services. Reporting will help ensure integrity of government procurement, working in concert with the recommendation that only businesses with a good tax record are able to contract with government. Further, government should take a lead in best practice and be subject to the same reporting obligations many businesses are.

## ***Other options considered***

### *Full expansion of TPRS across the economy*

We examined whether the TPRS should be expanded to all industries at the same time or expand it progressively to more high-risk industries. We note that the Inspector-General of Taxation's Review of ATO's Employer Obligations<sup>5</sup> compliance activities recommended the government consider expanding the TPRS to all contractors in all industries.

An immediate expansion would ensure that all payments to contractors across the economy are captured as soon as possible, increasing voluntary compliance and enhancing the data available to the ATO for audits and investigations. It would also impose the same requirements on all businesses, regardless of whether they operate in a high or low-risk industry. Further, the benefits of increased transparency in providing a more level playing field for honest business would apply across the economy.

While these are significant benefits and many stakeholders support the expansion to all industries in principle, we do not recommend that this step be taken for the following reasons.

The TPRS imposes a compliance cost on businesses. Applying the TPRS to all industries would significantly raise the number of businesses required to report, increasing the compliance burden across businesses. While reporting only has to be done annually, at the moment many business

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5 Australian Government, Inspector-General of Taxation, Review into the ATO's employer obligations compliance activities: List of Recommendations, accessed 5 October 2017, <http://igt.gov.au/publications/reports-of-reviews/atos-approach-to-employer-obligations-compliance-activities/>.

systems are not able to easily produce the reporting as required. For small businesses this can involve considerable time and resources, even though the reporting is done annually. Many businesses are using paper-based reporting for the TPRS which can be time-consuming for businesses and is also not ideal for the ATO. If the TPRS is further modernised, this compliance burden might be lowered in the future.

Payments by business to contractors should be captured in business records and the increasing digitisation of business should mean the cost burden of increased reporting should not be significantly greater for digitised business. However we recognise that not all businesses use software systems yet.

In addition, the ATO's access to other sources of third-party reporting is expanding. From 1 July 2017, payment systems administrators processing electronic sales for their business clients will be required to report to the ATO monthly transactions totals on an annual basis. This reporting will cover contractors in all industries receiving electronic payments through credit and debit card transactions.

On balance, we do not consider that expanding the TPRS beyond identified high-risk sectors is merited at this time.

### *Use state and territory payroll tax or workers' compensation reporting*

We heard feedback that ReturntoWorkSA, the State authority responsible for work injury insurance, promotes as best practice, that businesses report all workers (including self-employed contractors) to them for insurance purposes. We strongly encourage Commonwealth agencies to continue discussions with state agencies such as ReturntoWorkSA and other state workers' compensation schemes to explore better sharing of data and intelligence and also the multi-skilling of auditors to help tackle non-compliance.

### ***International experience***

The OECD recommends revenue bodies seeking to achieve significant improvements in voluntary compliance explore the costs and benefits of reporting regimes.<sup>6</sup>

Some examples:

- Canada has a Contract Payment Reporting System for construction and all goods and services provided on contractual basis to Federal Government bodies.
- A number of countries have implemented reporting requirements in the building and construction industry.

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6 OECD, Information Note: Withholding & Information Reporting regimes for Small/Medium-sized businesses & self-employed taxpayers, August 2009.

## Stakeholder views

While there was some stakeholder support for extending reporting to all industries, business and tax professional stakeholders preferred targeted expansion of TPRS to further high-risk industries. Some stakeholders have cautioned that excessive expansion of the TPRS model could potentially stifle small business growth, particularly in the start-up phase. There is also strong support across stakeholders for making the reporting as easy as possible for businesses, automating where possible.

Feedback also suggested that data on the performance of the TPRS on compliance in the specific industries needs to be publicised to galvanise community acceptance and support for the scheme including for extension to other industries.

Stakeholders also noted that low compliance with Fair Work laws is often accompanied by non-compliance with other obligations including PAYG, payroll tax and visas.

## Implementation considerations

An education campaign by the ATO to advise businesses, tax agents and industry bodies will be required for any further extensions of the TPRS. The ATO would also need to educate the additional government entities brought into the third-party reporting regime about the measure and how to comply.

In addition, software changes may need to be implemented by software developers. The developers will need advance notice to be able to make the changes required.

The ATO should explore alternate reporting options and, where possible, automate reporting and make reporting as simple as possible for businesses.

*‘The previous Prescribed Payments System required householders to forward a record of payments made under construction contracts of more than \$10,000 to the ATO. An Australian National Audit Office performance audit of the ATO reported that there were significant obstacles for the ATO in enforcing this aspect of the legislation and any attempt to do so would provide a poor return on investment (refer The Auditor-General Audit Report No. 14, 1998-99).’ The Tax Institute*

In the intervening years there have been significant advances in technology and automation. The issues with the previous system will need to be taken into account when designing how to expand reporting to owner-builders, but increased automation, increased data sharing from state and local governments, and the advances made in technology since the Prescribed Payments System could all mean those issues can be overcome.

## **Recommendation 6.2: A sharing economy reporting regime**

Operators of designated sharing ('gig') economy websites should be required to report payments made to their users to the ATO, DSS and other government agencies as appropriate. The Government should also continue to raise users' awareness about the potential tax obligations from participation in sharing economy activities.

### **Description**

#### *Reporting income information*

Operators of sharing economy platforms should be required to submit at least annual data on income received by their users based in Australia to the ATO.<sup>7</sup> The information should be comprehensive enough to allow the ATO to match the information to individual taxpayers, that is, it should contain at a minimum the full name of users, address and date of birth. Extending the requirement to ABNs should also be explored (for those who have, or should have ABNs), but the detailed set standard for reporting can be agreed on implementation. **The ATO should use this data to pre-fill tax returns.** The data should also be available to other agencies such as DSS. We are aware that some platforms already provide information to the ATO, or they withhold and remit PAYG. Additionally, many of these platforms already provide a summary of this data to their participants and the platforms have sophisticated and intelligent data and modelling capabilities that can provide meaningful data to regulators.

The options for more regular reporting of such data should be explored; more regular reporting would allow more real-time analysis and use. Whether the sharing economy reporting regime can be incorporated to comply with TPRS obligations, immediately or later, should also be explored.

Consideration will need to be given to determine which platforms the scheme should extend to given the variety of business models in use. As a guide, reporting should apply to payments to users who offer their labour as services (rather than goods) and are not classified as employees (in which case other reporting obligations already apply). Difficulties may exist where platforms are a mere matching service without the payment going through the platform itself.

Relevant overseas located platforms should be included in the scheme. Where platforms are not participating voluntarily, options may need to be developed to ensure they comply. For example, reporting obligations could be included as a condition for operating in Australia, such as being a condition of obtaining a licence (where applicable), and the Government should work with States and Territories to consider such options. The Government should also work in close cooperation with other countries to find ways to cover global sharing platforms in domestic tax and regulatory frameworks. Internet Service Provider (ISP) level blocking may need to be considered as a final resort

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<sup>7</sup> For the purpose of this discussion, sharing economy websites are online services which operate as platforms for the sale or hire of goods/services or operate as a labour market intermediary and, in providing such services, capture the payments or require payments of fees or wages to an individual or entity to pass through an entity controlled by the online service.

for non-compliant platforms. Working with banks to prevent payments to or through non-compliant platforms could also be considered as a final resort for non-compliant platforms.

### Education

Users of sharing economy platforms need to be made aware that income earned from participation in the sharing economy is likely taxable income. Their activities could also give rise to capital gains tax obligations, and could impact welfare and other payments.

The ATO already provides guidance. However, it is important that sharing economy participants receive information even if they do not look for it, as many may not be aware that even small or intermittent income could be taxable. Operators of sharing economy websites should also be encouraged to highlight the need to consider tax obligations to their users, and refer them to ATO information.

### Objective

- For the ATO and other agencies to receive information on income received by sharing economy users to enhance voluntary compliance and provide data for income information matching, including for social security purposes.
- Ensure that sharing economy users are aware of their tax obligations, further driving voluntary compliance.

#### OBSERVATION: LABOUR HIRE AND THE SHARING OR GIG ECONOMY

Some newer models of what could be considered labour hire use the sharing or gig economy model. The labour hire firm operates as an online platform, workers and businesses seeking workers are matched through the platform. The labour hire platform may just match staff to jobs, with the business paying users directly, or may provide users with the business paying the platform. The same platform may operate both models, with it varying between what the business chooses, either generally, or for particular workers.

### Discussion

#### *Problem this recommendation seeks to address*

The sharing economy has grown strongly over the past few years and platforms have evolved from a place where people could share their existing assets on a casual basis and do some work on the side to a more substantial form of income generating work.

*'...most existing policy and legislative instruments would have been designed for a world that predominantly traded on physical goods or in-person services relying heavily on paper-based business process ...'* COSBOA

The number of users is growing strongly, and is supporting a rise in freelancing. Users selling their services through sharing economy platforms may be employees or may be contractors, depending

on the particular arrangements for that platform. If they are independent contractors no tax is withheld from the income they generate on the platform, and platforms do not have to report information on payments made to users to the ATO, unless asked to do so under the ATO's information gathering powers, or through voluntary participation by the platform.

There is a risk that people selling their services through sharing platforms are not paying the right amount of tax as there is no reporting and withholding and many users may not be aware of or understand their obligations. Lack of knowledge about tax, the novelty of this type of income generating work and platform-user relationship, as well as poor record keeping all contribute to the problem. While there is no reliable data available yet, it may also be the case that some of the non-compliance is deliberate. While payments are electronic, without a reporting regime in place it is difficult for the ATO to gain information on compliance of sharing economy users unless targeted audits are used.

#### **OBSERVATION: DAY IN THE LIFE OF A 'GIGGER'**

Spend the morning dog sitting through 'madpaws' app.

Spend the afternoon putting furniture together from Airtasker apps.

Deliver food in the evening with 2 or 3 food delivery apps (Uber eats, Menulog, Foodora, Deliveroo).

Drive for Uber on Friday night when demand is high.

#### *Rationale*

Streamlined reporting and pre-fill of tax returns will reduce individuals' compliance costs and make it easier for sharing economy participants to meet their obligations. It would help individuals by providing them with information on their sharing economy income through the tax return pre-fill service, and allow the ATO (and other agencies through data sharing) to undertake compliance activities.

Formalising the reporting requirements would also send a clear signal that income from sharing economy platforms is in most cases taxable income. It would level the playing field between traditional operators and new economy operators.

*'As digital technology is adopted across the economy, segmenting the digital economy is increasingly difficult. In other words, because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy.'* COSBOA

## ***Other options considered***

### ***Sharing economy platforms to withhold tax***

This option would require sharing economy platforms to deduct income tax from payments made to users and remit this money to the ATO. This would either be topped up or refunded as part of the tax return process. The withholding tax could be at various rates, for example a flat 20 per cent or based on an individuals' prior year income.

Applying withholding would substantially reduce non-compliance by sharing economy participants and may raise additional revenue through increased compliance. However, such an approach is relatively onerous and may be criticised as discriminating against transactions which occur on sharing economy platforms. As discussed above, there are various reasons for treating independent contractors differently to employees, and this extends to those sharing economy suppliers who are independent contractors (and not all necessarily are). As discussed above, withholding should be considered as an option if non-compliance remains a problem despite a reporting obligation.

### ***Bright-line test for business-hobby distinction***

In connection with the sharing economy, we also examined whether the hobby-business distinction remains suitable. It was put to us that current test creates a lot of uncertainty and is difficult to apply.

After consultations and considering various alternative options for a bright-line test, we came to the view that the current distinction remains appropriate. Overwhelmingly the activity on sharing economy platforms is likely to be business related, with users generally using the platform to generate income, provide services to strangers and undertake regular rather than once-off activities. A bright-line test could also be seen to interfere with the current tax free threshold and rather than simplify compliance, introduce further complexities. A bright line test just for sharing economy activity would also create a distorting disparity between different business operating models. While there may be instances where it could be considered a hobby, there should be a general presumption that sharing economy users are conducting a business, and the current test and guidance are sufficiently clear. A reporting regime, including pre-filling of tax returns, as well as education of sharing economy users will further provide clarity.

## ***Stakeholder views***

Feedback from consultations has overwhelmingly backed applying a reporting regime to sharing economy platforms. A well-known Australian sharing economy platform has told us that they would support a formalised reporting regime and that the suggested data (name, address, DOB) could easily be provided. They, and other similar platforms, already collect this information about their users. ABNs could also be supplied.



### ***International experience***

Many other jurisdictions (India, France, Spain, and the USA) require sharing economy websites such as Airbnb to withhold tax, mostly local hotel/accommodation taxes. Uber withholds tax for drivers in Estonia.

Working with global sharing economy platforms to bring them into domestic tax and regulatory frameworks has been identified as an important matter for international cooperation.

### ***Implementation considerations***

Overseas platforms will not easily be covered by Australian legislative change. Consideration will have to be given to how they can be compelled to participate if voluntary cooperation is not sufficient.

Consideration will also need to be given to determine at what point sharing economy platforms come under this scheme. While this is an issue that applies more broadly if TPRS is implemented across the economy, it may be particularly difficult for businesses in the 'new economy' and the need to avoid imposing large compliance costs on start-ups, and the potential for very rapid change.

The recommendation should also be considered in conjunction with our views on contracting, outlined in Chapter 10.

These organisations are sophisticated and have significant data holdings which can assist with valuations, intelligence and industry trends. For example, a particular sharing economy operator told us that the ATO income benchmark for taxi drivers in capital cities was 40 per cent below what drivers were actually earning.

## SUPPLEMENTAL RECOMMENDATIONS

### *Single Touch Payroll*

The reporting of wages and superannuation under STP provides transparency. STP starts for employers with 20 or more employees from 1 July 2018. The Government has announced it will include employers with less than 20 employees in STP from 1 July 2019. Legislation will need to be enacted for this to occur. As much black economy activity related to underpayment and under-reporting of wages and superannuation occurs in small business with fewer than 20 employees, we support this initiative. An option for the Government to consider would be introducing the requirement for payment of wages into bank accounts from 1 July 2019 as well.

### *Airbnb and GST*

Airbnb, or rather the people supplying accommodation through Airbnb, directly compete with hotels and similar commercial accommodation. How GST applies to accommodation like hotels, inns, hostels and such like was established when GST started in 2000. Airbnb did not exist then. GST applies to hotel rooms and the like. It does not generally apply to rooms someone lets out through Airbnb in their own home. GST would, of course, apply to accommodation like hotel accommodation that is let out through Airbnb.

The government should examine how GST should apply to accommodation provided through Airbnb and similar platforms compared with that provided in traditional hotels and similar commercial accommodation.

#### **OBSERVATION: AIRBNB**

Tourism Accommodation Australia told us:

‘Data scraped from the Airbnb website by Inside Airbnb shows that in Sydney, commercial operators offer un-hosted accommodation in over 8000 whole properties, representing for 35 per cent of listings. In Melbourne, commercial operators offer un-hosted accommodation in over 6100 whole properties which accounts for 42 per cent of all listings. Nationwide, the proportion of commercial operators rises to 50 per cent of all listings.’





# CHAPTER 7

## AN OVERHAUL OF INCENTIVES AND DETERRENTS

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# CHAPTER 7: AN OVERHAUL OF INCENTIVES AND DETERRENTS

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## THE RIGHT MIX OF INCENTIVES AND DETERRENTS

### *Key points*

Effective behavioural interventions must focus on both incentives and deterrents, be appropriate to the spectrum of behaviours we see (as opposed to one-size-fits-all) and not have perverse results (like driving more people into the black economy).

High tax and regulatory burdens are one of the major factors fuelling the black economy. Existing policy settings across a number of areas (including tax, workplace relations, welfare and immigration) have their own rationale, but can sometimes provide incentives for people to move into the shadows. Regulatory ‘noise’ is a further problem: regulations that are complex, uncertain or difficult to comply with.

In this Report, we highlight the importance of tackling consumer and small business incentives. We set out a strategy to raise consumer awareness of the role they can play to combat the black economy and the risks they face when they elect to be part of it. The message must be ‘think carefully before you do this’, given the legal, financial and other risks they face. Education also has to be targeted, for example by working with migrant communities.

Our small business strategy aims to reward those businesses that engage in low-risk behaviour. Specifically, we propose a regulatory safe harbour which would reduce compliance burdens for firms which take prescribed low-risk actions (for example, by operating on a largely non-cash basis). We also propose a time-limited amnesty for small businesses, recognising that many want to ‘come clean’ but worry about the consequences of doing so.

Overhauling deterrents requires a four part strategy: (a) education, (b) stronger and more visible enforcement of existing laws, (c) a regime of new offences, linked to a new way of dealing with them (tax tribunals) which ensure more prosecutions and (d) tougher penalties in particular areas. These are explored in Chapter 8. Partnerships with industry groups, unions and others can be better used to prevent and identify black economy activity (see Chapter 11).

### *The link between behaviour and incentives*

Effective behavioural interventions must focus on both incentives and deterrents. This is particularly the case with the black economy, given the wide spectrum of behaviours it encompasses, the diversity of those involved and the hidden nature of much of this activity. The authorities cannot rely on traditional audit processes to address the black economy. They must rely instead on behavioural

triggers. Incentives and deterrents influence people's rational calculations: their weighing of the costs and benefits of a particular course of action. We argue that, too often, current policy, regulatory and enforcement approaches encourage rather than deter participation in the black economy.

Before we turn to these, it is important to make a number of cautionary points.

- When looking at incentives and deterrents, we must avoid one-size-fits-all approaches. Some black economy participants are only minimally involved, pocketing cash from time to time and only dealing in small amounts. Others are more heavily engaged, but feel they have little choice given competitive pressures (from others in the black economy) or regulatory complexity. At the other end of the spectrum, of course, are serious offenders and criminals. Incentives designed with the first two groups in mind will not be appropriate for the latter, who must be confronted with strong deterrents and sanctions. Equally, consumers, firms and employees are confronted with different incentives and deterrents (as the following table shows).
- This underlines the importance of graduated approaches. The need for a broad spectrum of penalties and sanctions, from civil to criminal, tailored for particular behaviours we see and reflecting different levels of culpability. We see the effectiveness of this in other areas of policy, including drink driving, speeding and other traffic infringements. Minor offences are both easy to prove (involving strict liability) and come with relatively light sanctions (the loss of points). Intermediate offences attract harsher penalties (such as licence suspension). And serious offences must be tried and can involve imprisonment. We need to make better use of civil rather than criminal penalties, which are more cost effective and appropriate for behaviour which is difficult to see as criminal. Criminal penalties have a higher burden of proof, are expensive and should be reserved for the most serious matters. This is further explored in Chapter 8 on Enforcement.
- Third, any attempt to shape incentives and deterrents must be consistent with other elements of our strategy. Our focus on social norms, reporting and transparency, moving people away from cash and better reporting and transparency is also relevant. All of these components must work together, although in particular cases and contexts some will necessarily feature more than others. That said, incentives and deterrents must always play the central role. Incentive-incompatible regulation has a long and sorry history.

**TABLE 7.1: INCENTIVES AND DETERRENTS**

	<b>Businesses</b>	<b>Workers</b>	<b>Consumers</b>
<b>Incentives for participating in the black economy</b>	Avoid regulations and complexity Avoid taxes Competitive advantage Worker preferences	Avoid taxes and welfare means test Avoid visa conditions Employer preference	Price incentives Cash preference Regulatory complexity Priority
<b>Deterrents to participating in the black economy</b>	Risk and penalty of being caught Costs of cash Firm valuation issues Loss of legal protection Unable to claim deductions	Loss of protections or benefits (such as super and work-cover) Risk and penalty of being caught Loss of reputation Personal injury damages	Loss of consumer protections Loss of standing in courts Insurance and warranties Valuation of assets Owner liability

### *Policy-related incentives*

In a number of areas, policy settings create incentives for people to move into the black economy. They do not aim to. Indeed, each of these policies has its own rationale and justification. The problem is their unintended consequences. In this case, the rewards they offer to those who move into the shadows.

- High effective marginal tax rates, for example, are a key reason people may decide to take a cash-in-hand job. In some cases, these can be as high as 80 per cent where welfare is involved. This means that for every extra dollar earned, four fifths of this amount will be lost (in lower welfare payments and the burden of taxes paid) if the income is declared. If the employment opportunity lacks permanence or security, the incentive to declare income will be even weaker, and the incentive for employees to seek cash-in-hand payments will be even stronger.<sup>1</sup>
- Our workplace relations system, including award rates and penalty rates, provides important protections for those already employed. When the labour market is soft and profits are low, both businesses and would-be employees may be tempted to strike informal, cash-based bargains to avoid tax and loss of welfare benefits. This is compounded by the complexity of the awards system.
- Another example is provided by parts of our visa system. Student visa holders are only allowed to work 40 hours a fortnight. Those who, for whatever reason, want or need to exceed this limit, have no choice but to ask for cash-in-hand wages. These people are placed in a highly vulnerable position. Unscrupulous employers, knowing they risk deportation, are able to exploit

<sup>1</sup> This problem is not an anomaly, but reflects basic design features of our tax and welfare systems. Progressivity and means testing serve important community objectives and have strong support, but make black economy participation more attractive.



them. Other visa holders without work rights, such as tourists, may also seek cash-in-hand work. Refugees are now able to work while on temporary protection visas, which is a welcome development.

We are not arguing that policy settings must in every case be revisited. It is well beyond the scope of our terms of reference to do so. We also think that wrong-doers should face consequences: welfare recipients should lose benefits if they do not declare their income and visa holders should have their visa cancelled for serious breaches of conditions.

Our point is a forward-looking one. When developing new policy blueprints, policy-makers should take the likely black economy consequences of the options into account. These should be frankly acknowledged, where they are likely to crop up, rather than assumed away. If this is done, better choices will be made.<sup>2</sup>

### **Regulation-related incentives**

The impact of regulation on black economy participation should also be acknowledged. When hard-to-monitor regulatory requirements are complex, onerous and poorly publicised, compliance levels will be low. This is a particular problem for smaller businesses. Our consultations have highlighted three set of complaints.

- **One-size-fits-all:** In many cases, regulatory restrictions are imposed in a one-size-fits-all manner. All businesses are subject to the same requirements, regardless of their circumstances or the relative risks they pose. In this one-size-fits-all approach, low-risk businesses are effectively over-regulated while the worst offenders, who operate underground, escape regulatory scrutiny all together. In recent years, regulators have begun to acknowledge this problem, applying differentiated or risk-based approaches.
- **Lack of understanding:** Regulatory requirements are often not well understood or publicised. For example, we heard that small businesses have difficulties interpreting how the various awards apply to their employees. Too often, the regulated population is expected to trawl through government websites and other official information channels. Apps, social media, industry networks and other innovative techniques are underutilised, although again there are exceptions to this rule. There are opportunities from increasing digitisation. Education and training have a clear role to play, as do ‘nudge’ and other behavioural economic insights. These are discussed in Chapter 11.
- **Duplication:** A perennial complaint is that regulatory requirements are duplicated across agencies and levels of government. For example, in certain locations a new café owner has to fill out 48 forms, including two sets of music licenses, to operate. The overwhelming call is for a

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<sup>2</sup> In some cases, black economy risks might necessitate fundamental changes of approach. In others, fine tuning might suffice. In still others, stronger enforcement action might be contemplated with no policy change. We are not advocating a black economy ‘box ticking’ exercise for new policy ideas, but rather a change in perspective and mindset within government. Policy advisers need to develop a better feel for ‘real world’ incentives in the imperfect world we live in.

simple, one-stop-shop. A number of state governments have made impressive progress in harmonising regulatory requirements. A pilot NSW government initiative in some parts of Sydney has cut café licencing times from 18 months to 60 days. But more needs to be done. We discuss working across different levels of government in Chapter 15.

Most people try to do the right thing. Where they face too many burdens and slip into the black economy, it comes at a cost to the economy and society as a whole.

## Recommended actions

### *Starting with small businesses and consumers*

We think particular attention needs to be paid to consumer and small business incentives.

Consumers and householders play a substantial role in the black economy. For every tradesperson asking for under-the-table cash, there is a consumer agreeing to pay it — or in some cases demanding it. These bargains benefit both sides of the transaction in financial terms, entail relatively little risk and are supported by a number of social norms and excuses. Cash jobs are viewed by many as a victimless crime, for example, or something everyone does. Some even boast about the money they save this way. We think the best approach for consumers is to focus on raising awareness in the first instance. They should understand the risks, costs and longer-term consequences of their conduct. We say this because we have found that, in some quarters at least, there is reluctance to acknowledge this problem. Any public campaign should take a leaf out of successful behavioural change campaigns we have seen in other areas, including road safety, anti-smoking and drink-driving. Education should also play a role, starting at the school level.

#### Checklist for consumers

Do the right thing:

- **Pay electronically:** Paying electronically – by card, phone or electronic funds transfer – has become easier and cheaper.
- **Ask for an invoice:** For transactions over \$75 (ex GST) it is compulsory for businesses to issue a valid receipt, below that amount you have a right to obtain one if you ask — and you should.
- **Validate ABNs:** Use the ABN lookup tool to check whether the ABN of a business or contractor is valid and they are registered for GST. It is online and easy to use.
- **Use a trusted tradesperson:** For example, the Royal Automobile Club of Queensland (RACQ) approves tradespersons.
- **Report:** If a business or contractor refuses to receive electronic payment or issue a receipt, report them.
- **Do not risk it:** It is in the interest of consumers to be responsible: do not jeopardise warranties, insurance cover and value by gaining a few dollars from avoiding tax.

Consumers need to have a better appreciation of the **risks** they run by participating in the black economy. **There are significant downsides for consumers from participating in the black economy: they may not be able to seek legal redress for defective work, lose insurance cover, and could be liable for accidents that happen while tradespeople or child carers are doing work paid for in cash.** Use of unregulated or unlicensed operator is fraught with risks.

The view that it is a victimless crime should be countered. Indeed, over time, the message has to be that being in the black economy is socially unacceptable. Consumers should also be aware of the obligations of business, for example, **it is compulsory to provide a receipt for goods or services which cost \$75 or more (excluding GST)** and without that receipt it will be more difficult to prove claims in a court.

Consumers also need to be aware that they may be considered employers if they engage someone to perform work, for example employing a nanny. They may have obligations such as registering with the ATO, withholding tax, paying superannuation contributions, and taking out work cover insurance.

#### **OBSERVATION: RECEIPTS**

**Receipts or a proof of purchase must be provided for anything that a consumer buys that costs more than \$75 (ex GST).** A receipt must include a supplier's name and ABN or ACN, date of supply, the product or service bought, and the price paid. Without a receipt or proof of purchase, it can be difficult for consumers to use their rights for repair, replacement or refund if goods are faulty or there is a problem with a service.

Small businesses incentives will be our major focus. In particular, we want to reward those who adopt entirely non-cash business models. We think they should receive a tangible benefit for taking this step, as recommended in Chapter 3. We also want to develop, working with the Small Business Ombudsman, a regulatory safe harbour for low-risk small businesses. Businesses that agree to a small number of basic compliance actions (across tax, fair work and eventually state areas of responsibility) should be treated as 'trusted traders'.<sup>3</sup> Audits, inspections and other burdens should be streamlined for them. This will reduce their burdens and help the majority of businesses that want to comply. Industry associations and professional bodies will have a role to play in helping new businesses meet these requirements.

We also recommend that Government consider applying targeted and time-limited amnesties to small businesses in some sectors. The amnesty should encourage small businesses to 'come clean' and be followed by an audit blitz with potentially increased penalties applying to those that did not come forward during the amnesty.

We also highlight the need for clear rules on record keeping. Records provide an important audit trail, especially where transactions are done in cash, and as such serve as both an incentive and

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3 Note that the safe harbour and trusted trader labels are used interchangeably in this Report.

deterrent to the black economy. Similarly, we believe that trade discounts must be recorded — doing deals on the side is not acceptable.

### *Deterrents*

Behavioural interventions cannot ignore deterrents. The behaviours in many cases are hard to detect. A diverse population of businesses and individuals may be involved. The sums involved can be relatively small, but of course add up. Deterrents are essentially preventative. They are intended to stop problematic behaviours from occurring in the first place. Deterrents must be carefully calibrated, matching the penalty with the nature of the misconduct. A deterrent for a first time offender or small amount of tax evaded will differ from one applying to systematic misconduct or criminal behaviour. There should be a spectrum of penalties and offences.

Based on our consultations, we think there is significant scope to strengthen our black economy deterrents.

- Education can play a deterrent role. Employees should know that workers' compensation payouts may be based on their declared income only, not cash-in-hand payments. Small businesses should recognise that bank lending is undertaken on this basis. Education is a key part of our consumer and small business strategies.
- We need to ensure that egregious actions by some tax practitioners and other advisers are dealt with. While most tax practitioners work hard to provide good and correct advice, there are a few who behave egregiously. They aid the black economy and illegal activities, and if not addressed visibly and effectively, they can drive the behaviour of others.
- We need a better approach to enforcement, including more visible enforcement of existing laws, new offences and different ways of dealing with them, making more use of civil sanctions where appropriate and more use of the Federal Court. These are discussed in Chapter 8.

## RECOMMENDATIONS

### **Recommendation 7.1: A strategy for consumers**

Consumers should be encouraged to become drivers of compliance and not be complicit in black economy activities. They need to recognise the risks of participating in the black economy.

#### **Description**

We recommend that actions to combat the black economy include a focus on the role of consumers.

Consumers need to know how they are contributing to the black economy, the risks they face when transacting in the black economy, and how they can avoid doing the wrong thing.

*‘Activity in the Black Economy takes many forms and many good people may be contributing to it without even realising. Paying cash for a job or service can provide an unfair advantage to those who do the wrong thing by the broader Australian community.’*  
Chris Jordan, ATO Commissioner

The key message must be stated clearly and unambiguously: *‘When you pay cash for childcare or plumbing work or for personal training, you are part of the problem. Not only are you running legal and financial risks, you are short-changing your fellow citizens.’*

An educational campaign is needed, drawing attention to their responsibilities and highlighting options such as paying electronically, ensuring there is a record of the transaction when paid for in cash, asking for receipts, checking ABNs and reporting businesses that are refusing to take electronic payment or issue a receipt. **Receipts are compulsory for transactions over \$75 or more** (excluding GST) and consumers should make the most of that (see guide on page 149 on how to do the right thing). Consumers need to be aware that there are considerable downsides from participating in the black economy, whether that is paying in cash without a receipt or being engaged in activities such as offering or using unregulated childcare. For example they will not have the evidence required to enforce their rights in court. There are increased safety, quality and recovery risks from dealing cash-in-hand with unlicensed or unregulated providers.

Consumer education should be part of the campaign to address social norms outlined in Chapter 11. Education should also be targeted to particular high-risk groups, including working with migrant communities, which is further explored in Chapter 10.

We also see scope to apply specific incentives and deterrents to consumers. Elsewhere in the Report, we recommend that undocumented wage and contractor payments should not be tax deductible. This recommendation, if adopted, would apply to investment property owners who pay for improvements and renovations in cash. In the future, other measures could be considered, including tax incentives for home renovators to obtain receipts and limiting protections for goods and services obtained in the black economy. We understand that WorkCover and personal injury

payouts are based on the injured employee's taxable income, giving him or her, an incentive to fully declare their earnings. This could be linked to other income-linked payments, including publicly-funded severance payments.

Attitudes and social norms will take a while to change (an issue which is explored in detail in Chapter 11), but if consumers continue to assist rather than hinder black economy activities, stronger interventions should be examined.

## Objective

- Bring consumers into the discussion on countering the black economy.
- Provide consumers with the necessary information and tools to help combat this problem.

## Discussion

### *Problem this recommendation seeks to address*

Most of our current anti-black economy efforts are directed toward businesses, yet consumers play a central role in the black economy. Many high-risk industries are those which involve a high number of low-value business-to-consumer transactions, for example restaurants and cafés, and the hair and beauty sector. Many people also pay for home-based services such cleaners, dog walkers and nannies: consumers may often not be aware that such payments are likely taxable income for the provider and may attract GST and other obligations. Paying for these in cash can facilitate the avoidance of these liabilities.

In some cases consumers may be more like employers, for example in the case of nannies, where the payer should register with the ATO, pay award wages, pay superannuation and even make sure they have insurance to cover workers' compensation. Where they do not do so they may expose themselves to risks, including claims by the person they employ.

The role consumers play can take the form of unwitting participation due to a lack of knowledge of obligations, to deliberate actions, for example agreeing to receive a discount for cash with a view to avoid paying GST.<sup>4</sup> Involving consumers in the solution is an important step in our community-wide approach to addressing the black economy.

### *Rationale*

To reduce the black economy consumers need to help. As long as consumers continue to pay for goods and services in cash without valid receipts, and agree to or even ask for discounts for cash payments, the black economy will continue to proliferate, particularly in areas such as domestic services. To effectively combat the black economy, consumers need to be brought into the fold and

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<sup>4</sup> We consider that home-based businesses, for example, dog walkers, with income above a minimum amount should register for an ABN.

educated about their rights, obligations and the potential downsides of participating in the black economy.

## *Other options considered*

### *Removing consumer protections*

We believe that the behaviour of consumers who deliberately transact in cash to avoid tax and other obligations is not socially acceptable and considered introducing a deterrent such as removing or reducing consumer protections.

Currently, to access rights under a claim for refund, repair or compensation under Australian Consumer Law, a proof of purchase (such as a receipt or bank statement) is required. A variety of documents can qualify as proof purchase including: a GST, cash register or hand-written receipt; a credit or debit card statement; lay-by agreement; reference number given for phone or internet payments; or a copy or photograph of the receipt. These options may also apply even when a consumer does not obtain valid proof of purchase by dealing in cash.

While removing consumer protections would send a message that goods and services need to be obtained in the formal economy, we also recognise that consumers are often not aware of their rights and protections when making purchases. Consumer law can be complex and differs between the types of product purchased. Businesses are typically more aware of their obligations regarding consumer law and there is a risk that removing protections will spur businesses to lower the quality of goods and services sold in cash as they may no longer be liable for warranties.

As a result we do not recommend this action. However, consumers should be encouraged through education to request a valid invoice and be made aware of the potential consequences of paying for goods and services in cash, for example, making it more difficult to enforce their consumer rights, such as by taking a matter to court, and risk of liability. This includes domestic and home based services which are often conducted in the black economy. There should be greater pressure to enforce the requirement for an invoice for purchases above \$75 and ensuring there is a record of all transactions (see Recommendation 7.6).

### *Penalty for receipts*

We considered whether penalties should be applied where consumers do not obtain a valid receipt for purchases above \$75 (the current threshold ex GST for compulsory receipts under Australian Consumer Law). This would make it very clear to consumers that they are implicated in black economy transactions between businesses and consumers. However, such an approach is seen by many as too drastic: the emphasis should initially be to educate and inform consumers rather than to punish them. As a result we are not recommending that the Government implement penalties at this stage.

### *Financial incentive for homeowners*

If the above measures are insufficient to change behaviour, the Government should look at the option of incentivising the right behaviour financially. For example, the Government could introduce

a time-limited scheme whereby homeowners who undertake renovations or significant repairs on their residential property receive a capped tax deduction. To be eligible homeowners would have to pay contractors electronically, report to the ATO the nature of the renovation, the contractor(s) engaged and exact amounts paid, all of which would need to be substantiated by a valid receipt for the work undertaken.

Due to the direct revenue impact of this solution and risks associated with providing a tax incentive to individuals, we do not recommend this as a course of action at this stage. However, the Government should consider this option if participation in the black economy by consumers remains at current levels or increases. Overall, the benefits from increased compliance through the scheme and associated publicity are likely to have a more than offsetting positive impact, and beyond financial considerations, it is important to recognise that in order to change behaviour, financial incentives are sometimes required, particularly where enforcement is difficult.

### *Relying on whistleblowers*

We considered whether there could be greater action in response to concerns raised by whistleblowers. For example, follow up correspondence from the ATO which notes that the matter was reviewed, and seeking further information. At this time, we are not making a recommendation along these lines. There has been mixed success with whistleblower arrangements in Australia. This would also come at some cost, which could divert resources away from other serious black economy matters.

### *International experience*

In 2014, the Portuguese Government introduced a weekly lottery for people who have receipts for the purchase of goods and services that include an official tax number. Consumers receive coupons based on the amount on the receipts with lottery prizes including new cars. Similar programs exist in Brazil, Slovakia and South Korea amongst others. We looked at this experience but did not consider it to be a useful option for Australia.

### *Stakeholder views*

Consumer organisations have objected to the suggestion that consumers lose rights when they deliberately make cash payments for discounts or to avoid taxes. They are concerned the proposal would cause consumer harm and could increase non-compliance with consumer law by businesses. Their view is that the measure is unlikely to have an impact anyway and recommend instead that the focus be on businesses' failure to comply rather than involve consumers.



### **Recommendation 7.2: A strategy for small business**

The Government should introduce a regulatory safe harbour for small businesses which are prepared to take prescribed steps to reduce the compliance risk they represent (for example, by moving to largely non-cash business models).

Other elements of this strategy include: education (a pilot course for vocational education students), a new-to-business initiative (for new businesses and start-ups) and our incentives for entirely non-cash businesses.

#### **Description**

A coherent strategy is needed to reduce the cost of compliance for small businesses. The strategy should focus on minimising the impact of policies on small business, reducing and simplifying the complexity of the regulatory environment, and digitisation.

In line with this, we emphasise the need for continued consideration of how policies and regulations impact the operations of small businesses, and how they drive black economy activities. This should cover the following.

- **The role of taxes and regulations:** The Government has to carefully consider the impact of policies on black economy participation. This includes reviewing existing policies and regulations which may contribute to the black economy and making sure that all new policies are examined for their possible impact on the black economy. The focus should be on a simple, fair and transparent tax and regulatory system that is easy to comply with. This is not just a matter for the Australian Government. State and local governments can play an important role here, given the wide range of licences and permits that they require.
- **Business simplification:** The Government should continue with and support business simplification programs which streamline and facilitate businesses interaction with government requirements without affecting the operation of underlying regulations.
- **Digitisation:** The Government should digitise its interactions with small businesses wherever possible. Developments in financial technology, including blockchain, offer the possibility of better, easier and more transparent interactions between government and businesses. COSBOA strongly supported greater digitisation in its submission to us.

Specifically, we recommend:

- **A 'safe harbour':** We recommend that the Government implement a regulatory 'safe harbour' approach to compliance of small businesses. This would be similar to the Australian Trusted Trader program which operates for participants in international trade activities.
- The safe harbour would reduce red-tape burdens faced by small businesses which adopt a number of prescribed actions. The rules that small business must follow to achieve safe harbour could include (there may be others):

- Electronic payment of salary and wages.
- Electronic payment of suppliers.
- Possession and use of electronic payment facilities.
- Use business/accounting software for all record keeping and reporting to the ATO, and other agencies where possible.
- Use e-Invoicing (when available).

In the first instance, this could be applied in the tax area. Small businesses which adopt entirely non-cash business models would automatically qualify for this safe-harbour, but other businesses should also be able to qualify, with the ATO determining criteria, influenced by ATO work on benchmarks and the tax gap. We recognise that many firms will continue to accept cash payments from their customers.

In the future, it could be expanded to include rules for employment law obligations (for example, use of an FWO app to determine wage payments), and for interactions with state revenue offices (for example, for payroll tax purposes) and workers' compensation authorities.<sup>5</sup>

The safe harbour does not allow for a poorer standard of behaviour, or less rigorous enforcement of the law, for firms which benefit from it. When they break the law, they will still face penalties.

Other elements of our strategy are noted below.

- **Better education** for small businesses through a 'New-to-business program' (see Recommendation 11.3). Education will assist new businesses to understand and be compliant across the breadth of their legislative obligations.
- **Incentives for non-cash businesses** including treatment as a 'trusted taxpayer' and instalment relief (see Recommendation 3.5).
- **Removing tax deductibility of non-compliant payments to employees and contractors** (see Recommendation 7.5).
- **Initiatives with the States and Territories and local governments** to remove regulatory burdens. Cross-jurisdictional activities are explored further in Chapter 15.

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<sup>5</sup> We note that while a business operating fully electronically is likely to pose a lower-risk of cash behaviours, it does not necessarily follow that it is low-risk for tax avoidance more broadly. For example, this would not preclude the business from structuring to avoid tax or from phoenixing. The design of a safe harbour would need to take this into account.

## Objective

- To make it easier for small businesses to comply with their obligations and incentivise them to operate in the formal economy.

### OBSERVATION: THE RESTAURANT GAME

One restaurateur told us:

‘Good chefs and baristas all insist on some cash-in-hand. If I don’t pay it they can get it from my competitors. Many waiting staff make similar demands. So many are on visas where they have work restrictions. Centrelink and student loan issues are also common excuses. Really some of the staff are more worried about the Fair Work man than the employers.

Of course I have to fit within the Small Business tax office benchmarks. My real purchases are 40 per cent of my sales so like everyone else I pay some of my purchases in cash so I fit within the benchmarks. Restaurant meal prices have hardly moved up for years but costs of fruit, vegetables and meat has gone through the roof. Often I am working my books to a lower benchmark than my actual cost of purchases. The suppliers are all onto this and they offer to take some cash so everything looks OK for the tax office. The tradies and builders all know to pay for some of their materials in cash.

It’s all got beyond a joke. The restaurant game is all I know. It would suit me if we became a cashless society it would create a new level playing field where I didn’t have to become a crook to compete with crooks.’

## Discussion

### *Problem this recommendation seeks to address*

Regulatory burdens, overlaps and inconsistent approaches across different jurisdictions are major drivers of black economy participation. The higher the cost of any tax or regulation, or the administrative cost of complying with it, the stronger the incentive will be for individuals and businesses to move into the black economy. The complexity of the regulatory environment which arises from the significant regulatory noise, overlap and fragmentation further increases those costs. Small businesses and individuals often have to navigate their way through multiple, duplicative and cross-jurisdictional regulatory regimes. With small businesses often overburdened and confused, many simply choose to operate the black economy in order to avoid the complexity.

### *Rationale*

Small businesses and their representatives have told us that many of them are often worried that they do not comply correctly with the whole suite of obligations, despite their best efforts. The complexity of requirements, frequent changes and technological advancements can be overwhelming. The idea of a safe harbour is designed to address this by offering some respite for small businesses which take a few simple but necessary steps to comply. Designed to capture firms which want to comply voluntarily, a safe harbour would offer a direct benefit to them by reducing their compliance costs while only requiring minimal changes to legislation, administrative practices, and few resources. This could take the form of fewer and less onerous audits and inspections and easier reporting requirements.

The strategy attacks the problem of regulatory burdens and compliance costs from three angles:

- At the top, it makes sure that there are continued efforts across Government to carefully consider the regulatory impact of policies and to look for opportunities everywhere to simplify compliance and streamline regulations. This will ensure that the burden decreases over time, reducing the likelihood that small businesses operate in the black economy because of compliance costs.
- As a targeted offer to all small businesses, the safe harbour immediately simplifies compliance for those small businesses that want to do the right thing but find the complexity daunting and are worried about what their obligations are.
- Finally, a couple of specific incentives to help small businesses move towards practices and business models which reduces their risk will help direct the small business community towards greater automatic compliance.

## *Other options considered*

### *Simpler awards*

Many small businesses highlighted the complexity of the awards system as a contributor to compliance costs which results in some businesses preferring to deal in cash. Simplifying awards would be a powerful tool to help small businesses do the right thing and the Government should consider black economy implications in any future policy directions on industrial relations, particularly the awards system.

We also examined the idea of introducing a single award for small businesses to simplify the complex regulatory issues faced by small businesses which employ people. Such an award would apply to all employees of participating small businesses, overriding the awards that would normally apply to those individual employees. A variation to this option would be to establish a 'majority clause'. This would allow an individual company to use the award covering the majority of employees in that establishment as the sole award for all their employees.

Despite the advantages such options would bring, we can see a number of possible drawbacks. Choosing appropriate levels of remuneration and other conditions would be a complex exercise, resulting in some employees receiving higher or lower conditions. There would also be added difficulties if a business grows above the small business threshold. Would all employees have to revert to their ordinary industry award or only new employees? The impact on those individuals from potentially quickly changing award wages and other conditions would impose significant uncertainty. Given these difficulties, we do not recommend a single small business award.

### ***Stakeholder views***

The idea of a safe harbour has strong support from small business representatives. Many stakeholders spoke to us about the difficulties small business face, pointing out that even businesses that want to comply find it hard due to the complexities of requirements. A safe harbour is seen as a welcome recognition that many businesses want to do the right thing.

### ***Implementation considerations***

The safe harbour proposal will need to be carefully designed in close consultation with small business representatives. The criteria to satisfy in order to be considered under the safe harbour rules will have to find an appropriate balance between simplifying compliance and ensuring that most, and all key, taxes and regulations are covered and complied with. The proposal should make things easier for small businesses, but not promote lax compliance.

### ***Recommendation 7.3: Amnesty for businesses***

Offer time-limited and targeted amnesties for small businesses. An amnesty should be followed by an enforcement blitz.

