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James Mason
Financial System Division
The Treasury
Langton Crescent
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Via email: phoenixing@treasury.gov.au

Dear Mr Mason

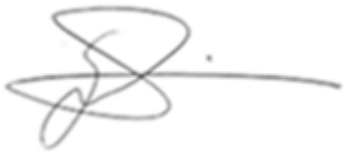
Consultation Paper – Combatting Illegal Phoenixing

CPA Australia represents the diverse interests of more than 160,000 members in 118 countries. We make this submission on behalf of our members and in the broader public interest.

CPA Australia supports coordinated statutory and associated administrative measures to combat illegal phoenixing as a critical element in ensuring market integrity and safeguarding the privilege of incorporation and limited liability. The proposals appear well-targeted and should, if appropriately pursued, provide incremental improvement to Australia's corporate insolvency laws which are, by and large, robust and economically sound.

Our detailed response is provided in the attached appendix. If you require further information on our views expressed in this submission, please contact either Gavan Ord, Manager – Business & Investment Policy, on [redacted] or at [redacted], or Dr John Purcell, Policy Adviser – ESG, on [redacted] or at [redacted].

Yours sincerely



Stuart Dignam

General Manager, Policy & Corporate Affairs

Appendix

General comments on the consultation paper

CPA Australia strongly supports the introduction of appropriate reforms that seek to combat illegal phoenix activity in order to reduce the harm such activity is causing to the community, legitimate businesses and the economy more broadly.

As noted in the consultation paper, one difficulty that will require attention and further consultation is ensuring that legitimate business activity and restructuring is not inadvertently caught and adversely impacted by any reforms.

Response to consultation proposals

1. A Phoenix hotline

A central phoenix hotline is a reasonable suggestion that could assist deterring and detecting illegal phoenix activity if properly implemented.

Development of such a reporting facility will need to be cognisant of proposed amendments to Part 9.4AAA (Protection for whistleblowers) contained in Treasury Laws Amendment (Whistleblowers) Bill 2017 - the Exposure Draft for which was released for public consultation on 22 October.

CPA Australia suggests that success of such a reporting facility can be measured by how many tip-offs it receives and how many of those tip-offs result in action and prosecution by federal and state agencies.

To help achieve such success, we suggest that such a reporting facility should clearly set out to those considering contacting the hotline the type of information that is actionable by regulatory and enforcement agencies.

Further, consideration should be given to how best the hotline can share information with an informant on what action, if any, has come from their information. While we understand the limitations around such a suggestion; not sharing such information may diminish public confidence in the hotline.

The need for such a reporting facility may diminish if there is a freely-available public register listing those that have been declared 'High Risk Phoenix Operator' (HRPO) or have been found guilty of a phoenixing offence.

2. A phoenixing offence

Introducing a specific phoenix offence that prohibits the transfer of property from Company A to Company B if the main purpose of the transfer is to prevent, hinder or delay the process of that property becoming available for division among the company's creditors could assist in deterring and disrupting illegal phoenix activity.

We suggest that consideration could be given to the offence applying to transfers to other types of entities, not just companies.

We support the adaption into the Corporations Act of section 121(1) of the Bankruptcy Act 1966 - transfer to defeat creditors offence and section 121(4) - good faith defence; though we caution the need for considered drafting to appropriately mesh with the existing voidable transaction provisions (Part 5.7B – Division 2), and therein, the various clawback time thresholds (s 588FE and the 'relation-back day').

We support the remedies proposed in the consultation paper, including criminal penalties. We however suggest that the government disclose their preferred position as to the types of civil and criminal penalties that it wishes to impose, including the maximum length of any jail sentence. We suggest that it would be reasonable that these be set equivalent to the insolvent trading offence (s 588G(3)) and the accompanying penalty (Schedule 3 Item 138).

Another remedy for consideration is placing the name and information of a person found to have undertaken illegal phoenix activity (including facilitating such activity) on a freely-available public register.

We agree with the proposed recognition of 'designated phoenix offences' and suggest development along the lines of the presumption of insolvency in s 588E(4) concerning financial records and suggest consideration might also be given to reference to s 1307 (Falsification of books).

We do not consider it necessary in the promulgation of any illegal phoenixing offence to provide a statutory 'signpost' to the officers and employees general duties provisions (Part 2D.1 – Division 1) as this would derogate from the inherent adaptiveness of the latter.

