25 May 2023

The Hon Dr Jim Chalmers MP
Treasurer
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Logan Central QLD 4114

via email: jim.chalmers.mp@aph.gov.au; ruth.moore@treasury.gov.au

Dear Treasurer

Pausing Director Penalties to Keep Housing Subcontractors in Business

As you would know, UDIA National is a strong supporter of the Government's housing and economic initiatives. We are also acutely aware of the growing financial hardship that continues to undermine the supply of housing, which in turn is threatening to collapse Australia's small business subcontractor industry.

The supply chain delays, rising cost of materials, COVID-19 shutdowns, lack of skilled labour and construction company failures have created serious cash flow fragility for the industry. It is pushing development and construction small businesses and contractors to the limits of their financial capacity. We are seeing significant signs of stress in the industry – even worse than during the middle of the pandemic – coupled with a rise in the number of Director Penalty Notices (**DPNs**) from the Australian Taxation Office (**ATO**) for unpaid taxes.

Contractor and developer small businesses are trying to keep themselves afloat with the cash available to them and balance payment of due debts. Industry needs a pause before essential businesses break.

The immediate solution is a pause on ATO DPNs as a straightforward measure that will address the critical situation facing building contractors. This approach does not incur any additional expense to Government as it only alters timing of payments. This would be akin to the arrangements in place during the COVID-19 pandemic.

Broad Challenges Impacting Industry

The Australian construction industry has suffered significant challenges since the commencement of the COVID-19 pandemic that have put the financial health of small business and subcontractors under stress. These include:

- **Material and supply chain issues –**
  - Global supply chain disruptions and increased costs of shipping have significantly delayed delivery of necessary goods and equipment, resulting in construction delays impacting all parts of the industry.
  - According to the ABS Producer Price Index series, input costs to house building have grown by 11.4% in the 12 months to March 2023. While the pace of cost increases moderated in the December quarter, overall building material costs have elevated by

32% compared to the pre-COVID level, with all categories of building materials recording significant price increases.

- **Labour and skills shortages –**
  - Border closures, while effective in protecting us during the pandemic, added to the skills and labour challenges that were already being experienced in the construction industry in Australia. Since late 2019, construction vacancies have rose by up to 80% according to the 2022 Arcadis Construction Costs Index Report, with an acute shortage of bricklayers, carpenters, and roofers in recent times.
  - With a significant amount of construction activity happening across the country, boosted by Commonwealth and State investment, and compounded by border closures, the typical labour movement experienced between the east and west coasts did not occur.
  - While there has been a ramping up of skilled visa arrivals into Australia across the last year, the most recent ABS data shows that the volume of permanent skilled workers arrivals for March 2023 (32,240) was 28% below the pre-pandemic level. Temporary skilled visa holders were also down 26% on the long run average.
- **A shrinking pool of builders –**
  - Due to the issues encountered, we have seen numerous building firms and developers struggling and collapsing, including impacted companies such as Caydon, Porter Davis, UrbanEdge Homes, Probuild, ABG Group, Langford Jones, Snowden Developments, Jaxon Construction, New Sensation Homes, Home Innovation Builders, Pivotal Homes, Condev Construction, Waterford Homes, Privium, Hotondo, Lloyd Group, BA Murphy and Pindan Group among others.
  - Pandemic period shutdowns contributed to construction company failures, where works could not be undertaken, delaying revenue generation/cashflow. For example, in some states, work stopped on development projects during the construction industry shutdown in the later months of 2021, as well as during additional restrictions imposed by the state Government's directions regarding COVID-19 safety plans.
  - Government directives around labour capacity on construction sites also had an impact. For example, in some states, capacity was reduced to 25% and then by 50% during October 2021.
  - The flow on effect of these Government driven delays, combined with an overall lack of productivity due to material and labour shortages, and poor weather, led to significant delays on completion (and therefore cashflow) construction projects. These delays eat into overheats and capital, and have ultimately lead to the increased level of business failures already mentioned.

- The clear danger is that following this challenging period, current low housing approval data indicates that many small businesses and subcontractors may go into a period of minimal work.