#### ***Description***

Businesses in certain sectors could be offered an amnesty if they come forward ahead of an enforcement blitz on that sector. Specific features should include:

- **Time-limited:** The amnesty should apply for a limited time only, for example six months. There should not be any advance warning to ensure it does not motivate wrong-doing ahead of the amnesty.
- **Reduced penalties:** Businesses coming forward should remain accountable for their primary tax liability but receive reduced penalties. Penalties should be further reduced if the firm can identify other black economy participants to the authorities.
- **Enforcement blitz:** Immediately following the amnesty there should be a significant enforcement blitz targeting the industry, with increased penalties for non-compliance.
- **Education:** The amnesty should be complemented by incentives included in the small business strategy (Recommendation 7.2 above) and education (see Chapter 11).

Amnesties could target firms in the cash economy, including shop keepers, tradespeople, farmers and labour hire firms. Criminal operators should not benefit from it.

#### ***Objective***

- Encourage small businesses that have previously been active in the black economy to come forward.

#### ***Problem this recommendation seeks to address***

Businesses are generally unlikely to come forward and admit to past wrong-doing for fear of repercussions, even when they want to change practices.

#### ***Rationale***

An amnesty, coupled with the threat of increased compliance activities targeting businesses in that sector, would provide an incentive for these businesses to move into the formal economy. The information received as part of the amnesty would further help target these efforts.

The amnesty should also be used to raise the issue of small businesses participating in the black economy and help shift public opinion and behaviour.

### ***Implementation considerations***

The design of the amnesty would have to carefully consider and address risks associated with an amnesty. Risks include businesses participating but not changing their behaviour, companies winding up shortly after taking part in the amnesty and starting up as a new business without a change in practices or behaviour, negative reactions from those who already do the right thing, and encouraging reluctant compliers to slip into non-compliance.

The mere discussion of amnesties can incentivise people to not come forward voluntarily as they wait for the amnesty, even if it never comes. Discussion of amnesties can even incentivise people to take the risk of not complying until the amnesty starts, even if it never occurs, so that they 'get their share' just like the dishonest people the possible amnesty is intended to bring into compliance. For these reasons, whether or not an amnesty will occur would need to be announced shortly after this report is published.

### **Recommendation 7.4: A strategy for tax practitioners**

The Government should:

- Take action against implicated advisers and promoters.
- Take more visible action against egregious tax practitioners and make clearer their ethical responsibility to report suspected illegal activities and tax evasion.
- Increase the capacity of the Tax Practitioners Board (TPB) to take sufficient effective action against egregious tax practitioners by increasing its resources and interactions with the ATO.

### **Description**

#### *Action against advisers*

Actions need to be taken against advisers that aid and even promote black economy and illegal activities. In the course of our consultations we have witnessed many different sophisticated actions being taken in the black economy, including structuring to avoid tax or fair work obligations, phoenixing, money laundering or organised crime. It has been raised with us that behind all these activities there is an adviser: a lawyer, accountant, ‘pre-insolvency’ adviser or other practitioner. The culpability of such advisers needs to be acknowledged and addressed along with the black economy client whose behaviour they are enabling and even actively encouraging.

Consideration could be given to promoter penalty type consequences and more active prosecution of co-conspirators.

#### *Egregious tax practitioners*

The self-assessment tax system relies on honest and reputable tax agents and other practitioners advising correctly on the tax law. The vast majority of tax practitioners are law abiding and adhere to the tax practitioner Code of Professional Conduct. Among other things, the Code requires tax practitioners to take reasonable care in ascertaining a client’s state of affairs.<sup>6</sup> However, there are some egregious tax practitioners, and they reflect poorly on a very responsible profession that is the backbone of our self-assessment system. If not addressed effectively and visibly, they can also drive the behaviour of others. Unfair competition and the need for a level playing field affect tax practitioners just as much as the business they advise. That is, if clients of one tax practitioner are seen to be getting a better deal because of the egregious behaviour of their practitioner, other businesses will want the same outcomes. Some other practitioners will be under pressure to become egregious just to compete.

<sup>6</sup> Australian Government, Tax Practitioners Board, Explanatory Paper TPB (EP) 01/2010 Code of Professional Conduct. Paragraph 123: ‘... this requirement is a duty of registered tax practitioner to take care beyond placing complete reliance on the accounts prepared, or work done, by a person without considering their level of knowledge and/or understanding of the taxation laws and the correctness of their work to ensure that the information upon which the provision of the tax agent services is based is accurate.’ Paragraph 126: ‘Where there are grounds to doubt the information provided by a client, the registered tax practitioner must take positive steps and make reasonable enquiries to satisfy themselves as to the completeness and/or accuracy of that information.’



### **OBSERVATION: TAX PRACTITIONERS**

The TPB has 77,000 members. There are 56,000 tax agents and 21,000 financial advisers who are not allowed to do tax returns, etc. Members are subject to a Code of Conduct, a fit and proper person test and must keep their qualifications up to date. The TPB only acts when it receives a complaint against someone. They receive about 1,200 complaints per year.

The ATO has also identified organised criminal activity where agents lodge fake returns to obtain refunds and then the agents keep the refunds. A few years ago, the TPB deregistered 120 members; this year they deregistered about 45 members. All decisions of the TPB are reviewable by the Administrative Appeals Tribunal (AAT), often by members who are not experienced in tax matters.

TPB needs court approval to impose pecuniary penalties and to act against unregistered people who are providing tax services. The court process is slow and difficult.

#### *Tax agents registration*

More visible action should be taken against egregious tax practitioners (tax agents and BAS agents) who wilfully or recklessly prepare false tax statements. The ATO and TPB need to better communicate to address the problem. The TPB needs to be made aware of the 747 agents of concern by the ATO. Additional work should be undertaken by the ATO to identify such practitioners, and additional work should be undertaken by the TPB to investigate them with a view to barring them from the profession should their conduct fall short of professional standards. There is an existing disciplinary framework in the profession and this should be more rigorously applied, including by better provision and use of ATO data (with changes made to the information sharing provisions as necessary) to allow deregistration and prosecution.

#### *Reporting suspicious matters*

Tax, and other practitioners, can be the first to know when there is suspicious behaviour by their clients. Suspicions of illegal behaviour should be reported to the relevant authorities as part of practitioners' social responsibility. While this ethical responsibility should drive practitioners' behaviour in the first instance, we recommend that they should formally be under obligation to report when they become aware of black economy or other illegal activities. This approach has already been adopted in the UK.

*'It has never been acceptable for tax accountants to turn a blind eye to their clients' tax affairs or help them break the law.'* CPA Australia

#### *Tax Practitioners Board*

Insufficient action is currently taken against egregious tax practitioners. This is mostly due to a lack of resources in the TPB and imperfect communication with the ATO. The Government should consider whether the TPB is sufficiently resourced and has the necessary powers to properly police the large tax profession given the vital role the profession plays in our economy. This includes the TPB being able to take a more holistic view of tax agents, work with the ATO on cooperative approaches, research and analyse trends in the profession and monitor the profession for compliance with ethical standards. If more resources and powers are necessary, these should be

granted to the Board. It should be made clear to all that the TPB has an important enforcement mission; it is not merely a passive registry.

### **OBSERVATION: TURN A BLIND EYE NO MORE**

One tax practitioner with 20 years in practice told us:

‘In some way, you have to engage the accounting and taxation profession to assist with the stamping out of unethical practices.

Basically somehow, advise the professional accounting bodies that the days are gone where it’s acceptable for tax accountants to cast a blind eye at the clients’ tax affairs, or assist taxpayers with breaking the law, in which many of them do.

The Government and the ATO somehow need to take strong stance against tax practitioners that do the wrong thing.

How you do this I’m not sure, one method would be a public campaign, and perhaps asking Chris Jordan to say things.

It might bring about a public war between the professional accounting bodies and taxpayers, politicians and etc.

This is what may be required — in order to get the message out that the days are over for the black market economy — the Government is hitting back.’

## **Objective**

- Deal effectively with egregious tax practitioners to remove the damaging influence they have.
- Send a strong message that it is not acceptable to turn a blind eye to black economy activities of clients.
- Ensure that the regulators that are intended to police tax practitioners can effectively do so.

## **Discussion**

### *Problem this recommendation seeks to address*

#### **Egregious tax practitioners**

Egregious tax practitioners enable, or even instigate, black economy participation by their clients. A number of people have told us that some accountants and lawyers perpetuate tax fraud and money laundering. Their behaviour increases unfairness for honest business, increases unfairness for the vast majority of honest tax practitioners, undermines the integrity of the tax system, and contributes to the degradation of tax moral and community standards. Not enough action is currently taken to remove them from the position of influence they have. They need to be identified and effectively dealt with, including by being barred from practice.

Improved data and information sharing and improved analytics (as discussed in Chapter 5) would support the better identification of egregious tax practitioners. For example, improved identification of clusters of behaviour linked to a tax practitioner.

## Tax Practitioners Board

Given the vital role tax practitioners play in the economy as primary advisers to small business they have a significant influence on whether small business comply with their tax, superannuation and other regulatory obligations. Whether or not the profession is effectively policed has a significant flow-on effect on the behaviour of small business, including participation in the black economy. These flow-on effects are driven by people's perception of whether action is taken. As discussed elsewhere, it is important that there be visible enforcement. This applies as much to tax practitioners as it does to taxpayers. We have been informed through our consultations that there is not enough action taken against egregious tax practitioners. Better coordination between the TPB and the ATO could make an important contribution in this regard.

Egregious practitioners display behaviours such as;

- Reckless return preparation practices,
- aggressive advice, including promotion of phoenix behaviour to clients to evade payment of tax, as well as phoenixing of practitioner firms,
- exploitation of their position and access, such as misappropriation of client funds, false returns and amendments lodged without client knowledge, including on behalf of clients who have departed Australia, and identity theft, or
- involvement in criminal groups.

### **OBSERVATION: TAX PRACTITIONER COMPLAINTS**

The TPB told us they received 81 referrals regarding egregious tax practitioners from the ATO last year. It was 300 previously. They received 1,200 complaints directly from the public (including other tax practitioners).

The TPB is inadequately resourced to appropriately address this level of complaints.

## Tax practitioners

Businesses generally engage with tax practitioners because they are seeking assurance that they are compliant with tax obligations. This is often driven by the differences in understanding between the client and the practitioner in regards to the operation of tax and superannuation law (and other regulatory obligations). Individuals trust that practitioners will do the right thing, and may accept advice from practitioners to engage in behaviours they shouldn't simply because they expect the practitioner has a better understanding of the legal requirements, the operation of the ATO and the risk of being identified. Liabilities (and therefore risk) for underpaid tax, including penalties, will fall on the client. Practitioners may even be pressured by clients into pushing some of these boundaries in order to receive the best possible tax outcome for clients.

**OBSERVATION: TAX PRACTITIONERS**

Registered tax agents lodge about 95 per cent of business income tax returns and 75 per cent of individual (including sole trader) income tax returns.

*Rationale*

Tax practitioners play an important part in the tax system. The vast majority of small business use a tax practitioner and rely on them for advice about how to meet their tax and superannuation and, not uncommonly, other regulatory obligations. Tax practitioners who do not meet standards can therefore be quite damaging to their clients' ability to meet their obligations. While the vast majority of tax practitioners seek to do the right thing and abide by the Code of Professional Conduct, some tax practitioners are not only enablers, but sometimes instigators, of black economy activity by their clients. Effectively dealing with egregious practitioners, including by removing them from the profession, can only assist in addressing the black economy.

Tax practitioners are under various business pressures. They are often time poor, and under significant pressures to lower their costs. This can lead, regardless of the intent of the practitioner, to little or no time to reconcile or dig into the records and information given to the practitioner by their client. We have been informed of tax agents turning a blind eye to obvious discrepancies due to time pressures or competency issues, choosing not to dig into the details. There is also the incentive that arises from the natural desire not to lose clients, which questioning information provided by clients may cause. Even honest practitioners, the vast majority of the profession, can as a result of time pressures unwittingly participate in enabling black economy participation by a client in the black economy who presents them with carefully arranged information.

*Options considered*

The option of developing of a 'trusted trader' type model for tax practitioners, which could include public certification of trusted tax practitioners, was considered. It is not recommended as registration as a tax practitioner should itself be regarded as that, backed up by sufficient enforcement to deal with egregious tax practitioners as recommended.

*Stakeholder views*

There is general agreement that egregious tax practitioners need to be effectively dealt with, including by being removed from the profession.

### **Recommendation 7.5: Removing tax deductibility of non-compliant payments**

Businesses should not be able to claim tax deductions for payments made to employees if they did not report and withhold properly.

Similarly, payments to contractors should not be deductible if the correct ABN was not provided, the payer has not withheld part of the payment under the 'no ABN withholding' requirements, or there is no invoice.

#### **Description**

Businesses can currently claim deductions for expenses even when these expenses were part of black economy activity, such as paying cash-in-hand wages to employees or paying contractors without withholding tax when no ABN was quoted.

This practice essentially amounts to a loophole and should be closed.

#### **Discussion**

##### *Problem this recommendation seeks to address*

Businesses paying employees cash-in-hand or paying for contractors without knowing their ABN may still deduct those payments in their Business Activity Statements.

Currently, if a company is caught under-reporting their income and expenses they may have their tax bill re-assessed using the extra deductions.

##### *Rationale*

In effect, the recommendation will close a loophole allowing businesses to deduct non-compliant payments.

It will create a financial disincentive to operating in the black economy by disallowing deductibility for payments to employees and contractors which are not properly reported and without meeting certain other requirements.

The measure also sends a message that certain black economy behaviours are not legitimate activity for tax purposes.

The Australian Council of Trade Unions submission put the matter well:

*Businesses should not be able to claim deductions on cash wage payments where they did not make or report Pay As You Go (PAYG) payments, issue payment summaries or statements of earnings, or make applicable superannuation contributions. Similarly, businesses should not be able to claim deductions for payments to contractors where a valid Australian Business Number (ABN) is not quoted and the payer has not withheld part of the payment*

*under the 'no-ABN withholding' requirements. These payments should not be included in cost bases for capital gains tax or depreciation purposes.<sup>7</sup>*

### **Costs and benefits**

Disallowing deductions encourages proper reporting of wages and payments to contractors. It increases financial deterrents to operating in the black economy by removing an opportunity to reduce taxable income through deductions.

While the measure makes it clear that incorrectly reported wages and payments to contractors are not considered genuine business expenses, the measure itself may not prevent businesses from operating in the black economy or from claiming those expenses. Only those operators that are caught doing the wrong thing are genuinely affected. Hence it is important that the measure be accompanied by appropriate detection and enforcement mechanisms.

Recommendation 3.2 to mandate electronic payment of salary and wages will further assist in reducing opportunities to deduct non-compliant expenses.

### **Implementation considerations**

Deductions are normally allowed for expenses (such as wages) that have been incurred in carrying on a business. Implementation of the recommendation would need to be considered in light of this current principle of deductibility, noting that expenses incurred as part of illegal activities are already not deductible.

Deductibility should be disallowed for cash payments to both employees and contractors. If restricted to employees' wages only, employers may have incentive to engage workers on a sham contracting arrangement which is undesirable as sham contracting has a range of risks including black economy participation.

The recommendation should be implemented ahead of, or at the same time, as mandating electronic payment of wages.

These payments should also not be included in cost bases for capital gains tax or depreciation purposes where they were used to produce a capital asset.

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<sup>7</sup> Australian Council of Trade Unions, Submission to the Black Economy Taskforce, August 2017, p. 5.

### ***Recommendation 7.6: Improving record keeping practices***

The requirements for tax record keeping practices should be clear and simple.

#### ***Description***

Government should require businesses to maintain records that include key features of all transactions. This could include the item sold, what was paid for it, underlying GST, the amount, date, ABN and preferably time.

These essential features are already automatically recorded for transactions paid for electronically and for cash transactions where the transaction is run through modern electronic POS equipment.

Penalties for breaches of these rules should be designed so that the ATO has a range of administrative sanctions available at its discretion. The Government has already agreed to ban sales suppression technology.

#### ***Discussion***

##### ***Problem this recommendation seeks to address***

The tax law has a general tax record keeping requirement, but it not specific about what needs to be recorded. This has led to inconsistent record keeping standards for different types of businesses, especially those that engage in low-value, high-frequency cash sales.

Compounding the lack of clarity in the record keeping rules is the absence of an immediately enforceable strict liability and infringement notice regime to take action against those that omit income by hiding or not recording cash transactions.

The existing offences are based on the lodgment of returns and other statements which aggregate a taxpayer's assessable income over a given period. Charges tend to be provable on the basis of alleging that relevant returns are false, for example because they have omitted income. As these returns do not require the reporting of individual transactions which may be fungible, proving these offences presents significant evidentiary difficulties for investigators and prosecutors.

We note that a GST receipt must be issued for all taxable sales above \$75 (excluding GST), but is optional below this threshold. We are not proposing any changes to this rule.

##### ***Rationale***

Businesses that do not fully record and declare their income by not recording all sales, particularly cash sales, are at the heart of the black economy. Providing businesses with clear guidance on their obligations whilst also reducing the attractiveness of such activity by equipping regulators with the right tools will be a strong black economy deterrent.

Mandating the consistent recording of transactions for tax purposes would improve the availability of auditable records and enable a clear breach of requirements to be more easily identified. A strict liability and infringement notice regime will provide a quick and effective way to address those who deliberately do not create such records so they can hide the transactions.

#### **OBSERVATION: PROSECUTING FALSE RECORD KEEPING**

The Commonwealth Director of Public Prosecutions (CDPP) informed us:

‘In relation to offences in the *Taxation Administration Act 1953* (TAA) involving allegedly false records in many instances the prosecution is required to prove beyond reasonable doubt that the records held or produced by the defendant do not accurately record the true state of affairs. There may be significant evidentiary difficulties faced in prosecuting these matters which rely heavily upon accurate records being available or insider information being obtained during the investigation.

The CDPP considers that proposals to enable ATO officers to access third-party information such as bank account information and other increases in the ATO’s coercive information gathering powers may assist in addressing these evidentiary difficulties.’

#### *Costs and benefits*

The prevalence of electronic POS systems means the new requirement would not have significant, if any, additional costs for honest business using such equipment given the system already generates these records. Improvements and widespread adoption of technology will also help minimise additional costs through e-invoicing. As technology develops, such records are likely to become part of new payment systems too. There could be scope, for example, to include relevant information as part of payments under the NPP. This means that business operating without modern POS equipment (for example, a tradesperson without mobile POS) would, by accepting payment through such payment platforms, not need to create any additional record of the transaction.

Those businesses that will be impacted by higher compliance costs are not currently keeping the full and proper records that other businesses are keeping. This requirement will bring their costs in line with the honest business that do properly record all their transactions. Some businesses may choose to receive electronic cash payments in order to minimise their risk.

Dishonest businesses which continue to offer cash only sales with the intention of under-reporting their income will be on the radar sooner, and face more timely action from regulators. Given the voluminous nature of such low-value offences, regulators would have to prioritise targeting high-risk operators first. The behaviour of dishonest business that under-report their cash sales will be able to be more readily dealt with, helping to level the playing field for honest business who record and report all their income.



## ***Other options considered***

### ***Mandatory receipts***

Other countries have addressed this problem by requiring that a receipt be issued by all business for all transactions and that a receipt be obtained, and retained, by customers for all transactions. Both the business and the customer can be penalised for breaches of this requirement. Requiring a receipt provides a record and a way for authorities to verify that transactions have been accounted for properly.

As previously noted, we do not consider requiring a receipt to be necessary to achieve this result. It is already compulsory to provide a receipt for a purchase of goods and services for \$75 or more. In the modern world electronic payments (and proper accounting of cash payments through modern POS) automatically create the required transparency and consumers increasingly do not want a pocket full of receipts. This recommendation will only in practice affect those businesses taking cash payments who do not already create a record of transactions, rather than increasing the costs for all businesses, as requiring a receipt could, just to target this smaller, non-record keeping, population.

### ***Implementation considerations***

Breaches of these rules should be designed so that there is a scaled set of administrative sanctions. For example (and noting that these sanctions could be applied as appropriate to the circumstances of the non-compliant business, not necessarily in step order):

1. Infringement notice.
2. Requiring them to obtain electronic/up to date POS.
3. Requiring them to obtain and use business/accounting software.
4. Requiring them to obtain and accept payment through merchant facilities.
5. Requiring a 'black box'<sup>8</sup> linked to the ATO.
6. Mandating that they cannot accept or make cash payments.
7. Monetary penalties of varying sizes that can apply for failing to meet the terms of sanctions 2 through to 6.

The ATO should be given the administrative discretion to excuse minor, inadvertent breaches of the law by taxpayers and should reserve the use of sanctions 6 and 7 as a last resort, or for the most seriously non-compliant businesses.

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8 A 'black box' is an electronic device that is connected to a cash register in order to read all its transactions.

## SUPPLEMENTAL RECOMMENDATION

### *Trade discounts*

During our consultations a number of people indicated that certain hardware stores are deliberately not recording trade discount transactions. These transaction records are used by the ATO as an audit trail. We recommend that to access trade discounts on purchases, businesses should have to provide their ABN to the seller who must verify and keep a record of the transaction. They should also record whether the transaction was in cash or card, and the amount. To falsify purchase accounts should be a false accounting offence. Suspicious high-value card transactions should also be subject to a reporting requirement.





# CHAPTER 8 ENFORCEMENT

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# CHAPTER 8: ENFORCEMENT

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## VISIBLE AND EFFICIENT ENFORCEMENT IS NEEDED

### *Key points*

A combination of growing demands and limited resources have forced law enforcement agencies to focus their efforts in areas like national security and counter-terrorism.

This has, perhaps understandably, taken some attention away from a focus on organised crime and the black economy.

What this has meant is that undesirable community perceptions have formed as individuals and businesses increasingly discount the likelihood of being caught participating in the black economy. A further problem is the perception that the associated penalties are low. The general approach of seeking settlement rather than pursuing prosecution furthers these perceptions.

While there is a need to devote more resources towards enforcement activities, these activities need to be carried out in more efficient and smarter ways by making better use of data and focussing on problem areas. There is a need to have visible examples to heighten community awareness of the consequences of doing the wrong thing. The high-profile approach being taken in the Plutus Payroll case is a positive step.

Enforcement can also be improved by taking a more differentiated approach to dealing with offences. There are different levels of culpability and not all offences should need to go to criminal prosecution, which is expensive and slow. The worst offences should be dealt with through criminal sanctions. Less damaging behaviour should be dealt with in faster, more efficient ways through civil penalties, some of which would be based on strict liability. Sanctions should be scaled such that repeat offenders, even for lower level offences, face escalating sanctions. Such scaled sanctions could go beyond merely increasing monetary penalties. Non-monetary sanctions may be more effective. For example, perhaps if through repeated offences someone shows they cannot be trusted to account for cash transactions properly, they should be required to only use electronic payment.

The Federal Court should be better utilised. Its case lists are shorter, it has better expertise in white collar crime, and with increasing convergence of issues relating to workplace relations, duty and tax matters, it may be able to deal with multiple offences more efficiently and effectively.

Any changes to penalties and enforcement must ensure that procedural fairness is maintained.

### *Enforcement efforts are inconsistent*

It has become evident that both within and across agencies, enforcement activities and effort are not consistently applied. This to some extent is reasonable given the size of many agencies and the

scale of responsibility each has. It makes sense for agencies to plan and carry out their own compliance programs focussing on the risks they see as most pertinent across their regulatory landscape.

However, where enforcement occurs across agencies on interrelated issues, agencies should seek to ensure that a consistent approach is taken to ensure loopholes or lack of clear regulatory boundaries do not create opportunities for individuals to avoid penalties.

In case after case, we have seen that black economy offences are many-sided, touching on immigration, tax, welfare, workplace relations and even corporate regulation. For this reason alone, agency officials will increasingly need to be multi-skilled. A tax auditor should be able to spot potential immigration and workplace violations, for example, and alert other agencies. The same applies, of course, to those working elsewhere. We argue later in this Report for the same approach with state governments.

### ***Enforcement outcomes are not equitable***

Where responsibility for enforcement on a particular issue crosses a range of regulatory agencies the outcome of any enforcement activity can vary greatly depending on which agency it is that undertakes the enforcement. This is often caused by inconsistent penalty frameworks. This results in a range of diverse outcomes occurring for what is in essence the same offence.

There is also a need to ensure that the resulting impact of enforcement, be it penalties or prosecutions, delivers outcomes that are commensurate with the activity they are seeking to mitigate. Penalties that fail to offset potential benefits gained by doing the wrong thing will not discourage individuals from engaging in undesirable activity even if the likelihood of being caught is high; they will just be seen as a cost of doing business. This is perhaps most evident with regard to the penalties applied to the possession of illegal tobacco which can vary greatly (see Chapter 13).

### ***Enforcement has become invisible***

Many agencies have developed low-cost, light-touch approaches to the delivery of enforcement. Through smarter data analysis and other technological advancements many activities often undertaken by auditors or field officers have now become streamlined automated processes.

While this has delivered significant efficiency gains for the Government it has also hidden from the public a large number of the enforcement activities that are undertaken. This has been further propagated by the preference of many regulators to settle rather than seeking to prosecute, and the reduction of Commonwealth shopfronts as services have increasingly been delivered through digital means. While the ATO does undertake a number of successful prosecutions, they tend to attract very little publicity.

Our consultation in regional areas highlighted to us the impact of these changes. Businesses and individuals explained that those in regional areas do not think they will be subject to enforcement proceedings because they do not see a visible presence by major regulators in the area. While this is

not in fact the case as enforcement is generally carried out remotely, it is the perception that there is no enforcement and that perception can lead to people going astray. We encourage agencies to explore ways that would allow for a greater regional presence, for example, during peak harvest season. Agencies are best placed to identify what regions should be targeted and how this can be done in a cost effective way, as inevitably there would be an additional cost to agencies.

The threat of audit is a strong tool in ensuring compliance with obligations. Studies have shown that uncertainty of the probability and regularity of audit activity is key in encouraging voluntary compliance.<sup>1</sup> As enforcement processes have increasingly become hidden, perceptions about the likelihood of being selected for audit have decreased.

### ***Consequences are poorly understood***

The fragmented application of enforcement, combined with varying consequences — commonly for similar offences — has meant individuals and businesses often have little understanding of the penalties they will face for doing the wrong thing.

This lack of understanding can reinforce negative perceptions as individuals do not understand the scale of penalties that they could be subject to if they are caught. Failure to fully apply penalties or communicate enforcement outcomes also contributes to these perceptions.

### ***Failure to enforce results in ‘victimless crime’ perceptions***

As outlined in Chapter 11 many participants in the black economy justify cheating the system as they consider it to be a victimless crime. Enforcement, or more specifically lack of enforcement, plays a key role in forming this perception.

Where particular laws are not enforced, or where the penalties are not commensurate with the activity being undertaken or seen as being set at an arbitrary value, individuals can form the view that their actions do not impact negatively on others and are therefore justifiable.

*‘Policy reform and regulatory requirements will never be more effective than the enforcement frameworks which support them. It is important that new initiatives are supported with equally well invested enforcement frameworks.’* Master Builders of Australia

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<sup>1</sup> Z Dai, RM Hogarth & MC Villeval, Ambiguity on Audits and Cooperation in a Public Goods Game, European Economic Review, vol. 74, February 2015, pp. 146-162.



### **OBSERVATION: SERIOUS FINANCIAL CRIMES TASKFORCE: PANAMA PAPERS**

The SFCT was set up to bring together the data, knowledge, resources and experiences of federal law enforcement and regulatory agencies to identify and address serious and complex financial crimes — such as international tax evasion fraud, phoenix fraud and trust fraud.

The Taskforce builds on the success of Project Wickenby which enhanced the strategies to collectively detect, deter and deal with international tax evasion. Project Wickenby saw \$2.3 billion in tax liabilities raised and \$1 billion in outstanding revenue recouped.<sup>2</sup>

The SFCT has played a key role in the domestic response to tax evasion and crime identified in the Panama papers. The ACIC has been working closely with the ATO, AFP, AUSTRAC and other partners across the SFCT to analyse data relating to the Panama Papers.

Through its enforcement activities involving the Panama Papers the SFCT as at 31 August 2017 has raised over \$12 million in liabilities and there are two criminal investigations underway. In addition through direct engagement, 53 taxpayers have either made or have indicated they want to come forward and make a disclosure. These disclosures are expected to be in excess of \$40 million.<sup>3</sup>

### ***Recommended actions***

We need new offences and different ways of dealing with them. Tax offences tend to lie at opposite ends of the spectrum. There are penalties for minor infringements, like making false and misleading statements. At the other end, serious fraud cases are tried in higher courts. But there is an offence gap between these extremes.

We recommend that a new category of mid-range offences be developed. We also recommend a specialist tax tribunal to speed up prosecutions. This could be established as part of the Federal Court given the Court's expertise in Commonwealth law. The ATO, for its part, should be prepared to take serious cases to court rather than pursue financial settlements before that stage.

Lastly, we recommend that entities and trusts should be obliged to disclose their legal and controlling owners at the request of the authorities to assist with enforcement of laws.

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2 Australian Taxation Office, Project Wickenby has delivered, accessed 5 October 2017, <https://www.ato.gov.au/General/The-fight-against-tax-crime/News-and-results/Project-Wickenby-has-delivered/>.

3 Australian Taxation Office.

## RECOMMENDATIONS

### ***Recommendation 8.1: Targeted, stronger and more visible enforcement strategy***

Implement a multi-pronged strategy to increase the level and visibility of enforcement and prosecutions, covering tax, industrial relations, welfare and immigration and financial regulatory compliance.

The strategy needs to make better use of intelligence and be focused on problem areas.

#### ***Description***

The Government should increase the level and visibility of enforcement and prosecutions. Many existing laws are appropriate for dealing with the black economy, but the low level of enforcement and visibility of enforcement can leave these laws ineffective as deterrents. A multi-pronged strategy, covering all aspects of black economy participation, is required to lift enforcement and make smart use of limited resources.

This strategy needs to make better use of prosecution powers (particularly in high-profile cases) and utilise default assessments more often and earlier in the process. Other recommendations in this report, such as the reverse onus of proof, better targeted mid-range offences, more strict liability offences and specialist tax tribunals should also be utilised to increase the efficiency of enforcement activities.

For optimal outcomes all elements must come into play. A one-size-fits-all enforcement approach is destined to fail.

*‘Enforcement is also a key driver of compliance, both directly and indirectly, by promoting system integrity and fairness in application.’ Business Council of Australia*

#### ***More multi-agency cooperation***

Black economy behaviour leads to multiple regulatory issues. For example, underpaying in cash a migrant worker who is working more hours than their visa allows while also not paying superannuation, PAYGW, as well as under-reporting related business income is a set of behaviours that has regulatory implications for DIBP, ATO, FWO, and possibly state revenue offices and workers’ compensation insurers. The same can be said for underpaying citizens, but with implications for DHS from potential over-claiming of welfare benefits and avoidance of child support obligations.

To support information sharing and data exchange, agencies also need to pool and leverage resources more efficiently to address issues which cross regulatory perimeters. While agencies already undertake some joint work, agencies need to work together more, and in a more coordinated fashion to effectively and efficiently address the behaviour. This could initially be achieved through establishing ‘virtual’ teams consisting of people from multiple agencies tackling a common problem area (for example, building and construction, horticulture, restaurants and cafés are high-risk industries for multiple agencies). Skills need to be harnessed across all regulatory

bodies to leverage resources. Eventually, the development of multi-skilled officers who are able to address issues across a range of agency obligations should be considered.

In Chapter 16, we propose the establishment of a multi-agency taskforce to target high-value, complex and cross-cutting black economy cases.

### *Cross delegation of appropriate powers between agencies*

Agencies should delegate some of their powers to other agencies (including state and territory agencies) so that on-the-ground enforcement officers can address the multiple regulatory issues arising from black economy behaviour. This would lead to a more efficient and immediate deployment of resources — and more effective outcomes as black economy participants would be dealt with from multiple angles at once. Unlike the current situation, there would be no need for the officer to have to refer it back to another agency for action via their home agency.

### *Increased information and data sharing and matching across agencies*

Agencies need to be able to share information and data in order to effectively coordinate action; such information and data sharing is currently too constrained by secrecy and privacy provisions that are not fit for purpose, as well as organisational cultures and technology platforms that impede information sharing. See Chapter 5 on Hardwiring Government for further discussion and recommendation.

### *Increased research to inform enforcement strategies*

All enforcement agencies need to better understand the causes of black economy behaviour and what is effective in addressing it at the behavioural level to better target interventions, whether it be education, services, enforcement or other activity. Research, particularly behavioural research, such as partnerships with academic institutions and behavioural specialists, is needed to inform better targeting of interventions.

The ATO can make greater use of information and intelligence held in the private sector. Banks, local industry associations and unions typically have good systems and knowledge of where risks exist in the communities they serve.

### *Joint raids for the most egregious behaviour*

Joint raids already occur and often gain wide media publicity. As they are costly and time-consuming they are generally used to tackle the most egregious behaviour. This should continue as the raids and the publicity they gain are an important part of addressing black economy behaviours. Less egregious behaviour can be more efficiently and effectively dealt with through other coordinated and joint multi-agency work as discussed above.

#### **OBSERVATION: THE VIRTUES OF JOINT ACTION — 911 COMMISSION REPORT**

‘When agencies cooperate, one defines the problem and seeks help with it. When they act jointly, the problem and options for action are defined differently from the start. Individuals from different backgrounds come together in analysing a case and planning how to manage it’.

### *Increased publicity of the actions and outcomes*

Behavioural research indicates that people not only need to see that the worst behaviour is addressed (such as joint raids for the most egregious behaviour), but they also need to see that people behaving like them are also affected. For example, tradespeople doing cash jobs need to see that other tradespeople doing cash jobs get caught and dealt with.

Publicity also has to be regular and ongoing to affect long-term behaviour because people tend to have short memories when considering the risk of engaging in black economy like behaviours. The older publicity is, the less someone is likely to remember it in making the risk decision.

*‘CPA Australia is supportive of greater publicising of enforcement action and outcomes. This serves a few purposes, for example as a deterrent, and also providing confidence in the system for honest hardworking taxpayers.’ CPA Australia*

### *Collaboration with industry to improve education and compliance behaviour*

Some agencies are co-designing regulatory frameworks with industry, tailored to their regulatory needs and nature, size and complexity. This approach is to build a knowledgeable, vigilant and capable sector able to prevent, detect and respond to risks and threats. It also provides greater clarity and certainty operating in regulatory environments. This is coupled with more timely and relevant guidance, education and feedback, to strengthen their regulatory processes and improve resilience. Greater collaboration with industry will translate into greater compliance behaviour, reducing the need for government intervention and, ultimately, cost for industry and government. This is further explored in Chapter 11.

#### **OBSERVATION: THE BEAUTY BUSINESS**

A hair and beauty salon told us:

‘We have had 2 apprentices in the last 12 months, do 18 months of their apprenticeship with us, and then go and open Barber shops at the back of coffee shops, run them as cash and receive Centrelink. They are not qualified yet they are still able to obtain an ABN and trade. We of course have to pick up the bill for all their training, and because they never qualify we do not receive the final incentive from the government. We cannot take on an apprentice unless we have qualified senior staff supervising them at all times. Yet they can trade unqualified! Also an adult apprentice after their first 6 months is paid \$1 less (\$19.44) than a fully qualified hairdresser (\$20.61) who has done 3 years. Hence why we have a massive skills shortage in Australia!

We have had staff tell us it is more beneficial for them to work for cash and get Centrelink, because then they get rent assistance, family payments, health care card, bulk billed, reduced pharmacy, reduced utility bills, and spend more time doing what they want.

### **Objective**

- Increase visibility and enforcement of existing laws to bring to people’s attention the consequences of participating in the black economy.
- Improve the gathering and application of intelligence across agencies.

- Make more efficient use of limited resources for enforcement of existing laws.

## Discussion

### *Problem the recommendation seeks to address*

Community feedback has suggested that it is currently ‘too easy to get away with’ operating in the black economy. Stakeholders have also advised that where laws are enforced, this is often not visible to the general community or even to their peers, reinforcing the perception that it is easy to get away with doing the wrong thing. The growth in the use of ‘invisible’ enforcement strategies such as letters and desk audits, while far more efficient than sending enforcement officers into the field, is far less visible and is ineffective in lifting the general perception of the likelihood of being caught.

Many industry, business and community stakeholders have also suggested increasing resources for specific agencies, including the ATO, AUSTRAC, FWO and ASIC to combat the black economy. There is a general recognition that agencies face a significant challenge in making an impact given the size and clandestine nature of the black economy.

### *Rationale*

A key message from our consultations has been that increased publicity of agency action and the outcomes are needed. Increased and more visible enforcement will help deliver the message that people engaging in the black economy will have to face consequences.

During our town hall meetings we were surprised by the number of people who didn’t know where to send information or who were frustrated with the current hotlines. Existing reporting systems are largely inefficient, dob-in lines suffer from privacy limitations which hinder the ability of agencies to follow-up with individuals, are sometimes offered only in English, experience long delays and have functions which are replicated across agencies. Our proposal for a dedicated black economy hotline (see Chapter 16) will address these issues and support this recommendation.

While agencies already have a high-level of sophistication in the development and delivery of their black economy enforcement strategies, fresh and smarter multi-agency approaches to enforcement are needed to comprehensively tackle black economy behaviour, make more efficient and smarter use of existing resources, incorporate advancements in FinTech, and address black economy behaviour comprehensively.

#### **OBSERVATION: WORKING WITH INDUSTRY TO IDENTIFY WHO MIGHT BE AT RISK**

Major wholesale trade suppliers, such as of construction supplies like bulk concrete, cladding, bricks (that is, not hardware stores), can have a good idea of who is at risk of poor behaviour. They make decisions about to whom they will and will not extend trade credit, and on what terms. Such information could be of use to regulators in determining business at risk of black economy behaviours.

## ***Other options considered***

### *Re-open regional offices and/or shopfronts*

Some stakeholders have suggested that the ATO should have a wide geographic footprint and should re-open regional offices or ATO shopfronts. The rationale is either that the presence of an office can influence the levels of compliance and more readily allows for the delivery of education and awareness activities in the community. A visible enforcement presence can be maintained in regional areas without the high cost of multiple small offices through other approaches such as field officers visiting regional areas at key times, such as harvest season.

### *Name and shame*

We considered recommending that a register be established to publish the details of deliberate tax evaders. This exists in the UK. Naming and shaming can be an effective behavioural tool as the risk of public exposure is a deterrent to those willing to engage in significant tax evasion. A register would also allow companies, consumer and employees to make better judgements when decision who they should conduct business with. However, we consider that with increased visibility of enforcement through other means, as recommended in this Report, name and shame is not necessary at this stage.

## ***Implementation Considerations***

Implementation of some elements of the recommendation would need to be considered in further detail including:

- How cross-delegation of powers would work.
- How the states and territories could be included.
- Any constitutional barriers.
- Models for virtual teams.

### **Recommendation 8.2: More effective prosecution processes**

Prosecution processes should be made more effective by designating the ATO as a criminal law enforcement agency; giving the ATO powers to obtain bank information; and reviewing the evidence gathering powers of other regulators.

#### **Description**

The Government should implement measures to ensure that prosecution processes are more efficient. This includes the following changes:

- **Expanding the number of criminal law enforcement agencies:** The ATO and AUSTRAC should be designated as criminal law enforcement agency for the purpose of the *Telecommunications (Interception and Access) Act* so that they can access stored communications and telecommunications metadata. This will protect public finances from criminal activities such as serious tax fraud and ensure parity with other regulators such as ASIC and ACCC.
- **Powers to obtain bank information:** For criminal offences under tax legislation, the ATO should be given the powers to issue search warrants to source bank data directly from banks, rather than burdening the AFP.
- **Reviewing evidence gathering powers:** The evidence gathering powers of other regulators should also be reviewed to assess whether they have appropriate and timely access to bank data and telecommunications metadata. The ability of regulators to access data held by online social media providers should also be explored.
- **Making use of a specialist tax tribunal:** More matters should be dealt with through tribunals as part of the Federal Court given its expertise in Commonwealth law. This would be an appropriate venue for dealing with these white collar crimes. There should be further specialisation in tax and related matters that can be dealt with through the Federal Magistrates Court and District Courts. We think these changes can be achieved within existing funding frameworks.
- **Joint prosecutions:** Businesses that participate in the black economy usually breach more than one regulatory regime. Not only should there be joint enforcement action, the breaches being addressed through that action should also be prosecuted together for greatest impact and to improve the visibility of such enforcement and prosecution action.

#### **Objective**

- Improve the ability of the ATO and other regulatory agencies to obtain necessary evidence including bank account information and telecommunications data to support investigations and enforcement.

## Discussion

### *Problem this recommendation seeks to address*

**Bank data:** Bank information is a staple of most low to mid-range black economy criminal offences. For all criminal matters the ATO has to rely on the AFP to issue and execute friendly search warrants on banks to gather information on their behalf.

Because the AFP is often, and rightly, busy dealing with more serious offences such as counter-terrorism, there are competing pressures and delays in getting the AFP to issue and execute search warrants on banks. Sometimes the whole process of engaging the AFP may have to be repeated if the initial search warrant uncovers new leads which require additional warrants to be issued.

This is an unnecessary resource drain on the AFP which should instead be freed up to deal with more serious crimes.

The ATO currently has the coercive powers to gather information from banks for only administrative investigations, not for criminal investigations. In our view, there is no valid reason why the process of gathering bank information for criminal investigations should differ from administrative investigations.

**Telecommunications data:** Telecommunications data such as telephone numbers, name and address details, itemised call records are vital to criminal investigations conducted by regulators such as the ATO.

Telecommunications data can be used to identify connections between contacts within syndicates and their controllers, and it is once this broader picture is known the full picture of criminality can be understood.

Recent amendments to the *Telecommunications (Interception and Access) Act* in October 2015 meant that regulators such as the ATO, which previously had direct access to telecommunications data, lost it. These regulators are currently restricted to receiving this data only as part of joint investigations with the AFP.

It is impractical for all criminal investigations of these agencies to become joint investigations with the AFP.

Designating the ATO and AUSTRAC as a criminal law enforcement agency for the purposes of the *Telecommunications (Interception and Access) Act* will allow the ATO to access to appropriate telecommunications data in a timely manner.

### *Rationale*

Equipping regulators and law enforcement authorities with the efficient and appropriate powers to gather intelligence in a timely manner will improve the prosecution rate of black economy offenders.



### ***Stakeholder views***

Designating the ATO as a criminal law-enforcement agency was recommended by the Parliamentary Joint Committee on Law Enforcement (PJCLE) in its inquiry into financial related crime in September 2015.

Establishing a tax tribunal as part of the federal court has received considerable support but it was also noted that there may be limits to what it can achieve and resourcing may be required.

### **Recommendation 8.3: Reverse onus of proof**

Consider reversing the onus of proof for all/some elements of a small number of serious black economy offences and harmonising the various unexplained wealth provisions.

#### **Description**

The Government could consider reversing the onus of proof for all/some elements of a small number of serious black economy offences. This should be coupled with increased use of default assessments. Some areas we have identified are:

- **Proving the origin of unexplained wealth:** The *Proceeds of Crime Act 2002* (PoCa) governs the majority of confiscation processes at the Commonwealth level. These civil provisions target high level criminal bosses who obtain the proceeds of criminal operations they have directed, but not participated in. When a link is demonstrated between a person and a criminal offence, or a link between the wealth and a criminal offence, that person can be ordered to attend court and prove that their wealth was legitimately acquired.

Due to constitutional limitations, the Commonwealth unexplained wealth provisions can only apply if there is a link to a Commonwealth offence, a foreign offence, or a state offence with a federal aspect. Unexplained wealth that is purely derived from a state offence is unlikely to fall under the purview of the Commonwealth rules, they would fall under the relevant states' unexplained wealth provisions.

We recommend harmonisation of the various regimes.

- **Falsification of accounting records**

In addition, if someone claims that unexplained wealth was obtained from gambling winnings over a certain threshold (which would be high, say \$50,000), the origin of funds would need to be substantiated through a third-party. For example, they would need to produce receipts for wagers they made (see also Chapter 14). Regulated bookmakers and betting agencies already store this information.

#### **Objective**

- Reduce barriers to prosecuting black economy offenders.

#### **Discussion**

##### *Problem this recommendation seeks to address*

Gathering proof to the criminal standard is difficult and resource intensive. Proof may be hard to obtain because such knowledge is only privy to the defendant.

In criminal proceedings, the prosecution bears the legal onus of proof to prove the elements of an offence beyond reasonable doubt. The defendant then bears the evidential onus of proof for any defences or excuses that they raise in response. This general principle is a core principle of common law where a party is presumed to be innocent until proven guilty.

Laws that expressly reverse this general principle are considered to ‘reverse the onus of proof’. Because such laws adversely affect individual rights and liberties, they are considered appropriate in serious offences relating to terrorism, drugs and child sex offences. A key justification for the reversal of the onus of proof in these cases is the formidable difficulty faced by the prosecution to secure proof.

The legal onus of proof need not be reversed for all elements of an offence. Reversing the legal onus of proof for even a few elements of an offence may be a good compromise between the competing objectives of protecting individual rights and reducing the prosecution’s burden of proof.