3. Addressing issues with directorships

Limiting backdating of director appointments and resignations

CPA Australia is of the view that this suggestion may contribute to the deterring and disrupting of illegal phoenix activity. In particular, the rebuttable presumption of responsibility in the period between resignation and lodgment of notification would overcome apparent difficulty in proving a de facto director under s 9 (*director*) (b)(i).

The onus for reporting to ASIC changes in directorships should however remain primarily with companies themselves as this is consistent with the thrust of ss 201G and 203A, for example, which treat the company as a legal person having its own powers and responsibilities, though consideration should be given to shifting onus in cases of delay or avoidance.

The action should at first instance reside with ASIC's administrative powers, however as liability potentially ensues under the proposed measure, capacity for seeking the setting aside by a court should be allowed for.

We would suggest that if this proposal is adopted, that it be accompanied by an information and education campaign to reduce the probability of the measure inadvertently impacting otherwise good directors.

Abandoning a company

This suggestion should significantly contribute to the deterring and disrupting of illegal phoenix activity.

The more precise prohibition on resigning without appointing a liquidator or deregistering the company is favoured over developing an offence of abandoning a company which we see as presenting both statutory drafting and administrative challenges.

The government may wish to consider how such a proposed reform could apply in circumstances where a number of directors (but not all) resign, leaving the company without a quorum as per its constitution.

We would suggest that if this proposal is adopted, that it be accompanied by an information and education campaign to reduce the probability of the measure inadvertently impacting otherwise good directors.

4. Restrictions on voting rights

This suggestion may also contribute to the deterring and disruption of illegal phoenix activity, however we see distinct potential risks in some instances of undermining the legitimate rights of related creditors. As such, consideration should be given to development of a basis for seeking the setting aside of any such prohibition or having its application restricted to particular size or type of external administration, or indeed, company.

5. Promoter penalties

CPA Australia is of the view that this suggestion may contribute to the deterring and disrupting of illegal phoenix activity.

One potential issue with option one is that broadening the current scope of the promoter penalty regime to cover 'activities designed to avoid taxation obligations' may result in a significant expansion of the regime and could be used by the ATO to tackle non-phoenixing issues. We would therefore recommend that any expansion of the promoter penalty regime to target phoenix activity be drafted to only focus on this issue and ought therefore to be embodied in the Corporations Act

2001, though within which care will be needed to avoid undue overlapping or conflict with the involvement in contravention rules in s 79.

6. Extending the director penalty notice regime to GST

We support this proposed extension on the basis of consistency with other statutory remittances noting also that the practice of non-compliance to illegitimately fund working capital is often an indicator of insolvent trading.

7. Security deposits

The proposed measures should contribute to both combatting illegal phoenix activity and strengthening the integrity of revenue collection through addressing an apparent anomaly in the recognition of a tax-related liability. Nevertheless, we caution the extent of potential extension of garnishees to third-parties and query whether the noted scope for judicial review is adequate and practical if there is a proliferation of such actions by the ATO. Limiting application to HRPOs may provide more administrative certainty, however the mischief being attacked in the proposal may not be exclusive to phoenixing activities.

8. Targeting higher risk entities

The introduction of the designation 'Higher Risk Entity' and being declared 'High Risk Phoenix Operator' (HRPO) seems reasonable. The safeguards built in to determining a HRPO seem reasonable subject to seeing the draft legislation and a law companion guide or a practical compliance guide detailing how the ATO intends to administer the proposed law. Having stated that, as currently presented in the consultation paper, the notion of 'entity' applicable to a natural person is ambiguous.

In the event the government decides to establish a two-step process to determining a HRPO, we recommend the ATO should, at the time of issuing draft legislation, release draft guidance on the process they will go through to declare an entity a HRPO. This will give stakeholders a more complete understanding of how such a process will work in practice, particularly as currently the power of administrative declaration appears particularly wide.

9. Appointing liquidators on a cab rank basis/establishing a 'government liquidator'

The cab rank system presents a potentially effective means of addressing illegal phoenix activity and should apply only to the circumstances of HRPOs. Any broader extension of cab rank would undermine present legal and economic efficiencies within the overall external administration system, along with likely dilution of effectiveness of other targeted measures within the reform proposals. Similarly, seeking to define application by industry sector, the presence or otherwise of pre-insolvency advice and so forth, would likely introduce unwarranted arbitrariness.

Funding of such a system would be subject to wider consideration being given to ASIC's funding model, though we would support some detailed exploration of a company – as opposed to industry levy applied upon registration.

Concerning establishing a "government liquidator", such a proposal requires greater elaboration though we raise concerns about potential market distortions if confined to small-to-medium enterprises, along with it duplicating capacity which already exists within the insolvency practitioner profession.

