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# CREDIT ISSUES

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## WOODGATE & CO.

*Turnaround & Insolvency*

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### PRIVACY NO BAR FOR OVERDUE BUSINESS TAX DEBTS

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#### Background

It is difficult to obtain precise statistics of the number of businesses operating in Australia. The Australian Securities & Investments Commission ("ASIC") is responsible for the regulation of companies and collects statistics as to the number of incorporated companies. However, not all companies conduct businesses. Further, partnerships, sole traders, superannuation funds and trusts are not regulated by ASIC. According to the Australian Business Register, administered by the Australian Taxation Office ("ATO"), in March 2017 there were 2.6M entities which had an Australian Business Number ("ABN") and which were registered for Goods & Services Tax ("GST"). Registration for GST is an indication of an operating business. However, the registration threshold for businesses is \$75,000 and \$150,000 for non-profit organisations.

Statistics released by the ASIC for the year ended 30 June 2016 show that taxation authorities are creditors in 87% of corporate insolvencies. Because of Australia's imbalanced tax system, most tax revenue is raised by the Commonwealth Government and hence the principal revenue authority is the ATO. Therefore, the ATO is likely to be a creditor of most businesses, not just companies.

Historically, overdue debts due to taxation authorities have not been

reported to credit reporting agencies, due to privacy concerns. However, the Australian Institute of Credit Management ("AICM") has made representations to Parliament over a number of years to change this policy.

The AICM sees the failure to report overdue tax debts as resulting in a significant gap in the information which should be available to creditors in order to assess credit risk. As the ASIC figures show, the one creditor common to almost all insolvent companies is the ATO.

#### The ATO's debt collection problem

The ATO's annual report for the year 30 June 2016 disclosed the quantum of unpaid taxation debts amounted to \$19B. The small business segment accounted for \$13B (or 65%), of that debt.

Despite different strategies employed by the ATO over a number of years, the small business debt has not materially reduced. Improving tax collections would assist the Commonwealth Government to reduce its significant budget deficit. Further, the debts owed by small business may be understated, due to the non-reporting or under-reporting in a self-assessment system. The ATO has sought to address the debt collection problem by referring overdue debts to mercantile agents and partially automating the process for the

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approval of payment plans.

During the year ended 30 June 2016, the ATO agreed to 950,000 payment plans, which was an increase of 17% over the previous year. We are aware of many companies that enter numerous payment plans with the ATO, before they enter into insolvency administrations. Clearly, to date, the ATO's strategy has not been effective.

### **A novel solution**

The Mid Year Economic and Fiscal Outlook ("MYEFO") released in December 2016 stated that from 1 July 2017 the ATO will be allowed to disclose to credit reporting bureaus the tax debts of businesses that have not "effectively engaged with the ATO to manage [their] debts". The MYEFO did not define what was meant by "effectively engaged". Further, the measure will initially only apply to businesses with ABNs and having tax debts of more than \$10,000, that are at least 90 days overdue.

Treasury expects the measure to realise a modest \$63M of additional revenue over the four year forward estimates period. The costs of implementing the measure is budgeted to be \$27M over the forward estimates period, including \$25M of GST revenue collected and paid to the States and Territories.

### **Credit reporting bureaus**

Credit reporting bureaus are important in any modern financial system, as they enable creditors to consider objective data on the creditworthiness of their customers. The information provided by credit reporting bureaus enables credit to be provided more efficiently and at a lower cost than would otherwise be the case, for both businesses and consumers.

The three major credit reporting bureaus in Australia are Equifax (formerly Veda Advantage), Dun & Bradstreet and Experian Credit Services. Tasmanian Collection Service

operates primarily in Tasmania.

Until March 2014 Australia operated a system of negative credit reporting. Negative reporting limits information on debtors to overdue debts, defaults, bankruptcies, liquidations and/or Court judgments. In addition to such information, positive credit reporting also includes details of current credit accounts, accounts that have been opened and closed, the dates that any default notices were paid and whether repayments made within due dates. The switch to positive credit reporting brought Australia into line with the United States and the United Kingdom.

In this context, the proposal in the MYEFO to provide overdue tax debt information, is consistent with the philosophy of providing more information to credit providers, to enable them to make informed decisions about whom to provide credit and how much credit should be provided, particularly in the small business sector.

### **Likely implications from the proposal**

There are a number of possible consequences arising from the disclosure by the ATO of overdue business tax debts:

1. the ATO expects that businesses will pay their debts to the ATO in a more timely manner, in order to avoid negatively affecting their credit rating;
2. many financiers have loan agreements and/or security documents that require borrowers to pay their tax obligations as and when they fall due for payment. Failure to pay those taxation obligations can give rise to an event of default. An event of default can then result in a financier demanding the immediate repayment of the debt or appointing a Receiver;
3. there may be a decrease in phoenix activity, particularly in the construction industry, as it becomes more apparent which businesses are not paying their tax debts;

4. credit managers may tighten credit terms for customers with overdue reported tax debts, or seek additional third party security such as personal guarantees from directors;
5. in due course, the State and Territories revenue offices, may also commence reporting overdue tax debts to credit reporting agencies.

### **Privacy issues**

Section 355-25 of Schedule 1 of the Taxation Administration Act 1953 (Cth) provides that it is an offence for a taxation officer to disclose protected information of a taxpayer, except in very limited circumstances. It is not apparent that disclosure to a credit reporting bureau is exempt from those restrictions. Therefore, there is a question as to whether the ATO currently has the legal power to make the disclosures set out in the MYEFO.

From 1 April 2017 the Commissioner of Inland Revenue of New Zealand has the power to disclose tax payer's information to approved credit reporting agencies. The disclosure is limited to companies, where the debt is at least \$NZ150,000 or the debt is at least one year old. This required an amendment to the Tax Administration Act 1994 (NZ). It may be that a similar legislative amendment is required in Australia.

### **International experience**

In the United States of America, if a Federal tax debt is unpaid the Internal Revenue Service ("IRS") may file a Notice of Federal Tax Lien, which is a

public document. Whilst the IRS does not directly report the issuing of tax liens, through searches of public records the information quickly becomes available to credit reporting bureaus. During the financial year ended 30 September 2015 (the latest available statistic), the IRS issued 515,000 tax liens, so the effect on credit ratings would have been significant. A number of States and counties also file tax liens for unpaid State and local taxes.

The British Government also announced plans in the 2014 budget to allow for the controlled release of value added tax data from Her Majesty's Revenue and Customs' Service. However, at this stage, the plan has not proceeded.

The disclosure of information to credit reporting bureaus is currently not permitted in either Singapore or Hong Kong.

### **Conclusion**

The disclosure of overdue business tax debts to credit reporting agencies will not result in a significant increase in tax revenue to the Commonwealth Government. However, there are consequences arising from this change in public policy, which may result in an increase in corporate insolvency administrations due to a tightening of credit.

If you are a company director or an advisor to a company concerned about overdue tax debts, do not hesitate to contact Woodgate & Co. for advice.

## **WOODGATE & CO.**

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