### *Rationale*

Reducing excessive burdens on the prosecution will improve the likelihood of aggressive black economy offences being successfully prosecuted, which can act as an effective deterrent. Reversing the onus of proof can lead to cost effective high-volume enforcement.

### *Other options considered*

#### *Cash deposits*

We considered reversing the onus of proof onto those found depositing large sums of cash in financial institutions. We decided not to proceed further as the existing AML/CTF legislation already covers such scenarios. Financial institutions should already be reporting cash deposits greater than \$10,000 and suspicious matter reports with AUSTRAC if they form suspicion of an offence against a range of laws, including Commonwealth laws.

### *Implementation considerations*

Reversing the onus of proof requires serious consideration. While it can be more efficient, it must not be seen to remove due process. Appropriate safeguards must accompany the changes.

### **Recommendation 8.4: The introduction of new black economy offences**

Consider introducing a new class of mid-range black economy offences to give law enforcement agencies a broader range of more appropriate offences and sanctions to deploy against black economy behaviours.

Consider introducing a new class of strict liability offences for low to mid-range black economy offences to reduce the time and cost of enforcement. These offences should be supplemented with civil penalties and infringement notice regimes to penalise breaches of these offences.

## **Description**

### *Mid-range offences*

Develop offences that are suited to the mid-range of behaviours that are common in the black economy; behaviours that are more egregious non-criminal, not quite or low-order criminal.

Develop responses more appropriate for addressing the contemporary problems arising in the black economy, such as identity theft, avoiding know-your-client and obtaining false documents from the dark web.

We consider that a broader range of sanctions, that is, not just monetary or criminal sanctions, is needed to address black economy behaviours.

### *Strict liability offences*

An offence is one of strict liability where it allows people to be punished for doing something, or failing to do something, irrespective of their motivation. Put simply, proving that someone committed the act that constitutes the offence is enough to prove that someone committed the offence. The prosecutor does not have to prove that they intended to commit the action, had knowledge of their actions, were reckless, or negligent. The only defence available to a person charged with a strict liability offence is a mistake of fact (a reasonable, honest belief in a state of affairs which, if they had existed, would mean the act would not constitute an offence, for example, if charged with theft, but the defendant honestly and reasonably believed the property was their own). However, there would also likely be a need to include some statutory defences to ensure onerous penalties weren't applied to one-off mistakes or simple human errors. Strict liability offences are efficient for regulators and professionals and save time and money. Again, the use of default assessments should be considered here.

Some areas where the introduction of strict liability offences and an infringement notice regime could be considered are:

- The quotation of a false ABN or another entity's ABN, such as on invoices.
- Applying for an ABN on behalf of an individual, associate or an individual with an ABN entity, without the individual's consent.
- Sale of illicit tobacco, or possession of significant quantities.

- Paying wages in cash (see Recommendation 3.2).
- Exceeding the cash payment limit of \$10,000 (see Recommendation 3.1).
- Failure to keep proper books and records.
- Betting with illegal operators (state and territory).

## **Objective**

- Address the gap in the existing black economy offence regime by expanding the range of offences, both civil and criminal, including strict liability offences.
- Improve the ease and timeliness with which regulatory authorities can enforce and prosecute black economy offences.

## **Discussion**

### *Problem this recommendation seeks to address*

#### **Mid-range behaviours**

We have seen significant gaps in the offence profile available to law enforcement agencies addressing black economy behaviours, which handicaps their enforcement efforts. Too often agencies, whether dealing with tax or fair work or any of the other manifestations of the black economy, have little choice between applying low-level sanctions that are just seen as a cost of doing business or taking expensive and high-risk litigation or prosecution action.

What is required is offences that are suited to the mid-range of behaviours that are common in the black economy; not quite criminal, or if they are, lower order, or the more egregious of non-criminal behaviours. A slap on the wrist is not enough for these behaviours, but requiring time consuming and expensive prosecution action is a disproportionate burden on law enforcement agencies and the community in seeking to address these behaviours.

What is also needed are responses more appropriate for addressing the contemporary problems arising in the black economy, such as identity theft, avoiding know-your-client and obtaining false documents from the dark web.

A broader range of sanctions should be adopted, going beyond monetary penalties or criminal sanctions. For example, we have suggested various different sanction options elsewhere in this report for particular matters, such as those discussed for record keeping, visa forfeiture for visa breaches and procurement (that is, not being able to participate in government procurement being a consequence for not meeting certain tax obligations). This kind of broader view about what are appropriate sanctions should be taken in developing the required mid-range offences.

### Strict liability

Law enforcement agencies face challenges when prosecuting black economy offenders using criminal offence provisions. Criminal offence provisions usually require the prosecutor to prove beyond reasonable doubt that the defendant intended to commit the offence. Given the serious consequences of being convicted of a criminal offence, it is only fair to place a high burden of proof. The requirement of proof of fault is one of the most fundamental protections of criminal law, but it can mean that regulators are unable to obtain and demonstrate sufficient proof to the criminal standard. In contrast to criminal provisions, the burden of proof for civil penalties is lower, as are the sanctions. Regulators often resort to civil proceedings where lower evidentiary standards are sufficient.

The Government could also give consideration to introducing strict liability offences for a range of other behaviours that we have heard about in community consultations. This could include strict liability offences where an entity seeks to coerce or mislead an individual to incorrectly apply for an ABN, or an entity seeks to suggest or incite an individual to set up an interposed entity to which payments are made in order to avoid employer obligations or an offence where an entity seeks to require another entity to have an ABN as a condition of gaining work.

### *Rationale*

#### Mid-range behaviours

Black economy behaviours range from serious crime through to skimming a little out of the till every week, and, as we have discussed elsewhere, cover many different types of behaviour and activity. There are multiple motivations and multiple drivers for the behaviours. Yet the offences and accompanying sanctions available to address such behaviours are limited in range and variation, creating a gap and limiting the ability of enforcement agencies to respond in the most appropriate and sensible way. Contemporary thinking that goes beyond just increasing the dollar amount of monetary penalties, or longer jail sentences, is required to address this problem that is both as old as the hills and as innovative as the most cutting-edge of modern businesses.

### Strict liability

Easily enforceable legislative provisions act as strong deterrents that adjust a black economy participant's cost benefit assessment of committing an offence. Strict liability offences allow law enforcement agencies to deal with offences in a timely manner, and reduce the cost of doing so. These offences provide for people to be punished for doing something, or failing to do something, irrespective of whether the defendant intended to commit the offence. A good example is speeding fines. Supplementing these offences with an infringement notice scheme will equip regulators with an effective enforcement tool that they can enforce swiftly at a lower cost.

Defendants accused of strict liability offences still have the defence of having made an honest and reasonable mistake. For example, if the defendant had an honest and reasonable mistaken belief in a certain state, which, if existed, the defendant's actions would have been innocent.

It must be noted that any proposals to introduce strict liability offences should not be based on administrative convenience. Strict liability offences should not unduly trespass on personal rights and liberties.

### **Recommendation 8.5: Transparency of beneficial ownership**

Entities and trusts should be obliged to disclose their legal and controlling owners at the request of the authorities consistent with Australia's international obligations. Failure to comply with the request should attract significant sanctions.

#### **Description**

We consider that a request-based model for beneficial ownership adequately balances increased transparency with the potential additional regulatory burden on individuals and businesses from alternate options.

All companies would be obliged to maintain up-to-date information on beneficial ownership in their own company register. Other legal entities (such as trusts) would also need to maintain accurate and up-to-date records of their ultimate beneficial owners. This information would have to be disclosed at the request of the authorities.

Significant sanctions for failure to comply are necessary to act as a strong deterrent to those entities that seek to avoid complying with the request of authorities in order to continue to hide the owners and controllers.

#### **Objective**

- Improve the ability of regulatory and law enforcement authorities to tackle illicit activities.
- Balance meeting Australia's international obligations against the regulatory burden on individuals and businesses.

#### **Discussion**

##### *Problem this recommendation seeks to address*

The hidden ownership and control of entities and trusts is a barrier to regulatory and law enforcement investigations, particularly where there are offshore interactions or layers and layers of companies and trusts. Reducing this anonymity will not only help agencies in tackling money laundering, tax evasion, corruption and bribery but also in addressing phoenixing. In addition this imperfect transparency means that when government is procuring goods and services it does not know who the owner or controlling mind behind the entity is.

*'Beneficial ownership arrangements which are used to illegally and deliberately avoid tax or launder money should be condemned and company directors should face the full legal consequences of these actions. Concurrently, the use of trusts and other business structures are a legal and important feature of legitimate businesses tax planning and should remain in place.'* Master Builders of Australia



### *Rationale*

Improving transparency of beneficial ownership for companies, trusts and other legal arrangements is an important reform which is also a focus internationally. Australia has committed to the G20 Principles and implementing the Financial Action Task Force Standards' recommendation in this area. Treasury has released a public consultation paper seeking views on the details, scope and implementation of a beneficial ownership register for companies and will provide a recommendation to Government on this.

Greater transparency of beneficial ownership is highly desirable as it will equip regulatory and law enforcement agencies with information to track down the owners and controllers of entities that engage in illicit activity more effectively allowing for remediation activity, such as asset forfeiture, to be carried out.

### *Costs and benefits*

The recommended model seeks to balance increased transparency with the regulatory burden on individuals and businesses.

We have heard some reservations about whether this proposal will be sufficient to enable Australia to fully meet the Financial Action Task Force (FATF) standards. We consider that the detailed design could iron out these concerns.

It is noted that a request based model may limit the ability of authorities to progress investigations without alerting entities of the investigation.

Stakeholders also raised concerns that multiple requests for information by authorities to entities (including potentially duplicate requests) could impose significant compliance costs and, depending on the scope, quantity and timing of requests and could potentially be less efficient than other options.

### *Other options considered*

#### *Non-public central government register*

A central non-public register of beneficial ownership information which regulatory and law enforcement agencies have access to would assist enforcement activities. Stakeholders generally supported this model on the basis that law enforcement was highly desirable.

Stakeholders also suggested that if the non-public register was made available to AML/CTF reporting entities this could assist in meeting their due diligence obligations and thereby reduce the associated compliance costs. The central register was not supported on the basis of the additional compliance burden on individuals and businesses in providing the information.

#### *Public central register*

This proposal was strongly supported by a number of groups who support full transparency. Three main benefits were put forward: (i) easier compliance with due diligence for financial institutions

and business under the AML/CTF rules, (ii) ensures a level playing field for business as businesses and individuals will know who they are dealing with, and (iii) assists honest businesses to remain competitive by avoiding dealing with ‘dodgy’ operators.

A further benefit is that state and territory bodies which also encounter beneficial ownership issues would also have access to the information, if they do not fall within the authorities with access under the non-public register option. The public central register was not supported on the basis of additional compliance costs burden on individuals and businesses of providing the information.

### *Public central register, like the Torrens Title system register*

This proposal was suggested by a stakeholder. The thinking is that under the Torrens Title system, a land title register, the person recorded on the register as the owner is the beneficial owner. In the time available we have not been able to determine whether this proposal is practical.

*‘Chartered Accountants agrees that, on public policy grounds, a beneficial ownership register (BOR) as part of a modernised whole of government business registry will assist in the administration of tax and other laws. There are many reasons for this view. For example, a BOR could reduce the ability of unscrupulous persons to operate ‘phoenix companies’, undertake money laundering, participate in terrorism financing, invest corrupt proceeds in Australia, and exploit a variety of Federal and State/Territory laws (such as the laws relating to political donations). It could also give Australian policy makers and regulators greater insights into who owns strategic assets in Australia and who is bidding for Government contracts. Put simply, our community should not be blind-sided by opaque company ownership arrangements.’* Chartered Accountants Australia and New Zealand

## **International experiences**

In Europe many central registers implemented to meet the FATF recommendation are not public.

The UK has a central public register of people with significant control (PSC) of companies. Companies must also keep their own PSC register and file annual relevant information (there are exceptions for certain listed companies). Recently, the UK introduced a non-public trusts register and trustees are required to provide details of beneficial owners of relevant taxable trusts to HMRC.

## **Stakeholder views**

We have heard broad support from stakeholders for increased transparency of beneficial ownership. Stakeholders have noted that greater transparency should not be limited to companies and should also apply to trusts. Some stakeholders expressed strong support for having beneficial ownership information publicly available through a central register on the basis that hidden ownership poses problems for honest businesses and the community because they do not know who they are doing business with. Other stakeholders agreed that compliance costs should be minimised through government using the information it already has.

### ***Implementation considerations***

A range of issues, such as the time period in which entities and trusts must comply with requests and nature of sanctions for failure to comply, would need to be considered.

The availability of information provided at the time of sale of a business, including that available through business brokers, should also be explored.

Additionally, the ability of agencies to access information and exercise search powers would also need to be considered.

## SUPPLEMENTAL RECOMMENDATIONS

### *‘Check-ins’, bonds and suspended penalties*

We consider that new sanctions are needed to deal with egregious and persistent non-compliance to supplement our recommendation regarding escalating sanctions for failure to comply with record-keeping obligations.

For the more egregious cases of non-compliance where people have repeatedly failed to meet obligations, including failing to keep records, there should be a requirement to ‘check in’ with the ATO (perhaps six monthly) over a set period to explain what steps they have put in place and are doing differently to improve their record-keeping and tax compliance. This ‘check-in’ could be a scheduled phone conference or attendance at the ATO and the person would advise the ATO on status of activities such as engaging professional assistance (for example, BAS preparer or registered tax agent), installing and using POS equipment or methods for accepting payments through payment facilities. Where over time the person’s compliance has improved and the steps are proving effective, the need to ‘check-in’ to the ATO would stop.

In addition to the ‘check in’, an additional requirement could be that the person must pay a bond to the ATO at the start of the ‘check-in’ arrangement period, which would be refunded in four years, when the taxpayer has demonstrated consistent, ongoing, improved compliance. The bond concept is similar to a rental bond and would be kept and applied against tax obligations if they are not paid, or refunded if the person meets their tax obligations over the four year period.

A third sanction which we recommend is suspended penalties. These could apply where a penalty should apply and the ATO and person agrees to suspend the payment of penalties on the agreement that certain conditions, such as improvements in record-keeping or lodgment of returns be met. If at the end of the suspension period, the conditions have been met, the penalty is cancelled, otherwise the person will need to pay the penalty.

### *Resourcing for the ATO and Fair Work Ombudsman*

We consider that the ATO and FWO need to be adequately resourced to tackle black economy issues and for enforcement activity to be visible on the ground. We heard from stakeholders that the number of FWO inspectors fell far short of what is needed to ensure that workers are correctly paid the right wages and other entitlements such as superannuation. We found that the incidence of fair work issues was significantly higher than what we anticipated and agree that the current staffing level is lower than would be expected to deal with this scale of risk. We are also of the view that the ATO requires additional resources to deal with black economy compliance, including enhanced data analytics which is discussed in Chapter 5.

### ***Use of estimates to value businesses and transactions***

Businesses are often bought and sold through specialised brokers. When a business with undeclared cash earnings is sold, the broker might ‘adjust’ the booked earnings upward to reflect that fact. The ATO should closely monitor these practices. Business brokers, moreover, should have a positive obligation to report cases where earnings adjustments are requested.

In addition, the ATO should continue to employ proxies in its compliance and enforcement action (including issuing default assessments) in the black economy, such as the use of Small Business Benchmarks. These benchmarks should also be better publicised. It may be worth exploring the application of proxies to illegal phoenix arrangements, where appropriate. We note the limitations of proxies in this type of area as they would not provide sufficient evidence for criminal prosecution and more comprehensive audit and investigation work would need to be done to gather that evidence. There is also a need to remove impediments to effective prosecution of tax offenders in these cases.

### ***Correct deficiencies in the prosecution process***

‘Double jeopardy’ refers to the circumstances in which a person may be penalised for the same offence more than once. In the area of taxation law, double jeopardy occurs when a taxpayer who is required to pay an amount of penalty tax under a civil tax assessment process, does so, but is then subject to criminal prosecution for the same offence.

Double jeopardy is sound policy, however, section 8ZE of the *Income Tax Administration Act 1953* goes beyond that. In effect, the administrative penalty must be withdrawn by the Commissioner, and it cannot be re-imposed — even when the criminal prosecution is withdrawn or the charges are dismissed.

Due to the higher standard of proof required in a criminal prosecution, there is a likelihood that a guilty taxpayer may never be convicted of the offence. Section 8ZE compounds this issue by allowing the taxpayer to get away without facing either the administrative penalty or the criminal penalty.

In our view, this section should be amended so that the administrative penalty stands. Administrative penalties should only be remitted if the taxpayer has been proven guilty in criminal proceedings.



# CHAPTER 9 SUPPLY CHAIN INTEGRITY

## LIST OF RECOMMENDATIONS

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# CHAPTER 9: SUPPLY CHAIN INTEGRITY

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## SUPPLY CHAINS ARE BECOMING MORE COMPLEX

### *Key points*

In the years since the global financial crisis, governments and private sector firms have been under considerable pressure to cut costs. We have seen that the integrity of procurement practices, in many cases, has been eroded. Firms that comply with tax, workplace relations and other regulatory requirements have told us that they are consistently being outbid by those who break the rules. There should be an adverse commercial consequence for these firms.

As supply chains lengthen and become more complex, existing standards are harder to enforce. In this vacuum, exploitative and even illegal supplier practices can thrive.

Governments can take a lead in this area. They are often one of the largest procurers of goods and services and can influence behaviour. They should make sure they do not award contracts to firms with poor tax and regulatory compliance records by creating a ‘trusted trader’ status for businesses that comply with a set of standards. They should also invest in smart technology and make the most of blockchain as it becomes more mature.

Many large companies, such as BHP, Rio Tinto, Wesfarmers and Woolworths already have good frameworks in place. Government needs to follow suit to set an example for the rest of the economy. Private sector practices can be improved in two ways. Businesses, including their procurement officers, need to be accountable for the integrity of the supply chains they use. Suppliers, working through their industry associations, should develop rigorous, independently-audited self-certification codes, supported by the Government setting standards.

Better commercial practices can be fostered in other ways. The Australian Supplier Payment Code, an initiative of the Small Business and Family Enterprise Ombudsman (SBFEO) and the BCA, could potentially be a vehicle to improve supply chain practices.

### *The next big economic challenge*

Fiscal constraints have driven the public sector to aggressively pursue savings. In the private sector, tightening margins are behind this trend. Lower costs, of course, benefit both taxpayers and consumers. But if suppliers are winning contracts by cutting tax and regulatory corners, the integrity of these systems is undermined. Tax bases will be eroded, employees will fail to benefit from the protections embodied in our workplace relation and other laws and the operation of markets will be distorted. If suppliers who do the right thing are outbid by unscrupulous competitors who appear to get away with it, some will be tempted to cut corners themselves. If this is not checked, a race-to-the-bottom can develop.



As supply chains evolve, standards can become harder to enforce. Procurement officers will find it difficult, if not impossible, to know what subcontractors several levels down are doing. Which people they are employing, whether they are paying award wages and providing safe workplaces, and whether they are meeting their tax obligations. In these circumstances, some may be tempted to 'look the other way', satisfied that their immediate suppliers are above board. In this accountability vacuum, exploitative and even illegal supplier practices can thrive. New business models arising from disruptive technologies add further complexity. As regulations lag behind rapid changes in the economy, supply chains similarly struggle to keep up.

This is an OECD-wide phenomenon, with policy-makers sometimes slow to respond. In Europe and the US, an ethical sourcing industry has emerged in recent decades. Independent social auditors are used to monitor supply chain practices. Standards-setting bodies have set codes of conduct in areas such as slave labour, basic working conditions and environmental protection. Investors and consumers, for their part, are demanding better practices.

In Australia, supply chain integrity has not been ignored. Government agencies and large firms have procurement codes in place. Many reputable private sector businesses are already leading the way by developing their own codes of conducts and vetting businesses before taking them into their supply chain, including BHP, South32, Wesfarmers, and Woolworths. Particular care is taken when goods are sourced from developing countries. And abuses have been publicised by the media, including abhorrent practices in the meat industry. Notwithstanding this, we believe that more needs to be done, by both governments and the private sector, to lift standards in this area.

In the course of our industry and public consultations, we heard a number of complaints from firms, unions and others about poor supply chain practices. The problem appears to be most prevalent in sectors where unskilled labour is directly supplied, such as cleaning, security and construction. Horticulture was also a concern, given its reliance on unskilled and seasonal labour. Labour hire operators that provide such workers have also been identified as an area of concern. Firms reported being significantly under-bid by competitors, even when they had reduced their labour costs to the legal minimum. The same allegation has been made by union representatives, who not only see this as a threat to their members' conditions but worry about the exploitation of vulnerable workers. Indeed, in specific cases, we have heard reports of criminal groups infiltrating supply chains. They take advantage of cheap labour (including visa holders who agree to work for below award wages and conditions), the ease of obtaining ABNs (which they hide behind), and the complexity and multi-layered nature of modern supply chains.

We are not discounting the effectiveness, in some areas, of existing integrity efforts. We would argue, however, that too often these focus too narrowly (for example, on particular abuses like modern slavery) and are too reactive.

**OBSERVATION: LABOUR HIRE — SUPPLY CHAIN PRICE PRESSURES**

Price pressure from the top end of a supply chain can cause worker exploitation down the supply chain, in horticulture, cleaning, security services and elsewhere. These price pressures can lead to entities through the supply chain, such as unscrupulous labour hire firms, using structuring to avoid responsibilities, such as using one entity to enter the supply contract and accept payment, but using another related entity to hire the workers (and leave any debts with that entity, while the income has all been received in the other entity). We have been informed that it is not uncommon for cleaners to not even know who their employer is. This structuring is not uncommonly followed by phoenixing. Not only is this a way to avoid responsibilities to workers, it also means procurement officers looking for ethical suppliers may not be able to avoid the unethical or dodgy operators. Hiding who is the true owner/operator means workers cannot enforce their rights, enforcement agencies cannot enforce, phoenixing can be done easily, and other businesses looking for ethical procurement cannot find it.

***The policy response: how to lift supply chain standards?***

In our view, if governments want better supply chain practices in the private sector, they should lead by example.

Governments should only purchase goods and services from suppliers who meet their tax, workplace relations and other legal obligations. They should be exemplars of best practice, sending a strong message to all that cutting corners is not acceptable. All governments have detailed procurement guidelines in place. Some have taken worthwhile steps to strengthen them in recent years. The Australian Government requires its suppliers to comply with applicable laws and regulations. For certain contracts, specific indigenous and workplace gender equality goals must be met. We argue that the procurement rules should include a specific tax and regulatory requirement. For larger contracts, bidders must demonstrate they have a good tax compliance record. This should be based on a small number of criteria, including not being convicted of tax evasion offences, not having serious tax arrears and, for larger companies, publishing the Board of Tax's Tax Transparency Report. For all bidders, there must be a specific contractual requirement to comply with the tax law. Any new set of requirements should minimise compliance burdens for businesses. Our detailed proposal, which is discussed below, is designed to achieve that objective.

By strengthening its procurement regime in this way, the immense purchasing power of the Commonwealth would be harnessed to foster better tax behaviour. Firms that fail to comply should suffer clear commercial consequences.

**OBSERVATION: GOVERNMENT PROCUREMENT**

Government (across all levels) is a large procurer, including of services in high-risk sectors, such as building and construction, for example for public works, and cleaning and security services. We have heard of examples where honest businesses are underbid by tenderers with unrealistically low bids. In such cases businesses are unlikely to comply with all tax and employment obligations. In some examples, there were connections to organised crime. Such businesses may operate through entity structures hiding the beneficial owners, using companies with cleanskin or straw directors, or just rely on the inability of agencies tendering the work to link the directors or other participants to their other activities, or even to identify the beneficial owners.

In the private sector, we think the focus needs to be on businesses and on the suppliers.

Procurement officers are uniquely placed to influence supply chain practices. They must focus on both price and integrity when dealing with suppliers. This will necessarily involve the exercise of due diligence on their part. One company told us that they spend up to six months looking at a potential supplier before engaging them. Others detailed how they work closely with suppliers, including small and emerging businesses, to bring them up to standard. Procurement practices vary widely, however. Some procurement officers, faced with strong commercial pressure, may not be as careful. This attitude has to change.

We also think attention needs to be paid to suppliers. When supply chains are long and complex, integrity lapses will be more likely. In these cases, even the most diligent procurement officers may not be aware of what is taking place further down the contracting line. This is why we think that suppliers can do more. In this context, there is a role for industry-led interventions that can be used by businesses and supply chains as an additional means to show their commitment to acting lawfully. A ‘trusted trader’ status could be established for businesses that meet some standard. This could be modelled on the Australian Trusted Trader (ATT) programme, which is a voluntary programme that provides trade facilitation benefits to traders that are trade compliant.

The labour hire industry, in part in response to poor practices in some parts of this sector, is developing a certification initiative. Labour hire firms would only receive certification if they complied with all tax and regulatory obligations. Their performance in this regard would be independently audited. We would encourage other supplier groups to follow suit: our recommendation is to develop an Australian standard of trusted trader, which counterparties could have confidence in. When credible, robust certification regimes are in place, purchasing officers have a much easier job. The certification gives them some confidence that abuses are not taking place. They will save on red-tape as they will know their suppliers comply and do not have to check independently. Non-compliant bidders can be excluded immediately, further reducing their costs.

What is the role of government in this area? We are conscious that some jurisdictions have moved to directly licence labour hire firms, one of the key risk areas for supply chains. While the state-by-state approach is creating a lack of harmonisation, we do not favour this approach for a number of reasons. Any licensing scheme is creating further regulatory burdens. Government licencing, if not backed up by strong enforcement, can sometimes degenerate into a tick-the-box exercise. Licence fees are paid, but little action is taken. A further risk is that otherwise credible licencing regimes, over time, are diluted and compromised. As a result of lobbying, they come to define the lowest common denominator. A third licencing pitfall is that, being defined by government, they fail to keep pace with changes in technology, consumer preferences and commercial practices.

We are not suggesting that industry self-certification is a panacea or without risk. The standards that are applied must be credible, with consumers, investors and regulators consulted on their content. Auditing processes must be rigorous, independent and constant. There should be an Australian standard. We think that governments should specify the minimum probity requirements industry

certification requirements should meet. We provide further information below and elaborate on labour hire more specifically in Chapter 10. Potential regulatory reforms to the labour hire sector, complementary to industry efforts, are under consideration by the Migrant Workers' Taskforce, which will report to Government in early 2018.

#### **OBSERVATION: SOCIAL AUDITING FOR ETHICAL SUPPLY CHAINS**

Social auditing is already starting to occur in Australia and has been occurring in Europe and the US for some time. Social auditing is an independent audit of the supply chain for ethical behaviour, including meeting regulatory obligations such as proper payment of workers. In Australia, some large retailers are now having social audits of their supply chains done. However, it has been reported to us that what has occurred here so far, in the horticulture sector, has been the retailer at the end of the supply chain requiring the audits be done and pushing the cost of them down the supply chain, usually to the producer. This just adds an additional cost pressure to the producer on top of the cost pressures driven by retail prices. It is these very cost pressures that lead to some of the black economy practices, such as accepting low prices for seasonal workers needed to pick crops. This practice of forcing the costs of social auditing, introduced to demonstrate an ethical supply chain, onto the producer just adds to the incentive, and likely in many cases, the imperative, to act unethically in sourcing inputs such as labour at harvest time, the very opposite effect it is supposed to be ensuring. The cost of social auditing to ensure an ethical supply chain needs to be borne across the supply chain.

#### **Other observations**

First, supply chain integrity cannot only be a matter for large businesses, their procurement officers and suppliers. Consumers and investors must also play a role. We have seen this internationally, reflected in concerns about modern slavery, bribery and corruption and poor environmental practices. Increasingly, attention is being paid to what is happening domestically. This is the case in other OECD countries as well as Australia. If informed consumers and investors demand better supply chain practices, experience shows that our leading firms will take notice.

Second, better commercial practices can be fostered in other ways. The Australian Supplier Payment Code, an initiative of the SBFEO and the BCA, aims to improve payment terms for small business suppliers. This initiative can also be a vehicle to lift supply chain practices as shorter payment terms improve the cash flow of small businesses, easing the pressure on them.

#### **OBSERVATION: CLEANING ACCOUNTABILITY FRAMEWORK (CAF)**

The CAF is an independent, multi-stakeholder initiative that seeks to improve labour and cleaning standards in Australia. Under the CAF, sites are certified and awarded star ratings based on set standards in areas such as labour conditions, payment of tax and super, record keeping and workplace health and safety. CAF works with the people involved, from building owners to the workers themselves. They help ensure that CAF standards are being met and identify where changes need to be made.

Third, blockchain, while still an emerging capability, may emerge as a powerful supply chain integrity tool. A firm could manage its supply chain through a distributed ledger. Access to the supply chain would be regulated by the ledger's rules. These could prescribe the identity and other probity checks

that sub-contractors would have to meet. Payments could be made in fiat-backed, digital currency and only released when agreed work, or other milestones, had been met. The integrity of products moved along the supply chain, in this system, could be confirmed by attaching a unique Radio-Frequency Identification (RFID) code to them. We discuss a possible pilot in the recommendation section below.

Fourth, other reforms we recommend in this Report will also, directly and indirectly, foster better supply chain practices. These include strengthening the integrity of the ABN system, the digital identity initiative, stronger enforcement (of visa rules and labour laws), and better data sharing, analytics and joint work by the authorities, both Commonwealth and State.

### ***Recommended actions***

We recommend the following reforms to supply chain integrity.

- A Commonwealth Government initiative to limit access to contracts to firms with a demonstrated good tax record.
- A Government quality framework, including an Australian standard for trusted traders, that industry certification initiatives must exceed.

## RECOMMENDATIONS

### ***Recommendation 9.1: Increasing the integrity of Government procurement***

The Government should promote good tax behaviour by excluding businesses with a bad tax record (and convictions of bribery and corruption) from its procurement processes. This has two components:

- Commonwealth contracts should include a clause that requires contractors and their suppliers to comply with all tax legislation and regulation for the duration of the contract.
- For large contracts, tenderers must also provide evidence of their tax record as part of the procurement process including adopting Tax Transparency Code requirements.

#### ***Description***

The Government should take a lead in responsible supply chain management and ensure that the businesses it contracts have a good tax record and comply with their tax obligations over the course of the contract.

#### ***Tax clause in Commonwealth contracts***

Government contracts should include a clause that specifies that contracted businesses and their suppliers have to comply with tax legislation and regulations. The Commonwealth Contracting Suite, which is mandatory for contracts under \$200,000 already, covers legal compliance, which would include compliance with tax legislation. Contracts should provide a representation and warranty at the time of contract and for the duration of the contract that the contracting party will comply with all Australian taxation laws and specify contractual consequences for a breach of the clause.

#### ***Tax compliance certificate for large contracts***

Tenderers for large contracts (for example over \$4 million) should have to provide a 'Tax compliance certificate' ('Certificate') at the time of applying for a contract. The Certificate would be issued by the ATO on the basis of a number of criteria. Such criteria could include requirements that the entity:

- Does not have a judicial or tribunal decision against it for tax evasion over the past five years (not including decisions under appeal or where there was a genuine dispute over interpretation of tax laws).
- Has fulfilled its tax reporting and payment obligations over the past five years. If there is an outstanding debt, a payment plan must be in place and the terms must be met.
- Does not have any directors that have been involved with identified phoenix operations.

Certificates issued to businesses which have been operating for less than one financial year would indicate that they are registered for tax but that no tax record is available yet.

Businesses based in a foreign jurisdiction would not be excluded from tenders if they are unable to produce a Certificate due to being based overseas. Businesses which have not previously been required to pay tax in Australia could be required to provide a statutory declaration that they do not have a bad tax record applying the criteria above.

The framework for certificates will need to ensure that certificates can be issued in a streamlined, timely and secure manner in order to limit any additional compliance costs for businesses or procuring agencies, and could be expanded to other areas, such as licenses. See further discussion on implementation below.

### *Tax Transparency code*

A good tax record should also include a requirement that businesses have disclosed information under the Tax Transparency Code where their annual turnover is above \$100 million.

### *Bribery and corruption*

Companies that have been convicted of bribery or corruption should be debarred from Commonwealth Government contracts for a 2-year period. This should not apply where individuals within companies have been convicted, but not the company itself.

Tendering agencies will need to make sufficient inquiries to satisfy themselves that there are no grounds for debarment of a tenderer prior to signing a contract.

## **Objective**

- Ensure Government does not procure goods or services from businesses that do not have a good tax record or evade their tax obligations over duration of the contract.
- Promote responsible supply chain management.

## **Discussion**

### *Problem this recommendation seeks to address*

The black economy is a large and complex problem. It creates an uneven playing field, challenges the integrity of our tax system and undermines tax revenue. The Government is not immune. With total procurement of \$57 billion in 2015-16, the Government is a large and important player in the economy.<sup>1</sup> Governments across all levels are active in some of the highest-risk industries, including building and construction (we have heard that about 80 per cent of civil construction is government-initiated), cleaning and security. We have heard of black economy participation by government-contracted firms through our consultations, and the strong feedback from the community is that the Government needs to take action. The proposal would align procurement

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<sup>1</sup> Australian Government, Department of Finance, Statistics on Australian Government Procurement Contracts, accessed 5 October 2017, <http://www.finance.gov.au/procurement/statistics-on-commonwealth-purchasing-contracts/>, captures contracts over \$10,000 only.

rules with community expectations that not only is government funding used efficiently, effectively, and ethically, but that the businesses it contracts with have a history of complying with their tax obligations.

### *Rationale*

The Government has the opportunity to demonstrate best practice, sending a strong message to the community and the private sector that poor tax practices are unacceptable. The proposal would harness the purchasing power of the Government to foster better tax behaviour, including by providing adverse commercial consequences for businesses that are non-compliant. It also sets an example for private sector firms to improve their own supply chain management practices. It is recognised internationally that responsible supply chain management is critical in the combat against the black economy and ethical sourcing has become an important part of the commercial landscape in Europe in particular.

Once established, the ATO-issued Tax compliance certificate could be promoted for use across the economy, including by other Australian jurisdictions and the private sector.

### *Other options considered*

#### *Government agencies to verify good tax record*

Under this option, the tendering government agency would be required to verify a tenderer's good tax record as part of the tendering process by seeking a yes or no answer from the ATO. Tenderers would have to sign a disclosure document to provide authority to the ATO to disclose their taxation information and that of any related entity to the procurement agency for the purpose of the tender process.

We consider this option less preferable. Making government agencies responsible for checking would mean that most of the action takes place behind the scenes. Placing the onus on tenderers is more likely to bring the need for a good tax record to the fore and change behaviour. Unlike the preferred option, this option would also require changes to tax secrecy provisions which could be a significant barrier.

#### *Self-certification*

Under this option, all tenderers would be asked to self-certify their good tax record through a statutory declaration. The UK has implemented this model. By making specific reference to taxation, self-certification would encourage compliance and send the message that the Government is committed to ensuring the companies they deal with have a good tax record. By extending the requirement to sub-contractors, government would still engage in responsible supply chain management. However, self-certification is likely a much less effective option and without appropriate checks may simply be another requirement imposed on tenderers.

#### *Application to all contracts*

A compliance certificate could be required from tenderers for all Government contracts or a smaller threshold could be set (at \$80,000, \$200,000 or \$1 million). However, to minimise impact on small



businesses we consider that the proposed standard tax clause for smaller contracts is a more appropriate solution.

### *International Comparison*

The UK government uses the procurement process to promote tax compliance. Suppliers bidding for all central government contracts over £5 million must self-certify their tax compliance.

South Africa and Ireland have a tax compliance certificate regime. Both countries use it for government procurement but also require it for other matters. In Ireland, for example, it is required to obtain government grants as well as certain licenses. In South Africa, the system allows others to view the tax compliance status of a taxpayer.

### *Stakeholder views*

Stakeholders have very strongly supported the Government taking a lead on responsible supply chain management by restricting access to procurement to entities with a good tax record.

### *Implementation considerations*

Any changes to procurement policies need to be practical and verifiable and not introduce unnecessary red-tape or costs for businesses or procuring agencies. New requirements will have to comply with Australia's free trade obligations.

### *Compliance certificates*

Funding will be required for the ATO to set up, maintain and administer a system to issue tax compliance certificates. The process for businesses requesting a certificate should be simple, ideally online, in order to minimise compliance costs. Conditions for issuing a certificate will have to be clear and simple such that the system can be automated.

The design of the compliance certificate will have to take into account the risk of fraudulent certificates. Ideally, the certificate should be issued digitally.

### *Definition of a good tax record*

The proposed definition of a good tax record will have to be designed carefully to minimise unintended consequences. It has to be clear and unambiguous to ensure the system can be automated and causes for challenging the certificate are minimised.

It should set a high benchmark, but not disqualify businesses that may have had minor transgressions that have, or are being attended to (for example through a payment plan that is being adhered to). Businesses should not be disqualified due to a dispute that is under appeal or arose due to a genuine disagreement.

### *International obligations*

Australia is party to a number of international trade agreements which include provisions for reciprocal access to Government tendering opportunities. Typically the agreements include requirements for transparency and access to information, standards regarding procurement procedures, and equal treatment of foreign suppliers. Therefore, it is essential that any changes take account of these obligations and ensure that they do not contravene any of our international commitments.

### *Future options*

#### *States and territories*

To be most effective, all levels of government should require contractors to have a good tax record. We recommend that the Commonwealth Government work with states and territories to implement complementary rules. We note the pilot underway in Western Australia, where the Department of Finance checks tenderer's compliance with state taxes. We have heard anecdotal examples of councils unwittingly contracting with black economy participants.

#### *New opportunities from digitisation*

The Government should also consider how best to harness the digitisation of the economy. Developments in financial technology, including block chain, offer significant opportunities for procurement systems to integrate digital solutions which can play a role in ensuring integrity, competitions and transparency.

#### *Government licenses*

The requirement to demonstrate a good tax record could be expanded to other aspects of government services. One such area is the issue of Government licences, including Commonwealth licences and state licenses (for example casinos and corporate bookmakers). Local Government also has a role to play.

### **Recommendation 9.2: Supply chain integrity**

Establish national probity standards that private supply chain certification credentials should comply with to ensure responsible supply chain management practices are followed. This would include minimum standards, use of trusted trader certification, and publication of misconduct.

#### **Description**

The Government should establish a national framework for private supply chain integrity initiative. The framework should promote ethical behaviour along supply chains. It should encourage all stakeholders in supply chains to assume greater responsibility for adhering to and driving all businesses to be compliant with their tax and other regulatory obligations. It would also relieve business from having to conduct their own due diligence for each of their suppliers. A national framework should include:

- **An Australian standard for trusted traders:** The Government should develop a collective ‘social audit’ standard. This would provide minimum probity and other standards that private institutions should adhere to as part of their supply chain management and procurement practices. This standard could take the form equivalent to the collective standards set in Europe. For example, the Business Social Compliance Initiative (BSCI) Code of Conduct and the Sedex Ethical Trading Initiative (ETI) Base Code establish the principles of the highest labour standards protecting workers’ rights, which business partners commit to implementing within their supply chains. Such a standard would ensure consistency of ‘social audit’ quality for industry-led schemes.

Different criteria might apply based on industry and business size, recognising the greater impost of compliance costs on small businesses. For small businesses the Chamber of Commerce or certified industry associations could be involved in setting standards, while for large businesses independent certification would be more appropriate.

Businesses compliant under these standards would be considered trusted traders for the purpose of procurement processes while non-trusted traders are likely to be subject to increased scrutiny.

- **Use of licensed and certified businesses:** Under the framework, businesses and consumers should contract with certified and licensed businesses, where available in their industry. Such schemes provide greater assurance that participating businesses meet their legal obligations. This can assist consumers in making decisions on suppliers without having to do their own due diligence, and has the potential to drive more businesses to certification in order to secure contracts. This also provides a benefit to business by reducing the costs of multiple customer due diligence processes.

Many industries already have licensing schemes in place, often through state legislation, for example in the building and construction industry and other trades. Where licensing is not

available, not appropriate, or insufficient for the purpose of ensuring compliance, industry bodies are encouraged to develop their own certification schemes, particularly in high-risk industries. A separate recommendation in this report deals with certification of labour hire firms, which are of particular importance for supply chain integrity (see Recommendation 10.5).

Certification should impose conditions regarding compliance with all tax and regulatory obligations, including employment laws, and set out requirements for independent audits, enforcement, processes for corrective action and penalties. Where possible, the conditions should be nationally uniform, not state-by-state where differences drive up costs and make compliance unnecessarily complex.

## **Objective**

- Drive a national push toward broad and universal supply chain integrity.
- By supplying a national framework provide guidance for businesses on what is required for responsible supply chain management, and their customers and investors with comfort that solid practices are being followed.

## **Discussion**

### *Problem this recommendation seeks to address*

Supply chain risks are a major and growing problem. Commercial pressure to cut costs, for example, from big supermarket chains, car insurance companies and government procurement officers, is strong in this low-margin economic environment. We have been told that overseas procurement is increasing. While purchasers can often vouch for their immediate suppliers, they cannot do the same for those downstream. The latter can be involved in money laundering, exploitation, immigration fraud and organised crime. As supply chains lengthen, these integrity risks escalate, threatening major reputational damage for firms further up the chain.

### *Rationale*

While some business are already doing the right thing and have in place a code of conduct for responsible supply chain management, there needs to be a greater push to ensure that these practices are rolled out across the nation. This will ensure that individual code of conducts adhere to minimum standards, can be better publicised and allow better vetting by consumers. By establishing a national framework which sets clear standards, the public — which is increasingly demanding ethical supply practices — can have greater assurance that a benchmark for supply chain integrity is being applied.

### *Costs and benefits*

By tapping into supply chain management practices, efforts to reduce the black economy are able to utilise a powerful and ubiquitous business management arrangement which will permeate throughout the business sector. While Government will show the way by improving its own

procurement rules, introducing a framework which encourages all businesses to sign up will ensure that everyone takes responsibility for minimising the black economy.

There is also a significant benefit for business themselves to adhere to a national standards framework and support its goals. Businesses which engage in unethical supply chain practices face a number of significant risks, including damage to the reputation of their business and legal responsibility for the actions of a contractor. These will be mitigated through the national standards framework. Many businesses already recognise this and have processes and standards in place to ensure good supply chain practices, for example BHP and other companies.

These benefits have to be weighed against the potential cost of compliance. Any measures introducing new obligations on businesses will impose regulatory burdens. By having the Government develop a framework which businesses are encouraged to adopt, rather than be required to, these costs will be limited. We believe businesses, pushed by consumers and investors, will sign up to the framework as they realise their social obligations and see the significant benefits.

Care will need to be taken to ensure that costs of compliance, for example becoming certified, are reasonably distributed among large businesses at the top of the supply chain and businesses operating lower down the supply chain. If compliance becomes too costly, particularly for small businesses, and top down cost pressures remain, it may create perverse incentives and drive businesses to operate in the black economy.

## ***Other options considered***

### ***Code of conduct***

An alternative option would be to develop a voluntary or prescribed code of conduct. A voluntary code of conduct would have little or no involvement by Government, but could be supported by funding for the development and implementation of a code. A prescribed code of conduct could, for example, be established under the *Consumer and Competition Act*.

We are not recommending this option due to the compliance costs and regulatory burdens that would be imposed by a formal code of conduct. However, should there be sufficient support from the business community to establish such a code of conduct, the Government should consider this option in the future.

### ***Mandatory use for large companies***

The national framework, including use of certified businesses, (or a formal code of conduct) could be made mandatory for large corporations, for example those with a turnover of at least \$100 million. While imposing a new requirement on big businesses, it would limit the impact of additional compliance burden on small business. Smaller businesses would be captured ('nudged') through improved supply chain integrity pushed down by the large businesses. However, concerns regarding large businesses pushing down costs remain.

## SUPPLEMENTAL RECOMMENDATIONS

### *Blockchain/distributed ledger pilot*

The Government could collaborate with a large company to trial distributed ledger technology as a tool to improve supply chain integrity. Blockchain technology has the potential to offer significant benefits to supply chains from enhanced integrity in transactions and data. By creating an electronic fingerprint each time information in the distributed ledger is modified, there is greater transparency and certainty over changes made throughout the supply chain. Lead contractors have greater visibility which helps them monitor and verify actions along their supply chain.

Blockchain technology is already used by several global companies to better track goods along their supply chain. In Australia, wheat farmers are using blockchain for fast and secure payment. If successful, its use could be promoted within Government and in the private sector.

### *Accountability of procurement officers*

Procurement officers play a critical part in ensuring supply chain integrity. Their role should go beyond ensuring a good price. They should be seen as responsible, and be held accountable, for procuring only firms which have a good record of complying with their tax and other obligations, and ensuring that their suppliers adhere to all such laws and regulations for the duration of the contract.

To ensure this happens, businesses, organisations and governments must broaden how they view the procurement process and the officers in such positions. They need to place greater emphasis on due diligence of their contractors. This should include a solid investigation of the integrity of their suppliers. In the most high-risk cases, this could include the following.

