THE TAX INSTITUTE

2 November 2017

Mr James Mason
Senior Adviser
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: phoenixing@treasury.gov.au

Dear Mr Mason,

Combatting Illegal Phoenixing

The Tax Institute welcomes the opportunity to make a submission to Treasury in relation to the paper entitled "Combatting Illegal Phoenixing – September 2017" (**Consultation Paper**).

As a general principle, The Tax Institute supports measures to combat illegal phoenixing. However, the Institute notes that appropriate checks and balances need to be in place to ensure that taxpayers who are not intended to be targeted by the proposed reforms are not inadvertently affected by the reforms.

We have provided comments below on the tax specific measures proposed in the Consultation Paper where we consider it appropriate to do so.

A Phoenixing Offence

The Tax Institute supports the proposal to amend the *Corporations Act 2001* to introduce a phoenix offence. The Consultation Paper proposes that the phoenix offence will specifically prohibit the transfer of property from one company to another where 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.

As noted in the Consultation Paper, it is proposed that the offence will operate in a similar manner to the provisions under the *Bankruptcy Act 1966*. In our opinion, there is no policy reason that would justify different treatment under the bankruptcy and corporations law.

However, our support for the proposed offence is caveated by the requirement that sufficient safeguards are implemented to ensure it does not inadvertently capture legitimate transactions and business restructures. In this regard, we consider that determination of the 'main purpose' of the transfer needs legislatively prescribed guidance. A subjective test of purpose is not appropriate given the potentially devastating effects that the offence could have.

Further, it is not sufficient that ASIC 'suspects' illegal phoenix activity to issue a notice requiring a company to deliver property or money along the lines of the *Bankruptcy Act 1966*. As above, there needs to be legislatively prescribed guidance on the matters to be taken into account when determining the 'main purpose' of the transfer.

Promoter Penalties

As noted in the Consultation Paper, there are concerns with "Option 1" (ie extending the promoter penalty laws to apply to activities designed to avoid taxation obligations by extending the definition of a 'tax exploitation scheme').

The Institute shares these concerns that expanding the definition of what constitutes a tax exploitation scheme may potentially affect innocent advisers involved in legitimate business rescues and restructuring.

The proposed defence for providing "mere advice provided for legitimate purposes" is too uncertain and may not give advisers providing legitimate advice the comfort they need to provide advice in relation to business rescues and restructuring. It is also open to unfair application or misinterpretation by the ATO as the administering authority.

The Tax Institute considers that Options 2 and 3 should be given further consideration. That is:

- Option 2 - adding a new limb to the test to provide than an entity must not engage in conduct that results in that or another entity being a facilitator of illegal phoenix activity.
- Option 3 – creating a new provision similar to the promotion of illegal early release of superannuation benefits.

In our opinion, Option 3 is the preferred option as a standalone provision is likely to be the simplest way of addressing the promoter penalty issue.

Extending the Director Penalty Notice Regime to GST

The Tax Institute supports the extension of the director penalty notice regime to GST. As this is already the approach for PAYG Withholding and compulsory superannuation contributions, we cannot see any policy justification for treating GST differently.

Security Deposits

The Consultation Paper proposes giving the ATO the power to use its garnishee powers to garnishee an amount from a third party to cover, in full or in part, the amount of a security demanded by the ATO.

In our view, the proposal has the potential to destroy legitimate businesses. Therefore, The Tax Institute considers that it is critical for safeguards to be developed if this proposal is to be implemented. There must be some form of wrong doing by an entity before any measure like this should be permitted. Otherwise, there is a real risk that action by the ATO would bring about the demise of a struggling business in circumstances where there is, in fact, no illegal phoenixing activities.

One possible option would be to link this proposal to the 'two-tiered' approach discussed in Part 2 of the Consultation Paper (this approach is discussed below). Linking this proposal to the classification as a High Risk Entity (see below) should decrease the chance of taxpayers who are not intended to be targeted by the proposed reforms being inadvertently affected by those reforms.

Targeting Higher Risk Entities

The two-step process proposed in Part 2 of the Consultation Paper is:

1. Designation as a "Higher Risk Entity" (**HRE**); and
2. Being declared to be a "High Risk Phoenix Operator" (**HRPO**) by the Commissioner of Taxation.

In our opinion, there is not enough information about the safeguards that would be implemented to ensure that the Commissioner's discretion is exercised appropriately and is subject to independent review.

Detailed consultation on this issue is required.

In relation to the possible safeguards that should be considered, we note the following:

- In our opinion, the 'objective test' referred to in the Consultation Paper needs to be prescribed in legislation.
- The Consultation Paper states that an individual might be 'entitled to request a statement of reasons for the designation' as a HRPO. In our opinion, the Commissioner should be required to provide a statement of reasons whenever a decision is made to declare an individual as a HRPO.
- The Consultation Paper refers to the fact that the declaration as a HRPO will be subject to review. There is no discussion of who would be responsible for the review.
- Given the potentially devastating effects of this classification, a timely external (ie by a body other than the ATO) review process must be available.

- If the Commissioner is to be given the power to override the review process as alluded to in the Consultation Paper, the circumstances in which this is to be permitted should be clearly prescribed in legislation.

Appointing Liquidators on a Cab Rank Basis

The Consultation Paper proposes implementing a cab rank system under which a registered liquidator would be chosen from a panel on a 'next cab off the rank' basis.

We support Option 1, that is only applying the cab rank system to entities where an officer of the company is a HRPO. In our opinion, this is a sensible proposal.

Removing the 21 Day Waiting Period for a DPN

We understand that this proposal is only applicable to those that have been declared a HRPO. Therefore, our comments in relation to safeguards outlined above also apply in relation to this proposal.

Providing the ATO with the Power to Retain Refunds

As above, we understand that this proposal is only applicable to those that have been declared a HRPO. Therefore, our comments in relation to safeguards outlined above also apply in relation to this proposal.

If you would like to discuss any of the above, please contact either myself or Tax Counsel, Angie Ananda, on [redacted]

Yours faithfully,

Matthew Pawson
President