10. Removing the 21-day waiting period for a DPN

This suggestion should contribute to the deterring and disrupting of illegal phoenix activity, and should be confined to directors designated as HRPOs.

If this reform is introduced, regulators need to monitor whether it encourages other behaviour to escape creditors.

11. Providing the ATO with the power to retain refunds

This suggestion should contribute to the deterring and disrupting of illegal phoenix activity and is highly consistent with other proposed measures.

Other:

Public register of High Risk Phoenix Operators

We recommend that as part of the suite of policy initiatives to deter and disrupt illegal phoenix activity, the government should make available a free public register of those people and entities that have been designated a High Risk Phoenix Operator (HRPO) by the ATO and those found to have committed a phoenixing offence.

We further suggest that if such a register was publicly available (and free), it would be another effective deterrent to illegal phoenix activity. Additionally, it would assist individuals and businesses make more informed decision on potential suppliers, contractors or customers.

To enable searches by individual or company name, such a register should include:

- The name of the individual
- The name of the corporate entities with which they are and were relevantly affiliated
- A summary of the conduct that resulted in being convicted of a phoenixing offence or being designated a HRPO.

Such an approach is consistent with recommendation 9 of '*Phoenix Activity: Recommendations on Detection, Disruption and Enforcement'* by Professor Helen Anderson *et al.* This recommendation states:

> *Establish an online register of restricted & disqualified directors*
>
> *ASIC should establish registers of directors who are restricted (see Recommendation 14) or disqualified that:*
>
> - *are online and available via the ASIC website with a user-friendly interface;*
> - *are entirely free-of-charge to view and download linked documents;*
> - *can be both browsed and searched using key terms via a search engine function;*
> - *contain hyperlinks to the disqualification orders and the reasons for the orders (in the case of non-automatic disqualification);*
> - *provide the name and ACN of all companies of which the disqualified or restricted person is or has been an officer; and*
> - *subject to feasibility considerations, include people who are automatically disqualified from managing corporations under s 206B of the Corporations Act.*

Our suggestions here are also highly consistent with the government's measures towards introducing a Director Identification number (DIN).

Pre-insolvency advisers

We recommend that the government act with some urgency to address the actions of pre-insolvency advisers.

Guidance on the direction the government could take on addressing these advisers can be drawn from the Senate Economics References Committee's report titled '*Insolvency in the Australian construction industry*' – particularly recommendations 40 and 41, which state:

- *The committee recommends that ASIC focus enforcement action on business advisors specialising in pre-insolvency advice who advise firms to restructure in order to avoid paying their debts and obligations.*
- *The committee recommends that ASIC publish a regulatory guide in relation to the nature and scope of pre-appointment advice given or taken by companies.*

Recommendation 32 of '*Phoenix Activity: Recommendations on Detection, Disruption and Enforcement'* by Professor Helen Anderson *et al* also provides useful guidance on the action the government could take on this issue - being:

- *The government should consider whether it is possible and desirable to empower the courts to revoke, or impose conditions upon, professional licences where*
  - *an advisor is disqualified from managing corporations by the court, or*
  - *an advisor has been found to be an accessory to a director's breach of duty.*

- *ASIC should make greater use of the enforcement mechanism contained in s 79 to bring proceedings against both professional and other pre-insolvency advisors.*
- *To achieve effective deterrence, courts must impose meaningful penalties on pre-insolvency advisors found to be accessories to directors' breaches of duty.*

Withdrawal of tax lodgement concessions for HRPO

The government and the Commissioner of Taxation may wish to consult on the possibility of withdrawing any lodgement concessions an entity declared a HRPO may otherwise have access to, including the lodgement of tax returns and activity statements through a registered tax agent.

Pre-pack insolvency

While we are aware of some enthusiasm for pre-packed insolvency, we also note that Professor Anderson does not support such a policy. In her publication, she states '*while the speed of the procedure might maximise its benefits, it contributes to a lack of transparency that engenders suspicions of unfair dealings.'* Further, Professor Anderson states that such pre-packed insolvencies are not common in the UK and could facilitate harmful phoenix activity.

Reasons for not pursuing law reform or administrative procedures to facilitate this form of arrangement are all the more apparent when viewed in the context of the passing of the Treasury Laws Amendment (2017 Enterprise Incentives no. 2) Bill 2017 which extends to directors an insolvent trading safe harbour where they develop a course of action reasonably likely to provide a better outcome for the company than an immediate liquidation or administration.