- Current/past litigation in regards to mistreatment of employees or unfair dismissals.
- Indications or claims of unethical conduct as reported in the media (including non-traditional sources) such as bribery and corruption, or underpayment of employee wages.
- Listing on the National Personal Insolvency Index (NPII).
- Tax evasion or poor tax compliance.
- Phoenix activity (see Recommendation 10.1).
- Criminality.

### *Supply chain reporting obligations*

In August 2017 the Government released a consultation paper on modern slavery in supply chains. The Government is proposing reporting requirements that will require corporations and other entities operating in Australia to public annual statements outlining their actions to address modern

slavery in their operations and supply chains. We support this initiative and urges the Government to implement the reporting requirement as soon as possible.

We also recommend that the Government adopt the recommendations contained in the interim report of the Joint Standing Committee on Foreign Affairs and Trade's inquiry into establishing a *Modern Slavery Act* in Australia. In addition to the reporting requirement proposed by Government, the Committee's interim recommendations support a broader application of the requirement, including limiting government procurement to only those entities that have submitted a modern slavery statement, and establishing an independent Anti-Slavery Commissioner. These proposals are based on wide consultations and the UK experience with its *Modern Slavery Act*.

We further recommend that the Government should consider a similar approach to tie reporting requirements to tax and superannuation obligations.

### **Supporting payment term reforms**

We applaud the initiative by the BCA to introduce an Australian Supplier Payment Code. The voluntary code commits participating businesses to pay small business suppliers on-time and within 30 days of receiving an invoice. It also helps suppliers implement new technologies and practices to speed up invoicing. The code will support small businesses to be compliant by improving their cash flow and help improve supply chain integrity. We strongly urge businesses to sign up.

We also support the recommendations of the Payment Terms Inquiry by the Australian SBFEQ.

### **Other supply chain initiatives**

We also support other initiatives which aim to lift supply chain integrity. This includes the CAF and RACQ approved tradespeople program. The CAF promotes the adoption of best practices throughout the cleaning supply chain by certifying sites and awarding star ratings. CAF works with property owners to achieve certification which is publicised. The RACQ trusted tradespeople are approved by RACQ, this gives customers further comfort about their legitimacy. Industry led initiatives such as these drive compliance within supply chains and are of high value to customers who can make an informed choice when presented with certified suppliers or services.

We recommend that the Government sign up to the CAF for all government-owned buildings.



# CHAPTER 10

## TARGETING PARTICULAR PROBLEM AREAS

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# CHAPTER 10: TARGETING PARTICULAR PROBLEM AREAS

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## URGENT, TAILORED AND TARGETED RESPONSES

### *Key points*

In the course of our consultations, we have identified particular problem areas which require urgent, tailored and targeted responses. These include:

- Phoenixing, whereby firms deliberately go out of business only to reappear in another guise, leaving employees, creditors and shareholders out of pocket and tax bills unpaid.
- Sham contracting, under which employees are wrongly reclassified as contractors and lose access to basic workplace relations protections (including minimum or award wages). This is used to avoid paying PAYG and payroll tax, workers' compensation premiums and superannuation contributions.
- Student visa abuses. When student visa holders exceed their 40 hour per fortnight work restrictions, they must work in the black economy. In these circumstances, they can sometimes fall prey to unscrupulous employers, or even be exploited by organised crime.
- The broader problem of labour exploitation.
- Parts of the economy where, for a variety of reasons, black economy activity may be entrenched or seen as usual practice. Segments of the labour hire industry, horticulture and produce markets fall into this category.
- Addressing risks in the charities sector.

The recommendations in this chapter outline possible strategic approaches in each of these areas. These are not intended as isolated or standalone responses. When framing our recommendations, we have been guided by the following considerations: (i) the importance of prevention and early detection where possible, (ii) targeting our responses carefully at the actual wrongdoers, avoiding blanket approaches that impose needless burdens on everyone, and (iii) recognising that, in some cases, particularly the student visa system, other policy objectives and considerations must be taken into account.

We recognise that the Government has established reviews (and either taken action or is about to) on phoenixing, migrant worker abuse, slave labour and the non-payment of superannuation. We have compared notes with these reviews and, in some cases, shaped their recommendations. The additional actions we propose have been canvassed with them.

We also stress that many of our other recommendations, and indeed our entire black economy strategy, will also help in combatting these problem areas.

These include reforms of the ABN system, a digital identity initiative for individuals, moves to encourage non-cash payment methods and improved reporting of contractor payments under the Taxable Payment Reporting System. Our recommendations in the areas of social norms and education, better sharing of data within and across governments, new penalties and enforcement, and new institutional arrangements are also relevant.

### *Recommended actions*

In particular, we recommend that the Government take action to:

- Limit opportunities for phoenixing, sham contracting and SG avoidance.
- Address black economy activities by visa holders, particularly international students.
- Address unscrupulous labour hire firms.
- Better protect vulnerable workers.
- Reduce black economy activity at markets.
- Address risks in the charities sector.

## TARGETED: PHOENIXING

### Key points

Phoenixing is a serious problem that undermines the community's confidence in corporate and wider regulation. Taxpayers ultimately bear the burden of the reduced revenues. In addition, business operators who intentionally and repeatedly become insolvent cheat trade creditors and employees and undercut legitimate operators. We came across many instances of phoenixing in our community consultations.

#### OBSERVATION: WHAT IS PHOENIXING?

Phoenixing is where an individual operates a business through a company structure, takes the profits and/or assets out of the business by moving them to one or more other entities and recommences business through those other entities.

Phoenix activity involves the intentional transfer of assets from an indebted company to a new company to avoid paying creditors, tax or employee entitlements.

The directors leave the debts with the old company, often placing that company into administration or liquidation, leaving no assets to pay creditors.

Meanwhile, a new company, often operated by the same directors and in the same industry as the old company, continues the business under a new structure. By engaging in this illegal practice, the directors avoid paying debts that are owed to creditors, employees and statutory bodies (such as the ATO).

In some instances, the individual employs workers through a separate entity. That way, the phoenix activity does not disrupt the supply of labour.

Not all business reconstruction involving new companies is problematic, and care is necessary to ensure measures aimed at tackling phoenixing do not impact on legitimate business and entrepreneurialism. Our recommendations are directed at the deliberate and fraudulent phoenixing activity.

We heard that phoenixing continues to proliferate in the building and construction (including crane operators) and labour hire industries, and that it may be becoming an issue in the retail sector. As noted earlier, the economic costs of phoenixing are estimated at up to nearly \$3.3 billion per year. We also heard that there is an entire industry supporting phoenixing by providing advice prior to a company winding up on how to structure the business to avoid obligations.

Regulatory agencies have made a concerted effort over the years, but phoenixing activity continues. This is partly because of the difficulties in identifying and taking action against directors and their associates or 'controlling minds' that may be involved in multiple phoenixing companies. We strongly support the Government's announcement to engage with stakeholders on the Director

Identity Number.<sup>1</sup> It is important that this measure is part of an economy-wide digital identity program which links to other government agencies and government registers.

#### **OBSERVATION: PHOENIXING — ‘CONTROLLING MINDS’**

To combat phoenixing there is a need to identify the true controlling powers behind a company. In many of these cases this is not a director. Rather there is a need to look at management contracts, powers of attorney or other similar instruments to determine who the real economic owner or ‘controlling mind’ is. Looking at who pays out the trade creditors can be useful, as can looking into signatories to bank accounts established by the business.

We commend the continued efforts of the Phoenix Taskforce and SFCT established by the Government focussing in this area. We encourage them to widely publicise the outcomes of their phoenix enforcement activity, to act as a deterrent to others contemplating this action.

#### **OBSERVATION: PHOENIXING — ATO IS ‘THE CANARY IN THE COAL MINE’**

A small business told us of their personal experience of phoenixing:

‘I would also focus on the role the ATO can play as they are the canary in the coal mine. They will usually see the problem in a failing business before anyone else owed money by that failing business.

We recently personally lost \$50,000 as the landlord to a business, when the business was sold off prior to putting the holding company into receivership. We subsequently discovered the business had been \$1m in debt to the ATO for more than 12 months. The business was an accounting firm!

Our company recently lost \$175,000 owed to us by a client, after they went into receivership. We gained hard evidence that the owner had started two new businesses in the names of his children and started diverting all new work, away from his failing business and into the new businesses in his children’s names. The receiver had no funds to pursue what should have been an easy target. The ATO’s debt at the time was large and had been large for many months, possibly more than a year.’

The unethical activity associated with phoenixing has to be tackled.

We support the Government’s public consultation process on a package of measures announced in September 2017.<sup>2</sup> The table below summarises our views on factors which will need to be considered in the final design of those measures.

1 The Hon Kelly O’Dwyer (Minister for Revenue and Financial Services), A comprehensive package of reforms to address illegal phoenixing, media release, 12 September 2017.

2 The Hon Kelly O’Dwyer (Minister for Revenue and Financial Services), Consultation on reforms to address illegal phoenixing, media release, 28 September 2017.

TABLE 10.1: PHOENIXING REFORMS

Proposal	Taskforce comment
<b>New phoenixing offence</b>	<p>We support this measure. Strong deterrents are needed to send a signal to phoenix operators and their advisers that phoenixing activity is not tolerated.</p> <p>The consultation paper notes that as part of implementing the phoenixing offence the Government is considering whether liquidators and ASIC should be able to claw back assets from the transferee.</p> <p>We support allowing asset clawback and are of the view that in the property development sector asset clawback should be allowed by permitting a charge to be created over the assets where phoenixing occurs in a short time after the asset sale. In designing this measure, it will be important to distinguish genuine insolvency situations and deliberate phoenixing to ensure that measures intended to address phoenixing do not inhibit entrepreneurship.</p>
<b>Extension of Promoter Penalties regime</b>	<p>We support this measure. Stakeholders told us that this measure will act as a strong deterrent to those that enable phoenixing and is long overdue. All those who aid or abet another party to engage in phoenix behaviour, regardless of their label, must be brought to account.</p> <p>The consultation paper focusses on promoters or facilitators such as unscrupulous pre-insolvency advisers, business consultants and repeat shadow directors. Promoters and facilitators could also include liquidators, accountants and lawyers and these must be covered.</p> <p>In our view, the measure also needs to cover the ‘controlling minds’ behind phoenixing operations who are often not listed as a director.</p> <p>In addition, where several parties act in concert, the effect of the collective actions should be able to be considered and proportionate penalties apply against the parties acting in concert, even if no single party is seen to have played, by themselves, a significant role.</p> <p>We also recommend increasing the severity of the penalty to reflect the serious harm this activity causes to other business and employees and increase the deterrent effect the potential of the penalty has.</p>
<b>Books and records</b>	<p>We support the focus in the consultation paper on failure to maintain adequate books and records, and failure to provide them to a liquidator. We consider that where directors have demonstrated a clear pattern of avoidance and non-cooperation in providing books and records of a company they should be held to account.</p> <p>The consultation paper proposes that breaches of <i>Corporations Act</i> offences such as not keeping written financial records be made a ‘designated phoenix offence’ where a breach could result in a director being deemed a higher-risk entity. While a step in the right direction, we consider that the director disqualification rules in the <i>Corporations Act</i> may need to be broadened to encompass directors where there is a clear pattern of avoidance and non-cooperation in providing books and records of a company. A review of the effectiveness of the new measure should be undertaken after a period of time to determine if this further step is also required.</p>
<b>Security Deposits and extension of Director Penalty Notice (DPN) regime to GST</b>	<p>We support the Government’s announcement of stronger powers for the ATO to recover a security deposit from suspected phoenix operators and extending the DPN regime to GST. These are a step in the right direction.</p>

Clearly, a multi-pronged solution is needed to assist detect, deter and disrupt those responsible and also enable the successful prosecution of offences and recovery of debts. A number of our other recommendations relating to individual identity, better data sharing and enforcement will support regulatory agencies in their efforts.

*'The Tax Institute strongly supports any measures to stamp out phoenix activity including those outlined in the Consultation Paper. A major challenge is identifying who actually is the "controlling mind" behind any company so that action (for example, for personal liability) can be taken against that person. In this regard, a 'fit and proper person' test for becoming a director should be rigorously enforced for all companies to help in reducing the use of "strawman directors".'* The Tax Institute

### **Recommendation 10.1: Tackle phoenix behaviour**

Tackle phoenix activities through:

- Better early warning systems through combining government and private sector information, including through enhanced suspicious matter reporting and better data sharing.
- Extending the promoter penalty regime to the 'controlling minds'.
- Potential new offences relating to the proposed Director Identification Number.
- Greater enforcement of offences and recovery of debts, including through greater expertise in the ATO in debt collection, improvements to the Assetless Administration Fund and establishing an Insolvency Advisory Panel.<sup>3</sup>

### **Description**

A multi-faceted approach is required to detect, deter and punish phoenix behaviour.

Information held by the private sector must be collected and combined with the intelligence held by regulatory agencies to provide early warning or a red flag of potential phoenix activity that regulatory agencies then use to monitor and prevent phoenixing.

Strong deterrents must be targeted not only at the directors and the promoters and facilitators but also at 'controlling minds' through offences and penalties that fit the seriousness of their deliberate and harmful activities.

In addition, regulators, including the ATO, ASIC and the FWO, must closely monitor high-risk directors and companies and vigorously pursue tax debts, unpaid superannuation, and unpaid wages and, where possible, take action before the phoenix activity occurs. Where phoenixing takes place, liquidators and the courts need better support. Greater funding and broadening of the scope of the Assetless Administration Fund is needed. Courts dealing with the sometimes complex issues in

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<sup>3</sup> The Assetless Administration Fund finances preliminary investigations and reports by liquidators into the failure of companies with few or no assets. A particular focus of the fund is to curb fraudulent phoenix activity.

phoenixing matters could have support from an Insolvency Advisory Panel constituted by experienced liquidators, lawyers and accountants.

These proposals will supplement measures in other areas which will all contribute to detecting and deterring phoenixing activity. We support the Government's consultation on extending the AML/CTF legislation to include the regulation of legal practitioners and accountants (including insolvency practitioners), high-value dealers, real estate agents and business service providers (including trust and company service providers). Stakeholders have told us that such changes would make a significant difference in dealing with phoenixing issues by requiring relevant reporting entities to provide suspicious matter reports to AUSTRAC.

We also support the Government's announcement of a proposal to improve the transparency of tax debts.<sup>4</sup> Under the proposal, the ATO will be allowed to disclose tax debt information to registered credit reporting bureaus. The bureaus can then include tax debt information in their credit reports. Creditors or potential creditors that purchase credit reports can take these reports into account when making business decisions. However we note that a company's tax debt depends on its reporting and payments cycles and the accuracy of information reported to the ATO. An ATO debt may not be the only debt a company has as it may also have debts to trade creditors for unpaid invoices.

## Objective

- Earlier detection of potential phoenixing activity through implementing early warning systems using information from the private and public sectors.
- Deter phoenix activity by extending the promoter penalty laws to the 'controlling minds'.
- More vigorous pursuit of tax debts by ATO officers with greater expertise.
- Enable liquidators and the courts to consider matters effectively and in a timely way.

## Discussion

### *Problem this recommendation seeks to address*

There is no silver bullet which will solve the phoenixing problem. As noted earlier, the Government has announced a package of measures and released a public consultation paper. However, we consider that further proposals are also necessary.

We heard feedback that the rich intelligence held in the private sector (including by financial institutions, credit reporting agencies, superannuation funds, trade unions and insolvency experts) is underutilised in providing early warning that pre-phoenixing activity may be occurring.

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<sup>4</sup> Australian Government, Mid-Year Economic and Fiscal Outlook 2016-17, Appendix A: Policy decisions taken since the 2016 PEFO.



We have also heard that due to insufficient data gathering and sharing of early warning information, regulators are not able to pursue phoenix entities until it is too late and phoenixing has occurred (for example, the ATO regarding tax and superannuation debts and FWO regarding employee entitlements). We note that the introduction of STP will provide earlier information, such as whether superannuation entitlements have been paid. This could provide advance warning, as could including increased suspicious matter reporting to AUSTRAC by financial institutions on phoenixing specific behaviours, discussed further below.

We also heard that there is a growing industry of pre-insolvency advisers. Some of these help to shift assets, leaving only liabilities behind in the company shell. We also heard that often they will target companies that are winding up, which they identify by trawling through court lists, and offer their services, including phoenixing advice. They operate with little supervision, oversight or consequence.

### *Better early warning*

We recommend that the ATO, ASIC, FWO and other regulators should better utilise early warnings or red flags such as:

- Information held by financial institutions, superannuation funds, insolvency industry experts, credit reporting agencies, private sector third-party risk management and regulatory databases (such as Dow Jones) and trade unions regarding potentially high-risk companies (and directors).
- Improved suspicious matter reporting guidelines for financial institutions.
- SG non-compliance.

Stakeholders told us that financial institutions have rich sources of information that are not currently available to regulatory authorities. Suspicious matter transaction reporting from financial institutions must be enhanced to ensure this resource is utilised. Banks typically have security over the assets that are moved from one entity to another and accordingly are the first to know about assets shifting. They should have an obligation to report to the authorities as soon as they become aware of suspicious transactions.

In addition, insolvency industry experts, trade unions and credit reporting agencies may have information about high-risk phoenix operators. We strongly recommend that the ATO, ASIC and other regulators work with all of these bodies to formalise ways that intelligence can be provided where the bodies think suspect activity is underway. In addition to these early warning mechanisms, we consider that it may be necessary to supplement the tax debt transparency measure announced by the Government by requiring higher-risk companies to lodge relevant forms and make relevant payments more frequently. This could apply to PAYG, BAS and SG payments. In addition, entities which are considered to be a higher-risk of engaging in phoenix activity could be required to notify the ATO if they transfer assets to an associated entity.

We also heard that non-payment of payroll tax and WorkCover premiums may be a source of early warning. More data sharing with state and territory governments on these issues is required. This requires better data and information sharing, as well as better data matching and analytics as discussed in Chapter 5. Our recommendations will support improved early warning.

### *Superannuation early flag*

The Government's superannuation announcement requiring superannuation funds to report to the ATO contributions received more frequently (at least monthly), is welcome.<sup>5</sup> This means the ATO will be better placed to use superannuation non-compliance as an early warning of pre-phoenixing.

We also encourage the ATO to continue discussions with superannuation funds to share intelligence about non-compliance.

We note that the ATO is not the lone regulator addressing phoenixing and so this information needs to be able to be shared with other regulators as necessary.

### *New offences*

In addition to the phoenixing offence announced by the Government, we recommend that, as part of its consultation on the Director Identification Number, consideration is given to further criminal or summary offences for:

- Seeking to appoint a director that does not have a valid director identification number;
- Providing false information in the process of seeking to obtain a director identification number;

### *Extension of Promoter penalties regime to the 'guiding minds'*

The mastermind or real economic controller of the phoenix operator is often not listed as a director. In these cases it is generally not the directors who orchestrate the activity.

It is critical that the promoter penalty regime also apply to these unscrupulous 'controlling minds'. The 'controlling minds' will often not be listed as a director, but may hold a company power of attorney. Their use of such powers of attorney, for example, to pay trade creditors can be an early indicator of phoenix activity as they are generally required to support a restart of the business.

### *Enforcement and recovery of debt*

We recommend further measures to improve enforcement of offences by regulatory agencies and more vigorous recovery of debts. Banks have specialised teams focussing on lending and also invest heavily in monitoring fraud risk. We consider that the ATO needs more expertise so that it can more actively pursue tax debts.

We recommend a number of additional measures:

- The ATO should build its expertise in monitoring the tax, superannuation and other debts of potential phoenixing companies and more actively pursue tax debts before the companies phoenix.
- Further consideration should be given to providing regulators such as ASIC, ATO and FWO with the ability to designate a collection of phoenix-associated entities as a single group for the

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5 The Hon Kelly O'Dwyer (Minister for Revenue and Financial Services), Turnbull Government backs workers on superannuation, media release, 29 August 2017.

purpose of recovering debts. This grouping should not be confined to a traditional concept of a corporate group. The regulators should be empowered to notify each of the entities in the deemed group that they have been identified for this potential debt recovery purpose. The notification itself should act as a deterrent to any phoenixing liquidation of any of the grouped entities, which protects all parties including trade creditors and employees. In the event of any liquidation, this also provides for improved recovery of debts owed.

- Making individuals involved in multiple phoenixes personally liable for the debts of the entities.
- The resourcing and scope of the Assetless Administration Fund needs to be significantly increased. In addition, the criteria for funding of actions by liquidators to recover assets in circumstances where phoenix activity is suspected need to be reviewed to encourage liquidators to pursue commercial recovery of assets transferred for uncommercial consideration. The Assetless Administration Fund criteria for funding recovery of assets is too narrow and will only partially fund the expected costs of the action.
- Establishing an Insolvency Advisory Panel. This Panel would provide peer review of technical matters referred by commercial courts in an expedited manner and provide an opinion about whether arrangements to move the assets sideways for the benefit of the owner and related parties were deliberate. This process would support the effective and cost efficient operation of the courts by helping to resolve matters where there are significant issues to be determined.

Our recommendations in Chapter 8 on enforcement will also support regulatory agencies in tackling phoenixing.

## ***Other options considered***

### *Regulation of pre-insolvency advisers*

We have heard from industry experts that pre-insolvency advisers are unregulated.

We reviewed current activities associated with pre-solvency advisers and consider that the new penalties should be effective in deterring them from future activity. We think that regulatory agencies should continue to assess the role of pre-insolvency advisers to determine whether further regulation is required in the future.

## ***Implementation considerations***

Stakeholders have warned that distinguishing legitimate phoenixing activity from illegitimate activity is a significant challenge in this area.

It will be imperative that any prosecutions using the new phoenixing and extended promoter offences are widely communicated throughout the community to send a signal to promoters and those contemplating this activity to think again.

## TARGETED: SHAM CONTRACTING

### Key points

In the modern Australian economy, labour services are supplied by both employees and independent contractors. As is well-known, the rights, workers' compensation obligations, and tax and superannuation treatment of each type of worker differ.<sup>6</sup>

Independent contracting plays an important role in the economy. As at August 2017, approximately 17 per cent of the workforce was classified as self-employed<sup>7</sup>. Businesses using contractors are able to more flexibly and efficiently organise their operations. Contracting is also attractive to individuals who value the independence and potential rewards it offers. While contracting has traditionally been associated with tradespeople and sectors like building, the profile of contractors is changing. Information technology, professional services like law and accounting and human resources all feature strongly, today, as do contractors working in the sharing economy.

We are conscious that stakeholder views differ on how contracting should be defined and treated for tax and workplace relations purposes. We make some observations in this chapter, but do not deal with these questions here. This Report focusses instead on sham contracting, which has emerged as a particular concern in our industry and public consultations.

Sham contracting refers to the unlawful practice of disguising an employment relationship as an independent contracting arrangement, taking advantage of the differential in tax and other obligations. The capacity for people to abuse the system by engaging in sham contracting is unambiguously contributing to the black economy. Unscrupulous employers engaged in this practice get an unfair commercial advantage through reduced labour costs, both over law-abiding employers and those engaged in genuine independent contracting arrangements. In some circumstances, they exploit workers who have very little bargaining power, denying them their lawful workplace entitlements. More broadly, society is affected because sham arrangements facilitate tax avoidance by both employers and workers, and subvert the policy settings underpinning retirement savings.

We do not have specific estimates on the size of the sham contracting problem. Anecdotally, our consultations suggest it may be growing and numerous examples have been brought to our attention in sectors such as IT, labour hire, courier, beauty and hairdressing, and even executive assistants, but this is an area which requires further examination.

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6 For example: (i) A non-casual employee is guaranteed minimum standards, including paid leave, reasonable limits on working hours, and protection from unfair dismissal whereas an independent contractor is not subject to these standards. (ii) An employer is liable to pay payroll tax, workers' compensation and the superannuation guarantee for all its employees. In contrast, acquirers of services from genuine independent contractors are not liable for these on-costs, nor are the independent contractors themselves. (iii) An employee's income tax is withheld and remitted to the ATO under the Pay As You Go system, whereas independent contractors, genuinely running a business and working for clients, are taxed differently depending on the business structure used.

7 Australian Bureau of Statistics, 6202.0 — Labour Force, August 2017. This figure includes owner-managers with employees.

According to ABS data, growing numbers of contractors report that they do not have control over their own work (64 per cent in 2016, up from 38 per cent in 2008) and are not able to sub-contract (42 per cent in 2016 compared to 35 per cent in 2008).<sup>8</sup> These figures need to be interpreted with caution. The changes may be due, in large part, to shifts in the sectoral composition of contractors and other factors. Most of the contractors in each of these categories are legitimate, but a small proportion of them will be in sham arrangements.

#### **OBSERVATION: ALLIED HEALTH CARE INDUSTRY**

Through our consultations, professional advisers provided us with examples indicating that sham contracting is rife throughout the allied health care industry. These arrangements involve a contrived business-to-business relationship for the delivery of services such as physiotherapy, podiatry, dentistry, radiology and speech pathology. When examined, these arrangements are employment-like in substance. For example, radiologists who work for just one firm where the radiology equipment is owned by the firm, have no business plan for dealing with the public and bear none of the risk of profit or loss.

We also saw job advertisements for medical practitioners where applicants could choose to work as a contractor with an ABN despite the job entailing such conditions as controlled hours, being paid for labour only by one payer, no unrelated clients, working as part of a team, and having to comply with the company's delivery of service.

Sham contracting can occur as a result of employer and employee collusion. It can also be imposed on unwilling employees by unscrupulous employers.

1. Collusion: Businesses and workers together, sometimes with professional advice, contrive arrangements to exploit the tax differential,<sup>9</sup> avoid the obligations associated with an employment contract, and take advantage of the perceived benefits associated with independent contracting.<sup>10</sup>
2. Exploitation: Unscrupulous employers coerce and deceive workers into contracting arrangements under the threat of no paid work at all.

We make two key recommendations targeting sham contracting, including on the ATO Alienation of Personal Services Income (APSI) rules and lowering the legal threshold for prosecuting employers involved in sham contracting arrangements. These are discussed in detail below.

A number of other recommendations in this Report, if implemented, should also help counter sham contracting. Our proposals to restore integrity to the ABN system are critical in this regard (this is

<sup>8</sup> Ibid. and Australian Bureau of Statistics, 6359.0 — Forms of Employment, Australia, November 2008.

<sup>9</sup> Sham contracting arrangements achieve inappropriate tax benefits through the alienation of income. For example, an individual may disguise the fact their services are provided through their personal exertion by billing through an interposed company. Under this arrangement, the person paying for the services makes payment to the interposed company rather than the individual. This is a legal fiction that allows reduced or deferred tax liabilities through work-related deductions not available to employees, income splitting, and retention of income in the company to take advantage of the lower corporate tax rate.

<sup>10</sup> The employer paying for the services benefits through reduced payroll tax, workers' compensation and superannuation liabilities. Workers may willingly enter into sham contracting arrangements if they perceive that being classified as an independent contractor is beneficial to them, for example, independent contractors can claim tax deductions for their work.

discussed in Chapter 4). More needs to be done for employees, some of them visa holders, who find themselves trapped in sham contracting arrangements. These people should be encouraged to come forward, and if appropriate benefit from an amnesty, if they report their employers, as further explored later in this chapter. In addition, enforcement agencies should work more closely together to identify, disrupt and visibly respond to forced sham contracting.

#### **OBSERVATION: SHAM CONTRACTING AND ABN ABUSE**

Many people think the ABN creates a business, rather than it simply registering a business.

There is a widespread belief in the construction industry that having an ABN automatically confers the status of 'independent contractor', regardless of what the working arrangement is. There is also a widespread belief that quoting an ABN, whether it belongs to a hardware store or petrol station, immunises the person doing so from tax consequences or means they cannot be tracked down.

We were informed in consultations and in various submissions that apprentices obtain ABNs even though they are required to be directed and supervised as part of their trade training, meaning they cannot be contractors or business operators in that capacity. We have also been told of other blatant examples of ABNs being required by employers for people who are employees, such as sales staff in retail shops in shopping centres, Irish backpackers working for traffic management firms, and cleaners forced to incorporate prior to taking on a role. A national cleaning company even refers job applicants to an accountant to obtain a trust package for a flat fee when incorporation wasn't feasible.

We also heard a graduate in media applied for a job in a small magazine company in Sydney. She was told to get an ABN and invoice \$25.00 per hour, or else she wouldn't get the job. Without any resistance or checking, she secured an ABN and is working under this arrangement.

We have observed misleading websites instructing visa holders to increase their chances of employment by applying for an ABN without consideration to the key requirement of carrying on a business.

## ***Recommendation 10.2: Change the APSI rules and strengthen enforcement***

We recommend that:

- The Government review the APSI rules, and reconsider the options for reform canvassed by the Board of Taxation.
- The ABN application (and renewal) should require taxpayers to indicate they are an independent contractor. The ATO should subsequently scrutinise a sample of cases where taxpayers self-assess against the 'results test' and 'unrelated clients test'.
- The ATO should undertake a test case to resolve uncertainty and contention about how the APSI rules work.

### ***Description***

#### ***Review APSI rules***

Aspects of the APSI rules introduced in 2000, which are intended to deny tax benefits to those engaging in sham contracting, continue to be easily gamed by some and misunderstood or misapplied by others. In both cases, the rules are not being sufficiently enforced by the ATO.

In 2009, the Board of Taxation (the Board) found the APSI rules do not provide an acceptable level of integrity and equity in the tax system. Notably, the Board found there is poor compliance with the rules, both in terms of those deliberately interpreting the rules in their favour, and those who have difficulty in understanding the rules and uncertainty about their operation. The ATO was not seen to be widely monitoring and auditing the application of the rules, contributing to complacency among taxpayers and advisers. The Board recommended that alternatives to the rules be considered and put forward a number of options that were to be further analysed as part of the Henry Tax Review.<sup>11</sup> The Henry Tax Review further proposed that the rules be changed, after finding that they were not fully effective, and were complex and uncertain.

In the intervening period between the Henry Tax Review and now, no changes have been made to the APSI rules. Nor has the community seen any enforcement action by the ATO since the Board's assessment. It cannot be surprising then, that we have heard the same anecdotes and complaints about the rules throughout our consultations.

The urgency of this issue has intensified given the move to a more services-based economy and the rapid growth of the gig economy, as more people are interacting with the APSI rules. We call for the Government to consider a revised regime in line with the options canvassed by the Board.

#### ***Enforcement of existing personal services business tests***

All individuals are able to self-assess against the 'personal services business' tests. The most widely used test is the 'results test', which generally works well in many sectors, particularly more traditional industries such as building and construction. It is satisfied if you work to produce a result,

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<sup>11</sup> N Sherry (Assistant Treasurer), Release of report into personal services tax laws, media release No. 109, 16 December 2009.

provide plant and equipment or tools of the trade, and are liable for rectification of any defects in work performed. It is designed to work even in circumstances where 100 per cent of income is from a single source, which makes sense in the building and construction industry where projects have long lead times.

When the 'results test' is not satisfied, you can default to the '80/20 rule'. That is, if you earn less than 80 per cent of your income from a single source in the income year, you can self-assess against the other three personal services business tests:

1. Unrelated clients test: you have two or more unrelated clients who were obtained as a result of making offers or invitations to the public at large.
2. Business premises test: you have a separate business premises.
3. Employment test: you have an employee who performs 20 per cent of the principal work by value of the business.

We have observed a number of problems with these tests. First, the self-assessment character of the tests is being deliberately abused by some purporting to be independent contractors but working in an employment-like manner. In the most egregious case, we were informed of unscrupulous labour hire firms organising ABNs for backpacker workforces on various high-rise construction sites. In other cases, individuals genuinely misunderstand the rules. We heard that workers in the information technology, security, courier, administrative services and allied health industries have easily obtained an ABN, earn 100 per cent of their income from one employer, favourably assess themselves under the tests, and inappropriately access tax benefits that should be reserved for those independent contractors genuinely running a business.

#### **OBSERVATION: ABUSE OF THE 'RESULTS' TEST**

In both the Board of Taxation review of 2009 and during our consultations, stakeholders have pointed out the 'results test' in the APSI rules is, at best, misunderstood and, at worst, used by individuals to self-assess as an independent contractor and avoid taxes knowing they're unlikely to be checked.

Some individuals simply tick the 'results' box on the tax return, not aware they do not meet the criteria.

Stakeholders also told us it is easy to structure a contract that looks like it would be a 'results-based' contract when it is not.

It was pointed out to us that payment under any of the following ways does not constitute a result:

- Hourly rate
- Daily rate
- Piece rate
- Percentage of a fee
- Commission only

An example of a legitimate results-based contract is one where a project or service is quoted for a fixed dollar amount.



Second, the unrelated clients test is not fit for purpose in the context of the gig economy. It is far too easy to conduct minor work for two unrelated clients using online platforms.

#### **OBSERVATION: UNRELATED CLIENTS TEST NOT FIT FOR A MODERN ECONOMY**

The use of the peer-to-peer jobs platform, Airtasker, is expanding at a rapid rate. It has more than 1.7 million users in Australia and generates \$90 million in transaction volumes annually.<sup>12</sup>

#### *Increased scrutiny*

While the tax system is fundamentally a self-assessment system, we think there should be more intense scrutiny of individuals applying for an ABN and subsequently self-assessing against the existing APSI rules at tax time.

To improve the ATO's visibility of individuals who are employees at law (and in fact) but are abusing the APSI rules, ABN applicants should be required to signal on their ABN application (and ABN renewal) that they are an independent contractor. The ATO could then target particular industries and examine a sample of cases where individuals have self-assessed against the results test or unrelated clients test. This activity is especially necessary to tackle those who hold themselves out as independent contractors who earn 80 per cent or more of their income from a single source. It ensures the existing APSI rules are appropriately enforced.

#### *A test case*

In addition, the ATO should undertake a test case to resolve uncertainty and contention about how the APSI rules work. This test case should set an example in the community and counter the complacency among some taxpayers and advisers in complying with the existing APSI rules.

#### **Recommendation 10.3: Bolster the sham contracting penalty provisions**

We recommend that the Government implement the Productivity Commission's recommended changes to the sham contracting provisions of the *Fair Work Act 2009*.

#### *Description*

We agree with the Productivity Commission that the legal threshold for a defence of a contravention of the sham contracting provisions in the *Fair Work Act 2009* should be lowered. Under the current law, employers can escape prosecution if they can demonstrate that they were not acting 'recklessly'.<sup>13</sup>

12 Y. Redrup, 'Airtasker raises \$33 million to hit the UK as Seven West and Exto up takes', Australian Financial Review, 10 October 2017.

13 The *Fair Work Act 2009* has provisions prohibiting sham contracting. They include two strict liability offences whereby an employer cannot: (i) Dismiss or threaten to dismiss an employee to re-engage them as an independent contractor; (ii) Persuade or influence an employee to become an independent contractor. There is a third offence, whereby an employer cannot misrepresent an employment relationship as an independent contracting arrangement.

The Productivity Commission reviewed these provisions in 2015 and found that the ‘recklessness’ test was generally too high a bar for regulators and others to prove, and should be lowered to a test of ‘reasonableness’.<sup>14</sup>

## Other observations

As raised above, in our consultations we were told not only of problems with sham contracting but have also been made aware of broader issues relating to contracting. Set out below are some of these observations. These are not recommendations, but draw on our extensive consultations with businesses, unions, contractors and the public.

### Complexity

At the moment, to tell an employee from an independent contractor, the courts refer to a multi-factor test with a number of elements that have to be considered. It is a test of overall impression, with no set number or combination of factors that lead to a conclusion one way or the other.<sup>15</sup> It is therefore a fact-intensive inquiry, and in practice the distinction can be very hard to draw.<sup>16</sup>

*‘Determining whether a worker is an employee or contractor is one of the most complex issues faced by businesses (particularly small businesses).’ The Tax Institute*

Some stakeholders argue that this complexity and lack of clarity may be a factor behind the growth in sham contracting. The law would be easier to enforce, they point out, if a clear statutory definition was in place. The Productivity Commission considered this question in its 2015 review. While it acknowledged the potential benefit of a statutory definition, it expressed concern that it would be gamed and, in any case, be rendered out-of-date by future commercial developments.

In many circumstances, those engaging contractors must pay payroll tax, workers’ compensation premiums and superannuation contributions to them. Each of these is subject to its own definitions and tests, buried in multiple statutes and articulated differently. In these circumstances, employer compliance with these requirements is unlikely to be high.

To reduce red-tape, we think the Commonwealth and the States should work together to harmonise or bring greater consistency in this area. There should be a uniform bright-line test used to determine when these obligations must be paid for some contracting services. We appreciate how difficult in practice this will be, but this is a necessary task.

### New business models

New business models are bringing more and more people into working arrangements which lack clarity. With the number of gig economy platforms expanding and with them the variety of business models employed, more people are burdened with the complexity associated in working out their

<sup>14</sup> See Productivity Commission, Workplace Relations Framework: Productivity Commission Inquiry Report Volume 2, No. 76, November 2015, chapter 25.

<sup>15</sup> See A Stewart, Stewart’s Guide to Employment Law, 5<sup>th</sup> edn, The Federation Press, Section 3.7.

<sup>16</sup> Ibid., Section 1.5.

obligations under these rules.<sup>17</sup> These business models may well be legitimate, for example genuine rent-a-chair arrangements where hairdressers work as independent contractors, but the rules are blurry and difficult to understand.

As an increasing share of the workforce works through new business models, there may also be a need to consider whether and how the SG applies to them. This is explored later in this chapter.

#### **OBSERVATION: 'NDIS'**

The NDIS is reshaping the disability sector. Under this scheme funding is allocated directly to consumers who therefore have control over the services provided to them.

Some consumers will choose to engage directly with their support workers, rather than use a traditional service provider. For individuals with a disability who are managing their own funding, engaging a support worker as an independent contractor may be easier than becoming an employer with all the responsibilities that entails. Although this has benefits for consumers, there are also risks with this approach.

National Disability Services (NDS), the peak organisation for non-government disability services, has expressed concern about the potential for sham contracting under the NDIS, stating that it:

'could be a new and growing problem in our industry as the NDIS creates a more competitive market for disability services. Our concern is that greater choice and control for people with disability should not entail increased legal risk for them, and/or unfair wages and working conditions for their workers'.<sup>18</sup>

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17 Some platforms offer a strict introduction service, but have no continued relationship with the contractors that use them. This is not the case for other business models, which adopt a variety of approaches to tax, employment and superannuation matters.

18 National Disability Services, Response to Productivity Commission Draft report — Review of the Workplace Relations Framework 2015.

## TARGETED: VISA HOLDERS

### Key points

Throughout our consultations we have received the clear message that temporary visa holders are particularly likely to be involved in black economy activities.

There is an economic and perhaps cultural dimension to this issue. Some student visa holders may exceed their permitted hours (40 hours per fortnight) for economic reasons. For others, language and cultural barriers and a limited understanding of their rights and obligations may be the problem. Some students may be particularly vulnerable to exploitation (which is further discussed later in this chapter), and we have heard that deceitful migration agents and training colleges are sometimes implicated.

There is also a criminal dimension in a small number of cases. We have also heard of instances where visa holders enter Australia under false pretence in order to work, offer to work cash-in-hand below award wages or have links to criminal elements, including smuggling and money laundering. We are not suggesting that more than a small minority of students are involved.

We argue that educational institutions should take more ownership of the integrity of the student visa program. They benefit financially from this and are already subject to regulation and reporting obligations, but these should be strengthened, particularly for higher-risk institutions.

We recognise the work the Migrant Workers' Taskforce is doing to address many of these issues and commend it for the many positive steps that have already been taken in response.

#### OBSERVATION: BEING A MIGRANT JOBSEEKER

The Federation of Ethnic Communities' Councils of Australia (FECCA) informed us about the difficulties migrants can have in finding stable legal employment, telling us:

'At June 30, 2016, 28.5 per cent of Australian population was born overseas and nearly 50 per cent of Australians have one or more parent born overseas. Australia's economy and future prosperity is heavily reliant upon the skills that migrants bring to this country through temporary and permanent migration streams and our migration system is designed to attract appropriate skills for the needs of Australia's economy. This is reflected in the figures: 65 per cent of recent migrants held tertiary qualifications before arriving in Australia and many more obtained tertiary qualifications after arriving in Australia; and migrants with Australian citizenship have an unemployment rate of 3.3 per cent versus 5.4 per cent for people born in Australia.

However, for some individuals and communities of CALD backgrounds, there are greater challenges in securing employment. In particular, for a small but significant number of individuals, the informal sector — as either an employee or as a business owner or sole trader — may be the only opportunity available as a means of income generation and support for their family.

Australians of CALD backgrounds, in particular recently arrived migrants, from new and emerging communities or refugees, face a number of barriers to obtaining employment. FECCA's own research has highlighted some key challenges including:

- Difficulties obtaining recognition of skills and qualifications earned overseas or lack of Australian qualifications

### **OBSERVATION: BEING A MIGRANT JOBSEEKER (CONTINUED)**

- English language proficiency. This includes employer discrimination with regards to accent
- Experiences of discrimination, prejudice or racism
- Lack of networks for seeking and securing employment
- Limited familiarity with the Australian workforce, employment systems and culture
- Pre-migration experience, including experiences of torture and trauma.

FECCA's own understandings are supported by the latest census data where, approximately one-third (31 per cent) of recent migrants who have had a job in Australia reported experiencing some difficulty finding their first job. The most common difficulties were:

- A lack of Australian work experience or references (65 per cent)
- A lack of local contacts or networks (31 per cent)
- Language difficulties (25 per cent)

Experiencing these barriers, often in combination, mean that many people from CALD backgrounds find themselves in lower-skilled and low-paid jobs. For example, research has demonstrated how a 'lack of mainstream networks' can contribute to directing new arrivals into undesirable employment within 'secondary labour-market niches' often characterised by unhealthy work environments, including long hours, relatively high occupational health and safety risks, and limited job security'. An inability to have one's overseas qualifications recognised or to find acceptance in the Australian job market means that many migrants take jobs below their skill level — a phenomenon termed 'occupational skidding' by the renowned demographer the late Professor Graeme Hugo of the University of Adelaide.

These barriers mean that for some CALD Australians, their employment options are focused on the retail, hospitality, hygiene, construction and fast food sectors. Our Interim Report identified the high-risk sectors for black-market economy to be 'building and construction, restaurants and cafés and hair and beauty salons'. As noted above, these are sectors that employ a high percentage of migrant and refugee workers.<sup>19</sup>

### ***Student visa holders***

There are currently over 500,000 student visa holders in Australia. Most student visa holders are subject to a condition limiting paid work to 40 hours per fortnight when their course is in session. Many OECD countries impose similar limits, which have a legitimate rationale. The idea is that students should be able to self-fund their studies and living expenses with part time jobs. The concern is that if no work limits applied, visa holders could in effect become economic immigrants, working full time. If, on the other hand, visa holders were not allowed to work at all, some might not be able to support themselves over the course of their studies (noting that visa applicants have to demonstrate they have the financial means to do so). Australia's competitiveness on the international education market would be undermined.

In the course of our public and industry consultations, including in regional centres, our discussions with the FWO and unions, our liaison with law enforcement agencies and the Government's Migrant

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19 Federation of Ethnic Communities' Councils of Australia, Submission to the Black Economy Taskforce, August 2017.

Workers' Taskforce, the message is that the 40 hour work limit is being widely ignored and often not enforced. Student visa holders risk visa cancellation if they are found breaching this visa condition, so have no choice but to ask for, or accept, cash-in-hand work. In these circumstances, below minimum and award wages are often paid, basic workplace requirements are sometimes not met and labour exploitation and abuse can occur. There is a link to criminal elements in some cases where criminal activity is conducted under the cover of student visas, such as smuggling illicit tobacco. Some people on student visas have the intention of working rather than studying. Some 'agents' in the country of origin act in cahoots with lower order education institutions here to assist in specifically orchestrating such arrangements. There can be connections between such arrangements, unscrupulous labour hire operators and organised crime.

Stakeholders, both within and outside government, have expressed alarm about the consequences of this, which include: the distortion of markets for labour intensive goods and services (with firms employing legal labour being underbid), the violation of basic labour and even human rights and the role of criminal groups in organising this shadow labour force. We have no firm data on the extent of the problem, which requires further work. It is clear that it is worse in particular parts of the economy, including restaurants, cafés, cleaning and horticulture, than in others. There is also a cultural dimension to this, with foreign language websites openly offering below minimum wage work. We are not suggesting that all students who exceed the 40 hour limit are exploited. Many, no doubt, elect freely to do this. But as the FWO has argued (in its recent report on Working Holiday Makers), they may be ripe for exploitation.

Our responses to the student visa problem need to be carefully framed. International education is an important industry. We must be mindful of the broader policy considerations which underpin our visa and educational systems. Some other recommendations in the report, for example mandatory payment of wages into bank accounts, will help address some wrong-doing. We stress that our enforcement approaches should be cost effective, focussing on serious rather than minor cases (the latter would include those who only intermittently break the visa rules), but also visible (acting as a deterrent for others). Responses need to deal with dishonest migration agents and training colleges which lure students to Australia under false pretences.

