Property Commercial Construction

ATO's ticking time bomb of unpaid construction tax bills

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Construction-related businesses have built up a mountain of unpaid tax bills during the pandemic, threatening a wave of failures this year that could take otherwise-healthy creditors down with them, insolvency practitioners warn.

Outstanding debts to the Australian Taxation Office soared [https://www.afr.com/link/follow-20180101-p59lsi] by almost one-third to $58.8 billion last year over the two years affected by the pandemic, while over the same time court wind-ups of businesses – half of which are typically triggered by the ATO – fell by three-quarters.

House of cards? Propping poorly run companies up artificially means they build up debts that may never get paid.

The pandemic has created a dilemma for the ATO, which has tried to help companies through tough trading conditions [https://www.afr.com/link/follow-20180101-p59to2]. In its 2021 annual report the ATO said it collected $11.5 billion in revenue, below its own $15 billion target, for reasons including a "cautious approach to compliance".

But for industries such as building, where ATO enforcement plays a big role in weeding out poorly run companies and supporting the health of the industry as a whole, this was a problem, said John Winter, chief executive of the Australian Restructuring Insolvency & Turnaround Association.

"It is a huge moral hazard issue," Mr Winter told *The Australian Financial Review*. "It provides no mechanism to signal to the market that you shouldn't build up debts you can't pay."
When enforcement resumed, building-related companies would be among the first to be hit, Mr Winter said.

"We all know one of the first places we're going to see a return of insolvency activity is in building and construction," he said.

"That is primarily being driven by the fact that a vast percentage of the deals done in this space are fixed price contracts and we are seeing significant increases in supply chain costs."

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The ATO, which on Wednesday said total debt had risen to $61.4 billion at end-December and collectable debt to $39.9 billion, said it had resumed debt collection activities in ACT, NSW and Victoria after "a general pause" during the lockdowns.

Debt collection would be prioritised for higher-risks clients and those refusing to engage, it said.

"We expect late or non-lodgment penalties and director penalties will be more noticeable in these areas," a spokesman said.

"These activities have continued in areas that were not directly impacted by lockdowns, including SA, WA and Queensland."

Sydney-based interior building specialist Cubic, whose projects included Campbelltown Hospital, went into liquidation in November with debts over $10 million, after suffering labour cost overruns.

Insolvency documents show an ATO claim of $4.6 million against the company, which liquidator Simon Cathro said reflected a tax debt of about $2.1 million in November 2020, which had grown to $3.3 million by December 2021.

"We have identified warning signs that the Cubic Group was neglecting its tax debt, and prioritised its trade creditors ahead of the ATO, from at least June 2020," Mr Cathro said.

Some companies were taking advantage of the ATO's decision to not enforce debts, Mr Cathro added.

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— ARITA CEO John Winter

"Unfortunately this process has been taken advantage of by underperforming companies, who are relying on the ATO as an unofficial source of funding to pay their other liabilities required for day-to-day trading (such as their trade creditors or landlords)," Mr Cathro said.

"Certainly before the pandemic the ATO was starting debt collection much earlier when a company showed signs of distress. Now, it is very uncommon to see any communications from the ATO chasing debt, although there has been a modest increase in recent months."

The ATO is the largest initiator of wind-up actions against companies, normally accounting for more than half of the total.

There were 583 court wind-up actions economy-wide in the December quarter of 2019, a total that sank to just 48 a year later. Among construction-related companies, the figure plummeted to just 10 from 119.

Insolvency numbers – like wind-ups – have picked up from their pandemic lows, but remain well below historical levels.

It's in the interest of the insolvency industry to have a constant flow of work – the drop-off in failures created by support measures such as JobKeeper has ensured slim pickings for corporate undertakers – but propping up marginal companies also has wider implications.

"Capitalism without insolvency is like Catholicism without hell," Mr Winter said. "It keeps businesses honest and makes them actually do what they need to do."

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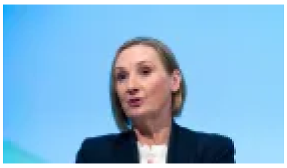
The longer an underperforming business continued to trade, the worse the damage it could leave, Mr Winter said.

"When the underperforming company does fail then the fallout will be greater – leaving behind creditors that will then also struggle and, potentially, also fail. It can be a domino effect," he said.

It also advantaged firms that traded unethically, Mr Winter said.

"If you're in construction firm A and paying right and trading ethically, and construction firm B isn't, they're sitting there racking up an advantage to you," he said.

"They're not paying the ATO, particularly if they intend to phoenix their business. They get this massive advantage to the one that's being honest."



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Mr Winter said enforcement actions were unlikely to pick up again until after the federal election, as the ATO would be under pressure not to send companies to the wall in a way that would create bad publicity for the federal government ahead of the vote.

“Politically it is impossible for them to do it,” he said.

Mr Cathro agreed.

“Commencing enforcement action – especially after sitting idle for so long – could definitely create a bad perception,” he said. “There are still a lot of businesses struggling, and people’s emotions are at an all-time high, so delaying enforcement action could be a strategy.”

The ATO said that was incorrect.

“The ATO is an independent statutory authority and elections have no influence on our administrative approach to debt collection,” the spokesman said.

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