Electrical Trades Union

ETU Submission to Treasury on Proposed Reforms to combat illegal phoenix activity – Draft Legislation

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1 PRELIMINARY SUMMARY

1. The ETU does not oppose the draft Treasury reforms on illegal phoenix activity. However, there is strong evidence that in their current format they will be deficient, difficult to operationalise and unlikely to be enforced.

2. The ETU is aware of submissions by the ACTU and its affiliates and supports the recommendations contained within those submissions.

3. Stronger reform is needed to successfully combat illegal phoenix activity.

4. Phoenix activity is costing the Australian economy billions of dollars annually and is literally destroying workers lives.

5. The Government must expand the reforms to ensure they successfully eradicate phoenix activity to the greatest extent possible.

2 INTRODUCTION

The Electrical Trades Union of Australia (ETU) is the Electrical, energy and Services Division of the Communications, Electrical, Electronic, Energy, Information, Postal, Plumbing and Allied Services Union of Australia (CEPU). The ETU represents approximately 65,000 electrical and electronic workers around the country and the CEPU as a whole represents approximately 100,000 workers nationally, making us one of the largest trade unions in Australia.

The ETU welcomes the opportunity to make a submission to Treasury on the proposed reforms to combat illegal phoenix activity – Draft Legislation.

The ETU, along with other Unions has been a long term and vocal advocate for the introduction of more effective measures to deal with companies and directors who engage in phoenix activities. The measures proposed in the Treasury reforms must include additional reforms otherwise the effectiveness of the proposed measures will be undermined or rendered ineffective. More importantly, any proposed measures will be practically useless unless backed by significant further resources for ASIC, who retains responsibility for preventing and penalising phoenix activity.

In their current form, the proposed reforms will provide little more than window dressing and an opportunity for the Government to claim they are doing something without actually introducing practical and tangible reform.

The ETU is urging Treasury to bolster these reforms to address the direct cost to workers of illegal phoenix activity, which in the FY2016 was estimated to be up to $298 Million with a broader cost to business of between $1.2 to 3.2 Billion and to Government of approximately $1.7 Billion.[1]

Companies who phoenix are simply transferring risk from themselves to the Australian taxpayer. Phoenix activities must be stopped and the perpetrators must be held to account.

The free ride needs to end.

[1] https://www.ato.gov.au/uploadedFiles/Content/ITX/downloads/The_economic_impacts_of_potential_illegal_Phoenix_activity.pdf

3 GST Estimates and Director Penalties

Firstly, without the introduction of the Director Identification Number (DIN) regime, most of these provisions will be rendered inoperable. Secondly, the issues that are being addressed go beyond the individual Director and often involve conscious decisions and actions of other office holders defined by the *Corporations Act 2001 (Cth)*.

The measures which include allowing the Commissioner to collect estimates of anticipated GST liabilities, making directors personally liable for their company's GST liabilities in certain circumstances and allowing the ATO to retain tax refunds where returns or the information necessary to establish liability are not lodged have some deficiencies. The largest being the current ability to determine liability with multiple related entities.

To overcome this issue, the ATO ought to be able to group related corporate entities and make them jointly and severally liable for their collective tax liability in the way that related entities are grouped in other situations, for example collecting land tax under the *Land Tax Act 2005 (Vic)*.[2]

The ATO must have the ability to seek to recover all tax owed by the group jointly and severally.

4 Retention of Tax Refunds

The provisions for transferring a company's tax liability to the individual and recouping that liability through withholding future returns do not provide adequate disincentives to the kinds of Directors being targeted. If a Director is contemplating phoenix activities, then there are too many opportunities for them to work around this provision. More importantly the personal benefit a Director could obtain from not paying tax obligations of the business and instead spending that money on their own personal benefit means that the disincentive is lost entirely.

To strengthen this provision, as a minimum, the ETU believes that the transfer of the tax liability should be subject to recovery activities against the individual rather than simply providing a mechanism for retaining future returns.

5 Improving the Accountability of Resigning Directors

From the outset, the ETU believes that the penalty provisions in this section of the proposed amendments are deeply deficient. Other organisations are subject to much higher penalties for lower conduct issues.

The notification periods proposed appear so loose as to be practically unenforceable, providing too many different opportunities for a recalcitrant Director to misconstrue their actual resignation details.

[2] For an explanation of this, see the State Revenue Office of Victoria website: https://www.sro.vic.gov.au/grouping-and-land-tax.

Providing a mechanism to allow a Director to back date a resignation up to 12 months is preposterous and significantly weakens the provisions of this section.

Whilst we recognise that the measures in Schedule 2 of the Bill are attempting to prevent directors from shifting accountability to other directors, they don't actually penalise the underlying conduct.

Without the reforms contemplating an offence for appointing a straw director, very little will change in this critical area. Prohibited conduct for appointing a straw director would need to include conduct such as:

- appointing a director without the director's knowledge;
- appointing a director who does not exist;
- appointing directors with the knowledge that they will not be engaged in or aware of the day to day running of the business; and
- appointing directors and then excluding them (actively and/or passively) from the decision-making processes of the business.

6 Related Creditor Voting Rights

While the ETU acknowledges what Treasury is attempting to achieve in restricting related creditor voting rights, the proposed provisions do not go anywhere near far enough to achieving the stated aim. Most of the proposed provisions are difficult to enforce and largely impractical.