We must continue to enlist the support of education institutions that have responsibility for ensuring students turn up and study. Industry, unions and student associations and alliances are also important, as are migration agents and ethnic communities, who in many cases know where the problems are. And, finally, serious abuses and those linked to organised crime must be dealt with in a multi-agency manner.

The legitimacy of some education institutions should be further examined. We have heard of cases where some are linked to organised crime groups who are using the student visa system to carry out illegal activity.

### OBSERVATION: CULTURAL CHALLENGE — FOREIGN LANGUAGE JOB ADS

United Voice informed us:

'Audits of foreign-language job advertisements conducted by Unions NSW in 2016 and 2017 reveal 'endemic' levels of below-Award cash-in-hand jobs being promoted to temporary migrant workers, with the highest levels of wage theft and tax evasion occurring in the hospitality and cleaning industries. According to the *Lighting up the black market — enforcing minimum wages* report, 97 per cent of hospitality jobs were below Award minimums, and the average advertised rate was \$13.60/hour — \$5.79 below the Award. In turn, 65 per cent of audited cleaning jobs advertised wages below the minimum Award rate of \$18.66/hour. These findings are consistent with previous research conducted by Monash University and Fairfax, which found that 80 per cent of foreign language job advertisements offered below the award or minimum rate of pay, with many being openly advertised as 'black jobs'.<sup>20</sup>

### Recommendation 10.4: Black economy activities by visa holders

We recommend that:

- The Government consider more compliance activity to determine whether visa holders are acting consistently with their obligations.
- Visa holders with work permissions are provided with a TFN immediately upon their arrival.
- Visa holders should not be eligible for future visas, including permanent residency, if they have committed tax evasion.

### Description

#### Compliance activities

The Government should address black economy participation of temporary migrants and ensure the integrity of the visa system is maintained. This could cover:

- Stricter and more frequent monitoring of student visa holders' attendance and progress at their nominated educational institution. Students need to prove that they are genuine students. Educational institutions (including training colleges) should have in place measures that allow them to assess students' enrolment and satisfactory progress on a regular basis, and at least within six months of arrival. Educational institutions that benefit from international students should assume some responsibility. The National Code of Practice for Providers of Education and Training to Overseas Students, of which a revised version will come into effect on 1 January 2018, is a step in the right direction.
- Enforcement of existing visa work conditions, including through consideration of visa cancellation, where visa holders are deliberately and repeatedly non-compliant with visa conditions with regards to their work rights. Different treatment would apply to those found to be in a vulnerable position and subject to exploitation (see Recommendation 10.6 below).

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<sup>20</sup> United Voice, Submission to the Black Economy Taskforce, July 2017.

- Cancellation of visas where visa holders have been found to commit serious tax and workplace relations offences.
- Greater collaboration across agencies to ensure a more systemic, targeted approach.
- Greater use of risk assessment of educational institutions and education and migration agents to determine organised malpractice. In line with recent amendments to the *Education Services for Overseas Students Act*, action should be taken against institutions and agents that are found to provide wrongful information or be complicit in soliciting visa holders coming to Australia under false pretences.
- Strong cooperation with migrant and ethnic community organisations to educate visa holders about their rights and obligations and exchange intelligence to aid enforcement.

### *Tax File Number*

Visa holders with work rights should be issued a TFN immediately upon their arrival. This will provide a clear message that they have tax obligations, and help stem black economy activities. Their TFN could be linked at that stage to their visa status to give greater visibility of all wages paid to visa holders.

### *Visa eligibility*

Visa holders that have been found to have committed serious tax evasion should not be eligible to apply for other visas or visa renewals and should not be eligible for permanent residency (except in cases where the visa holder was exploited).

### *Other actions*

- Tourist visa holders should not be eligible to apply for an ABN (see Recommendation 4.2). In addition, the ABR is putting in place mechanisms to place greater scrutiny on ABN applicants that hold a visa.
- Regulatory agencies should undertake increased data matching to ensure visa holders comply with their obligations.



### **OBSERVATION: MIGRANT WORKERS IN THE BLACK ECONOMY**

The Federation of Ethnic Communities' Councils of Australia informed us about the pressures on migrants leading them to work in the black economy, telling us:

'People from CALD backgrounds, including migrants and refugees, are disproportionately represented among victims of exploitative workplace practices. One reason for this is seen in the balance of power between a CALD employee and their employer, particularly where that employee has struggled to find employment. Compounding this and contributing to the likelihood of a CALD Australian finding themselves engaged with the black economy include:

- A limited knowledge of the Australian workplace including obligations, rights and entitlements.
- Lack of support networks and social isolation
- Language barriers
- Visa limitations.

These barriers to employment mean that some CALD Australians, and particularly women with caring responsibilities and young people who may have fewer employment options, are pressured to accept cash-in-hand work as it may be the only option available to them when facing immediate financial demands including rent, transportation costs and childcare costs. Working in the cash economy leaves individuals vulnerable to exploitation and can lead to long-term exclusion from government services, further educational opportunities and long-term, meaningful employment.<sup>21</sup>

The Migrant Workers' Taskforce is also looking at these issues in detail and will report in early 2018.

## **Discussion**

### *Problem this recommendation seeks to address*

Black economy participation by certain visa holders, particularly international students, is rife. While no data is available due to the difficulties of measuring black economy activities, there are currently over 500,000 student visa holders in Australia and consultations across Australia have indicated that many of those are working in excess of the permitted 40 hours per fortnight and being paid cash-in-hand. Some tourist visa holders are also known to work despite having no work permit, with some applying for ABNs and working as contractors. Concerns about these abuses were voiced by industry, the community and law enforcement agencies. A range of sectors, including restaurants and cafés, cleaning and the horticulture industry appear to be particularly high-risk.

Most of the activity we identified by those abusing the student and tourist visa systems is not criminal in nature. We recognise that the number of individuals and organisations seeking to use the visa system to undertake criminal activity is small, but it is growing.

### *Rationale*

It is important to ensure that visa holders abide by their visa conditions and comply with Australia's tax and regulatory systems. Temporary visa holders are an integral part of Australia's economy and it is important to ensure that they abide by their visa conditions and where they have work rights they participate in the workforce in accordance with the tax and regulatory requirements, and do not operate outside the formal economy. As we argue throughout the report, while individual

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<sup>21</sup> Ibid.

transgressions are likely minor, the cumulative impact of non-compliance is significant and undermines the integrity of our tax and regulatory systems. Other recommendations address the criminal behaviour of visa holders (including money laundering).

### ***International comparison***

Most countries have limitations on the number of hours student visa holders can work.

In the UK, students can work 20 hours per week during term time and full-time during vacations (10 hours for language centre students).

In New Zealand, students are given a permit to work depending on the type of study, educational institution and duration of the course. If they are permitted to work, it is normally up to 20 hours per week during the academic year and full-time during Christmas and New Year holiday period.

In Canada, students can work 20 hours a week on campus. Off campus they require a work permit, which allows 20 hours per week during term and full-time during term breaks.

In the US, students are only permitted to work under certain conditions. On-campus employment is generally permitted, but is not to exceed 20 hours during term and full-time during breaks.

### ***Stakeholder views***

As discussed above, consultations have revealed significant issues with student visa holders working in the black economy.

The DIBP and Department of Education and Training (DET) both support the existing arrangements. They point out students are provided with information on the indicative costs of living in Australia prior to enrolling and are advised they should not rely on work to subsidise their stay in Australia. As part of their visa requirements, students are required to have or declare they have sufficient funds to pay for course fees, travel and living costs for themselves and accompanying family members while in Australia.

DIBP and DET note that Australian student visa holder work arrangements are comparable to those allowed competitor countries for international students. In defence of the working limit they note that completion rates among full-time tertiary students begin to decline for those working more than eight hours per week. Students working 16-24 hours a week are eight per cent less likely to complete their course, and students working more than 24 hours per week are 14 per cent less likely to complete their course.<sup>22</sup>

### ***Implementation considerations***

We are aware that the Migrant Workers' Taskforce is examining similar issues. We commend the work of that Taskforce.

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<sup>22</sup> C Polidano, & R Zakirova, Outcomes from combining work and tertiary study, National Centre for Vocational Education Research, January 2011.

Stronger enforcement of work restrictions by international students entails costs. Cancellation of visas is a grave undertaking and substantial effort is involved in collecting the necessary evidence through monitoring, audit and field activities. While it is important that individual wrong-doing is addressed, targeting organisations and intermediaries complicit in exploitation of visa holders is likely more resource efficient.

Regulations governing visa cancellation should be strengthened to permit visa cancellation for serious tax offences, including where a conviction is not recorded or the conviction does not meet the threshold for cancellation on character grounds. Visas may be cancelled on character grounds where a conviction results in a sentence of 12 months or more imprisonment. Cancellation of temporary visas can currently occur when a temporary visa holder is convicted of an offence irrespective of the penalty imposed — this includes where they are convicted of tax offences.

## SUPPLEMENTAL RECOMMENDATION

### *Withholding arrangements for visa holders*

The Government could examine the merits of extending the PAYG withholding regime on certain classes of temporary visa holders (for example, students) who have obtained an ABN and are working as a contractor. The aim of such a measure would be to increase the ATO's visibility of these workers and reduce the 'tax leakage' that occurs when they leave the country without having paid their tax bills. Any assessment would have to consider how to minimise additional compliance burdens on employers. We note that our proposals to restore integrity to the ABN system will prevent some visa holders, including those on tourist visas, from obtaining ABNs in the first place.

## TARGETED: LABOUR HIRE

### Key points

The labour hire and broader recruitment services industry is a valuable source of flexible, short-term employees for businesses. This sector is extraordinarily diverse, including high-end professionals, skilled office workers and, at the other end of the spectrum, various forms of unskilled labour. Parts of the labour hire industry, however, are infiltrated by unscrupulous firms and individuals that are operating in the black economy. Some sectors are particularly vulnerable to such operators, including horticulture, security and perhaps even aged care. This can range from simple non-compliance with PAYG tax withholding and payment of cash wages well below award rates, to exploitation of vulnerable workers and even labour hire firms with links to crime, money laundering, immigration fraud and other abuses. During our public roundtables, we were told that some employers split their payrolls, paying cash wages directly into foreign bank accounts.

#### OBSERVATION: LABOUR HIRE IN HORTICULTURE

Forty-thousand temporary positions need filling for fruit picking and other harvest activities seasonally. Historically this has been managed through the working holiday maker visa ('backpacker visa'). However, insufficient supply provides an opportunity of unscrupulous operators, frequently with connections to organised crime both locally and internationally, to set the terms both of the supply to the farmers and the payment and other terms to the workers.

We note that the Migrant Workers' Taskforce is also looking at the issue of labour hire in detail.

#### Recommendation 10.5: Labour hire

That the Government gives in-principle support for industry-led certification schemes for labour hire firms, which are credible, rigorous and strictly enforced. Certified firms could be treated as 'trusted traders' as outlined in Chapter 9 on supply chain integrity. We note that potential regulatory reforms to the labour hire sector, complementary to industry efforts, are under consideration by the Migrant Workers' Taskforce which will report to Government in early 2018.

### Description

The Government should give its in-principle support to industry-led certification for labour hire (or workforce services) firms. Certified businesses would be classified as trusted traders under the minimum standards proposed for supply chain integrity in Chapter 9.

The certification needs to be credible, robust and strictly enforced. It should include criteria such as:

- Operators of labour hire firms to meet a fit and proper person test.
- Firms to comply with tax, employment and other laws.
- Compliance with the requirements is regularly checked by an external auditor.

- Strict processes to withdraw certification in the case of non-compliance.

Criteria could be adjusted based on industry and business size, recognising that compliance costs are likely to impose a greater burden on small businesses.

The labour hire commercial environment is becoming increasingly complex. We have been told of simple matchmaking websites (who are not labour hire firms) directing clients to other platforms (which are), for example Sidekicker and Seek. This underlines the importance of any ethical code in this area being carefully enforced.

Offshore payroll services are playing an increasing role, with some wages and payments for contractors being deposited directly into an overseas account. In such cases it should be clear that the payroll services provider or employer is liable for any underpayment of tax.

Other recommendations in this Report, including an extension of TPRS and greater emphasis on enforcement and easier prosecutions (outlined in Chapters 6 and 8, respectively), will also help address misconduct by unscrupulous labour hire firms.

## **Discussion**

### *Problem this recommendation seeks to address*

While the majority of businesses in the labour hire and broader recruitment services industry are operating legitimately, there are some segments of the industry where firms routinely participate in the black economy.

#### **OBSERVATION: LABOUR HIRE IN HORTICULTURE**

Farmers told us that when they and their neighbours need pickers to harvest their fruit crops, their only choice is to call 'Joe' in town. They know that if they do anything that's out of line, the next time their crop is ripe 'Joe' will not take their calls and their crop will rot. They told us they have no choice but to go along with whatever occurs because 'Joe' is the only source of labour supply for picking, even if it means paying him cash in a plastic bag and being pretty certain the pickers are being underpaid, are working illegally and tax and superannuation obligations are not being met. An effective response needs to target Joe.

### *Rationale*

There are a range of possible options, from certification through to registration and licensing in this area. Certification of labour hire firms aims to enable businesses and governments to distinguish between labour hire firms which comply with their tax and other obligations and those which evade their obligations and therefore do not seek or obtain certification. By contracting only with certified labour hire firms, large businesses and governments can ensure that the labour hire firms they engage in their supply chains behave ethically and through it promote responsible supply chain management to the community.

### *Costs and benefits*

We consider that robust and credible industry-led certification is the most appropriate approach at this time. As discussed in Chapter 9, it should be linked to a ‘trusted trader’ status to help businesses select complying businesses as part of their supply chains. The industry itself has an incentive to ensure that non-compliance is eliminated in order to retain credibility of the industry. Industry associations will be able to tailor regulation appropriately to foster firms’ compliance with existing tax and other regulation without introducing overly onerous new obligations. The recruitment services industry has demonstrated a strong awareness of the problem and has on its own accord worked to address it. In addition, a certification scheme will be able to evolve over time in line with the commercial environment and social expectations. However, the voluntary nature of the scheme could mean that only those likely to comply would subscribe, thus limiting its effectiveness as a driver of improved work practices.

#### **OBSERVATION: LABOUR HIRE — NATIONAL ACCREDITATION**

One independent recruitment agency told us:

‘The ‘world of work’ needs a national accreditation scheme.

If we go down the state based route, it will fail. It may be possible to catch some rogue operators at a state level, but many rogue recruitment firms, are based in one location, source workers from a second location and place them into a job in a third location!

Also consider that as people find more and more work via internet based platforms, that attempting to have several state based systems keep up with the changing legislation required will as a minimum create enormous duplication or most likely, simply not work.’

### *International comparison*

In the UK, a dedicated authority (the Gangmasters and Labour Abuse Authority) administers that country’s licencing regime.

Canada, Japan and South Korea have licencing systems or codes of conduct which apply to the labour hire sector.

### *Stakeholder views*

The Recruitment and Consulting Services Association strongly supports the introduction of industry-led certification and is currently piloting such a scheme.

Trade unions support the introduction of a licencing regime.

A number of states have recently implemented or are planning to implement licencing schemes for the labour hire industry and there have been calls for the Commonwealth government to implement a national scheme. In our view having multiple state-based licencing schemes will likely create a regulatory burden for labour hire organisations that operate in more than one jurisdiction and harmonisation would be beneficial in the absence of a national scheme.

### ***Implementation Considerations***

Standards would have to be set at appropriate levels depending on the size of business and industry. As noted in Recommendation 9.2 on minimum standards for certification for supply chain integrity, it is important that small businesses do not face compliance costs which effectively do not allow them to continue operating.

Our recommended approach does not preclude potential regulatory reforms to the labour hire sector that are under consideration by the Migrant Workers' Taskforce which will report to Government in early 2018.

## TARGETED: ABUSE OF VULNERABLE WORKERS

### Key points

Much of this report has focussed on businesses and individuals who are participating in the black economy to dodge their obligations, gain a benefit or avoid compliance burdens. But there are also people who are in the black economy because they are forced to or are being taken advantage of. Migrants, particularly temporary residents (as also highlighted in our discussion on visa holders), are at particular risk as are young people. Lack of education and understanding of regulatory frameworks, including their rights, limited opportunities for alternative employment and pressure from their communities enable this exploitation.

We are not the first to point to this problem and a number of processes are underway that seek to address this issue. This includes the *Protecting Vulnerable Workers Bill* which passed both Houses of Parliament in September 2017 and makes a number of important changes, such as increasing penalties. In addition, the Migrant Workers' Taskforce and Labour Exploitation Working Group are both currently looking at ways migrant worker exploitation can be stopped.

#### OBSERVATION: INFORMATION FROM A TEACHER

A participant in one of our industry roundtables provided us with a list of businesses that are employing working holiday visa holders under exploitative conditions, driven by a lack of understanding of visa conditions, wrong advice, limited job opportunities and pressure from their communities. We have referred information provided by these examples to relevant agencies.

We recommend the following measures be adopted to address the exploitation of vulnerable workers. The strategy should include:

- Better education of visa holders, migrant communities, and other at-risk employees about the costs and consequences of black economy participation. This should include providing education and assistance to migrant communities.
- Providing amnesties (where appropriate) to people trapped in the black economy so that employers of such people can be held accountable without the worker losing their visa.
- Increased penalties for those found guilty of labour exploitation.
- Improving supply chain integrity, for both the public and private sector (see Chapter 9).



### **Recommendation 10.6: Strategy to counter the exploitation of vulnerable workers**

The Government should implement a strategy to protect vulnerable workers, including:

- Educating high-risk visa holders and migrant communities about the dangers of the black economy, working closely with migrant community organisations.
- Where appropriate, providing amnesties to people trapped in the black economy.
- Improving supply chain integrity through a framework of standards and 'trusted traders' concept (see Recommendation 9.2) and providing in-principle support for industry-led certification of labour hire (see Recommendation 10.5).

### **Description**

#### *Education*

Visa holders should be provided with comprehensive and targeted information (potentially at the time that they are granted a visa). This information could set out the risks and consequences of participating in the black economy. Targeting information in the right way is important here, and relevant agencies should work closely with migrant communities to provide education and assistance to ensure that these most vulnerable of workers have the knowledge and tools to prevent being trapped in the black economy or become subject to modern slavery conditions.

#### *Amnesty*

The amnesty would enable vulnerable workers who are being exploited and are trapped in the black economy to come forward and report on the actions of employers and businesses without fear of significant repercussions. Specific features should include:

- **Targeting vulnerable people.** The individual would have to be assessed as vulnerable, provide evidence of exploitation prior to the amnesty being announced, and not have any previous warnings, penalties or convictions against them.
- **Waiving penalties and fees only.** The individual should remain liable for their primary tax liability and welfare debt. Penalties and fees that would otherwise have applied would be waived.
- **Milder approach to visa holders.** If individuals coming forward breached visa work conditions, (for example, by working more hours than permitted), they should be issued a warning only and counselled in person.
- **Activities following the amnesty.** Immediately following the amnesty there should be a significant surge of compliance activities and increased penalties for non-compliance. Individuals who have come forward should be followed up to ensure that visa conditions are no longer being breached.
- **Complementary measures.** The amnesty should be accompanied by the establishment of a new whistleblower program and a targeted publicity campaign, including information on the greater risk of detection following the amnesty. (See Recommendations 16.3 and 11.2)

### *Modern slavery*

We urge the Government to adopt a *Modern Slavery Act*, including a requirement for large businesses to report on their activities to combat modern slavery, as proposed by the Government's discussion paper from August 2017.

### **Objective**

- Reduce the risk of vulnerable people being exploited in the black economy.
- Provide certainty to vulnerable workers that they receive the necessary support if they come forward.

### **Discussion**

#### *Problem this recommendation seeks to address*

Vulnerable people are particularly at risk in the black economy. Visa holders with limited or no work rights may perform work which exceeds their allowed limit and may then find themselves coerced to remain in the black economy. This can occur in rural areas. Fruit pickers, for example, may be underpaid and housed in unsanitary accommodation for which they are required to pay high rates. It can also occur in the retail and hospitality sectors, where an employer becomes aware that someone has exceeded their work rights. Some migrant communities are at particular risk, due to limited knowledge of Australia's workplace relations system, different institutional settings and attitudes to tax in their country of origin, as well as community pressure.

#### *Rationale*

Vulnerable workers often enter the black economy without understanding fully the risks that they are taking. If they are warned about these dangers, they may be less likely to engage in such activity.

An amnesty would encourage those currently trapped in the black economy to come forward, bring them into the formal system and allow agencies to follow-up to assist them with future compliance. The information gained through the amnesty would also provide information on businesses operating in the black economy which can then be targeted through audits. Furthermore, the amnesty would generate valuable data which can be used to estimate the size of the black economy, help target future compliance activities and assist in policy design.

### **Implementation considerations**

As discussed above the amnesty would have to be very carefully designed in order to provide the right incentives for participation and generate desired behavioural change. The recommendation will need to be implemented through close collaboration of relevant agencies, including ATO, FWO, DIBP and DHS. Relevant agencies at state and territory level may also need to be involved.

## TARGETED: SUPERANNUATION GUARANTEE CONTRIBUTIONS

### *Key points*

Several stakeholders have indicated that some employers are slow to pay their employees' SG entitlements and others do not pay them at all.<sup>23</sup> We have also heard that individuals may be reluctant to come forward to report these cases out of fear of losing their job.

### *Improving superannuation compliance*

The Government has recently announced a package of reforms to improve SG compliance. The package includes more frequent contributions reporting by funds, extension of STP to small businesses from 1 July 2019, strengthening ATO recovery powers, and empowering the ATO to seek court-ordered penalties for employers who repeatedly fail to meet their SG obligations.<sup>24</sup>

The Government will also provide the ATO with additional funding for an SG Taskforce to crackdown on employer non-compliance. We support these measures, which will strengthen the ATO's capacity to detect unpaid SG and recover the money on behalf of employees.

We further recommend that the ATO use the improved information it will be receiving to keep employees better engaged with their superannuation, by more regularly updating individuals' superannuation balances displayed online and, informing affected employees about recovery activities when taking action on unpaid SG.

### *Superannuation settings for independent contractors*

The Association of Superannuation Funds of Australia (ASFA) has estimated that about 100,000 workers in Australia are using web-based platforms to obtain work. While this estimate should be treated with caution, it indicates an increasing trend to work independently and find more flexible work.

Many of these workers may not be covered by the SG rules. In addition, more people are likely to be attracted to work in the gig economy, where some may not be covered by the SG rules. This will result in lower superannuation balances at retirement. We note that only about one-quarter of the self-employed made tax deductible contributions to their superannuation accounts in the 2014-15 year.<sup>25</sup> The Government should consider the implications of this trend on the superannuation system's ability to provide income in retirement to substitute or supplement the Age Pension.

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23 The ATO has estimated the SG gap for 2014-15 at \$2.85 billion. This represents 5.2 per cent of the total estimated \$54.78 billion in super guarantee employers were required to pay in 2014-15. Australian Taxation Office, Superannuation Guarantee gap, viewed 2 October 2017, <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Superannuation-guarantee-gap/?page=2#Methodology>.

24 The Hon Kelly O'Dwyer (Minister for Revenue and Financial Services), Turnbull Government backs workers on superannuation, media release, 29 August 2017.

25 Association of Superannuation Funds of Australia, Superannuation and the changing nature of work: Discussion paper, September 2017.

## TARGETED: MARKETS AND FOOD TRUCKS

### Key points

In our consultations, we have found that the operators of market stalls often deal in cash, though we also note that some have moved toward an exclusively electronic payment model. Cash trading provides an opportunity for market sellers to evade their tax obligations. Organised and connected markets (for example large vegetable, flower and fish markets) are at particular risk. A similar problem has been found with food trucks. Our recommendation in this area is discussed below.

### **Recommendation 10.7: Markets and food trucks**

Stall holders at large and organised markets and food trucks should be required to display their ABNs. Market operators should also be required to maintain a list of stallholders which can be reported to the ATO as required.

### Description

We recommend that stall holders at large organised markets and food trucks be obliged to display their ABNs. This would give buyers some comfort that they are not black economy operators. Our recommendations to strengthen the ABN system and enforcement of ABN breaches will help in this regard. In our Hobart Roundtable, local business complained of unfair competition from unregulated food trucks.

We further recommend that market operators (often local councils) be required to maintain a list of businesses and their ABNs which can be reported to the ATO as required. This will facilitate data sharing and verification of ABNs.

Market operators should also give serious consideration to other ways they can prevent black economy activities. One option is for them to set fees based on turnover to provide greater revenue assurance. Stall turnover would need to be verified through the use of independent third-party audits. We have been told that while many markets are accepting electronic payments now, cash economy practices may still be occurring higher up the supply chain, including warehouses, transport and deliveries.

Operators should also ensure their markets are not being used for illegal activities. It is illegal to sell contraband goods or illicit tobacco and market operators should put in place measures to prevent such activities taking place, including reporting such activities to authorities. Where they are found to be complicit by not reporting such activities, operators should be penalised.

These recommendations should apply to markets that are organised and connected, particularly large vegetable, flower and fish markets.

## ***Other options considered***

### *Incentives for electronic payment*

Some pop up markets already operate on a 'no-cash' basis. With electronic POS equipment becoming increasingly cheap and accessible, even small and temporary market stall holders may be able to move away from cash. Incentives could be provided through financial or non-financial support for market operations (for example grants to support payment platforms or market infrastructure). We do not favour this option at the moment due to the cost it would entail and unclear compliance benefit it would bring. It should be considered, however, if substantial evidence emerges that black economy operations at markets are significant.

## TARGETED: CHARITIES

### Key points

Australia's non-profit sector is not immune from black economy risks. The nature and scale of links to organised crime, money laundering and terrorism financing were identified in the 'Non-Profit Organisation National Risk Assessment on Money Laundering & Terrorism Financing 2017' conducted by the Australian Charities and Not-for-profit Commission (ACNC) and AUSTRAC which was published in August 2017. This was the most comprehensive risk assessment ever undertaken of Australia's non-profit organisations and drew on intelligence from all Commonwealth, state and territory law enforcement agencies and not-for-profit regulators. It also involved an extensive data matching exercise across the ACNC, AUSTRAC, ATO and ACIC.

The risk assessment identified a number of non-profit entities with links to serious organised crime. The work also identified high-risk cohorts beyond terrorism financing and organised crime, including those engaging in tax avoidance and child sexual exploitation. Four-hundred and twenty charities were identified as moving funds to an overseas tax haven, 34 registered charities had Responsible Persons listed on the National Criminal Target List (NCTL) and 55 not-for-profits were identified as being at risk of terrorism financing. Issues of phoenixing are also a significant concern to the ACNC with 2,500 new charity registrations per year and similar numbers of voluntary revocations.

In our consultations the chief risk officer of a major bank told us that 'charities involved in money laundering were his biggest AML concern'.

These risks can only be addressed by investigating the specific cases and increasing the cooperation between the ACNC and other relevant agencies. The ACNC has already data-matched its holdings against thousands of ACIC intelligence holdings. The ACNC now has an officer seconded to ACIC to examine other matches relating to categories such as financial crimes, violent crime, drug offences, and child sex offences. Similar deployments need to be made with the AFP and the Fintel Alliance.

The ACNC has told us it needs access to the *World Check One* system which would allow it to obtain access to global intelligence across a number of categories including financial crime, sanctions lists, and criminal lists. Registration with the ACNC is a pre-requisite to Commonwealth tax concessions and public funding. This gateway needs to be as robust as possible and having *World Check One* integrated into the ACNC systems would significantly strengthen this process.

### **Recommendation 10.8: Strengthen charities oversight**

The Government should strengthen the oversight of charities, including through better risk assessment capabilities.

### Description

The ACNC should instigate a program of work investigating the charities identified as having serious organised crime links and operating out of overseas tax havens. Investigations into all charities at

risk of money laundering or at risk of terrorism financing, including the deployment of compliance officers to partner regulators and law enforcement agencies to facilitate information sharing and joint investigative activity as appropriate is required.

ACNC intelligence capabilities should also be enhanced to more effectively identify financial crime, organised crime and terrorism financing risks in the Charity sector. This would include the purchase and implementation of the World Check One system.

The ACNC should be funded to undertake these activities.



# CHAPTER 11

## SHAPING SOCIETAL NORMS

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# CHAPTER 11: SHAPING SOCIETAL NORMS

## ADDRESSING COMMUNITY ATTITUDES

### Key points

Why is participation in the black economy seen by so many as justified or excusable, despite the costs and unfairness it inflicts on others?

After decades of effort, we have changed community attitudes for the better in other areas, including road safety, littering, drink driving and public health. Yet too many in the community defend, excuse and even, in some cases, boast of their participation in the black economy. This is endemic. It has even been described as a national sport.

The message to the community has to be as clear. If you are asking for, making or accepting under-the-table cash payments, you are part of the problem. It does not matter how small the amounts involved are or for what purpose, whether child care, renovations, a haircut or car repair. The same conclusion applies.

When you are part of the black economy, you are short-changing your fellow citizens. You are contributing to billions of dollars of unpaid tax and higher welfare costs. The result is clear. The Government is less able to fund needed public services, including education, the NDIS and healthcare. Alternatively, our taxes must be raised further.

The larger point is that black economy participation violates basic Australian notions of a fair go. When consumers, employees and businesses participate in it, they are seeking an unfair advantage over those who do the right thing. This behaviour has been tolerated, even celebrated, for too long, but it is time that it is called out.

How do we change hearts and minds on the black economy? How can we make it as unacceptable as drink driving and other anti-social behaviour?

### OBSERVATION: COMMON BELIEFS

There are a number of common excuses that individuals use to justify or explain black economy participation. We have outlined a number of these below and offer comments about each one.

- ***'The big end of town does not pay tax — so neither should I'***

Using the poor tax behaviour of others to justify our own non-compliance is not an acceptable defence. If it is wrong for multinationals to be evading tax, that same judgement should apply to all of us. As a society we expect all taxpayers to pay their fair share regardless of the actions of others.

### OBSERVATION: COMMON BELIEFS (CONTINUED)

- ***'The Government does not spend my money wisely'***  
Government spending should always be subject to critical scrutiny in the Parliament, the media, Senate Estimates and in the Auditor-General's reports. When someone cites poor spending as a reason not to pay their taxes, they are being self-serving and are short-changing their fellow citizens.
- ***'I reinvest my cash income so the economy still benefits'***  
By taking cash and not declaring this as income businesses are creating an uneven playing field, disadvantaging all other businesses that do the right thing. The same applies to employees who demand cash wages.
- ***'Everyone does it — I need to do it to compete'***  
We do not deny that when some participate in the black economy, they enjoy an unfair commercial advantage over their competitors. The latter, however, face a clear ethical choice: join the black economy themselves or do everything they can, both individually and working with their industry organisations, to counter it.
- ***'It reduces my costs'***  
This may be true, but it does so to the detriment of other businesses and consumers by forcing them to compete on an uneven playing field

A new social contract is needed. There needs to be an acknowledgement that participation in the black economy is not a victimless crime. Indeed, it violates basic notions of fairness and a level playing field, penalising the majority of small businesses, tradespeople and consumers who do the right thing.

*'Equity and trust in our tax collection process is paramount to a successful and sustainable system for all Australians. The erosion of the system's reputation through suboptimal social norms will undermine the development of a reliable collection model. Tackling destructive social norms as part of the Black Economy Taskforce's recommendations must be considered.'* PwC Australia

### ***Motivations matter — why behavioural insights are important***

Why is it that some people voluntarily comply with their obligations while others see participation in the black economy as justified or excusable, despite the costs and unfairness it inflicts on others? To answer this question, we need to understand the behaviours and biases that shape individual decisions: our behavioural cues that may not be rational or even conscious. This is the province of behavioural economics, which in recent decades has gained prominence among academics, marketing experts and, more recently, policy advisers.

Behavioural economics has left its mark on policy and regulatory efforts in a number of areas. Law enforcement, public health approaches, tax, welfare fraud prevention and road safety have all benefited from its insights and techniques.

**OBSERVATION: UNITED STATES EXECUTIVE ORDER**

In 2015, then US President Barack Obama issued an executive order requesting that in the development and implementation of policy, executive departments and agencies use behavioural insights to ensure measures are implemented in a way that encouraged compliance, reduced compliance costs and improved understanding of rights and obligations. In doing so the order noted the following.<sup>1</sup>

*'To more fully realize the benefits of behavioral insights and deliver better results at a lower cost for the American people, the Federal Government should design its policies and programs to reflect our best understanding of how people engage with, participate in, use, and respond to those policies and programs.'*

*Voluntary compliance*

It is easy to lose sight of the fact that our tax and other regulatory systems rely heavily on voluntary compliance. We count on the majority of people to instinctively do the right thing. When this occurs, our enforcement efforts can be better targeted, minimising compliance burdens for the rest of the population.

*'... research on tax compliance shows that moral persuasion is more effective than the threat of being caught. This is consistent with our experience talking to real businesses about tax compliance issues.'* Business Growth HQ

Voluntary compliance plays an important role in tax under our self-assessment system. Studies have repeatedly shown that taxpayers pay more tax, on average, than they would if they were motivated only by narrow financial considerations. They do this for a range of reasons. Some people are motivated by a sense of civic responsibility. Others might be guided by moral considerations, a desire to conform to social norms or even force of habit. Negative motivations are also relevant, including the perceived risk of getting caught, as are perceptions about the circumstances of others. This is evident in the recent community discussions on issues such as the Plutus payroll fraud, multinational tax perceptions and parliamentary entitlements.

Three observations are worth making.

- Behavioural economics confirms our intuitive view that people respond to the perception of risk, not necessarily the objective chances of being caught. This is one of the benefits of visible enforcement strategies, which we discuss in Chapter 8. When tax authorities have a tangible presence in local communities, people's awareness of tax enforcement is raised. When enforcement actions and prosecutions are publicised, it send a message to others.
- People benchmark themselves against their peers. This is often subjective. We make assumptions about our peer group's compliance approach and situate ourselves within the norm. This obviously works both ways. Tax authorities are increasingly resorting to 'nearest

<sup>1</sup> The White House, Executive Order: Using behavioural insights to better serve the American people, September 15 2015.

neighbour' comparisons to guide tax payer behaviour. This can be incorporated into nudge approaches, whereby people filling out returns electronically are notified, by real-time prompts, of what others in their occupational group earn and claim in deductions.

- Similarly, the perceptions, attitudes and actions of others within an individual's informal and formal networks play a significant role in influencing behaviour. Work colleagues, family, community group and other views will have an effect, as do wider cultural norms. It has been said that small-scale participation in the cash economy is a national sport in Australia. We argue this view should be countered. We accept this will not be easy, but point to the successful public marketing campaigns in areas such as road safety and anti-smoking we have seen in this country.

We should also understand the wider, non-tax influences on tax-payer behaviour. Trust in government and its institutions are highly relevant in this regard. One of the reasons Scandinavian countries have high 'tax morale' is that, for them, this trust is there. Views on how efficiently and effectively governments use the public's money are also important. In recent years, the ATO has sent information to taxpayers on how tax dollars are spent.

#### **OBSERVATION: CULTURAL CHALLENGE**

During the life of the Taskforce, there have been various media reports exposing poor labour practices in different migrant communities.

For example, The Sydney Morning Herald<sup>2</sup> reported that some businesses advertising Australian jobs on Chinese, Korean and Spanish language websites are offering illegal pay rates as low as \$4.20 per hour for a nanny and \$9 per hour for an office clerk. The minimum legal rate for both jobs is more than \$18 per hour.

Cleaning jobs were advertised with pay rates as little as \$10 per hour. Retail jobs offered as little as \$12.09 per hour, an average underpayment of \$7.36. The overall average wage rate advertised was \$14.03 per hour, representing an average underpayment in the hourly rate of about \$5.28.'

#### *Recommended actions*

We recommend:

- Introduction of a behavioural economics framework to guide future black economy policy-making.
- A national campaign to change social and cultural norms.
- The implementation of an innovative new-to-business program, employing nudge techniques which have proven successful elsewhere.
- New formal partnerships between the government and industry, union and advocacy bodies.

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2 A Patty, 'Chinese, Korean and Spanish websites advertise illegal pay rates as little as \$4.20 an hour', Sydney Morning Herald, 18 July 2017.

- A vocational training tax literacy pilot.

These recommendations should not be seen in isolation from the broader strategies we propose in this Report. Behavioural economics and a focus on social norms can be effective tools if properly applied, but they are not silver bullets. They must work in unison with the other parts of our armoury: moving people into non-cash payments, better reporting of the new economy, traditional incentives and deterrents, reporting of illegal behaviour or 'dob-ins', better data sharing across governments, stronger multi-agency action and improving the integrity of our identification systems.

We need to set clear benchmarks and standards outlining what we consider to be proper and ethical behaviour for consumers and businesses and then provide appropriate support and systems to make it easy for them to demonstrate these behaviours.

*'Minimising the size of the black economy is critical to the tax and criminal systems, and we believe this area is the last of the major "tax bases" which can derive significant revenue. But this goes much wider than just revenue — addressing tax evasion is also important to the general ethical fabric of our society and how we trust and relate to each other. The frequent 'justification' that 'everyone is doing it' must be challenged.'* KPMG

## RECOMMENDATIONS

### ***Recommendation 11.1: Behavioural economics framework***

Commonwealth departments should use behavioural economics principles to identify behavioural biases that incentivise black economy behaviour when developing policy and designing administrative processes.

Consideration should also be given to the need to address these biases in the development of policy and administrative reforms taking account of broader policy objectives.

Departments should also incorporate robust high-quality evaluation techniques to identify the behavioural impacts of policy and administrative decisions to determine where current approaches need to be changed.

### ***Description***

To accurately identify the behavioural factors driving black economy activities, the following questions should be asked when considering how elements of policy or administration are to be delivered.

- **Who is involved in the decision?** If one group is particularly likely to make certain decisions, interventions could be tailored specifically to them.
- **What is the motivation for the behaviour?** For instance, non-compliance can be driven by complicated application processes which deter participation. Streamlined or pre-populated forms reduce such activities.
- **How are choices presented?** A large number of options can lead to choice overload; opportunities to reduce options should be explored.
- **Can you change the default setting?** People are strongly inclined to go with defaults. Reducing the number of decisions can also reduce choice overload.
- **When is the decision being made?** For instance, if the benefits of making a good decision are delayed, policy makers should consider bringing these benefits forward to influence behaviour.
- **Why is the decision being made?** For instance, are there norms that are affecting the decision, such as individuals and business seeing black economy behaviour as a victimless crime.
- **Can we help people follow through on good intentions?** By making the process as easy as possible by providing checklists, helping set goals or craft plans.
- Strategies which may be useful in responding to these questions include:
  - **Make It Easy** — Complexity and ambiguity increases cognitive load and friction which pushes people to deviate from the desired action. Looking for opportunities to reduce the effort required to take up a service or complete a process can be effective.

- **Make it Attractive** — Personalised messages and framing choices in an attractive manner is a simple yet powerful way to encourage desired behaviour.
- **Make It Social** — Conveying that most people perform a desired behaviour can be particularly influential when decisions are made under uncertainty.
- **Make it Timely** — Prompting people when they are likely to be most receptive can improve the effectiveness of a policy or program.

## Objective

- Ensure that the potential behavioural biases that can result in black economy participation are identified and understood during policy and administrative design.
- Illustrate to government agencies and other decision makers the likely outcomes and responses to measures.

## Discussion

### Rationale

An individual's decision to engage in the black economy is strongly influenced by their perceived reputation, social norms and their behavioural responses to policy and regulatory settings. The application of behavioural economics principles provides insights into why individuals make these decisions. Understanding these factors helps to ensure that the design of policy and administration delivers the desired outcomes.

There are often multiple overlapping factors and biases that influence how individuals decide to act. These factors often cut across a range of portfolio responsibilities. Because of this, individuals' participation in the black economy may be more complex than is sometimes assumed.

Government decisions about immigration, industrial relations, law enforcement and competition policy all influence the tax compliance of individuals. Additionally, tax policy can influence compliance with immigration, industrial relations or competition requirements. The black economy is not just a tax phenomenon.

While these interactions are generally understood, the behavioural biases driving these responses are not always examined or explicitly addressed in the policy development process. This can result in poorly-designed measures which either create significant unintended consequences or fail to achieve the desired outcomes, both of which impose unnecessary costs on both government and the public.



Behavioural economic assessments are now at the forefront of developing impactful, cost-effective public policy. Behavioural interventions can be very low-cost and result in significant benefits.<sup>3</sup>

Consistently applying a behavioural economics framework during the policy development and evaluation processes will ensure that the Government is better informed about the likely impact and consequences of decisions they make. Additionally, better understanding the behavioural responses of individuals can help to ensure that measures are designed in a way that reduce the impost on the individual — removing points of friction and streamlining their experience.

#### **OBSERVATION: AGED CARE**

The market for service under aged care arrangements, such as home care, gardening and cleaning, is growing with the aging population. However, we have heard from users of these services that the red-tape required under the aged care arrangements acts as an incentive to use cash-in-hand service providers.

### ***Implementation considerations***

There are a number of ways departments could seek to undertake these evaluations.

- Departments with established behavioural insights areas should utilise this expertise to undertake these evaluations internally. Some Commonwealth agencies have behavioural insights capabilities which can be utilised in the behavioural assessment of policy. In particular, the ATO has one of the most developed behavioural capabilities across both domestic and international agencies and DHS also maintains a strong behavioural capability. The extent to which these capabilities are applied varies and in some areas capability is lacking.
- The Behavioural Economics Team of the Australian Government (BETA) has detailed knowledge and expertise in the application of behavioural insights to understand individual responses to policy and administrative measures. They also have an existing model for engaging with public service departments to test the effectiveness of behavioural interventions.
- There are a number of private and academic institutions that could be approached to assist in completing a behavioural assessment. This may be particularly beneficial where there is a private sector partner with a detailed knowledge of a specific part of the policy landscape and the expected responses of individuals or businesses to policy decisions in that area.

Ultimately, it will be up to each department to determine which process is most likely to identify relevant behavioural impacts.

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<sup>3</sup> The World Bank has estimated that the cost benefit ratio can be as high as 40 to 1.

### *International experiences*

The application of behavioural insights in the policy development process has taken on an increasingly important role for many governments across the world, with many establishing dedicated behavioural capabilities.

The Behavioural Insights Team in the UK was the first government institution dedicated to the application of behavioural sciences to improve policy outcomes. Others, including the Australian Government, have also sought to inject behavioural insights assessments and capability into processes.

### ***Recommendation 11.2: Campaign to address cultural norms***

We recommend that a high-profile, national cultural change campaign be undertaken to address the cultural norms and community perceptions that normalise and justify black economy behaviour.

#### ***Description***

A sustained high-profile national campaign which seeks to change societal attitudes, in a similar vein to other long-term public campaigns, such as road safety, anti-smoking or drink-driving, is required to combat the attitudes in Australia that contribute to the black economy.

The campaign should:

- Consider how to reach the broader community while also targeting specific groups who are at risk of black economy behaviours.
- Appeal to personal standards, highlight social impacts and also define what is considered acceptable to exert cultural pressure in support of expected behaviour.
- Be informed by regularly updated research to identify individual motivations and drivers to determine the interventions, including the mix of messages and channels that will be most effective.
- Be subject to regular measurements and evaluation to continually inform campaign strategies throughout delivery, and where required, highlight required changes.

Themes of equity and fairness will need to be central to any campaign.

We recommend that the first stage of the campaign addresses consumer behaviours and risks (as recommended in Chapter 7). Previous government and business efforts have been directed towards high-risk industries. In Australia, there have not been significant social campaigns to influence and empower the consumer to not participate in the black economy.

Achieving any cultural change is a challenge which will require significant effort, commitment and representation over many years. A sustained focus will be required to shift perceptions and norms as we have seen with road safety and drink-driving campaigns. However failing to act now makes future interventions more difficult and expensive as behaviours and attitudes become ingrained.

The social norms campaign will also play an essential role in helping to promote and support our other initiatives, including visible enforcement, prosecutions and education (as discussed in Chapter 8). Relying only on communications and marketing alone will not deliver desired behavioural changes.

The effectiveness of the campaign should continually be monitored using robust research and evaluation techniques to ensure required adjustments are made as needed.

## Objective

- Change the societal attitudes which have led to a cultural acceptance of black economy behaviour in Australia.

### OBSERVATION: IT IS JUST LIKE PROFIT SHIFTING

Honest small business have said to us that black economy behaviours are just the same as large business shifting profits offshore; the scale is different but behaviour is the same, with both resulting in unfair competition for honest business and a general cost to the community through higher taxes for those who are paying their share.

## Discussion

### *Problems the recommendation seeks to address*

Parts of the Australian population view black economy participation as a commonly-accepted and justifiable practice: it is seen as a national sport. To change this, the issue needs to be addressed outside of a traditional tax compliance perspective. While a desire to avoid tax is an important part of the problem, any campaign needs to acknowledge the broader social risks and long-term consequences of participation in the black economy.

There has been limited work to date in Australia at a whole-of-society level to shift social norms of black economy behaviour. While the ATO and other regulators such as the FWO have had some success with localised campaigns in high-risk (such as, hair and beauty and cafés and restaurants) and emerging industries (such as the sharing economy) a stronger whole-of-government focus and effort is needed at a national level.

