The ATO's latest moves

Thursday 22 October 2009

Terry Hayes (**www.smartcompany.com.au**)

Readers of my column will know I've regularly discussed the ATO's use of benchmarks. They give the ATO, and it must fairly be said, SMEs themselves, a window on the performance of a business - to help the ATO in checking on tax compliance, and to help a business compare its performance against industry averages (eg. by providing a measure of various business costs in relation to turnover). They are not a failsafe mechanism for such uses, but they are one of a range of guides that can be used.

The ATO considers that, by developing such benchmarks, it is making clear what it expects from businesses in an industry. It is all part of the ongoing development of more sophisticated tools by the ATO in the drive to ensure compliance with the tax laws.

These benchmarks have been around for awhile now, but the ATO has just recently released more than 50 new small business benchmarks which it says help it to identify non-reporting of cash transactions. The ATO hopes to release a total of 100 benchmarks by June 2010.

The benchmarks

Two types of benchmarks for the small business sector have been developed by the Tax Office:

- *performance benchmarks*, which are based on information small businesses reports to the Tax Office on income tax returns and business activity statements (BASs); and
- *input benchmarks*, which are based on information industry participants and trade associations provide to the Tax Office.

Some 58 benchmarks have so far been released by the Tax Office. They are grouped into categories based on the business industry codes, and include:

- **manufacturing**, eg. bakeries, cake shops;
- **construction**, eg. bricklaying, concrete, electrical, painting, plumbing, roofing, tiling;
- **retail trade**, eg. clothing, computers, florist, furniture, grocery, housewares, newsagents;
- **accommodation and food services**, eg. chicken shops, coffee shops, fish and chips, pubs;
- **transport, postal and warehousing**, eg. couriers, furniture removalists, taxi drivers;
- **rental, hiring and real estate services**;
- **administrative and support services**, eg. building and other industrial cleaning services, pest control;
- **other services**, eg. hairdressing, laundry services.

Performance benchmarks

Performance benchmarks are designed to allow small business owners to compare their business performance with other businesses in the relevant industry. The benchmarks are also designed to assist the owners in checking whether they are complying with their tax obligations, particularly in relation to cash income.

Five ratios are available to help the owners compare and check the performance of their businesses against other businesses in their industry. The ratios are:

- cost of goods sold to turnover;
- labour to turnover;
- rent to turnover;
- GST-free sales to turnover; and
- motor vehicle expenses to turnover.

The ratio ranges will assist business owners to work out whether they fall within or outside the average for their industry, and may also be helpful in identifying how and why their businesses may differ from the industry's average.

Input benchmarks

Industry benchmarks show an expected range of income for tradespeople based on the labour and materials they use. Generally, they apply to small businesses that work with household (domestic) customers rather than commercial customers.

The benchmarks as a compliance tool

Where businesses do not report within the ranges of the benchmarks, the ATO may take that as an indication that the businesses are not recording and paying tax on all of their transactions, especially cash transactions. SMEs should also be aware that comparing a business against the benchmarks for its industry is one of the methods the ATO uses to identify businesses for audit or review.

When the Tax Office selects a business for audit or review, it looks at the actual records of the business to assess whether it has reported all of its cash income. In addition, the Tax Office may use the benchmarks to:

- work out if the business's records are accurate and complete; and
- assist in calculating assessments to determine income tax or GST obligations where the business has provided insufficient or unreliable information.

Obviously, businesses falling outside the benchmarks for a particular industry, particularly on a regular or prolonged basis, are more likely to attract ATO attention. However, the ATO does acknowledge that there is often a reason why a business falls outside a benchmark, eg. the rent paid by the business may be higher than average because it is located in a city centre. In these situations, the Tax Office recommends that the business:

- review its record keeping;
- consider how its business operates;
- check if it has made a mistake on its tax return or not reported all its income. If so, the business should correct the information and advise the Tax Office.

There may be other reasons why a business falls outside its industry benchmark and SMEs need to be aware of this and be able to explain the reason should the ATO issue a query. As I mentioned above, the benchmarks are not a one-and-only test, and the results they produce can be subject to special circumstances that need to be explained.

Concreter pays the penalty

Here is an example of the use of the benchmarks. A Melbourne-based concreter received a tax bill for $115,953 after an audit by the ATO showed he had omitted $142,000 from his tax return.

The ATO said the concreter came to its attention because he had been reporting very low levels of income for a number of years. Apparently, the concreting benchmark helped the ATO understand the taxpayer's business relative to the industry.

During the audit, the concreter said his business was based on smaller suburban work, for which he received very little cash. He said he always issued tax invoices to his customers.

The concreter had declared a taxable income of $18,000 for the year, but had recorded only four concrete purchases during one of the quarters. In an example of how the ATO uses data from a variety of sources (including third parties), data it acquired from the concreter's supplier for that quarter showed 18 concrete purchases some of which were paid for in cash. Further examination by the ATO showed many of his jobs were for cash, they were not recorded in his records, and his customers did not receive tax invoices.

In this case, the ATO auditors formed the view that there was significant unreported cash income and expenses. As they found the taxpayer's record keeping was inadequate, the auditors calculated his income by applying his normal sale price per square metre to his actual purchases of concrete.

The audit resulted in tax liabilities of close to $67,000 and additional penalties of nearly $50,000.

Terry Hayes is the senior tax writer at ***Thomson Reuters****, a leading Australian provider of tax, accounting and legal information solutions.*