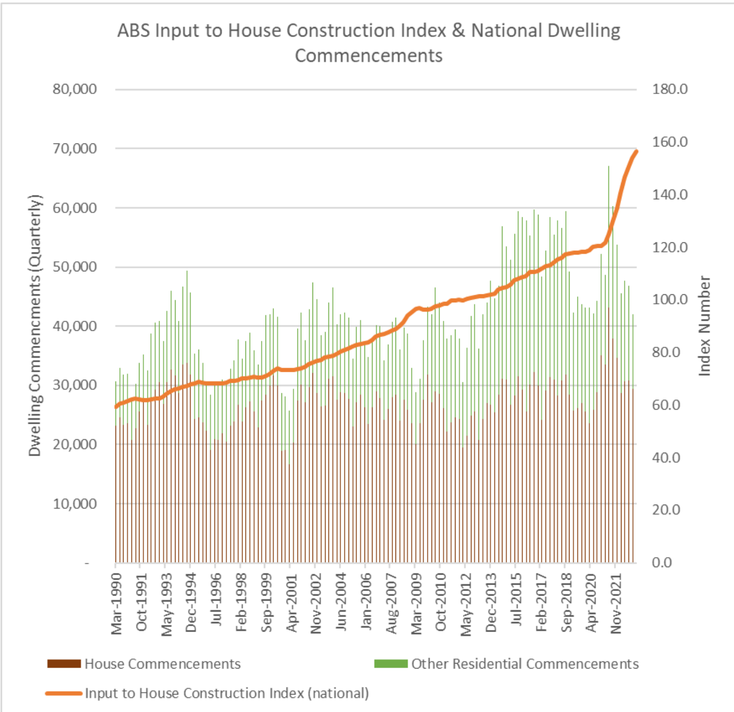
The Impact of DPNs

Company directors are personally responsible for ensuring that the company's tax and super obligations are reported and paid on time. Certain liabilities not paid by the due date, can be recovered personally from current or former company directors.

DPNs trigger director liability for a company's unpaid amounts of "pay as you go" withholding (**PAYGW**), Goods and Services Tax (**GST**), and/or super guarantee charge (**SGC**). Payments are generally required within 21 days and cannot be extended by the company entering repayment arrangements. Response to the DPN requires urgent payment, administration, or liquidation of the company.

In the current environment, small businesses and subcontractors are finding it difficult to make payments in the proposed periods which are not paused by payment plans.

Current financial and construction conditions are unprecedented. Our members are raising concerns that the DPNs currently issued cannot be serviced/paid within the 21-day notice period due to cashflow issues, constrained trading and cost blowouts for materials. While the costs are accelerating, many businesses are unable to commit to projects for fear of agreeing a contract that subsequently becomes unviable. In the December quarter 2022 national dwelling commencements retracted 10% and reflected a 21% decline on a 12-month rolling average.



Source: UDIA; ABS

The ABS produced Input to House Construction Index provides a quarterly assessment of the average material costs required for residential construction. Between March 2021 and March 2023 there has been a 30% escalation of building material costs with an average quarterly growth of 3% which compares to the long-run average quarterly growth of 0.6%.

Currently, the industry is fragile, cash flows are volatile, strength and depth of the contractor (and subcontractor) market is thin. Insisting on payment of these ATO debts risks crippling the construction industry which is effectively trying to trade out of difficulty currently.

The Significance of the Problem

The impact of the problem cannot be overestimated. 85% of the housing delivered each year is built and/or developed by small and medium sized enterprises. Subcontractors, in particular, are relied on by the entire industry to deliver dwellings in an already, tightly constrained supply market. If we lose further small businesses and subcontractors, the housing development capacity of Australia will be deeply compromised for years. Failed business owners rarely return to the industry.

This has a massive flow-on impact on the market because the construction and development industry drives 9% of Australia's GDP, creates 1.3 million jobs (11% of the full time workforce), and generates over $360 billion in economic activity each year. Each dollar spent on property and construction is shared between 40+ trades and businesses, with significant secondary boosts to manufacturing. Every dollar spent on housing generates $2.90 in the rest of the economy including an additional boost to GDP across secondary markets like manufacturing and retail.

A healthy development and construction industry generates continuous gains across the economy and makes the industry an effective primer for economic productivity.

The Simple Solution

UDIA National proposes that DPNs on the construction sector, be paused for a period of 12 to 18 months to enable the industry to stabilise. The pause could be broader to other impacted industries, however, that is a question for you and the ATO.

This would be an arrangement similar the solution in place during the COVID-19 pandemic when the Australian Tax Office suspended most overdue tax collection. This would address the critical situation facing many generally small subcontractors.

This can also be combined with a requirement that the construction business (head contractor / subcontractor) demonstrating improved proficiency to their business skills.

A DPN pause would acknowledge the extraordinary challenges experienced by the construction industry that have been outside anyone's ability to control and avoid unnecessary impacts on housing supply. It will help minimise the impact on housing delivery from further company failures and ameliorate the financial burdens on individual small businesses, subcontractors, their families, and others. It also does not interfere with any other creditor obligations.

Over and above immediate relief for impacted businesses there are numerous flow-on benefits across the industry and economy including:

- Reducing the risk of cascading liquidations or administrations for many companies.
- Minimising disruption to building projects currently underway.
- Avoiding disruption to flow-on suppliers, dependant on building contractors.
- Enhancing cash flow in the industry and third-party industries.
- Avoiding contagion impacts on other companies and individuals.
- Supporting the jobs of people employed by the industry and suppliers as well as ongoing certainty for the apprentices, trainees.
- Providing an opportunity for businesses to pay their liabilities to the government to be met, that might be diminished if companies cease operation.

We are keen to discuss this proposal with you at your earliest convenience.

Please do not hesitate to contact the UDIA National Head of Policy and Government Relations - Andrew Mihno on 0406 454 549 to discuss any aspect of this submission further.

Maxwell Shifman
UDIA National President