*'As [Law Professor, Eric] Posner notes ... if community members believe that the government is doing a good job, doing a good job may be an effective means of obtaining tax compliance.'* Housing Industry Association<sup>4</sup>

### *Rationale*

Black economy behaviours are powerfully influenced by cultural attitudes and perceptions. Achieving cultural change is a significant challenge; however the long-term rewards are relatively substantial, helping to ensure Australia's future social and economic wellbeing. Not addressing the broader cultural issue could be costly for the community as the black economy becomes further entrenched and negative behaviours and attitudes further normalised.

A sustained and whole-of-government approach and visible leadership, based on detailed research and understanding of individuals' motivations, which can respond quickly to new threats and pivots when required, and which engages the public and private sectors through a range of communication channels is needed.

<sup>4</sup> Housing Industry Association, Submission to the Black Economy Taskforce, August 2017.

*'Trust influences compliance decisions, driving increased voluntary compliance and creating a culture of compliance.'* Business Council of Australia

## **Implementation considerations**

The campaign will need to address social norms and cognitive biases which influence black economy participation and consider the 'psychological contract' between the taxpayer and the Government. There are layers of behavioural rationalisation which will need to be understood to develop appropriate themes.

The campaign should also use the most effective ways to change behaviour informed by the latest research and evidence. For example, the perception of risk is a possible point of focus. Accordingly, the campaign should consider how best to provide the community with evidence that those who are participating in the black economy do get caught and penalised.

Those most receptive to messages may be audiences most likely already compliant. The campaign will need to consider tailoring messages for this type of taxpayer. For those not easily reached through traditional channels, creative communication approaches will be required.

In designing and delivering the campaign, the following should also be considered;

- What research, evidence and data, is available on the drivers of current social norms and cultural values to guide the design of the campaign to best address these norms?
- How the campaign will work to support our other recommendations and existing black economy strategies?
- How mixed communication strategies, public relations and media, education, engagement and 'nudge' techniques could be used to best encourage voluntary compliance?
- How the government can work in partnership with state and local agencies and with industry and community sectors in the delivery of messages and shaping of attitudes?
- The target audiences and points of influence, messages, and channels that can be leveraged to shift behaviours and attitudes?
- How behavioural insight principles and research can guide campaign design and delivery?
- What new and innovative engagement approaches can be used in addition to traditional channels and processes, particularly from a consumer and social perspective?

In some cases campaigns will be best delivered by the private sector through a non-government branded approach.

Ultimately, the campaign needs to be meaningful. Framing the issue in terms of the loss to the community such as hospitals or schools forgone due to the black economy, or higher tax burdens for others can be very powerful if presented intelligently and credibly.

*‘A number of other factors affect compliance, such as attitudes towards government more generally and tax system fairness, and views on the appropriateness of government delivery and funding of services. This implies that improvements in these attitudes can help lift compliance and allow the same amount of revenue to be collected at lower rates from a broader, and less distortionary, base.’ Business Council of Australia*

### ***International experiences***

The New Zealand Government has initiated a program aimed at addressing black economy behaviours which was implemented with a 10 year funding commitment.

### **Recommendation 11.3: New-to-business program**

The Government should develop and implement a new-to-business program which helps new businesses to understand and comply with their tax and other legislative obligations in the early years of their existence.

This program should be built upon a systemic, evidenced-based framework, taking account of where existing strategies have failed and identifying how they can be better targeted.

#### **Description**

A unified whole-of-government approach to the delivery of information and engagement that will deliver prevention strategies with new business is required. The new approach should:

- Encourage new businesses to seek professional guidance, develop acumen and bring them into tax and other regulatory systems early on in the business lifecycle.
- Address problems driven by a lack of knowledge, poor business systems and business acumen.
- Help new business understand and develop capability to meet their obligations by providing them with guidance, support and practical tools at the right times.
- Align and tailor messaging and assistance with key stages in the business lifecycle.

This program could adopt some of the design features of a highly-successful New Zealand initiative. Under the initiative, new businesses receive timely text messages and other reminders of approaching tax dates. What wins this program praise is the innovative way it ‘nudges’ small business owners to do the right thing. Passive programs which rely on accessing central websites or form emails are unlikely to be as effective.

The approach should specifically focus efforts during the first three years of business operation.

*‘Feedback from industry suggests that a lack of business administration skills can be one of the biggest challenges facing new business owners in the building and construction industry and in some circumstances can be a cause of business failure.’*

Master Builders of Australia

Our consultations highlighted concerns that existing government information initiatives are not as effective as they should be. Our strategies need to be fundamentally different to what has been tried in the past, and should include innovations in systems design, tools and practical assistance. The way information is presented and provided should also be reconsidered. Engaging professionals in the financial advice sector to identify and leverage the role that they play in advising new businesses is also critical.

It is important that during development of these strategies existing research, knowledge and evidence is drawn upon to ensure that the diversity of small business needs is well understood and effective solutions are delivered.

An understanding of the role of business advisers, accountants, bookkeepers and local government registration processes should be incorporated into the design of the program. When small business make contact with good advisers early on they are more likely to establish good habits reducing the risk that they will get into trouble later on.

Any program should support and enhance, rather than replace or override, the National Business Simplification Initiative (NBSI) being run by the Department of Industry, Innovation and Science (DIIS).

The operation of [www.business.gov.au](http://www.business.gov.au), including any lessons from the Australian Small Business Advisory Services program, should be reviewed to determine how this can be used to support the delivery and operation of the program.

#### **OBSERVATION: SMALL BUSINESS MENTORING SERVICE**

The Small Business Mentoring Service, an independent, not-for-profit association partially funded by the Victorian government, delivers low-cost mentoring programs to small business people.

As an example, they have offered training to tradespeople on the Square reader and similar technology which immediately allows tradespeople to log receipts and transfers.

### **Objective**

- Ensure that government engagement with new businesses gives them the coaching, tools and assistance they need to understand and comply with their tax and other regulatory obligations.

### **Discussion**

#### *Problem this recommendation seeks to address*

While numerous resources and services are available to new businesses, many are unaware of the need to draw on resources or are overwhelmed by the vast array of information available. In addition, many new businesses are time poor and under financial pressure making it difficult to understand and meet their obligations during the first years of operation.

Many new businesses lack acumen in key areas vital to the operation of a successful and compliant business, including financial and business management skills and broad understanding of tax, superannuation and other regulatory obligations.

*‘Good governance isn’t just about legislation it’s also about establishing ethical norms and boundaries. Tax compliance needs to become more embedded in how the community thinks and operates, rather than something that the ATO “enforces”. Providing regulatory support to businesses at the start and critical turning points in their life cycle could assist them to absorb regulatory requirements into their business models.’*

Chartered Accountants Australia and New Zealand



### *Rationale*

There is a need to develop and implement education strategies specifically targeted at new businesses.

These strategies need to be delivered in an effective, tailored way. Simply providing more information through existing channels has not fixed these problems. To reduce the economic costs of business failure and non-compliance, inventive and genuinely whole-of-government early intervention strategies are required.

Existing prevention strategies are often focussed on specific issues and risks, applied after-the-fact and are overly reliant on conventional communications and marketing approaches. This appears to have come at the expense of more practical, evidence-based and preventative approaches.

By developing the capability to deliver coordinated whole-of-government strategies which prevent small businesses falling into non-compliant behaviour early in their operation, the Government will reduce the amount of rectification work that is required after the fact.

By ensuring this capability leverages existing processes and is designed and delivered in collaboration with industry partners an effective strategy will both improve regulatory compliance and minimise red-tape burdens.

### *Implementation considerations*

There is a body of research which can inform these strategies, but additional research and evaluation will be necessary. There will also be a need for the program to be agile enough to respond to new and emerging issues. Overly bureaucratic processes will hamper the ability of this program to operate effectively.

To be effective this strategy must focus on compliance and regulatory obligations at each stage of the early business lifecycle, such as starting, growing, employing, seeking opportunities for research, innovation of ideas and grants, exporting. The DIIS is best placed to lead the program given its responsibility for NBSI and its provision of a broad range of business advisory services. DIIS will be able leverage its existing partnerships.

However, local governments have a large role to play in educating businesses on their obligations and responsibilities. In designing and delivering the program, there will be a need to engage with state and territory governments to identify if efficiencies can be gained by incorporating state and territory regulatory messaging and education into programs delivery.

In addition, there are existing early intervention processes being undertaken across the Commonwealth that should be evaluated to determine how successful they have been and where appropriate enhancements should be identified.

Delivery of an effective prevention program should not result in an increase in the number of interactions or the scale of information provided by government agencies to businesses. Rather

existing communication activities should be streamlined to remove duplication of effort and information.

### *International experiences*

Prevention, education and ‘right from the start’ approaches are well recognised as important by tax and revenue administrators across the world. Nevertheless, there is little international evidence of strong, sustained comprehensive prevention strategies as most work in this area appears under-developed. This is a result of a tendency for the majority of investment to be directed towards rectification activities.

There are some contemporary examples of jurisdictions attempting upstream interventions, but these are generally still in formative stages. There are discrete examples of good practices that should be reviewed and where appropriate incorporated as strategies employed through this program. The New Zealand initiative is a good example of this.

### **Recommendation 11.4: Industry, community group, advocacy and union partnerships**

Regulators should develop formal partnerships with peak industry, advocacy and union bodies to jointly identify and address black economy behaviours and attitudes.

#### **Description**

In support of Recommendations 11.2 and 11.3, the ATO and the FWO should lead a multi-agency approach to develop and implement formal whole-of-government partnerships with peak industry, advocacy and union bodies. It is clear that where such associations exist there are higher levels of compliance, education and communication.

A number of partnership arrangements currently exist bilaterally between Commonwealth agencies and industry sectors. In addition, many Commonwealth departments also operate broader industry forums.

It is our view that there is greater scope for consolidation of some of these forums to allow for coordinated engagement between industry and the Government across the range of the Commonwealths' regulatory purview. This will reduce the number of touchpoints for businesses, improve the delivery of information and allow for coordinated cross-agency responses to issues.

*'We also recognise that efforts to counter the black economy will not succeed without the support of government at all levels, the business community and the public.'* COSBOA

These whole-of-government industry partnerships should seek to identify industry-specific issues and jointly develop approaches to address these issues. At a basic level this should include;

- Leveraging existing communication channels and relationships to identify where improvements to the provision and timeliness of education and advice to business can be made.
- Seeking to identify and rectify early on issues of non-compliant practices and behaviours.
- Identifying practical options to reduce regulatory or other compliance burdens.

#### **Objective**

- Develop strong partnership arrangements with key private sector groups to build strong collaborative relationships that improve the delivery of communication and education activities while also allowing for the identification of emerging issues and the development of strategies to correct non-compliance.

## Discussion

### Rationale

Black economy activity can largely be the result of industry-specific factors or accepted norms.

Industry associations play an important role in setting expectations for the conduct of industry members and provide a strong leverage point for the delivery of information and identification of issues. It is clear from our consultations that there is a strong link between how powerful an industry association is and the level of tax and regulatory compliance within the industry. Often industry associations are best placed to identify where compliance issues are and they are often the first to identify problems.

Unions similarly play an important role and are often able to identify issues and non-compliance early on — they also have the ability to set and influence expectations and attitudes and can be a valuable source of information for the ATO and other regulators.

Advocacy groups should also be engaged to utilise their influencing power to combat attitudes that justify black economy participation. These groups should highlight the social costs of black economy activity and how these can be communicated.

Formalised partnerships taking a whole-of-government approach will build trust with industry and reduce the friction arising from regulatory information overload. Formal partnerships between the government and industry associations will provide an opportunity to leverage existing relationships to identify the causes and design approaches to address black economy issues and (real or perceived) social norms in the most appropriate way.

In designing these partnerships there is a need to recognise the role industry associations (and others) play in shaping attitudes and demonstrating desired behaviours regarding compliance with regulatory obligations.

*‘Business has a critical role to play in addressing the black economy.’*  
Business Council of Australia

### Implementation considerations

This recommendation seeks to streamline and improve processes that exist (to differing extents) within the current engagement strategies of Commonwealth departments. By removing multiple touchpoints between government and associations, the costs associated with seeking out and understanding regulatory obligations can be reduced.

Presenting a whole-of-government front will also build trust and add weight to the partnership arrangement as members of partnered industry associations and unions will be able to seek resolution of issues more easily and quickly. The information delivered through these partnerships should seek to build on the educational outcomes delivered through the vocational training tax literacy pilot (see Recommendation 11.5).

Considerations of what is considered whole-of-government in the context of this recommendation will likely be specific to each partnership, based on the needs, perceived risks and operation of particular industries and groups. Some may only require engagement with the ATO and FWO. However, in some cases there will be a need to integrate other departments into the partnership where broader issues are prevalent.

### *First steps*

Current partnership arrangements should be reviewed to determine where there are areas of cross-over between Commonwealth agencies both in areas of focus and existing partnership relationships.

It is not reasonable to expect regulators to establish these partnerships with every industry in the economy. The ATO should engage broadly with other agencies and key industry bodies to identify the partnerships that should be formalised in the first instance taking into account the perceived and real risks within the industries, the size of the industry and the benefit a coordinated approach across government will provide.

### **Recommendation 11.5: Vocational training tax literacy pilot**

Tax literacy education and basic business skills should be incorporated into Technical and Further Education (TAFE)/Vocational Education and Training (VET) curriculums through required industry certification skill sets for courses of study in fields where black economy activity or lack of tax literacy has been identified.

#### **Description**

Tax literacy education should be a requirement for completing tertiary vocational training courses for the same reasons that OH&S and other regulatory requirements are. These should cover:

- Personal and business tax basics, including education about why we pay tax.
- Rights, entitlements and obligations as an employee or contractor including award wages, workers' compensation and other employment conditions.
- Basic business budgeting and acumen.
- Reporting and recordkeeping requirements.

This should be delivered by mandating these studies into the skill-set requirements of certificates and diplomas. The goal should be to make individuals aware of their tax obligations, not to make them tax experts.

It is not intended that delivery of this training should substantially extend the length of time required for an individual to complete their educational requirements. Rather, it is proposed that education across the basics of taxation and regulatory compliance could be tailored in some cases to provide specific information as it relates to a particular course of study. This will allow relevant information to be delivered with the smallest possible impost on the individuals.

*'Unfortunately, the black economy is also a problem in the hair and beauty industry. We believe programs that include education, information, mentoring, forums and networking such as in the Pilot program [a HBIASA training program] are powerful ways to start to get some traction and help change the industry's culture toward the black economy.'*

Hair and Beauty Industry Association of SA

#### **Objective**

- Provide individuals undertaking studies relating to sectors with known black economy issues with detailed education and understanding about their taxation rights and obligations prior to entering the workforce.

## **Discussion**

### *Problem this recommendation seeks to address*

In a number of cases individuals complete trade training courses and enter the workforce without a full understanding of their taxation obligations and rights. These individuals can fall (intentionally or otherwise) into non-compliant behaviours which are difficult and expensive to correct after habits have formed and individuals become disconnected from the tax system.

*‘Non-compliance can be a result of not knowing how to comply. Better education could therefore increase compliance and improve small business chances of success.’*

Master Builders of Australia

### *Rationale*

Providing individuals with this knowledge and education just prior to them entering the workforce or starting a business will better equip them to be compliant with their obligations and understand their rights.

Industry specific skill set certification requirements include elements of OH&S and other regulatory job-specific requirements. Tax literacy should be considered as vital to the education process as these requirements and elevated to the same status within the curriculum.

### **Implementation considerations**

The Government will need to work with states and territories as well as institutions and industry bodies involved in the delivery of vocational education. In a number of cases curriculums for trade training courses are set by industry associations. Where there is no national industry body these required skill sets can be a fragmented across states and institutions. Some vocational courses have some elements of tax literacy included in current course curriculums. However, none of these appear to cover the range of issues proposed as a minimum requirement here.

In the first instance, the pilot should be developed for building and construction in consultation with the relevant industry bodies. Opportunities to include some basic tax literacy education as mandatory institution-wide study modules should be pursued as an alternative possible avenue to implement this recommendation.

Review and analysis of industry compliance profiles will be needed to ensure the training remains appropriately targeted at the right courses of study.

If the pilot delivers measurable improvements in the future tax compliance of students undertaking these courses of study then consideration should be given to further expanding the literacy training to additional vocational courses relating to industries considered at a high-risk of black economy activity.

## SUPPLEMENTAL RECOMMENDATIONS

### *More awards should be accessible in app form*

We have over 120 awards in this country, but only 23 are available in app form. We think this number should be increased. While not a panacea, we have received feedback from some industry groups that these apps are used by their members and can help them correctly set pay rates and specify conditions. Employees, of course, are able to check their pay and conditions against them.

### *Review tax literacy education*

In 2020, when the Australian Curriculum for secondary schools is reviewed the Government should review the level of tax literacy education delivered through secondary institutions to ensure it provides students with an adequate awareness of the taxation system, the roles and responsibilities individuals and businesses have and the social benefit provided. This should also include the different types of taxes that are paid and the reasons why we pay tax.







# CHAPTER 12

## DISRUPTING CRIME AND ILLEGALITY

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# CHAPTER 12: DISRUPTING CRIME AND ILLEGALITY

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## TARGETING THE SHARP END OF THE BLACK ECONOMY

This chapter provides an introduction to the role of criminal interests in the black economy. It contests the assumption that this can be neatly separated from the non-criminal, or purely ‘cash’ part of the problem. We then outline the changing profile of criminal activities, drawing attention to their strongly cross-national character. We conclude by explaining why we focus on particular concerns in this Report, including illegal tobacco and unregulated gambling.

Our strategic response to crime and illegality has two central elements. First, we must disrupt the financial flows of the sophisticated, often cross-border, criminal networks we are confronted with. In many cases, this will be a point of vulnerability for them. Second, and just as important, we need to address the barriers and obstacles (both legal and operational) which are limiting the effectiveness of our enforcement agencies. The SFCT, which participants have told us is working well, is an example of what is needed, but more can be done in this area.

In implementing this response to crime and illegality, Australia is fortunate to have high-quality and robust enforcement agencies, such as the ACIC, AFP, AUSTRAC, DIBP, and others. We have been impressed by these agencies, which contain skilled and dedicated law enforcement professionals.

### *Links between the black economy and organised crime*

Organised criminals often blend lawful activity with illegal enterprises such as drug trafficking and dealing in illicit tobacco. Often the lawful activity will involve the black economy (for example, illegal labour hire and the motor trade). Organised crime groups are particularly attracted to areas where there are weak or easily compromised integrity arrangements and where these can be exploited to generate profits. This cash flow is then used to finance highly profitable illegal activity such as drug importation. The blending of criminal and lawful business activity makes it more difficult for enforcement agencies to detect illegal conduct.

*‘There are many reports that show direct lines of transmission between monies earned in the black economy and consequential participation in criminal undertakings.’*

Victorian Automobile Chamber of Commerce

Given this tight connection between the black economy and involvement in criminal activity, it is important that regulators follow the money as a key means of tackling organised crime. The majority of criminal masterminds do not reside in Australia.

## ***The changing nature of organised crime***

In step with changes in the broader economy, the organised crime landscape is changing. Organised crime is becoming increasingly white collar and money laundering is a key component of this activity. Organised criminals are employing professionals, using sophisticated IT and banking systems and diversifying into multiple criminal markets.<sup>1</sup>

The substantial profits generated by these activities must be laundered and, in many cases, sent offshore, where the controlling interests reside. Money laundering is becoming increasingly sophisticated, and organised criminals rely on international funds transfers, unregistered money changers and cryptocurrencies, as well as more traditional money laundering techniques such as smuggling cash and purchasing luxury cars in cash for almost immediate resale.

### **OBSERVATION: TRENDS IN ORGANISED CRIME**

The ACIC gathers data and intelligence about organised crime and exchanges this with its counterparts in several jurisdictions, including the US, UK, Canada and New Zealand.

This enables it to provide a useful snapshot of crime in Australia. The ACIC 2015-16 Annual Report notes that organised crime costs Australia approximately \$36 billion per year and is destructive, pervasive and complex. Organised criminal activity in Australia conceals itself by corrupting officials, using professional advisers and mixing criminal activity with legitimate fronts. It is constantly evolving and will quickly shift focus when a particular area becomes less profitable or more risky.

Most notably, the ACIC has observed the growing use of technology and digital infrastructure. Criminals are able to carry out fraud in online banking and identity crime. As well, they are able to facilitate criminal trade in a low-risk manner (for example, by using the dark web to buy and sell illicit drugs). It also draws attention to the increasing opportunities for money laundering (including through cryptocurrencies, sports betting and alternative banking systems).

The internet has provided organised criminals with new opportunities. Hackers can access personal information and steal identities, drugs and other illegal items can be traded via the dark web, and ransomware can be used to lock people's data unless they pay for it to be returned.

We are also witnessing the globalisation of criminal networks. Domestically-focused criminal groups are more deeply linked to cross-border networks. Their operations are increasingly directed from overseas. The proceeds of crime are often transferred out of the country. The ACIC has told us that seven out of the ten major organised crime figures operating in Australia are based overseas.

These global criminal actors have tapped into existing Australian groups such as outlaw motorcycle gangs, meaning that the gangs are better organised, more sophisticated and more dangerous than ever before.

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<sup>1</sup> Australian Criminal Intelligence Commission, *Organised Crime in Australia 2017*, p. 1.

## ***Attempts to corrupt officials***

Criminals also seek to identify and engage with corrupt public officials who can help them circumvent or compromise regulatory processes and systems. This is a particular risk where a single official has broad discretion to make decisions which create value and also where they are responsible for oversight of, for example, security matters. This risk highlights the importance of tough anti-corruption measures and rigorous enforcement of these measures as part of a black economy strategy.

## ***The dark web and organised crime***

Organised criminals are also heavy users of the dark web, which they use to trade illicit goods, launder money and communicate in secret.

### **OBSERVATION: THE DARK WEB**

The dark web is a major facilitator of organised crime activity. It is aptly named — the dark web is used to trade drugs, transfer the proceeds of crime and sell information from hacked government databases (including, for example, Medicare cards).

The dark web provides access to internet content generally via specific software or authorisations. Content on the dark web is not indexed by search engines and its hosting and access is entirely anonymous due to the use of layered encryption which makes it impossible to track users. Internet users seeking access to the dark web require specialised software.

While there are some legitimate uses for this kind of online anonymity (for example, banking databases), the dark web is well known for the online marketplaces it contains which offer illicit goods and services.

The dark web offers users the following.

- Simple privacy and the elimination of tailored advertising.
- Bypassing of censorship (commonly found in countries where the internet is government censored).
- Anonymous whistleblowing.
- Access to sites blocked based on location.

Participants also gain access to less than legal activities. Users can find almost anything they want, including procuring illegal goods or services. The biggest example of this is drugs.

Many marketplaces on the dark web allow individuals to purchase fraudulent and stolen identity documents. Image 12.1 is a screenshot that was presented to us to illustrate the types of documentation available that allows an individual to fraudulently present a false identity (see next page).

IMAGE 12.1: EXAMPLE OF 'DARK WEB' PAGE

The screenshot shows the AlphaBay Market interface. At the top, there is a navigation bar with links: HOME, SALES, MESSAGES, ORDERS, LISTINGS, BALANCE, FEEDBACK, FORUMS, API, SUPPORT. Below this is a breadcrumb trail: Counterfeit Items > Fake IDs > Fake IDs > Victoria Drivers Licence & Medicare - Physical... On the left sidebar, there are two sections: 'LISTING OPTIONS' with links like 'Contact Seller', 'Favorite Listing', 'Favorite Seller', 'Alert when restock', and 'Report Listing'; and 'BROWSE CATEGORIES' with a list of categories and their counts, such as 'Fraud' (44461), 'Drugs & Chemicals' (241390), 'Counterfeit Items' (9079), 'Weapons' (5011), 'Carded Items' (3849), 'Services' (7811), 'Other Listings' (3989), 'Software & Malware' (3365), and 'Security & Hosting' (839). The main content area features a product listing for 'Victoria Drivers Licence & Medicare - Physical Cards'. It includes an image of the cards, a description stating 'This Listing is for 1X Victoria Drivers License and 1X Medicare card. Victoria Drivers License: Hologram Stamp, Clear Window in the Middle of the Card, UV Print and Embossing. Australian Medicare card: Embossed and Tipped. Made to Order. This is 65 Points of ID.', a price of USD 449.00, and a 'Buy Now' button. The seller's name is 'theidguy' and their level is 'Vendor Level 1' and 'Trust Level 3'. There are also links for 'Description', 'Bids', 'Feedback', and 'Refund Policy'.

### Our strategic response

A new strategic response is required to address the growing sophistication of organised crime and its changing role in the black economy. The Government has already established the SFCT, bringing tax and traditional law enforcement capabilities together in an innovative and effective way. The new approach we advocate can be seen as an extension of this. It stresses five key things:

1. Improve information sharing through creating a National Criminal Database allowing a single search function to interrogate multiple agencies' databases as well as working to deepen relationships with international law enforcement agencies.
2. Disrupt the criminal networks by targeting their financial flows, which in many cases is their most vulnerable side. This requires us to strengthen anti-money laundering and proceeds of crime laws.
3. Address legal, operational and other obstacles which may be limiting the effectiveness of our law enforcement agencies. A recurring theme of this Report is that our enforcement efforts cannot be siloed or fragmented. But this also requires closer links to industry and other private sector sources of intelligence and, in particular areas, greater investigatory powers.

4. Ensure that assets cannot be hidden through misuse of legitimate commercial structures. This includes compulsory disclosure of the beneficiaries of trusts (see Recommendation 8.5).
5. Counter the risk of identity fraud through the introduction of a standardised identity framework (see Recommendation 4.1).

This strategic approach is reflected in our more detailed examination of illegal tobacco and gambling in the next chapter. In Chapter 16, we recommend the establishment of a standing taskforce to tackle complex, high-value black economy problems, including criminal threats. A number of our other recommendations will strengthen the hand of the law enforcement community, in particular our proposal for a secure, digital and biometrically-backed identity credential.

We offer some more specific suggestions on countering criminality below.

## ***Better information sharing and data management***

### *National Criminal Database*

At present, each of the States and the Commonwealth operate separate databases containing information about criminals and suspects. Many different agencies (for example the ATO) have their own databases. Privacy and secrecy obligations impose hurdles in inter-agency data sharing. Even where these hurdles can be overcome, many linkages can be missed, because the databases are often interrogated manually.

If there were a single national criminal database search functionality (or the databases were at least inter-operable), there could be more efficient data matching and law enforcement would be streamlined. In the United States, a single database was developed in response to the September 11 terrorist attacks and is regarded as having substantially improved intelligence gathering and assessment.

In addition, a new system could help in identity resolution. Many people have multiple identities in various databases. Sometimes this will have occurred innocently (for example, a person's middle name may not be included in one database). In other cases, the multiple identities will be deliberate (for example a person may have misstated their date of birth). By way of example, we were told that Man Monis, who committed the Lindt café attack, had dozens of different aliases in various government databases.

If the databases are able to incorporate data from social media platforms, they will contain much more information about connections between people than older style databases.

The ACIC is advancing work on a new National Criminal Intelligence System (NCIS), and is currently running a small scale prototype. This system operates as a distributed ledger, meaning that a search function is able to interrogate data held across a decentralised network. This means that a single search checks many databases without the need for expensive and integration of information into a single database. Additionally, maintaining data in a decentralised network reduces integrity risks.



### **Recommendation 12.1: National Criminal Database**

We recommend that the Government establish a National Criminal database, potentially by expanding the NCIS.

#### *Greater international cooperation*

As well as increasing collaboration amongst Australian enforcement agencies, there are also opportunities to deepen links with law enforcement agencies in other countries. As noted above, in recent years organised criminal groups have become increasingly international in their activities.

We have been told that law enforcement agencies from different countries already collaborate extensively in seeking to detect and prevent organised crime. In particular, a lot of information is shared amongst the AFP and its counterparts in the US and UK.

In particular, there would be benefits in sharing information about the movement of funds between jurisdictions. The US Office of Foreign Assets Control (OFAC) enforces sanctions against targeted foreign regimes, entities which threaten national security and international narcotics traffickers. It is run out the US Treasury Department and prohibits US citizens or entities from dealing directly or indirectly with a blacklisted person or entity.<sup>2</sup> OFAC may also freeze the assets of blacklisted persons.<sup>3</sup> As the mechanism for blacklisting people is a civil process, there is no need for proof beyond reasonable doubt to justify the blacklisting. This means that kingpins can be targeted even where there is not sufficient evidence to support a criminal prosecution against them.

#### **OBSERVATION: ALTAF KHANANI AND OFAC**

The Altaf Khanani case provides a useful example of OFAC's reach and efficacy. Mr Khanani is a Pakistani national who was based in the United Arab Emirates and laundered money for the Columbian drug cartels and others. He was responsible for laundering billions of dollars.

Mr Khanani was arrested in the US as part of a sting operation led by the US Drug Enforcement Administration and was therefore unable to continue his money laundering activities. However, his brother and son simply continued the business on his behalf. OFAC then blacklisted Mr Khanani and his known associates from trading with US citizens or businesses or using US financial systems. This shut down their activities and meant that they were no longer able to launder money.

OFAC already shares information with Australian banks and there may be useful information and detection strategies which it could share with Australian enforcement agencies.

2 US Department of Treasury, OFAC Resource Center, accessed 13 October 2017, [https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq\\_general.aspx#basic](https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#basic).

3 Ibid.

### ***Recommendation 12.2: Greater international cooperation between law enforcement agencies***

We recommend that Australian law enforcement agencies deepen relationships with their international counterparts, particularly the US OFAC.

As well as improving the management of law enforcement agencies and facilitating greater international cooperation between law enforcement agencies, Australian law enforcement agencies should seek to share information as a matter of course. At present, agencies are forced to establish taskforces for this purpose. While these can be useful, it is a fiction that it is necessary to have a taskforce simply for the purposes of exchanging operational information or gaining access to another agency's search or enforcement powers. In practice, these have cumbersome and strict protocols which detract from operational excellence and efficient law enforcement. We should designate that investigations of certain classes of offences automatically allow the exchange of information and powers, which would remove the need to play the taskforce game.

### ***Money laundering***

Money laundering facilitates both organised crime and the efforts of terrorists. We focus on the former in this Report.

Tackling money laundering directly impacts the leaders of organised crime groups who are often difficult to target directly. Disrupting money flows is often easier than obtaining sufficient evidence to support a conviction in respect of underlying crimes.

Money laundering enables organised criminals to extract their profits from Australia or to convert illegally obtained funds into legitimate wealth. Dirty money is also brought in from offshore — Australia's good governance and relative stability makes it an attractive location for people to purchase assets as a store of value.

Money laundering takes various forms. At its most crude, large quantities of cash are deposited into Australian bank accounts and transferred offshore or used to purchase investments. Money laundering may also occur through the use of cryptocurrencies or through informal value transfer systems, such as hawala. During our consultations, we were told that stolen Australian iPhones are exported in large numbers to the Middle East.

## OBSERVATION: MONEY LAUNDERING

Money laundering is the processing of criminal profits to disguise their illegal origin. There are various methods of money laundering.

### *Laundering cash*

The profits made from criminal activities are often returned to criminals in the form of cash. This cash then needs to be re-introduced to the mainstream financial system to appear legitimate.

Some methods of laundering cash are outlined below.

- **Structuring of transactions** by breaking down large quantities of cash into amounts that fall under the \$10,000 cash transaction reporting threshold. This can be achieved through a number of means.
  - Making regular deposits of cash into accounts in amounts under the reporting threshold.
  - Regular use of cash to purchase ‘instruments’ such as bank cheques and bank drafts, or to load onto credit or stored value cards in amounts below the reporting threshold.
  - The use of multiple branches or institutions, often within a short timeframe, to avoid detection.
  - The establishment of accounts at multiple institutions.
  - By using third parties to make deposits into a single account or multiple accounts.
- **Depositing cash during busy periods** such as holiday shutdowns and closing times to avoid raising suspicion.
- **Exchanging smaller denomination notes** into larger denomination notes.
- **Purchasing and/or exchanging Australian currency** into foreign currencies to obtain large denominations such as the 500 Euro note.
- **Exchanging or making deposits of foreign currency** at Australian financial institutions.
- **Purchasing other commodities** such as gold and precious stones which can be quickly converted back into cash, often at a profit.
- **Making cash payments** for either the purchase or lease of assets such as motor vehicles, or using cash to purchase cheques for the same purpose.
- **Regularly depositing cash** into established loans or investments or services which offer less scrutiny of a customer’s income such as ‘no-doc’ and ‘low-doc’ loans. These do not require significant evidence of customer identification.

### *Cuckoo smurfing*

‘Cuckoo smurfing’ has been identified as an emerging form of money laundering.

The term ‘cuckoo smurfing’ originated in Europe because of similarities with the activities of the cuckoo bird. Cuckoo birds lay their eggs in the nests of other species of birds which then unwittingly take care of the eggs believing them to be their own. In a similar manner, the perpetrators of this type of money laundering seek to transfer wealth through the bank accounts of innocent third-parties.

There are four key steps in this process.

Step 1: A legitimate customer deposits funds with an alternative remitter in a foreign country for transfer into another customer’s Australian bank account. This is a legitimate activity and is often cheaper and faster than using a mainstream bank.

## OBSERVATION: MONEY LAUNDERING (CONTINUED)

Step 2: Without the knowledge of the customer, the alternative remitter is actually part of a wider criminal syndicate involved in laundering illicit funds. This criminal remitter, while remaining in the foreign country, provides details of the transfers, including the amount of funds, to a criminal based in Australia. This includes the account details of the intended recipient in Australia.

Step 3: The Australian criminal deposits illicit cash profits from Australian crime syndicates into the bank account of the customer awaiting the overseas transfer. The cash is usually deposited in small amounts to avoid detection under transaction threshold reporting requirements. After an account balance check, the customer believes that the overseas transfer has been completed as legitimately arranged.

Step 4: The Australian criminal travels overseas and accesses the legitimate money that was initially deposited with the alternative remitter. The illicit funds have now been successfully laundered. The essential weakness being exploited by cuckoo smurfing is the lack of identification required of persons depositing funds into third party accounts.

### ***Trade financing***

One very common means by which black money is laundered is through acquiring goods and exporting them. For example, substantial numbers of Apple iPhones and stolen vehicles are exported from Australia to the Middle East to launder black money. This laundering technique is known as trade financing.

### ***Betting accounts***

Betting accounts offer an alternative to accounts held with mainstream financial institutions and in many instances can be used as de facto savings and deposit accounts. The frequent movements of funds through such accounts for non-gaming purposes may be indicative of money laundering.

### ***Domestic electronic transfers***

The ability to pool funds in accounts has been made much easier with internet banking. Although financial institutions have established internet banking thresholds, customers still have the capacity to transfer large amounts over a relatively short space of time. Customers may deposit cash funds into an account and then undertake rapid domestic transfers to separate accounts. This type of activity can be indicative of any number of criminal activities and should be viewed as a possible indicator of illicit activity.

### ***Wire transfers***

International funds transfers, or wire transfers, are often used by criminals to rapidly transfer funds across international borders. Multiple wire transfers, each with different transfer details, are often sent to disguise their true nature.

Criminals may also set up illegitimate businesses or corporations to send wire transfers. This not only conceals the true identity of the criminal, but the transfers can be hidden among the complexities of established international trade and financial market activities.

### **OBSERVATION: INTERNATIONAL MONEY EXCHANGES, INCLUDING HAWALA**

International money exchange providers or remittance services provide a relatively quick, low-cost service that allows customers to arrange for transfer of financial value to and from foreign regions that do not have modern banking systems. The remittance service sector is quite diverse and ranges from large, established money exchange providers to informal money transfer systems that operate outside the formal banking system.

The practice of 'hawala' is one example of an international money exchange and is quite straightforward. For example, Person A in Australia wishes to send \$10,000 to Person B overseas. Person A pays the \$10,000 to a hawala provider in Australia. The hawala provider in Australia instructs their counterpart overseas to pay \$10,000 to Person B. Even though the person B has been paid overseas, no money has left Australia.<sup>4</sup>

The formal remittance service sector is highly regulated in Australia. Those providing remittance services in Australia must register with AUSTRAC and comply with Australian AML/CTF reporting obligations. Since 2011, at least 19 remitters have had their registration cancelled, faced suspension or refused renewal.

The smaller, unregulated informal money transfer systems have posed the greatest threat to AML/CTF authorities across the world. The Financial Action Taskforce broadly defines hawala and other service providers (HOSPs) as 'money transmitters, particularly with ties to specific geographic regions or ethnic communities, which arrange for transfer and receipt of funds or equivalent value and settle through trade, cash, and net settlement over a long period of time'.<sup>5</sup>

The key distinction between a large regulated remittance service provider and a HOSP is their use of non-bank settlement methods, including settlement through trade, cash and net settlement over a long period of time. Broadly speaking, this practice of offsetting enables the international transfer of value without actually transferring the money. In addition to the difficulties involved in tracing the flow of value, AML/CTF authorities are faced with the challenge of identifying the criminals and terrorists who conceal their identity.

We realise that authorities are aware of such practices and are working to address them, but we remain concerned that cash smuggling is flourishing. Authorities should continue to be vigilant to the dangers this poses and work with international counterparts to ensure that actions against cash smuggling are effectively applied at borders and through data sharing. Our proposal to ban cash transactions over \$10,000 (see Recommendation 3.1) will also limit money laundering opportunities to some extent.

In addition, we propose that existing anti-money laundering rules should be tightened. This will benefit our counter terrorism efforts as well as help counter criminal activity in the black economy.

Earlier this year, the Government consulted stakeholders on extending AML reporting requirements to the trust accounts of real estate agents, accountants and solicitors.<sup>6</sup> We support extension of the AML regime in this way and note that, if adopted, our proposed \$10,000 cash payment limit would reduce the compliance burden this would impose.

4 D Rees, 'Alternative remittance systems in Australia: Perceptions of users and providers', Trends & issues in crime and criminal justice No. 393, April 2010.

5 Hawala and other similar service providers can be used to facilitate money laundering and terrorist financing.

6 Attorney-General's Department, AML/CTF statutory review implementation, accessed 9 October 2017, <https://www.ag.gov.au/consultations/pages/Amlctf-statutory-review-implementation.aspx>.

Money laundering would also be made more difficult if KYC obligations were imposed on real estate agents, accountants and solicitors and such professionals were obliged to conduct due diligence on clients. This would include verifying the identity of clients and knowing and verifying the ultimate beneficial owner of assets. This proposal was identified by the Victorian Law Reform Commission.<sup>7</sup>

A further area of focus should be illegal or unregulated money exchanges which facilitate cross border funds transfers.

The proposed reforms requiring disclosure of the beneficial ownership of assets (see Chapter 8), will also assist in making money laundering more difficult and in disrupting organised criminal activity.

### ***Recommendation 12.3: Strengthen anti-money laundering laws***

We recommend that the Government make money laundering more difficult by:

- Extending money laundering laws to the trust accounts of real estate agencies, accountants and solicitors.
- Imposing KYC obligations on these professionals.
- Cracking down on unregulated money exchanges.
- Banning cash transactions over \$10,000 (see Recommendation 3.1).

### ***Address legal, operational and other obstacles which may be limiting the effectiveness of our law enforcement agencies***

#### *Boosting ATO powers*

Another challenge is that the ATO has limited powers. For example, unlike the AFP and others, the ATO is not allowed to use covert listening devices, nor is it able to compel information from banks as part of a criminal investigation (it must rely on the AFP to do so on its behalf). Similarly the ATO does not have access to metadata which could disclose people's digital identities, their locations at particular times and the websites they own or operate. These short-comings are discussed in Chapter 8.

If the ATO is to be in the front line of tackling organised crime, it should have powers similar to those provided to other enforcement agencies.

<sup>7</sup> Victorian Law Reform Commission, Use of Regulatory Regimes in Preventing the Infiltration of Organised Crime into Lawful Occupations and Industries, February 2016.

### **Recommendation 12.4: Boosting the ATO's powers**

We recommend that the Government provide the ATO with powers to compel information from third parties such as banks for the purposes of criminal investigations; and access telecommunications metadata. See also Recommendation 8.2.

#### *Harmonisation of anti-bikie gang laws*

A further challenge to the enforcement environment in Australia is that our laws are not always harmonised between the Commonwealth, states and territories. There may be opportunities for greater harmonisation, which would provide for greater ease of enforcement and would make it more difficult for organised criminals to exploit inter-jurisdictional differences. Harmonisation is not an end in itself, but it would be particularly useful in dealing with sophisticated criminal actors who operate across several states. For example, harmonisation would help in tackling outlaw motorcycle gangs.

#### **OBSERVATION: THE MALIGN INFLUENCE OF OUTLAW MOTORCYCLE GANGS**

In recent years, outlaw motor cycle gangs have continued to increase their footprint in serious and organised crime, especially along the eastern seaboard. They are involved in the illicit drug trade, money laundering, extortion and the sex trade as well as infiltrating legitimate industries such as heavy haulage, the sex industry, the security industry, night clubs, gymnasiums and liquor outlets.

The most profitable part of bikie gangs' activities is where they act as the onshore facilitators for overseas criminal syndicates. Many members of these gangs are well educated, with good knowledge of IT and finance and have entrenched family connections into gang activity. They use sophisticated technology to communicate anonymously, including through various private networks.

They operate across borders via the use of secured networks and encrypted devices. Recent investigations have established networks between youth gangs, Middle Eastern organised crime groups and bikies, where youths are used as foot soldiers.

Various gangs have ties to: Middle Eastern organised crime families (with linkages into Dubai and Lebanon); Mexican drug cartels, crime syndicates from Italy and the west coast of the US; the Russian mafia; and Asian organised crime groups.

Prosecutions under existing laws are difficult as Australia does not have harmonised criminal organisation control legislation.

Financial institutions may be inadvertently lending money to these groups, which they use to facilitate their criminal activities. The use of false identities and fraudulent documentation may be used to secure these loans. The proposals to strengthen anti-money laundering laws (see Recommendation 12.3) would assist in reducing the occurrence of this activity.

Of course, harmonisation should not be used as an excuse to adopt a lowest common denominator approach. Instead, we encourage governments to follow the example set by jurisdictions with the most robust anti-bikie laws. For example, the laws introduced by the South Australian Government have been particularly effective. Similarly, the NSW Police has recently had successes in tackling outlaw gangs. Other jurisdictions may benefit from learning about its techniques.

### ***Recommendation 12.5: Harmonisation of anti-bikie gang laws***

We recommend that the Commonwealth, states and territories harmonise laws applying to bikie gangs by following the jurisdiction with the most rigorous provisions.

Another way to target the leaders of organised crime groups is through laws dealing with the role they play in the networks they lead. The 1970 US Racketeer Influenced and Corrupt Organisations (RICO) Act sought to do just this. This law allowed for crime bosses to be tried for actions they ordered others to commit, closing a possible loophole these people were previously exploiting. We understand that there are similar laws in Australia, but have seen no evidence of enforcement.

### ***Sanctions for serious tax evasion by non-citizens***

It is important to send a message to prospective Australian citizens and residents that tax evasion will be dealt with very firmly. Where a holder of an Australian visa is found guilty of an indictable taxation offence in Australia, we consider that it would be appropriate for the Minister responsible for immigration to have the power to cancel that person's visa and deport him or her. At present the Minister has the power to deport visa holders who have been sentenced to a period of imprisonment of 12 months or more and have lived in Australia for less than 10 years. Additionally, the commission of an indictable taxation offence should be a barrier to a person obtaining permanent residency in Australia or Australian citizenship.

### ***Recommendation 12.6: Sanctions for serious tax evasion by non-citizens***

We recommend that provisions for cancelling visas of those convicted of serious tax offences are strengthened and that such people are removed from Australia. Additionally, such a conviction should prejudice any future applications for visas, including permanent Australian residency or Australian citizenship.

### ***Reform the PoCa and other related provisions***

The PoCa allows for the freezing of bank accounts. A bank account at a financial institution can be frozen if a magistrate is satisfied that there are reasonable grounds to suspect that the account balance reflects proceeds or an instrument of a particular offence.

Freezing orders are intended to mitigate the risk that the account balance will be reduced. However, a freezing order can only be granted for a short period of up to three days and can only be extended if an application for a restraining order has been made. To obtain a restraining order, a greater amount of evidence is required.

To minimise the opportunity for the owner to deplete their account immediately after the freezing order expires it is important that enforcement agencies are able to obtain a restraining order in a timely way. In practice, this is difficult. The authorities often discover new leads which require



further information from the financial institution. Financial institutions have between three to fourteen days to supply this information by which time the freezing order would have expired.

To remedy this issue, we recommend that the Government consider extending the maximum freezing order duration to 14 days, and the introduction of a test to extend the freezing order until the financial institution has replied to the authorities' notice.

Further, we note that PoCa only allows for the complete freezing of an account. This can cause significant disruption to a legitimate business or charity that is under investigation.

