



Tax watchdog to investigate “heavy handed” use of SME benchmarks by the ATO

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The Inspector-General of Taxation will investigate the taxman's use of controversial tax benchmarks to spot under-reporting of tax after allegations the ATO's use of the benchmarks has been "heavy-handed".

The Inspector-General of Taxation, Ali Noroozi, released the terms of reference for his inquiry yesterday.

The review will consider whether record-keeping requirements expected of small businesses are too onerous, and whether it is fair to use benchmarks as the basis for default assessments.

Benchmarking refers to bands of expected financial performance ratios in which different small businesses are expected to fall. Those who do not are contacted by the ATO and **required to explain the discrepancy**.

The practice is intended to identify small businesses with a turnover of under \$15 million that under report profits or cashflow in order to avoid paying tax.

First introduced in 2009, the ATO has released benchmarks for more than 100 industries, encompassing over 900,000 small businesses. Further benchmarks are planned for release in the coming year.

Noroozi says every business is unique in some way and benchmarks can struggle to recognise this.

"Benchmarks like any rule of thumb may have limitations. We need to understand the extent to which taxpayers are being incorrectly captured and whether resulting compliance action is appropriate."

"It has been suggested that the overall ATO approach in this area can be 'heavy handed', with too much faith being placed in benchmarks," Noroozi says.

"Taxpayers and tax agents have expressed frustration at what they see as an inference by the ATO that their business is just not making enough money."

Principle of MGI Melbourne Sue Prestney says she has no problem with benchmarking, but the process needs to be more precise and efficient.

"It's good that the Tax Office and the Government are trying to keep up with the cash economy," she says.

"After all, people who don't pay tax on their takings are making us all pay more tax. So the idea of clamping down on the cash economy is a good thing, and benchmarking is one way of doing that."

But she says she was concerned with how imperfect classification presented huge compliance costs for otherwise perfectly legal businesses.

As the benchmarks determine bands only according to pre-determined types of businesses, differences due to location, management decisions or specific or unusual business types are not sufficiently taken into account, Prestney says.

"Once you get one of these letters, you have to spend the time to convince the ATO why your business falls outside the benchmark. It's costly, time-consuming, and often a little bit frightening."

"The implication is you're doing something wrong. That can be very intimidating for a small business."

Yasser El-Ansary, tax council at the Australian Institute of Chartered Accountants, welcomed the terms of reference.

"[They're] broad enough to allow the Inspector-General to do a comprehensive piece of work in this area," he says.

"It is important to do this exercise – there's concern among small businesses and their advisors, particularly in those industries targeted, that perhaps use of benchmarking tools by the ATO is being managed in an inappropriate way."

El Ansary says that while he hadn't seen evidence of this first-hand, or heard from any of his members that this was the case, the fact that the use of benchmarks was a new initiative meant it was important to see how the powers were being applied on the frontline.

He says it is important for small businesses to ensure they are keeping good records of transactions.

"Businesses that aren't able to provide the ATO with sufficient source record data that find themselves in a dispute where benchmarks become a factor in the

ATO's decision-making will have to spend time and money trying to negotiate that dispute."

"It can be problematic and extremely costly if not managed well from the outset," El Ansary says.

Submissions to the review are open to businesses that have been audited for benchmark compliance by the Tax Office. They close on February 3, 2012