We recommend that the Government consider widening the existing provisions so that the authorities have the option of freezing the complete bank account or part of an account or specific transactions in relation to an account or person. Such partial freezing arrangements would enable enforcement agencies to secure the proceeds of crime while reducing disruption for businesses at the early stages of a prosecution (where it has not yet been proven that they have committed an offence).

### ***Recommendation 12.7: Reform proceeds of crime laws***

We recommend that the Government reform proceeds of crime laws by:

- Extending the period for freezing orders from 3 days to 14 days.
- Allowing for the extension of freezing order until relevant financial institutions have provided data sought by enforcement authorities.
- Giving courts the discretion to freeze some of the funds held in a particular bank account.

### ***Offshore profits***

As noted earlier in this chapter, organised crime is becoming increasingly sophisticated, with global crime syndicates operating across jurisdictions in much the same manner as multinational companies. Australia is a 'destination country' for these criminal networks, not a country of origin — while the operations are planned and funded from overseas, the crimes are committed here. In many cases, only a small share of the profits these networks generate are actually earned in Australia, with most being generated offshore. But we, and other destination countries, bear enormous costs as a result of their activities.

We need to focus on disrupting the business models of these networks. Existing proceeds of crime provisions only apply to Australian profits, not the offshore earnings of these cross-border networks.

There are also other limitations with the proceeds of crime provisions. A case can be made that the tax and other penalties we impose on them should take more account of the latter. In effect, we would be deeming part of this offshore income to be Australian-sourced. This would provide another weapon in our arsenal, potentially allowing tax payments to be recovered and greater penalties to be imposed. It will also provide a point of leverage in talks with the countries that host these networks on what more they should be doing to shut them down.

We think the Government should examine the feasibility of this approach, taking full account of the potential law enforcement benefits, costs and risks involved. For tax treaty partners, this is a subject we could raise in future discussions with them and the OECD (the global standard setter for international tax principles). We understand that this has not been raised before. Care would need to be taken to avoid overlapping taxation claims in this ‘new’ area. We note, in addition, that many criminal syndicates conducting activities in Australia operate through tax havens or low-tax jurisdictions, where enforcement is challenging and no double taxation treaty exists.

In addition, the Controlled Foreign Company tax rules, designed to prevent Australian residents from deferring certain foreign-sourced income indefinitely, should also be examined in this context. Criminal proceeds should be immediately attributed to the Australian controllers under these rules. As such, the offshore criminal proceeds would be taxable in Australia.

### ***Recommendation 12.8: Deem criminal earnings to be offshore profits***

We recommend that the Government examine the feasibility of deeming criminals’ offshore earnings to be Australian-sourced. The Controlled Foreign Company tax rules should be modified to attribute offshore criminal proceeds to Australia for tax purposes.





# CHAPTER 13

## TACKLING ILLICIT TOBACCO

### LIST OF RECOMMENDATIONS

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# CHAPTER 13: TACKLING ILLICIT TOBACCO

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## BLACK ECONOMY ACTIVITY IN THE TOBACCO MARKET

### *Key points*

The illicit tobacco trade is large — it is estimated that one in every ten cigarettes and other tobacco products consumed globally is illicit.<sup>1</sup> In Australia, estimates of its size vary. The Australian Institute of Health and Welfare's National Drug Strategy Household Survey estimates that the illicit market comprises approximately 3.8 per cent of total tobacco consumption.<sup>2</sup> KPMG estimates that illicit tobacco represents 14 per cent of total consumption, causing the Government an estimated revenue loss of approximately \$1.6 billion per year.<sup>3</sup> Another stakeholder estimated the size of the illicit tobacco market at \$3.8 billion per year.<sup>4</sup> A Government research project is currently underway to determine the size of the illicit tobacco market and a peer-reviewed result is expected shortly.

During our national roadshow, businesspeople and community members highlighted how blatantly sellers of illicit tobacco operate. They reported that it is being sold through milkbars, websites, trade publications and that retailers appear to have little fear of detection by enforcement agencies. Most illegal tobacco is imported, but home-grown supplies of illegal tobacco appear to be growing. During our consultations, we were told of evidence of crops in Northern Victoria, Central NSW and South East Queensland. We were also told about boutique greenhouses cultivating tobacco and cannabis in the outer suburbs of Melbourne.

Law enforcement agencies report that the illicit tobacco market is growing and is largely the domain of organised criminals. This activity is attractive to criminals because it is highly profitable, the risk of detection is low and penalties are less severe than for dealing in illicit drugs.

As well as causing revenue loss, the wide availability of illicit tobacco has adverse public health effects. Illicit tobacco undermines the disincentive of pricing measures and is more easily accessible for underage users (who are sometimes able to buy single cigarettes). Plain packaging rules may be bypassed, as branded cigarette packs are sold. Further, while all cigarettes cause serious health problems, illicit tobacco can be even worse as it may be produced in unhygienic conditions and, if not properly dried, will be mouldy and can lead to complicated fungal and other lung infections.

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1 World Health Organisation, *Illegal Trade of Tobacco Products: What you should know to stop it*, 2015, p. 5.

2 Australian Institute of Health and Welfare National Drug Strategy Household Survey, 2016, p. 29.

3 KPMG, *Illicit Tobacco in Australia: 2016 Full Year Report*, p. 6.

4 Rohan Pike Consulting, *Submission to Parliamentary Inquiry into Illicit Tobacco*, 2017, p. 18.

### OBSERVATION: ILLEGAL TOBACCO

As a result of excise increases, tobacco in Australia is currently more valuable by weight than silver. This makes it very profitable to deal in illicit tobacco.

Loose tobacco, known as 'chop-chop', is both cultivated in Australia and smuggled in from overseas. Further, packs of cigarettes are smuggled into Australia from countries with low or no tobacco excise.

The street price of a pack of cigarettes in China and South Korea is approximately \$3. That same pack sells for closer to \$23 in Australia. There can be huge profits in smuggled tobacco – a single shipping container of tobacco can generate three to four million dollars profit.

We have been informed that cocaine with a street value of \$2.3 million here will have a cost of about \$150,000, with heroin being similarly-priced. The penalty for smuggling both is imprisonment. Whereas smuggling tobacco costing \$150,000, with a street value of \$10 million here, would, under current sentencing practices, generally result in a modest fine.<sup>5</sup>

Illicit tobacco comprises both tobacco on which excise or duty has not been paid as well as tobacco which is not compliant with plain packaging laws.

Illicit tobacco is already distributed through various businesses, such as tobacconists, convenience stores, pop up shops, milkbars and gift shops, some of which are controlled by bikie gangs. A cigarette manufacturer presented us with a list of hundreds of shops which are selling cigarettes below the excise price. We have also been told of many persons who have been convicted of tobacco offences, but continue to trade actively.

Illicit tobacco is also available at websites which currently sell cigarettes for less than the rate of excise which should be charged.

And yet, despite this flourishing illicit activity, law enforcement efforts have been ineffectual and fragmented. For example, illicit tobacco crops are usually ploughed into the ground and cultivation equipment is destroyed when found, but limited or no further action is taken. Organised criminals are attracted to dealing in illicit tobacco – it is more profitable and less risky than dealing in other drugs.

A particular challenge is that dealing in illicit tobacco, like many black economy activities, is seen as a victimless crime. It is underreported and, like bribery, all participants have an incentive to remain silent.

Dealing with the illicit tobacco market is not an insurmountable challenge. The UK, for example, which has more porous borders than Australia, has been successful in cracking down on illicit tobacco following the implementation of its From Leaf to Light strategy.<sup>6</sup> The UK Government managed to reduce the size of the illicit cigarette market from 22 per cent of the market in 2000-01 to 10 per cent in 2013-14 and the illicit hand-rolling tobacco market from 61 per cent to 39 per cent over the same period.<sup>7</sup> At the heart of its strategy is a focus on effective and coordinated enforcement.

5 While tobacco smuggling can attract a penalty of up to 10 years' imprisonment, courts generally deal leniently with persons found to be involved in tobacco importation and/or cultivation. We note that the social impact of both illicit tobacco and illicit drugs is substantial, but the impact of illicit drugs is more deleterious in the short-term.

6 HM Revenue & Customs, Tackling Illicit Tobacco: From Leaf to Light, 2015. (This is the latest version of a strategy which commenced in 2000.)

7 Ibid.

## ***The existing regulatory regime***

Currently, multiple agencies are involved in tobacco control activity linked to illicit tobacco. This includes the ATO, AFP, ACIC, DIBP, the Department of Health, the National Measurement Institute (NMI)<sup>8</sup>, and state and territory police, health agencies and local councils. While there is an Interdepartmental Committee on Tobacco Control, information sharing between agencies appears to be patchy and ad hoc. At present, enforcement agencies are hamstrung by difficult-to-enforce laws and penalties which do not reflect the seriousness of the crime. For example, most existing offences require prosecutors to prove whether illicit tobacco was cultivated in Australia or smuggled into the country. If illicit tobacco is discovered in a warehouse, it is very difficult to determine its origin. What this means is that once illicit tobacco crosses the border or leaves a farm, enforcement agencies have limited capacity to act.

The Government is addressing this problem, announcing tougher penalties and more workable offences in 2016. In particular, prosecutors will no longer be required to prove whether tobacco was cultivated in Australia or imported. Further, there will be an offence where a person possesses tobacco on which it is reasonable to suspect that excise has not been paid. These changes are welcome. In particular, it is very difficult to prove whether ‘chop-chop’ was cultivated in Australia or imported, which has been a reason for there being fewer prosecutions than there should be for those caught dealing in illicit tobacco.

The 2016 reforms also propose to introduce tiered offences for dealing in illicit tobacco. At present, possession of illicit tobacco attracts a maximum penalty of \$21,000. This will be increased to \$105,000 and new offences will be created for possession of more than 10 kilograms of tobacco (5 years’ imprisonment, \$210,000 fine) and more than 1000 kilograms of tobacco (10 years’ imprisonment, \$315,000 fine). Further, there will be a new offence for the possession of tobacco seeds.

Legislation to effect these changes has not yet been passed by Parliament. We encourage the Government to make these legislative amendments as a matter of urgency.

## ***A single tobacco control act***

Given that offences associated with illicit tobacco are spread across several tobacco control acts, we suggest these be consolidated into a single *Tobacco Control Act*. This act would include tobacco excise and duty provisions, but not the plain packaging laws. We acknowledge that there may be challenges in doing this. We note also that more than one enforcement agency would be responsible for the administration and enforcement of the proposed *Tobacco Control Act*.

We have been told that sophisticated criminal enterprises manufacture cigarettes in Australia from ‘chop-chop’ by filling empty cigarette tubes. To attack this activity, we recommend that the Government introduce an offence for the importation of large-scale cigarette tube filling equipment

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<sup>8</sup> The National Measurement Institute is responsible for ensuring compliance with plain packaging laws, not policing whether tobacco excise/duty has been paid. It is a part of DIIS.



and other cigarette manufacturing equipment in the *Tobacco Control Act*. We further recommend that the Government require licences to import commercial quantities of cigarette tubes and papers.

### **Recommendation 13.1: Modernising offences that apply to illicit tobacco**

We recommend that the Government.

- Enact the tobacco control measures it announced in 2016.
- Locate Commonwealth illicit tobacco laws in a new *Tobacco Control Act*.
- Create a new offence for the importation of large-scale cigarette tube filling machines and other cigarette manufacturing equipment.
- Require licences for the importation of commercial quantities of cigarette tubes and papers.

### **More and better coordinated enforcement resources**

There has been a clear regulatory failure by all levels of government going back a number of years to enforce laws governing illicit tobacco, in particular those governing retailing and distribution. We note that there has been widespread reporting of the sale of illicit tobacco, with some reports including shop addresses. Yet very little effective enforcement action appears to have been taken. This undermines confidence in the rule of law and provides free-rein to organised criminals. That, of itself, should justify a stronger and more coordinated enforcement regime.

For example, a lot of illicit tobacco may be packaged in containers which do not fully comply with the plain packaging laws. The Department of Health is responsible for initiating prosecutions for breaches of the plain packaging laws, but has allocated limited resources to this task. It has delegated fieldwork to the NMI which is part of DIIS. While the NMI is able to obtain warrants, its search and seizure powers are limited. As at 30 June 2017, since the plain packaging provisions came into force in 2012, there have been no prosecutions by the Department of Health for improperly-packaged illicit tobacco. This is despite the legislation containing strict liability offences (relatively easy to prove) as well as fault-based offences carrying penalties of up to \$420,000 per offence. We were provided with a list of 250 distributors in Victoria and NSW where tobacco was being sold for below the price of the excise which should have been charged and was therefore almost certainly illicit tobacco. Presumably, most of this is packaged in ways not consistent with the plain packaging laws. Accordingly, it would not be difficult for the Department of Health to detect and punish such activity if it were to enforce existing laws more energetically.

The ATO's current enforcement efforts focus on the top of the illicit tobacco supply chain (cultivation in Australia). This work is important and the ATO has recently stepped up its enforcement activity,<sup>9</sup> whereas in the recent past if the ATO discovered an illicit tobacco crop, it would often be ploughed back into the ground with no further action taken. The ATO should use all resources at its disposal for this crackdown, including gathering intelligence about the location of glasshouses. The banks

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9 We note that the ATO increased its enforcement activity and since 1 July 2016 and has led sixteen operations seizing 120 tonnes of illicit tobacco with an excise value of over \$90 million.

may be able to help in this regard. We were told that some have provided loans for the purchase of hydroponic equipment. While this has legitimate uses, we would expect the banks to be exercising due diligence in this area. To identify individuals and groups involved in the illicit tobacco trade, the ATO should seek out data about persons who procure large quantities of cigarette paper, hydroponic equipment and glasshouse components. This data could come from internet scraping and other sources.

It is also important that the ATO has a visible presence at the retail level, which will be possible once the Government enacts the new illicit tobacco provisions discussed above.

The DIBP's Tobacco Strike Team has been highly successful, conducting several major raids and prosecutions. The Strike Team's funding is due to expire on 30 June 2018. We recommend that this funding should be extended.

We consider that state governments could do more to tackle illicit tobacco. Despite this being an area apparently dominated by organised criminals, a number of state governments have delegated enforcement responsibility to local council health officers. These officers are unlikely to be trained or have the resources to tackle entrenched criminal enterprises. This appears to be reflected in levels of enforcement activity. For example, in Victoria it is an offence for a tobacco retailer to possess any tobacco which they know (or should have known) excise has not been paid. However, few prosecutions appear to have been brought under this provision.

We recommend that the Government examine the idea of creating a specific body responsible for the policing of illicit tobacco. This could be called, for example, the Illicit Tobacco Agency and could report to the new Home Affairs Department, when it is established.

Alternatively, the Government could establish a cross-agency Tobacco Taskforce. This could be modelled on the SFCT and would be able to build on the work of the existing Inter-Departmental Committee on Tobacco Control. The Tobacco Taskforce could comprise ATO, AFP, DIBP, ACIC and Department of Health officers who have responsibility for enforcement of tobacco legislation. A joint taskforce would improve information sharing and would also provide a single point of accountability.

DIBP's enforcement officials would benefit from greater surveillance powers — unlike AFP or state police officers, they cannot independently obtain a warrant to authorise the use of surveillance devices. In practice, the AFP has to become involved in a matter and use the surveillance devices, and the AFP often has other priority work to do. For example, this means that DIBP cannot use a surveillance device to monitor a cargo container of illicit tobacco or other products remotely, such as tracking its movement. Instead, it has to deploy surveillance teams or seek support from the AFP. As this is resource intensive, it provides a severe limit to the ability of DIBP to monitor such containers. We recommend that the DIBP be included in the definition of a 'law enforcement agency' for the purposes of the *Surveillance Devices Act* so that it is able to authorise the use of surveillance devices for enforcement related purposes, such as monitoring suspected tobacco shipments.

Once the regulation of illicit tobacco has been strengthened, we recommend that the Government should announce a blitz on illicit tobacco.

### **Recommendation 13.2: Coordinated enforcement to combat illicit tobacco**

We recommend that the Government:

- Establish an illicit tobacco agency reporting to the Home Affairs department.
- Alternatively, provide funding to enable the continuation of the DIBP's Tobacco Strikeforce incorporating the ATO's tobacco resources into this strikeforce.
  - Another option would be to create a prescribed cross agency Tobacco Taskforce, with clear lines of accountability and lead responsibility for targeting illicit tobacco.
- Include the DIBP as a 'law enforcement agency' for the purposes of the *Surveillance Devices Act* so that it is able to authorise the use of surveillance devices for enforcement related purposes, such as monitoring suspected tobacco shipments where they have a reasonable suspicion of the importation or handling of illicit tobacco.
- Conduct an enforcement blitz once improved illicit tobacco legislation has been implemented.

### **Use of new technologies**

We recommend that the feasibility of introducing technology which marks cigarette packs and cases to show their movement and indicate when excise has been correctly paid be considered. This could be done using 'track and trace' technology, which is a barcode-based tracking system. We note the development of micro RFID chips may also be suitable for this purpose. As this will benefit manufacturers of cigarettes (due to the reduction of illicit trade), it is recommended that if the introduction of 'track and trace' is found to be feasible, all costs of implementing tracking technology should be borne by cigarette manufacturers. During consultations, one large cigarette manufacturer indicated that that they would be prepared to fund the rollout of this technology.

If adopted, the technology should be made available to law enforcement agencies to allow them to visit retail premises and verify whether tax has been paid. To be effective, the rollout of 'track and trace' technology would need to be paired with additional resources and investigative powers. While this technology would not be of use in targeting 'chop-chop' it would be useful in ensuring the integrity of the duty regime for manufactured cigarettes. Although cigarette manufacturers could be required to bear the costs of introducing 'track and trace' technology, operation of the system itself could not be delegated to or performed by the tobacco industry.<sup>10</sup>

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<sup>10</sup> This would need to be done to ensure that Australia is consistent with the World Health Organisation Framework Convention on Tobacco Control Protocol to Eliminate Illicit Trade in Tobacco Products. While Australia is not yet a party to the Protocol, any legislation implemented should, where possible, be aligned with the Protocol in case Australia decides to accede to the Protocol.

### ***Recommendation 13.3: Tracing cigarettes***

We recommend that the Government examine the feasibility of introducing technology which marks packs and cases to show when excise has been correctly paid.

### ***Move the taxing point for tobacco excise***

At present, excise is charged on tobacco at the point that tobacco products leave licenced warehouses. The excise is payable when the product leaves the warehouse for distribution. This is a risk because criminals may seek to obtain untaxed tobacco where this happens. During consultations, we were told of several bonded warehouses which have been used to distribute illicit tobacco. If, instead, tobacco excise were charged on tobacco or tobacco products as soon as they were brought into an Australian port this weakness in the supply chain would be eliminated.

### ***Recommendation 13.4: Move the taxing point for tobacco excise***

We recommend that the Government taxes tobacco at the time that it enters an Australian port.

### ***Shisha tobacco***

In 2012, duty provisions were changed so that the tax on molasses tobacco (for example, shisha tobacco) was based on weight; previously the duty was based on tobacco content. Shisha tobacco has high moisture content and is therefore heavier than ordinary tobacco. Hence, the duty charged is comparatively high. Following this change in tax treatment, almost the entire shisha tobacco market has become illicit — one stakeholder estimated that approximately 1000 tonnes of molasses tobacco is consumed in Australia each year, but less than one tonne was imported legally in 2016.<sup>11</sup> On this basis, the stakeholder estimated that the revenue loss to Government on such tobacco is \$750 million per year.<sup>12</sup>

### ***Recommendation 13.5: Shisha tobacco***

We recommend that the Government reduce the level of duty which applies to shisha tobacco so that it is taxed at approximately the same rate as cigarettes.

<sup>11</sup> Rohan Pike Consulting, Submission to Parliamentary Joint Committee into Illicit Tobacco, 2017, p. 22.

<sup>12</sup> Ibid.





# CHAPTER 14 ILLEGAL GAMBLING

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# CHAPTER 14: ILLEGAL GAMBLING

## ILLEGAL GAMBLING AND THE BLACK ECONOMY

### Key points

Gambling in Australia is a heavily regulated activity. Historically, legal gambling was horse racing-based, but it has since expanded to poker machines, casinos and more recently to sports betting. A substantial portion of gambling revenue funds community projects through licence revenues collected by state governments. The racing industry receives funding from regulated bookmakers and parimutuels. The industry is one of the largest employers in Australia.

By contrast, unregulated sports betting undermines the racing and sports entertainment industries, making no economic contribution to social infrastructure or to the cost of the product. It puts legal betting operators at a competitive disadvantage, especially with high-volume professional punters. It undermines the integrity of racing and other sports because, unlike data collected by regulated providers, information about unregulated betting is not available to stewards or integrity units who investigate unusual wagering activity or results.

This is a particular problem in sports betting, because most sports do not have the same level of integrity oversight as the racing industry. There is a particularly high-risk of match fixing in sports as there is generally one winner and one loser.<sup>1</sup>

#### OBSERVATION: ASIAN GAMBLING ON AUSTRALIAN SPORTS

According to a 2013 article, more money was wagered by Asian gamblers on an Australian A-League soccer match than an English Premier League match.<sup>2</sup>

In addition, unregulated offshore gambling providers do not collect or remit GST in Australia.

Illegal offshore gambling is growing rapidly. This includes both offshore bookmakers (who take the risk on bets) and betting exchanges (which match people to both sides of a bet). In cooperation with a number of Asian racing clubs, some Australian racing clubs formed an Anti-Illegal Betting Task Force to investigate the growth of illegal internet gambling. This body has estimated that the Australian racing industry is losing approximately \$1.34 billion per year (12 per cent of turnover). Similarly, in 2012, the Final Report of the DBCDE review of interactive gambling estimated that

- 1 See, for example: C Crawford, 'How Australian sports are trying to stop criminals from making illegal betting billions', Herald Sun, 5 February 2016; and N Bucci, 'Former junior tennis champion Oliver Anderson avoids conviction after pleading guilty to match-fixing', The Age, 23 May 2017.
- 2 D Davutovic and J Bednall, 'Asian gamblers reportedly bet almost \$50 million on an A-League match in December', news.com.au, 10 February 2013.



\$1.6 billion is spent on online gambling activity in Australia.<sup>3</sup> Submissions to the DBCDE review suggested that about 60 per cent of this activity was with unregulated overseas services — equating to \$1 billion per year.<sup>4</sup> Illegal gambling creates money laundering opportunities and enables the shifting of profits into tax havens. There are also clear organised crime links to some of these punters and operators of unregulated gambling platforms.

Racing integrity agencies have informed the ACIC and the AFP of the problems caused by unregulated gambling and its links to money laundering and other illegal activity. Racing agencies benefit from the exchange of information with their international counterparts. These relationships have delivered a large amount of useful intelligence. Racing authorities have identified a dozen or more unlicensed operators who do business in Australia.

Of these, the largest unlicensed operation is Citibet, which appears to now operate out of Vietnam and is itself reportedly linked to an organised crime gang. It runs its business through a series of onshore agents and bookmakers, but often settles through offshore bank accounts. It seems that some of the clients of Citibet have links to organised crime or dubious histories with racing authorities. Racing authorities have accumulated useful information about these unlicensed operators and the integrity risks they bring to gambling markets. The ATO, the AFP and the ACIC are investigating this information.

#### **OBSERVATION: ONLINE GAMBLING AND BITCOIN**

The ACIC has shared some of its information about unregulated online gambling with us.

One particularly concerning organisation is a bookmaker licenced in Costa Rica, which permits the creation of betting accounts with no identity checks or verification. Upon the creation of an account, a specific internet address through which individuals and other associates can bet is automatically generated. It encourages the account owner to share the address and pays the owner a commission for all bets which are transacted via the address.

It accepts and makes payment via Bitcoin, which offers very high levels of anonymity.

The ability for third-parties to access and use an account, which itself has been created without any identity verification, shows how easily anonymous betting channels can be created and used to launder money.

Illegal online gambling sites generally offer more favourable odds than other bookmakers (because they do not pay tax or sporting industry levies). The better odds lower the costs of laundering money (for example, a launderer can take both sides of a bet and still obtain a return of, say, 95 cents in the dollar).

3 Department of Broadband, Communications and the Digital Economy, Review of the Interactive Gambling Act 2001: Final Report, 2012, pp. 28-29.

4 Ibid, p. 29.

## **Enforce existing laws**

It appears that there has been little progress in tackling illegal gambling. There must be a concerted enforcement effort involving the industry, the ATO, ACIC, AFP, AUSTRAC and the Australian Communications and Media Authority.

We note that there are several enforcement mechanisms available to regulators which could disrupt illegal gambling, including a number of recent tax measures.

- There are clear breaches of both Commonwealth and State legislation, including anti-money laundering laws by agents of unregulated gambling providers. These provisions should be vigorously enforced.
- GST should be collected on domestic online gambling transactions, which is allowed under existing laws. Also, GST should be collected from wagers placed by Australian residents with offshore gambling sites, which became possible from 1 July 2017 when inbound supplies of intangibles become subject to GST. Where operators are offshore and unregulated, collecting these taxes will be difficult.
- The onshore agents of the operators are generally given the power to conclude contracts and place bets. Arguably this means that they have a permanent establishment and hence a taxable presence in Australia. These operators could be subject to transfer pricing rules or the recently enacted Diverted Profits Tax or Multinational Anti-Avoidance Law. Potential recovery action could occur through double taxation treaties or bilateral trade agreements.
- In addition, racing authorities could apply existing racefields legislation to take action against the onshore agents linked to unregulated gambling sites (and the punters who use them) by publicly warning such people off racecourse and recovering fees. They will need specific information from government agencies to enable them to enforce these provisions. Further, the ATO should levy tax assessments against such agents and punters where income is not disclosed.

### **Recommendation 14.1: Enforce existing laws**

We recommend that the Government examine how to make further use of existing laws, including tax law, anti-money laundering regulation and laws against multinational profit shifting, in combatting illegal gambling.

## **Implementation of recommendations set out in the Review of Offshore Gambling**

We support the recommendations of the *Review of Offshore Gambling* by the Hon. Barry O'Farrell. We note that the Government has implemented many of the recommendations set out in this Review through recent amendments to the *Interactive Gambling Act 2001*. These amendments came into force in September 2017 and strengthen the framework for regulating illegal offshore gambling. The amendments make it very clear that a wagering operator providing interactive gambling services to a person in Australia must be licenced under the law of an Australian state or territory.

We recommend that the Government continue to press ahead with measures to limit illegal offshore wagering. This should include requiring internet service providers to block offshore sites that are illegally offering gambling services to Australians. ISP blocking has been used in Hong Kong and France and has resulted in a material drop in unauthorised wagering.

In addition, the Government should work with banks and credit card providers on ways to block payments to and from illegal offshore wagering businesses. In 2006, the US implemented the *Unlawful Internet Gambling Enforcement Act*, which outlawed the use of payment systems to facilitate online gambling. Recognising that it will be impossible to prevent all transactions, the US provides safe harbours for financial institutions provided that they have implemented appropriate integrity and due diligence processes. This would be a useful model for Australia to consider.

From our examination, it is clear that illegal gambling networks operate on a regional-wide basis. Australia is well-placed to play a leadership role, at both the diplomatic and operational levels, in a renewed regional effort to deal with this problem.

### ***Recommendation 14.2: Implement recommendations set out in the Review of Offshore Gambling***

We recommend that the Government:

- Require ISPs to block offshore sites that are offering illegal gambling services to Australians.
- Encourage banks to prevent transactions to and from offshore wagering websites.

### ***Prevent unregulated gambling sites from mixing with regulated gambling***

At present, people who hold premium accounts with Citibet are able to place bets through a regulated betting operator's platform. This means that the regulated platform may have limited visibility of the ultimate account holder.

We recommend that regulated gambling sites be prevented from accepting bets from unregulated platforms and that the sanction for knowingly accepting bets from them should be deregistration.

In some instances, it is possible for Australian law enforcement agencies to determine the identity of account holders. Where this occurs, we recommend that enforcement agencies provide this information to racing clubs and casinos and that state-based regulators should publicly warn off people from racecourses, including punters.

In addition, while regulated gambling providers are usually careful to comply with money laundering obligations, there are still weaknesses. For example, cash bets through machines located in hotels and clubs. Pub and club employees are unlikely to be trained to identify potential money laundering and other suspicious activity. Such training should be provided to them.

Further, given the transnational nature of unregulated gambling, close cooperation between law enforcement agencies in different jurisdictions would provide Australian regulators with better

intelligence. The Department of Foreign Affairs and Trade (DFAT) may also be able to help in gathering information about unregulated gambling operators.

### ***Recommendation 14.3: Separating unregulated gambling from legitimate activity***

We recommend that:

- The Commonwealth Government prevent regulated gambling sites from accepting bets sourced from unregulated sites.
- State-based racing regulators publicly warn off people from attending racetracks and prosecute them if they are found to be using unregulated gambling sites.
- Australian law enforcement agencies exchange information about unregulated gambling with their international counterparts.

### ***Better use of gambling data***

Stored value cards and betting vouchers contain useful information about the source of funds and the collection of winnings. This information is routinely collected by legitimate gambling operators and could provide useful intelligence about money laundering, links to organised crime and connections to illegal gambling. For example, betting vouchers are used by criminals as a money transfer device. If, for example, a voucher is issued in Melbourne and collected in Alice Springs, this may indicate that the voucher has been used for money laundering. This data could be collected into a single database and analysed with specialised algorithms to identify potential criminal networks or money laundering.

### ***Recommendation 14.4: Better use of gambling data***

We recommend that information contained in stored value cards and betting vouchers should be analysed to seek out potential criminal networks.

### ***Prevent gambling from being used to shelter tax evasion***

Unlike some countries, such as the US, Australia does not tax gambling winnings. This creates enforcement problems. Where a person is found to have an income much higher than the income reported in their tax return, they often claim that the difference is attributable to gambling winnings. It can be difficult to prove otherwise.

Similarly, where a person's assets are being pursued under unexplained wealth laws, they may claim that they have been a fortunate gambler. As they are not required to keep any records of gambling activities, they may have a good prospect of defeating the unexplained wealth claim.

We recommend that this problem be tackled by requiring that, where a person has gambling or lottery income greater than \$50,000 per year, they be required to keep records of wagers and winnings. In the absence of records which cover the whole of the gambling activities, any

unexplained income should not be attributed to gambling winnings by the taxpayer. Enacting such a measure may require collaboration with state Governments.

***Recommendation 14.5: Prevent gambling being used to shelter tax evasion***

We recommend that the Government require taxpayers to keep records of their gambling activities once winnings exceed \$50,000 per year.



# **CHAPTER 15**

## **WORKING ACROSS BORDERS**



# CHAPTER 15: WORKING ACROSS BORDERS

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## TAKING ACTION TOGETHER

### *Key points*

The black economy does not respect jurisdictional boundaries. Indeed, there is a significant economic dividend for all black economy participants from exploiting policy, regulatory and enforcement gaps and blind spots across different levels of government. All governments, of course, bear the economic, social and revenue costs of this problem. A recurring theme of this Report is that much greater collaboration is needed in this area.

In Australia, this means that all three levels of government together must take action, building on current initiatives but also striking out in new directions. Three priorities we highlight are data sharing, which can be a force multiplier for all government's enforcement efforts, harmonisation and reduction of small business regulatory burdens and greater cooperation in the area of enforcement. The Commonwealth, States and Territories, and local governments all have role to play.

Across our international borders, we have to work with our counterparts overseas to tackle both old and new problems. We have to collaborate to share information and drive change where regulation in one country alone cannot achieve results, for example in the sharing economy, and make sure that we take action together against cross border criminal activities.

### *Working with States and Territories*

We are aware that the states are already doing a great deal, including in the areas of licencing and regulation, workers' compensation, fair trading, small business deregulation, procurement and payroll and other tax enforcement efforts, and that the Commonwealth is already working with the states on certain issues.

*'We support the policy objective of reducing regulatory burdens. This should extend to the harmonisation of definitions and other legislative issues facing businesses that deal across jurisdictions ... businesses tend to comply and stay inside the system if it is made easier for them to comply.'* The Tax Institute

We recommend that this work be stepped up and prioritised. There are a few areas, such as data sharing, reducing regulatory burdens and cooperation on audits and enforcement where a lot can be achieved by working together to better encourage compliance and address non-compliance. Many of these areas have been raised in earlier chapters. Each jurisdiction pursuing action on its own will see limited benefits, but together multiple angles can be pursued, and jurisdictions can learn from each other to adopt best practice.



In other areas, shared or overlapping regulation makes cooperation absolutely necessary to address wrongdoing. This includes tackling sharing economy tax compliance, illicit tobacco and unregulated offshore gambling.

Lastly, we point to a number of our recommendations in this report where we think state and territory participation will greatly enhance what we can achieve. Limiting access to Government procurement to only businesses with a good tax record is one such area. Others include digital identity, electronic data standardisation, education and training, criminal intelligence and labour hire.

### *High-priority areas for cooperation*

#### **Data sharing**

While some data is shared between jurisdictions, there are opportunities to take this further. Better sharing of tax and other information between the Commonwealth and the states would help each enforce tax laws, counter serious cases of fraud and evasion, and also offer better services to their communities.

- There might be additional data or underlying data which is currently not shared or only shared partially. In some instances data sharing takes place but is onerous.
- States would also benefit from provisions which allow them to make more use of data that they have access to.
- Vice versa, from the Commonwealth's perspective, state payroll, licencing and workers' compensation data would be potentially useful.

We appreciate that there are legislative and other impediments to data sharing, but consider that these should not preclude an examination of ways this can be taken further or should be amended if required, as outlined in Recommendation 5.1 on data sharing.

Harmonisation of barcodes used across levels of government, greater digitisation of information and data and moving away from paper-based, PDF systems will help generate more usable information for agencies and reduce red-tape for businesses.

#### **Small business deregulation**

Regulatory burdens are a significant driver of black economy activities, particularly for small businesses. As highlighted in our business regulatory statement and Chapter 7 on incentives and deterrents, reductions in regulatory burdens play an important role in encouraging businesses to comply with their obligations and engage with the formal system.

A number of approaches might be considered, including:

- **Cooperation on regulatory reduction.** We appreciate the practical and other difficulties this proposal can encounter. That said we know that state and local governments have made

important improvements in particular areas. The Commonwealth and States and Territories should identify what works and what does not and implement good ideas where possible.

- **Extension of any Commonwealth small business regulatory safe harbour (discussed in Chapter 7) to States and Territories.** State and territory agencies could become part of this initiative, offering low-risk small businesses lower regulatory and compliance burdens. Businesses would benefit from this treatment when they undertake specified compliance actions, including adopting largely non-cash business models.
- **Digitisation.** As businesses and governments digitise, opportunities open up to make interactions between businesses and governments at different levels more streamlined and efficient. With distributed ledger technology, for example, data can be shared instantaneously among a large population of users. While still at an early stage, the technology offers enormous potential to reduce regulatory burdens imposed by interactions with government. As mentioned in Chapter 5, it could also be used as a common reference point to bring together different levels of government to host government registries of open data.
- **A more streamlined approach to the contractor definition.** At present, there is no standard definition for a contractor. While the Taskforce does not support a formal definition to be applied to the *Fair Work Act*, there may be some improvements that can be made by applying a more consistent approach to contractors across Commonwealth tax law, including superannuation, and state payroll and workers' compensation rules.

*'There is significant scope for greater cooperation between the Commonwealth and the States and Territories in policy and regulatory harmonisation. A good start would be harmonising definitions for payroll tax across all jurisdictions, and PAYG and Superannuation Guarantee at the Federal level.'* The Tax Institute

### Audits and enforcement

There could be further opportunities for the Commonwealth and States and Territories to conduct joint audits or raids.

Currently, various state jurisdictions conduct joint audits of payroll tax. It could be useful if such audits included the Federal government and were extended to Commonwealth tax obligations. Similarly, Federal government initiated audits could involve relevant state jurisdictions. Such programs could also be used to showcase best practice enforcement.

There may be scope for cooperation in the exercise of powers. In many areas, for example, state governments have licencing and regulatory responsibilities. Enforcement of these could be made more effective by linking them to certain Commonwealth powers, for example to revoke visas in some circumstances. This would also strengthen the integrity of our visa regime.

ReturntoWorkSA, for example, has been praised for its approach to labour hire operators. There may be lessons that other governments can learn from this initiative.

### *Joint action to address the black economy*

- **Sharing economy tax compliance.** We are looking at requiring sharing economy platforms to report contractor payments to the ATO (see Recommendation 6.2). For offshore platforms, this reporting could be made a requirement for doing business in Australia. Given that these are typically licenced by state governments, cooperation might be required. Better enforcement of sharing economy tax obligations would benefit both the Commonwealth and the states.
- **Unregulated offshore gambling.** In cooperation with a number of Asian racing clubs, an Anti-illegal Betting Taskforce was formed to investigate the expansive growth of web-based offshore gambling. The Taskforce concluded that the Australian racing industry is losing \$1.34 billion to offshore unregulated bookmakers per year. There are clear breaches of both Commonwealth and state legislation. There will be a requirement to collect GST on offshore gambling services from 1 July 2018. Recommendation 14.3 recommends that state racing regulators should publicly warn off people from racetracks if they are found to be using unregulated gambling sites.
- **Illicit tobacco.** As discussed above, regulation and enforcement of tobacco regulation is fragmented. To address this growing problem, Commonwealth agencies and States and Territories must work together.

### *Other important cross-jurisdictional areas*

#### **Government procurement**

We propose to limit Commonwealth procurement to firms with a good tax record (see Recommendation 9.1). This could also be extended to holding of licenses. We consider that state and territory governments could adopt the same proposal.

#### **Digital identity credential**

As outlined in Chapter 4 (Recommendation 4.1), we recommend that Government should introduce a standardised identity framework that enables businesses and individuals to prove their digital identity quickly and securely. A natural extension would be to allow the credential to be used in interactions with private sector and state agencies. It could also be used to approve or demonstrate that a person holds a particular licence. This will improve data holdings across governments, remove points of friction for individuals and combat identity theft.

#### **Electronic Data Standardisation**

For the purposes of the Commonwealth sharing data with the states, the form of information is just as important as the content. The Black Economy Taskforce considers a standard form should be applied to data sets required from the private sector to authorities and shared between authorities, both state and Commonwealth.

#### **Impact of changing work patterns on revenue base**

There is a widespread shift in the workforce with people moving out of traditional employment relationships. There are a number of dynamics at play here: people want to work part-time,

businesses want more flexibility when paying payroll tax and superannuation, and people want to freelance. There are many 'gig economy' intermediaries assisting in this shift, with online apps matching people with work.

### **Education and Training**

Educating taxpayers, particularly consumers and small businesses, can go a long way to help all taxpayers do the right thing. States and Territories can play an important role in this regard by providing clear guidance on obligations and how to comply in the information they provide, for example, as part of building approvals. In Chapter 11 we also raise the need for tax literacy education and basic business skills to be incorporated into TAFE/VET curriculums and recommend a vocational training tax literacy pilot (Recommendation 11.5). Industry associations can play a constructive role in this area. They already do a great deal to educate their members about their tax and regulatory obligations, but we consider more could be done to build on these efforts.

### **Criminal intelligence**

The current criminal intelligence capability and information sharing arrangements between Australia's law enforcement and intelligence agencies is subject to a number of weaknesses. The Taskforce supports the NCIS pilot program and recommends full rollout (see Recommendation 12.1).

### **Labour hire**

As discussed in Chapter 10, the Taskforce is recommending that the Government provide in-principle support for industry-led certification of labour hire firms (Recommendation 10.5). The certification would have to be credible and robust, and have strict requirements such as operators meeting a fit and proper person test, compliance with laws at the Commonwealth, state and local government levels and external audit.

The Taskforce is aware that a number of states have implemented, or are currently legislating, labour hire licensing schemes. While we prefer industry self-certification, having a number of different licensing schemes in place is also not ideal. It imposes significant compliance burdens on legitimate labour hire businesses that are active in several states. The Commonwealth Government and States and Territories should consider how best to introduce new regulation in a way that minimises compliance costs for these businesses.

### **Local government**

Local governments have a large role to play in combatting the black economy. They have responsibility for a wide range of matters, including regulations such as planning, registrations and service delivery. As we have pointed out repeatedly, costly, complex and overlapping regulations are a key driver of the black economy. If interactions with the government are too onerous businesses are more likely to disengage from the system.

Being close to the ground, local governments can also help educate people about their rights and responsibilities and change social norms.

The Commonwealth and State governments must therefore engage with local governments to find ways to reduce red-tape, work together to enforce compliance, share data, and deliver the message that participation in the black economy is harming our level playing field. An example of where a lot of progress has been made is the harmonisation of regulations applying to cafes across a number of local areas in Western Sydney. Other local governments might be able to learn from such experiences and replicate changes that have worked elsewhere.

### ***Working across international borders***

The black economy has an important international angle. As an economy closely connected to the rest of the world, many black economy activities taking place in Australia are not confined within our borders.

*‘Our observation is that revenue authorities across the world are cooperating and sharing information more than ever before.’ The Tax Institute*

Tax administrations are already working together across the OECD to share experiences, identify emerging trends and vulnerability and share information on the black economy. As we have seen with Base Erosion and Profit Shifting (BEPS), information sharing can be particularly helpful to combat tax evasion. The Taskforce sees great opportunities in the space of the black economy too and urges ambitious international collaboration. We have identified procurement and the sharing economy as high-priority areas where a common approach or information exchanges could improve individual countries’ ability to monitor and enforce compliance.

In addition, there may be opportunities to enhance joint approaches to cross border crime, for example on the transfer of cash across borders or harmonisation of barcodes. Use of money exchanges and transfer, including hawala, for criminal activities also needs to be addressed. These are explored further below.

### ***Sharing economy***

We outlined in Chapter 6 the opportunities but also risks presented by the sharing economy. Australia is not alone in having to deal with the challenge. Sharing economy businesses are growing everywhere, testing the regulations of countries across the globe. While some operate only in one place, many sharing economy platforms are active in more than one country. By their nature they are not constrained by jurisdictional boundaries. This poses the additional problem of platforms being registered in and operating out of one country whilst providing the service in another.

Australia should therefore work closely with counterparts to focus on the expanding risk for the black economy by sharing economy platforms. This includes addressing uncertainty for users of their tax obligations, lack of visibility of payments and interactions between platforms and tax authorities.

The Taskforce’s recommendation for a sharing economy reporting regime aims to address the visibility problem, but as noted in the recommendation, where the platform is located overseas there are difficulties in enforcing reporting requirements. This is where cooperation between

countries is critical: the country the platform is registered in may have a role to play, but more importantly there is an opportunity for many countries to get together to address the issue, for example by standardising reporting to make it easier for platforms to comply, multilateral information exchanges, or, if necessary, exercising pressure on platforms to comply with national laws, even where they are located in a different jurisdiction.

### *Procurement integrity*

We recommend that Australian Government procurement opportunities are limited to businesses with a good tax record (see Recommendation 9.1). The recommendation proposes that businesses tendering for a contract of \$4 million or above provide an ATO-issued certificate of compliance.

Businesses located overseas should not be disqualified on the basis that they have no Australian tax record and our recommendation makes this explicit. However, we believe that over time the tax record of overseas businesses should also be looked at. A lot of progress has already been achieved with better tax information exchanges. As this progresses, the Government should look at options for verifying tax records with overseas jurisdictions.

### *Organised crime*

As we outlined in Chapter 12, organised crime came to feature heavily in the Taskforce's work. It is pervasive, destructive and costly. As we have seen in this Report, criminal groups are often transnational in nature.

The Government works closely with other countries to combat organised crime. Sharing information, jointly addressing weaknesses in border controls and tackling the holes in regulations and identify verification are all part of this.

Australia has the opportunity to play a stronger regional role. The AFP has recognised this, placing more staff overseas to deal with these issues at source, before they arrive in Australia. Given the particular challenges Asian-based crime gangs pose, this should be a particular focus. We should also be working through diplomatic channels, where necessary.

### *Cash smuggling*

Criminal activities which span international borders rely on cash to make payments and to invest to legitimise their proceeds of crime. Cash remains a very attractive medium for criminal gangs because of its anonymity and that it does not generate a clear audit trail. A common method by which these gangs transfer value internationally is by using 'cash couriers': individuals who are recruited to carry cash across international borders.

Australia, like most other countries, has a cash declaration system in place to tackle this issue. Under the current AML/CTF legal framework, it is not illegal to carry physical cash greater than \$10,000 into or out of Australia provided that it is appropriately declared to the authorities. While some cash couriers take a risk and disguise and hide the physical cash within their clothing or in their luggage, experienced criminal organisations have found ways to circumvent this risk by gaming the declaration system. For example:

- Criminals may over declare the amount of currency they have when they come into Australia. If the accuracy of these declarations is not checked at the borders, criminals can then use this declaration as a cover to take cash out of the country.
- Criminals may even re-use the same cash declarations to deposit domestic proceeds of crime at multiple financial institutions.
- Some cash couriers that are travelling through multiple transit countries may declare their cash at these transits and use these declarations as a 'cover' for accidentally forgetting to declare the cash at the final destination.

A further weakness arises from exported cargo not being inspected. There may be opportunities to use scanning techniques to detect polymers which Australian banknotes are made of.

### *Harmonisation of barcodes*

Despite borders being tightly controlled, the high volume of cross border movements means criminals do find gaps through which undeclared or illegal cargo can be brought into Australia without detection. Barcode harmonisation would help with tracking containers across the world and tracking international mail. This would allow proper profiling of mail and cargo from particular higher-risk countries, and base it on a particular weight and going to particular postcodes.



# CHAPTER 16

## INSTITUTIONAL LEGACY

### LIST OF RECOMMENDATIONS

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# CHAPTER 16: INSTITUTIONAL LEGACY

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## COMBATTING THE BLACK ECONOMY IS A LONG-TERM VENTURE

In this Report, we set out a strategic plan to counter the black economy, together with a focussed set of both near-term and long-term reforms. In this chapter, we canvass possible institutional reforms the Government might consider.

### *Why change is required?*

We have come to the view that current institutional arrangements for the black economy can be improved.

- While there is crossover with the SFCT, there is not a single, policy and strategic home for black economy questions within the Government. No central body examines current vulnerabilities and emerging trends from a whole-of-economy perspective. At the same time, the black economy touches many parts of government, including tax, welfare, workplace relations and law enforcement. Our responses must be genuinely whole-of-government rather than siloed.
- The Government's planned establishment of a Department of Home Affairs represents an opportunity to overcome the silos and limits that hamper the effectiveness of current approaches. It will have an important role in combatting the black economy.
- We need to strengthen our capacity to tackle high-value, complex and cross-cutting black economy abuses.
- There is no obvious focal point for public complaints, concerns and allegations.
- The reform agenda set out in this Report, if adopted by the Government, will take time to implement. An implementation timeline, together with clear accountabilities, should be developed, if this Report is not to be left 'on the shelf'. As we argue elsewhere in this Report, closer cooperation with the states offers enormous opportunities.
- Our work has highlighted the value of close collaboration with the private sector, which needs to be part of any institutional response.

These considerations are discussed briefly below.

### *Strategic and policy overview*

We do not have a single agency which is responsible for the black economy. We have argued that the black economy does not respect neat departmental or jurisdictional boundaries. Tax, workplace relations, human services, licencing authorities at all levels of government, corporate and financial regulators and law enforcement each have a critical role to play, but only see parts of the jigsaw

puzzle. The split between state and federal regulatory boundaries is also a dimension. Too often, policy and regulatory initiatives reflect this partial, fragmented focus. We appreciate that many in the black economy are motivated by tax, but this tells only part of the story. Indeed, in many cases, a desire to bypass or evade other regulatory regimes is the problem.

Indeed, the black economy is a whole-of-government, whole-of-society problem. This was the reason why the Government set up our Taskforce in the first place, with 20 Commonwealth agencies represented, and placed the Secretariat in Treasury.

This is not just a matter of coordination. We need a forward-looking, strategic perspective. The black economy does not stand-still. The risks, vulnerabilities and abuses we will be confronted with in a decades' time will be different, in some cases radically so, than the ones we see today. The black economy, in critical areas, exists on the commercial, economic and technological frontiers, often beyond the regulatory perimeter. Indeed, it is a by-product, in some respects, of the wider process of structural change.

This point has been confirmed by our consultations. The last ABS estimate of the size of the black economy was published in 2012, but in some cases draws on 2001 data. Since that time, the sharing economy has emerged and grown strongly, we have had a prolonged period of low wages growth, the labour market's composition has changed, student and other uncapped visa numbers have risen and major changes to our payment system landscape have occurred. The growing sophistication and reach of criminal groups' participation in the black economy is another factor. This underlines the need for regular (perhaps 5 yearly) high-level strategic assessments in this area, something which does not take place at the moment.

### *Working with the private sector*

Working with the private sector has yielded large benefits for the Taskforce in the development of this Report. Capturing the knowledge and expertise of the private sector should remain a focus in future work.

### *Working with the States and Territories*

As we argue elsewhere in this Report, there is substantial scope to improve cooperation with the States and Territories. We propose that this focus on the following, high-priority areas in the first instance: (i) sharing of data, given the fact that each level of government holds tax and other information which would be valued by others, (ii) opportunities to reduce red-tape burdens for small business and (iii) joint auditing and enforcement, including the multiskilling of inspectors (so that, for example, a state inspector can identify possible violations of Commonwealth tax and regulatory requirements).

### *Cross-agency approaches*

At the operational level, we need to be open to innovative, cross-agency approaches. We discuss the importance of sharing data, better analytics and closer collaboration in our Report. In addition to this, our capacity for multi-agency action (both within the Commonwealth and in conjunction with the states) needs to be strengthened.

The Government has established the SFCT, bringing together the ATO, AFP, AGD, ACIC, AUSTRAC, Australian Border Force (ABF), ASIC and the CDPP, to share intelligence, conduct operations and prosecute crimes in this complex, cross-cutting area. We note that if legal restraints on information sharing between agencies were removed, it may not be necessary to set up taskforces like this. Agencies would collaborate in the course of their normal work.

Other countries have adopted other approaches. The UK's Serious Fraud Office, for example, investigates and prosecutes serious cases of fraud, bribery and corruption. The Irish Criminal Assets Bureau brings together law enforcement, tax, welfare and specialist forensic, legal and financial capabilities, reflecting a genuinely multi-agency approach. These take a proactive role in the enforcement and compliance, in contrast to the many reactionary services we have seen.

### *A public face*

From the public's perspective, there is no obvious home for serious black economy and white collar crime complaints and allegations. The ATO and other Commonwealth departments have dedicated hotlines, but our consultations have shown that these are sometimes ineffective. Some services are only offered in English, for example. Others do not offer confidentiality. Secrecy provisions limit the scope for departments to report follow-up actions taken.

A more fundamental point should be made: serious black economy cases can touch on tax, workplace relations violations, visa or identity fraud, links with criminal activities, official corruption and other regulatory breaches. The member of the public or small business reporting these will have little or no idea which particular agency or law enforcement body to contact. For this reason, we argue that a single black economy hotline, replacing the multiple existing hotlines, is needed. We discuss this in more detail below.

### *Implementation of the reform agenda*

We have argued that some problems need immediate action, including ABN fraud, the transparency gap in our reporting arrangements and enforcement in areas like phoenixing and sham contracting. Other reforms will require sustained efforts and attention, including reducing red-tape burdens for small businesses, our move to a near non-cash world and reforming some of the policy settings (in tax, workplace relations and other areas) which may be contributing to the black economy.

Regardless of how the Government responds to our Report, there will need to be a sustained focus on implementation; something we have not seen with earlier black economy reviews.

There are wider reasons to look at our institutional approach.

Since the 9/11 attacks, our national security institutions and approaches have been overhauled. Assessment, policy and enforcement agencies, in this area, operate in a seamless and genuinely collaborative way. This has been a force-multiplier, substantially strengthening our ability to identify, track and respond to threats. We think the same philosophy can be applied to our efforts to counter the black economy. This need not require the creation of new agencies or disruptive changes to existing ones; nor should it add new layers of complexity to government.

The goal of any institutional reform must be to better equip ourselves to meet both present and future challenges, while building on our strengths and traditions. Against the background of the Government's decision to create a new Home Affairs portfolio, it is timely to consider how our black economy task might best be tackled.

## OUR PROPOSALS

### ***Recommendation 16.1: Advisory board***

A central agency-led advisory board, including both public and private sector representatives, to monitor emerging trends and risks in the black economy and prepare a five yearly report on these.

#### ***Description***

The advisory board would meet twice each year. Its five yearly reports would be deliberately strategic in focus. In addition to looking at emerging trends and risks, they would consider the size of the black economy and factors (policy-related, economic and social) which may be contributing to its growth (or reduction). In doing so, the reports would adopt the same approach as this Taskforce, which has rejected the view that the black economy is merely a tax phenomenon and highlighted its dynamic and changing nature. The reports could be part of the Government's Intergenerational Reports.

A central agency would prepare this Report with the assistance of a joint public and private sector panel. The ATO, the ABS and relevant Commonwealth departments would be represented, together with representatives from key industry associations and academic experts. Representatives from state and territory governments should also be involved.

The reports would be made public. In addition to raising public awareness of this problem, the reports would inform future policy and enforcement efforts. Over time, they would provide insights into the success of existing programs and initiatives.

### ***Recommendation 16.2: Standing Taskforce***

The establishment of a standing Taskforce to identify, respond to and prosecute serious, complex black economy fraud.

#### ***Description***

This Taskforce would be led by the ATO, with participation from the AFP, the ACIC and relevant regulatory and policy agencies, including the Department of Home Affairs (when established) and the FWO. If necessary, state government agencies could participate in particular operations. It would be modelled on the SFCT, which has been effective but which does not have a purely black economy focus.

The Taskforce would deal with serious, complex and high-value cases which call for genuinely cross-agency approaches. From our work, criminal involvement in labour hire operations and pockets of entrenched labour exploitation could be possible areas of attention.

Matters could be referred to the Taskforce by the Government, on the advice of its participating agencies. At any one time, the Taskforce would be dealing with a portfolio of cases. Care would need to be taken to prevent mission creep, fragmentation of its agenda and a focus on routine matters.

The Taskforce would conduct its own monitoring and analytical work, drawing on intelligence provided by participating agencies. It would conduct joint operations, drawing on the powers, resources and capabilities of these agencies. It would also prepare prosecutions, working with the relevant Commonwealth and State authorities. Depending on the matter involved, it would include state agencies and work closely with similar bodies from other countries. Where possible, the Taskforce should work closely with private sector organisations, including industry groups, unions and academic and other experts.

The Taskforce would be modelled on the SFCT, but have a permanent secretariat and dedicated funding. Over time, the Taskforce would develop a core of expertise and a continuity of focus which would, ideally, strengthen its effectiveness. It would obviate the need for free-standing, issue-specific reviews which can be resource intensive and, by definition, lack institutional memory. After five years, the Taskforce should be subject to an independent evaluation.

An alternative option would be to expand the scope of the SFCT to deal with a wider range of black economy issues. Participants have told us that they are happy with how the SFCT operates. The Taskforce's existing focus is on financial crime, but there are potential synergies with the non-financial cases a reformed body would focus on. This option would have the additional benefit of not creating a new body. To accommodate this change, the membership of the Taskforce would have to be expanded, given that key agencies with an interest in the black economy are not members of the SFCT.

After consulting with regulators and the law enforcement community, we have opted against establishing a new agency like the UK's Serious Fraud Office. A new agency's legislative mandate, powers and staff would, in effect, need to come from existing departments and enforcement bodies. Reaching agreement on this series of transfers would necessarily be difficult and contentious and could take a number of years to settle. When finally established, the new body might operate in a siloed manner as it seeks to establish itself.

A Taskforce model, which has proven successful in Australia, operates differently. Rather than supplanting existing agencies, it brings them together for a specific, mutually-agreed purpose. Agencies' data, staff, powers and operational capabilities are shared or pooled, which helps breakdown siloes and fragmentation of effort. This is not only cost effective, making the best use of existing resources, but fosters collaboration and innovation.

### ***Recommendation 16.3: Ombudsman's office and hotline***

The creation of a Black Economy Ombudsman's Office and hotline.

#### ***Description***

We recommend the establishment of a Black Economy Ombudsman's Office to deal with public allegations. This person would be the public face for efforts to counter the black economy and accordingly have a high-profile and play a proactive role both within and outside government.

This would host a single, black economy hotline. A number of hotlines already exist in this area, but often these are not effective. They are linked to particular agencies, whereas serious black economy allegations often cut across multiple policy areas, including immigration, workplace relations, human services and tax. They do not always offer non-English language services. People who call them are sometimes denied anonymity. As a result of privacy restrictions, they are typically not told of any follow-up action taken. Public reporting on the performance of hotlines is poor.

To be effective, the hotline we propose would: (a) triage incoming calls, referring them to the right agency, (b) report to complainants on follow-up action taken, and (c) where possible, publish information on these responses.

This would ideally replace the plethora of existing agency hotlines, with the exception of the National Security Hotline. A public information campaign would be necessary to support this change and make clear what kinds of concerns it will cover. The Ombudsman would work with non-government groups, including Crime Stoppers, who receive public tip-offs.

The Ombudsman could also play a public role, helping to raise community awareness about the black economy's risks and costs. The Ombudsman would be a conduit for leading-edge private sector approaches and thinking, including the use of data and application of emerging analytics and smart technologies. It would also engage directly with community groups, seeking to build trust with them.

The Ombudsman would adopt the kind of consultative and collaborative approach the Black Economy Taskforce has. This Office must be highly visible to the public, as open as possible in its communication and easy for anyone to approach and make contact with.





# APPENDIX 1: BUSINESS REGULATORY STATEMENT

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Business representatives have played a crucial role in the work of the Taskforce. The Small Business and Family Enterprise Ombudsman, BCA, AIG and COSBOA participated in our private sector Reference Group. We have consulted businesses widely, including through our national roadshow. This engagement has substantially shaped this Report's analysis and recommendations.

We have consistently argued that our responses to the black economy must avoid raising regulatory burdens, which in many cases only push businesses and individuals into the black economy. It is possible to both relieve needless regulatory burdens and, at the same time, better target those who are doing the wrong thing. Agencies should adopt risk-based approaches in this respect, not one-size-fits-all. Where there are good policy reasons for regulations, the compliance burden should be no higher than is necessary. More can and should be done to reduce duplication of red-tape requirements.

The following points are worth making.

- Key recommendations in the report will lower red-tape burdens, including the regulatory safe harbour for small businesses which fulfil a set of core compliance activities, the proposed individual identity system and industry-developed, supply chain certification approaches.
- Harmonising government services and operations will reduce the regulatory compliance burden for small businesses by removing points of friction and reducing interactions with government.
- While the expansion of the Taxable Payments Reporting System (TPRS) and the development of a new reporting regime for sharing economy operators will establish new reporting requirement, the Taskforce rejected tougher options for these sectors, including direct withholding. We recommend that sectors which improve their compliance record should be taken off the TPRS. This is consistent with our risk-based philosophy.
- We should recognise the introduction of small regulatory requirements in one sector can reduce compliance burdens in other parts of the economy. When suppliers make the effort to comply with certification standards, for example, firms and individuals who deal with them do not have to separately check their credentials.

Additionally, digitisation of businesses, particularly small businesses, entails an initial cost but promises to lower regulatory burdens over time. We appreciate the importance of our recommendations being implemented in ways which keep compliance burdens down. As ideas are translated into particular proposals, they can be subject to regulatory creep.

To prevent this from happening, it is important that small business be consulted during the implementation phase. A possible option, in this regard, would be for the Government to appoint a high-level panel of small business representatives for this purpose.

This panel should be chaired by the Australian Small Business and Family Enterprise Ombudsman and its membership should include state and territory Small Business Commissioners and relevant small business industry association representatives. Its role will be to highlight to government departments relevant small business considerations and the impacts arising from the implementation of measures, with a goal of ensuring measures are implemented without imposing unnecessary compliance burdens.

# APPENDIX 2: THE WORK OF THE TASKFORCE

The work of the Taskforce started with an influential Board of Taxation project. The Taskforce was a close partnership between government agencies and the private sector and was led by an independent chair. It was supported by a secretariat from the Commonwealth Treasury including secondees from the ATO.

The views of the Taskforce have been shaped through significant consultation with the general public and the private sector. This has involved a national roadshow, bilateral meetings, a public consultation process, with an Interim Report and a Consultation paper and two rounds of submissions.

## *Interdepartmental Committee and Reference Group*

### *Interdepartmental Committee*

This comprised 20 Australian Government agencies, representing the key policy departments and regulatory authorities relevant to the black economy. It held ten meetings, ensuring that the Taskforce incorporated the views and experiences of the public sector and that it was well-integrated with other related processes.

**TABLE A2.1: INTERDEPARTMENTAL COMMITTEE MEMBERS**

AGENCY		
Treasury	Australian Transactions Reports and Analysis Centre	Department of Industry, Innovation and Science
Australian Taxation Office	Board of Taxation	Department of Prime Minister and Cabinet
Attorney-General's Department	Department of Education and Training	Department of Social Services
Australian Competition and Consumer Commission	Department of Employment	Digital Transformation Agency
Australian Federal Police	Department of Finance	Fair Work Ombudsman
Australian Prudential Regulatory Authority	Department of Human Services	Reserve Bank of Australia
Australian Securities and Investments Commission	Department of Immigration and Border Protection	

### *Reference Group*

The Private Sector Reference Group included a range of associations, representing key stakeholders, including from the small business community, key industries and public policy research bodies. The

Reference Group held ten meetings, chaired by Michael Andrew, and was integral in the development of recommendations and drafting of the Report.

**TABLE A2.2: REFERENCE GROUP MEMBERS**

<b>Organisation</b>	<b>Meetings attended</b> (total held: 10)	<b>Representative</b>
Australian Bankers' Association	8	Tony Pearson
Australian Industry Group	9	Innes Willox Julie Toth Peter Burn
Australian Retailers Association	7	Russell Zimmerman Heath Michael
Board of Taxation	7	Karen Payne
Business Council of Australia*	2 (of 2)	Lisa Gropp Pero Stojanovski
Chartered Accountants Australia and New Zealand	10	Michael Croker Susan Franks
Council of Small Business Australia	8	Peter Strong
Grattan Institute	2	John Daley
Housing Industry Association	9	Shane Goodwin Kristin Brookfield
Institute of Public Accountants	8	Tony Greco
PricewaterhouseCoopers	8	Peter Calleja Malcolm Shackell
Recruitment & Consulting Services**	4 (of 6)	Charles Cameron
Small Business and Family Enterprise Ombudsman	10	Kate Carnell AO Anne Scott Craig Latham James Strachan
Tax and Transfer Policy Institute	5	Miranda Stewart

\*Business Council of Australia joined on 7 September 2017

\*\*Recruitment & Consulting Services joined on 23 May 2017

## CONSULTATION PROCESS

### *National Roadshow*

The Chair of the Taskforce began a national roadshow on 30 May 2017. The roadshow events comprised both public forums and industry roundtables which were open to all members of the public and local business community.

These events provided the opportunity for individuals and businesses to directly communicate to the Chair their perspectives on the issues and factors that contribute to the black economy, including those specific to their local area. Over 300 people attended these events.

**TABLE A2.3: NATIONAL ROADSHOW DETAILS**

Location	Date
Perth, WA	30 May 2017
Sydney, NSW	5 June 2017
Bathurst, NSW	6 June 2017
Mildura, VIC	14 June 2017
Hobart, TAS	15 June 2017
Melbourne, VIC	20 June 2017
Adelaide, SA	27 June 2017
Brisbane, QLD	29 June 2017
Gold Coast, QLD	30 June 2017

### *Bilateral meeting program*

The Chair of the Taskforce conducted a lengthy series of bilateral consultations with a wide range of business, community, government and academic representatives. These engagements provided opportunity for the Taskforce to gather the knowledge and perspectives of a wide range of business leaders and senior government officials. They also provided valuable insights into the likely impacts and potential implementation issues of the recommendations under consideration by the Taskforce.

The broad scope of this meeting program highlighted the links that the black economy has across issues of law enforcement, highlighted how new methods of business and employment are changing the economic landscape and illustrated how technology can be used to better address black economy risks.

The bilateral meeting program has been ongoing throughout the life of the Taskforce. In total 144 bilateral meetings were held. The following lists the main organisations that the Chair held bilateral meetings with.

**TABLE A2.4: BILATERAL MEETING PARTICIPANTS**

<b>ORGANISATION</b>		
Apple	Convenience and Mixed Business Association	Master Painters
Arnold Bloch Leibler	Council of Small Business Australia	MGA Independent Retailers
Attorney-General's Department	CPA Australia	Migrant Workers' Taskforce
AUSTRAC	CrimeStoppers	Motor Trades Association
Australia Post	Crown Casinos	NAB
Australian Bookmakers Association	Deliveroo	National Farmers' Federation
Australian Border Force	Department of Employment	National Seniors
Australian Chamber of Commerce and Industry	Department of Immigration and Border Protection	NSW Police
Australian Council of Social Service	Department of Industry	NSW Small Business Commissioner
Australian Council of Trade Unions	Department of Prime Minister and Cabinet	Office of Australian Information Commissioner
Australian Criminal Intelligence Commission	Department of Treasury and Finance, NSW	PayPal
Australian Federal Police	Department of Treasury and Finance, Victoria	Personal Risk Management
Australian Finance Industry Association	Digital Transformation Agency	Pitcher Partners
Australian Hairdressing Council	eBay	PPB Advisory
Australian Hotels Association	Eftpos	Property Council of Australia
Australian Institute of Company Directors	Fair Work Ombudsman	PriceWaterhouseCoopers
Australian Local Government Association	Federal Court of Australia	Racing Australia
Australian Logistics Council	Financial Services Council	Recruitment & Consulting Services Australia
Australian Retailers Association	FinTech Advisory Board	Reserve Bank of Australia
Australian Securities and Investments Commission	Flying Solo Micro Business Community	Restaurant and Catering Association
Association of Superannuation Funds of Australia	Hair and Beauty Australia	Seek (Sidekicker)
Australian Taxation Office	Housing Industry Association	Small business and Family Enterprise Ombudsman
Automotive Dealers Association	IMK Accountants	Splend

## ORGANISATION

BDO	Independent Contractors Association	Spotless Group Holdings
Board of Taxation	Inspector-General of Taxation	Tabcorp
Bunnings	Institute of Certified Bookkeepers	Tax Institute of Australia
Business Council of Australia	Jaguar	Tax Practitioners Board
CarSales.com	Just Work Alliance	UBS
CBA	Knowledge Shop	United Voice
Cbus Super	KPMG	Victorian Chamber of Commerce and Industry
CFMEU	Law Council of Australia	Victoria Police
Clubs NSW	LendLease	Visa
Commonwealth Director of Public Prosecutions	Master Builders Association	
Consumer Action Law	MasterCard	

### *Public submission process*

The first round of submissions commenced on 19 January 2017 when the Minister for Revenue and Financial Services invited the public to make initial submissions to the Taskforce. Twenty-three initial submissions were received. These submissions, along with bilateral meetings with the Chair, helped inform the Taskforce's Interim Report.

The Interim Report was released on 9 May 2017. At this time the public was invited to make submissions on the recommendations and policy options outlined within. In addition, on 2 August 2017, the Chair released a Consultation Paper highlighting a number of additional issues and ideas that had been raised during the roadshow and bilateral consultation processes. Again, public views on these ideas were requested.

The public submission process closed on 14 August 2017. A total of 149 submissions were received.

The submissions were broadly supportive of the work of the work of the Taskforce and the proposals that had been presented in the Interim Report. The following illustrates the themes and ideas that were most commonly supported.

- Broader acceptance and reduced costs for non-cash payment methods to assist moving towards a near non-cash economy (including the introduction of an economy wide cash payment limit).
- Government agencies should engage more widely in data sharing.
- A stronger business identity and registration system is needed.



- There is a need for an increase in visible enforcement by regulators.
- Education and a focus on social norms is needed.
- Sham contracting and phoenixing have to be addressed.
- Improved reporting, including expansion of the Taxable Payments Reporting System (TPRS), will address the black economy.
- Compliance costs and regulatory complexity drives the black economy.

There was also a range of submissions suggesting a wide variety of changes to the tax mix.

There were very few submissions which were against measures or issues presented by the Taskforce. There were no clear trends across submissions showing disagreement with any single measure. The small number of submissions that did not support a measure was, in general, far outweighed by submissions which did support the measure. See Appendix 3 which sets out the issues raised in submissions and how many times they were raised.

### ***Other Taskforce activities***

Beyond the broad public and private consultation process outlined above the Taskforce undertook a number of other significant streams of work in developing this report.

One of the core activities undertaken within the Taskforce was the development of a number of working groups structured in line with the five policy building blocks identified in the Taskforce's interim report. The main purpose of these working groups was to identify and evaluate possible proposals and solutions that could address black economy risks in Australia.

To ensure a diverse range of views and the expertise of subject matter experts was captured and used to inform the development of recommendations, these working groups comprised a wide mix of Government, private sector and academic community representatives. The broad membership of these working groups meant the ability of proposals to deliver desired outcomes, implementation issues, unintended consequences and alignment with existing or ongoing processes could be identified and considered in developing recommendations.

The secretariat examined international best practices, academic literature and the experiences of a range of foreign Government regulators to assist work streams in developing and evaluating recommendations.

The Secretariat met with stakeholders and experts on black economy measurement issues, including the Australian Bureau of Statistics, the Australian Taxation Office tax gap team and the tax gap expert panel, Treasury, and the Australian Criminal Intelligence Commission. We also consulted on these issues with the SFCT and AUSTRAC.

# APPENDIX 3: SUBMISSIONS

## SUBMISSIONS ON INTERIM REPORT AND CONSULTATION PAPER

TABLE A3.1: NUMBER OF SUBMISSIONS

Submissions	Number
Total submissions	149
Submissions from an association, organisation, or identified business	78
Submissions from an individual	71
<i>Submissions with information referred to ATO Tax Evasion Referral Centre</i>	5
<i>Submissions about the technology or information technology product solution offered by the submitter</i>	7
<i>Out of scope non-referrable submissions</i>	4

### Issues raised in submissions

Below are the issues raised in submissions and in how many submissions they were raised.

- First is a table of the proposals supported or other proposals or issues raised with supportive comments.
- Second is a table of the proposals not supported or other issues raised with non-supportive comments.

TABLE A3.2: PROPOSALS SUPPORTED

Proposal/issue	Number
<b>Payment system (banknotes covered separately)</b>	
• Facilitate easier acceptance of non-cash payment/reduce merchant fees	11
• Cash limit (\$10K limit was too high = 2)	9
• Cashless society	8
• Require all business to accept electronic payment	7
• Government should be cashless	2
• Tax incentive or government funding for merchants taking up card/electronic payment	2
• Near cashless would reduce pressure to pay cash wages	1
• Regulate digital currencies	1
• Ban surcharging card transactions in high-risk industries like restaurants and cafes	1
• Require cashless payment in high-risk industries	1
• eftpos has rolled out 'tap and go' debit payment system to 70% of terminals and will complete roll out by year's end (debit lower cost to merchants)	1
• remove/disallow minimum electronic spend limits	1
• promote electronic payment of bills	1
• Government should champion electronic payment in public transport, including use of any contactless payment card/phone (trials underway)	1

Proposal/issue	Number
• No-frills debit card, if subject to equal regulatory treatment as existing cards	1
• New Payments Platform message standard should include ABNs	1
	<b>Total : 49</b>
<b>Reporting</b>	
• TPRS expansion (whole economy/staggered/1 x owner builders)	13
• Whistleblower reforms (protection and compensation of whistleblowers = 1)	6
• Extend AML reporting to accountants, lawyers, high value traders (1 x extend to all high value transactions)	5
• Expand withholding/withholding more effective than reporting	4
• Beneficial ownership (public register = 2, unstated either way = 1)	3
• Require a receipt for all transactions	3
• Asset audits; 1 each of: (i) on wealthy, (ii) declare assets and liabilities on tax return, (iii) all people at one or two points in life to compare against reported income	3
• Expand government third party reporting to all of government	1
• Adopt tax transparency code	1
• Certificates of compliance issued by tradespeople should show the amount charged and should be auditable by the ATO	1
• Audit and trace all horticulture exports to address cash-in-hand purchases from farmers by overseas business on tourist visas	1
• Daigou — use pseudoephedrine approach for products popular with Daigou	1
• Require people to swipe a bank card even when paying cash	1
	<b>Total : 43</b>
<b>ABN/ABL/Identity</b>	
• Business registry modernisation including business identity/director identity/ABN reforms/ABL	16
• Robust real time business ID and verification	2
• Mandate minimal level of understanding and acumen in applying for an ABL	1
• National digital personal identity	5
• Fit and proper	3
• Annual renewal of ABNs	2
• Displaying ABNs	1
• New business should know their obligations	1
	<b>Total : 31</b>
<b>Various government activities</b>	
• More work with industry associations and partnerships, unions, including intelligence gathering	7
• Harmonise regulation/reporting: eg, national business licencing system (presumably trade licences etc), national workers' comp, national payroll tax, employee/contractor	6
• One stop government shops for small business/regional offices	6
• Cross government activity required	5
• Working cross boarders	3
• Licence all trade industries, including hair salons, barbershops	1
	<b>Total : 28</b>
<b>Data/information sharing</b>	
• Data sharing reforms (free/wider data sharing between agencies) supported	13
• Data use/analytics capability improvement — including automation of prompts to taxpayers	4
• National Criminal database	4
• Commonwealth should have access to state asset registers like land titles	1
• Faster easier sharing of bank data with government	1
• Tax compliance data should be public	1
	<b>Total : 24</b>
<b>Procurement/supply chains</b>	
• Government procurement proposal (expand to employment standards = 1)	12

<b>Proposal/issue</b>	<b>Number</b>
• Improved payment times/terms	3
• Ethical supply chains/supply chain transparency	2
• Commonwealth procurement rules should require various matters to prevent human trafficking in the supply chain	1
• Require specified organisations to make public reports on their supply chains and the measures they take to ensure no human trafficking or slavery	1
	<b>Total : 19</b>
<b>Enforcement</b>	
• Fund/increase ATO activities (and one noted Average Staffing Level caps should be removed) – more and more visible enforcement	12
• More enforcement, tax, fair work or otherwise	2
• Need to tackle large companies not paying enough tax as well	2
• Markets are a problem	1
• WRE widely abused	1
	<b>Total : 18</b>
<b>Electronic payment of wages and contractors/suppliers</b>	
• Deny deductions for unreported cash wages and contractor payments	9
• Mandate electronic payment of wages for all	4
• Mandate electronic payment of wages by government and (presumably large) corporations	1
• Mandate electronic payment by business of their suppliers over \$200	1
	<b>Total : 15</b>
<b>Social norms and Education</b>	
<i>Social norms</i>	
• Social norms campaign	6
• Naming and shaming	2
<i>Education for small business</i>	
• On tax and regulatory obligations — trades, VET, high school	9
• Induction to taxation for new ABN holders	2
• Tax literacy training for small business, non-compulsory free and online	2
• New to business education visits	1
• Marketing campaign on penalty and offence for not meeting tax obligations	1
• Financial literacy	1
	<b>Total : 24</b>
<b>Visa/migrants/vulnerable workers</b>	
• Amnesty, limited use of	6
• Student visas an issue — abolish work limits (and replace with a check on student's educational engagement = 1)	2
• Monitor visa schemes for particular vulnerabilities to human trafficking and slavery	1
• Make information available to working visa holders when they enter Australia on working rights	1
• Increase ease of workers recovering unpaid wages	1
• Provide various assistance for migrant, refugees and CALD to enter legal employment, various	1
	<b>Total : 12</b>
<b>Prosecutions/penalties/offences</b>	
• Increase penalties	4
• Prosecutions	2
• Strict liability offences (suggestion use for large cash payments = 1)	2
• Specialist tax tribunal	2
• Reverse onus of proof that large amounts of cash legitimately obtained	1
• Expand unexplained wealth scheme	1
• Offence to advertise jobs below award wages	1
	<b>Total : 13</b>

<b>Proposal/issue</b>	<b>Number</b>
<b>Phoenixing</b>	
• Addressing Phoenixing (including support for a DIN from various)	11
<b>Regulatory Burden</b>	
• Cost of compliance/regulatory complexity a driver	10
<b>Sham contracting</b>	
• Sham contracting a problem	8
• Contractors working mainly for one company should be treated as employees	1
• Restore Prescribed Payments System to address sham contracting	1
• PSI rules: review/better enforcement	1
	<b>Total : 11</b>
<b>Digital business</b>	
• Tax or other incentive to go fully cashless and digital	5
• Going digital — business and government, such as supply chains, eInvoicing, New Payments Platform	1
• Link POS to revenue authority	3
• Encourage development of FinTech	1
• Supports Single Touch Payroll	1
• Make it compulsory for business to open a business bank account	1
	<b>Total : 12</b>
<b>Banknotes</b>	
• Replace all bank notes and put a use by date on the new ones, not accept the old as legal tender/track via serial numbers or use by date	3
• Withdraw \$100 from circulation	3
• Track all \$100 notes	1
• Implant notes so can be found in international baggage	1
• Offence to hold foreign currency notes above a threshold	1
	<b>Total : 9</b>
<b>Labour hire</b>	
• Labour hire reforms (including national licence/accreditation/sector specific licencing)	8
• Cash-in-hand rife in security industry labour hire arrangements	2
	<b>Total : 10</b>
<b>Sharing economy</b>	
• Sharing economy reporting regime, including covering offshore platforms	7
• Gig workers should be covered by Fair Work Act	1
• Sharing economy workers are employees	1
	<b>Total : 9</b>
<b>Institutional legacy</b>	
• Institutional legacy, whole-of-government approach supported	4
• National cross agency black economy taskforce required	1
	<b>Total : 5</b>
<b>Gambling</b>	
• Non-cash gaming	3
• Gambling — transaction/payment block and website blocking non-compliant wagering services	2
	<b>Total : 5</b>

Proposal/issue	Number
<b>Tax mix changes</b>	
• Increase consumption taxes (black economy participants eventually spend the money) and lower income tax (such as GST should be 15%)	4
• Reduce GST threshold (to zero = 1)	2
• Remove payroll tax	2
• Remove income tax and increase other better controlled taxes	1
• Limited deduction for home renovations with a valid receipt/tax invoice	1
• PAYGW taxpayers are the backbone, pay them a yearly bonus for paying correct amount	1
• CGT residence exemption should only apply after 5 years to capture buy-renovate-sell	1
• Remove all existing taxes and replace with tax on deposits, withdrawals and loans	1
• Remove all existing taxes and replace with a 2% tax on all changes in ownership	1
• Reduce income tax to reduce incentive to black economy participation	1
• Reduce income tax and increase land tax	1
• Reduce income tax rate to 25% for business	1
• Broad base low rate tax system required	1
• Introduce a turnover tax	1
• Review tax rates to maximise tax take with minimum dead weight loss	1
• Withholding tax for real estate deals with non-Australian residents	1
• Charge GST on ATM withdrawals	1
• Cash withdrawal tax for large cash withdrawals	1
• Minimum tax assessment	1
	<b>Total : 24</b>
Illicit tobacco: rationalise penalties and offences, national strategy, fund ABF Strike Team, single agency responsible	3
Tax Agents: deal with unethical, incompetent or work overloaded agents	2
Consumer participation a problem (consumer penalties = 1)	2
Hobby/business bright line	1
Private sector should apply a fit and proper test broadly, like credit checks	1
Adopt recommendations from Government's cross agency report into superannuation non-compliance	1
Restaurants pretending to be charities	1
Lower deeming rate for pensions so less \$100 kept under the bed	1

TABLE A3.3: PROPOSALS NOT SUPPORTED

Proposal/issue	Number
Reverse onus	5
Specialist tax tribunal	3
Cashless society	3
Strict liability	3
Minimum tax assessment	3
Non-cash payment of wages	3

Proposal/issue	Number
Australian Business Licence	2
Loss of consumer protections	2
Removing \$100 note	2
Reduced tax privacy	2
Biometrics	2
Cash limit	1
Expiry date on currency	1
Compulsory trade tax literacy education	1
Increase penalties	1
Test to get an ABN	1
Expanding TPRS further in building and construction, but did favour expanding to other industries	1
Tax and regulatory burden as a driver (rather, it's greed)	1
Card payment system Interchange regulation	1
Funding ATO	1
More, and more visible, enforcement	1
Employee/contractor bright line	1
Non-deductibility of unreported cash payments to contractors (silent about non-deductibility for unreported cash wages)	1
Withholding	1
Sham contracting	1
Lower GST threshold	1
Banning encrypted phones	1
Use of proxies	1
Requiring vendors to disclose cash-paid renovations	1
Changing rules around Tax Agent behaviour (rules enough as is, not enough funding for enforcement)	1
Name and shame	1
New agency to deal with black economy	1

## INITIAL SUBMISSIONS PRE-INTERIM REPORT

**TABLE A3.4: NUMBER OF PRE-INTERIM REPORT SUBMISSIONS**

Submissions	Number
Total submissions	23
Submissions from an association, organisation, or identified business	8
Submissions from an individual	15
<i>Submissions with information referred to ATO Tax Evasion Referral Centre</i>	1
<i>Submissions about the technology or information technology product solution offered by the submitter</i>	1

### Issues raised in submissions

Below are the issues raised in submissions and in how many submissions they were raised.

**TABLE A3.5: PRE-INTERIM REPORT SUBMISSIONS**

Proposal/issue	Number
<b>Cash</b>	
• Don't phase out \$100	2
• Restrict use of cash	1
• Don't impose limits on cash transactions	1
• Eliminate cash	1
• Cashless will not work	1
• Make it unlawful to operate a cash only business	1
• Increase audits on cash only business	1
• Incentive to transition away from cash	1
• All businesses that accept cash should register with the ATO and display their registration details in public	1
• Get banks to report to Government if ratio of cash to electronic payments exceed industry benchmarks	1
	<b>Total : 11</b>
<b>Electronic payment</b>	
• Mandate electronic payment	2
• Encourage electronic payment as increases traceability, transparency and security	3
• Wages in retail sector should only be deductible if paid electronically	1
• B2B transactions in construction industry should only be deductible if paid electronically	1
• Cash-in-hand wages a risk	1
	<b>Total : 8</b>
<b>POS/records</b>	
• Require electronic POS connected to ATO	1
• Require retailers to upload daily sales data	1
• Require certified POS in high-risk industries	1
• Require electronic record keeping	1
	<b>Total : 4</b>



Proposal/issue	Number
<b>Reporting</b>	
• Expand TPRS to other industries	2
• Increase frequency of current TPRS reporting in construction industry	1
• Improve reporting of B2B transactions	1
	<b>Total : 4</b>
<b>Data sharing/analytics</b>	
• Better across all government	2
• Improve government data analytics capability	1
• Single reporting point for employee information across Federal and State government (which would require data sharing)	1
	<b>Total : 4</b>
<b>Undeclared income problem areas</b>	
• Paying below award undeclared wages in certain ethnic communities	1
• Undeclared tips in retail sector	1
• Undeclared rental income	1
• Cash-in-hand wages	1
	<b>Total : 4</b>
<b>Social norms and education</b>	
• Social norms change	1
• community education and tax education at schools	1
• Educate consumers on risks of paying cash for trades work	1
	<b>Total : 3</b>
<b>Consumers</b>	
• Penalise/deny protections to consumers who do not hold a tax invoice	2
• Offer a 10% tax rebate to householders who obtain receipts and for trades work and submit them to ATO	1
	<b>Total : 3</b>
<b>Sharing Economy</b>	
• Base hobby-business distinction for sharing economy on a threshold amount	1
• Impose withholding	1
• Education	1
	<b>Total : 3</b>
<b>Withholding</b>	
• Expand withholding at source to contractors	1
• Introduce a domestic B2B PAYGW system	1
	<b>Total : 2</b>
<b>Funding</b>	
• Increase ATO funding for enforcement	1
• Ensure AUSTRAC funded appropriately to handle the volume of data it receives	1
	<b>Total : 2</b>
<b>Tax mix</b>	
• Tax money going in and out of bank accounts at 10%	1
• Tax cash withdrawn or deposited at 30%	1
	<b>Total : 2</b>

Proposal/issue	Number
<b>Require certain documentation</b>	
• Contractor compensation and public liability claims to require valid tax invoice	1
• Landlord rights to be conditional on having a valid ATO tax compliance certificate	1
	<b>Total : 2</b>
Require renewal of ABNs	1
Amnesty	2
Ban sales suppression technology	1
Harmonise definition of employee across Federal and State government, with a single reporting point	1
Measure and publish tax gap	1
Director Penalty Notices should apply to Superannuation Guarantee and GST	1
Simplify employee-contractor distinction	1
Online gambling needs to be account based to facilitate proper reporting and monitoring and subject to the ISP and 'financial payment blocking' measures	1
Change law to reduce illicit tobacco	1
Current laws sufficient	1



# APPENDIX 4: THE INDEPENDENT CHAIRMAN

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## MICHAEL ANDREW AO

Michael Andrew AO is the Chair of the Board of Taxation. The Board of Taxation is a non-statutory advisory body charged with contributing a business and broader community perspective to improving the design of taxation laws and their operation.

Mr Andrew was Chairman and CEO, KPMG International from May 2011 to July 2014. He is the first Australian CEO of one of the “big four” accounting firms and the first to be based in the Asia-Pacific region. A partner in KPMG since 1988, Michael practiced in Tax Law and was Partner in Charge of KPMG Tax Practice from 1995-2000 and Partner in Charge of KPMG International Tax Centre in Amsterdam from 1992-1994. Michael was Chairman of KPMG Asia-Pacific and Chairman, KPMG Australia from 2007 until 2011.

Mr Andrew was the Chair of the Australian B20 Working Group on Anti-Corruption and Transparency and a member of its Global CEO Forum. He was also a member of the Business Council of Australia and the International Business Council of the World Economic Forum.

Mr Andrew has a degree in Law and Commerce from Melbourne University. He is a qualified legal practitioner of the Supreme Court of Victoria and Fellow of the Institute of Chartered Accountants. He was recently awarded an Honorary Doctor of Laws by Monash University and an Honorary Doctor of Commerce by Melbourne University.

He is Chairman of the Australian Prostate Cancer Centre, Treasurer of the Melbourne Cricket Club, and a board member of Racing Victoria and Good to Great Schools Australia.

In January 2016, Mr Andrew was appointed an Officer of the Order of Australia for distinguished service to the accountancy profession, and to a range of business, anti-corruption, finance and community organisations. Mr Andrew was appointed Chair of the Black Economy Taskforce in December 2016.

He has undertaken this role for no remuneration.

Mr Andrew thanks the Secretariat for their work.



# APPENDIX 5: ACRONYMS

TABLE A5.1: ACRONYMS USED IN THE REPORT

Acronym	Meaning
ABF	Australian Border Force
ABL	Australian Business Licence
ABN	Australian Business Number
ABR	Australian Business Register
ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACIC	Australian Criminal Intelligence Commission
ACN	Australian Company Number
ACNC	Australian Charities and Not-for-profit Commission
ADI	Authorised Deposit-taking Institution
AFP	Australian Federal Police
AGD	Attorney-General's Department
AML/CTF	Anti-Money Laundering and Counter-Terrorism Financing
APSI	Alienation of Personal Services Income
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
ATM	Automatic Teller Machine
ATO	Australian Taxation Office
ATT	Administrative Appeals Tribunal
AUSTRAC	Australian Transaction Reports and Analysis Centre
BAS	Business Activity Statement
BCA	Business Council of Australia
BEPS	Base Erosion and Profit Shifting
BETA	Behavioural Economics Team of the Australian Government
BOR	Beneficial Ownership Registers
BSCI	Business Social Compliance Initiative
CAF	Cleaning Accountability Framework

<b>Acronym</b>	<b>Meaning</b>
CALD	Culturally and Linguistically Diverse
CDPP	Commonwealth Director of Public Prosecutions
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COSBOA	Council of Small Business Australia
DBCDE	Department of Broadband, Communications and Digital Economy
DFAT	Department of Foreign Affairs and Trade
DPN	Director Penalty Notice
DET	Department of Education and Training
CFMEU	Construction, Forestry, Mining and Energy Union
DHS	Department of Human Services
DIBP	Department of Immigration and Border Protection
DIIS	Department of Industry, Innovation and Science
DSS	Department of Social Services
DTA	Digital Transformation Agency
ECB	European Central Bank
ETI	Ethical Trading Initiative
EU	European Union
FATF	Financial Action Task Force
FECCA	Federation of Ethnic Communities Councils of Australia Inc.
FWO	Fair Work Ombudsman
GDP	Gross Domestic Product
GST	Goods and Services Tax
HMRC	Her Majesty's Revenue and Customs
HOSP	Hawala and other service providers
IMF	International Monetary Fund
ISP	Internet Service Provider
KYC	Know Your Customer
NBSI	National Business Simplification Initiative
NCIS	National Criminal Intelligence System
NDIS	National Disability Insurance Scheme

Acronym	Meaning
NDS	National Disability Services
NEIS	New Enterprise Incentive Scheme
NMI	National Measurement Institute
NPII	National Personal Insolvency Index
NPP	New Payments Platform
OECD	Organisation for Economic Co-operation and Development
OFAC	Office of Foreign Assets Control
OH&S	Occupational Health and Safety
PAYG	Pay As You Go
PAYGW	Pay As You Go Withholding
PoCa	<i>Proceeds of Crime Act 2002</i>
POS	Point of Sale
PSC	People with Significant Control
PwC	PricewaterhouseCoopers
RACQ	Royal Automobile Club of Queensland
RBA	Reserve Bank of Australia
RFID	Radio-Frequency Identification
SBFEO	Small Business and Family Enterprise Ombudsman
SFCT	Serious Financial Crime Taskforce
STP	Single Touch Payroll
SG	Superannuation Guarantee
TAA	<i>Taxation Administration Act 1953</i>
TAFE	Technical And Further Education
TFN	Tax File Number
TPB	Tax Practitioners Board
TPRS	Taxable Payments Reporting System
UK	United Kingdom
UN	United Nations
US	United States
VET	Vocational Education and Training