There are a range of simple measures that could be taken which would better serve the objective of reducing the incidence of illegal phoenix activity and its effect on creditors, including:

- Establishing clearer evidentiary requirements on creditors to demonstrate the asserted value of the credit holding by setting a robust threshold;
- Making it unlawful for a creditor to not to declare if they are a related party;
- Include a requirement for all companies to keep a related party transactions register;
- Contemplate a system of discounting the vote of related parties;
- Ensuring Unions are granted automatic representation of worker creditors who are members;
- Amending the newly proposed Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018 s596 AF to include Unions; and
- Ensuring free and open access to company records and reporting.

Further, the reforms appear to attempt to enhance the legal position of all creditors in a Phoenixing situation without a specific focus on assisting employee creditors. The ETU is concerned this will simply benefit secured creditors, that is, banks or other parties who have lent money to the company, secured by a mortgage or other security, at the expense of funds left available to employee creditors. A Regulatory Impact Statement accompanying the actual legislation must be developed which includes the expected increase in recovery in monetary terms for creditors by classes of creditors. This must include an assessment of the increased powers afforded the Commissioner of Taxation and if it will in practice diminish the pool of assets available to employee creditors.

7 NEW PHOENIX OFFENCES

One of the major concerns of ETU members is that it is apparent that the existing *Corporations Act 2001* provides for offences for much of the conduct contemplated by these reforms. The reality is that existing provisions of the *Corporations Act 2001* simply aren't policed by the regulator and are rarely enforced. Without appropriate resourcing and funding structures for the regulator and for liquidators to bring about prosecutions nothing will change.

Furthermore, the ETU is concerned that these provisions may act as a duplication of existing offences except that they add the uncertainty of being untested laws. Without established precedents, it is likely to take many years before these provisions are tested and bedded down. This raises the questions of why these reforms are being introduced with a sincere concern that this is more of an attempt to the seen to be doing something rather than actually addressing the proliferation of phoenix activity that occurs, particularly in the construction industry.

Put simply, the main question the ETU has about these reforms is how do they actually become operationalised?

The ETU is firmly of the view that in order to ensure these provisions will actually make a difference there needs to be the addition of a requirement for pre-insolvency advisors to be licenced and that the licencing scheme must:

a. Involve a 'fit and proper person' test in order to qualify or renew a licence (with renewals made annually);
b. Require a minimum standard of relevant training; and
c. Require annual reporting to ASIC of the companies assisted.

Finally, there needs to be a much broader reverse onus of proof for Directors to demonstrate they have not engaged in transactions for the purpose of creditor defeating dispositions of company property.

8 ASIC CLAWBACK POWER AND VOIDABLE TRANSACTION PROVISIONS

Once again, the main concern of the ETU in relation to these provisions is the likely enforcement of them and how they will actually be operationalised. The proposed system once again relies upon an underfunded regulator and liquidators that are inherently without resources due to the nature of the conduct of phoenix companies.

The liquidators need funding to gather the evidence required to enliven these provisions. Due to the company being phoenixed all assets will likely be stripped, and the liquidator will not have the necessary resources. In all likelihood the liquidator then applies to ASIC to determine voidable transactions or to void a transaction with the likely response from ASIC to reject the request based on there being insufficient evidence from the liquidator. This pointless circle then repeats.

The 12 months look back provision is too narrow in that it seeks to identify a single transaction rather than allowing for grouping of both simultaneous and consecutive transactions. It is not uncommon for a phoenix company to take a gradual approach to disposition of assets. Attempting to identify a claw back or voidable transaction by assessing each transaction as a stand-alone event will make it incredibly difficult to prove which transaction caused the insolvency.

9 RECOMMENDATIONS

The ETU makes the following recommendations to both bolster the existing proposed reforms and to expand the reforms in order to achieve a regulatory structure with a reasonable prospect of catching and prosecuting illegal phoenix activities and those who undertake them.

Recommendations Section 3

S3.1 The Director Identification Number regime must be implemented in conjunction with the reforms as a priority.

S3.2 The ATO ought to be able to group related corporate entities and make them jointly and severally liable for their collective tax liability.

S3.3 Director penalties must be expanded to include officers as described under the *Corporations Act 2001*

Recommendations Section 4

S4.1 Recovery activities must go beyond the retention of future tax returns and include cost recovery activities and penalties.

Recommendations Section 5

S5.1 Penalties should be increased significantly.

S5.2 The notice period needs to be more stringent, enforceable and the capacity to back date a resignation 12 months should be removed.

S5.3 A new form of prohibited conduct must be implemented for appointing a straw director which would need to cover conduct such as:

- appointing a director without the director's knowledge;
- appointing a director who does not exist;
- appointing directors with the knowledge that they will not be engaged in or aware of the day to day running of the business; and
- appointing directors and then excluding them (actively and/or passively) from the decision-making processes of the business.

Recommendations Section 6

S6.1 Clearer evidentiary requirements on creditors must be established to demonstrate the asserted value of the credit holding through setting a robust threshold.

S6.2 Making it a requirement for a creditor to declare if they are a related party with penalties for breaches.

S6.3 Include a requirement for all companies to keep a related party transactions register.

S6.4 Introduce a system of discounting the vote of related parties.

S6.5 Unions must be granted automatic representation of worker creditors who are members.

S6.6 Amending the newly proposed Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018 s596 AF to ensure Unions have standing.

S6.7 Ensuring free and open access to company records and reporting activities.

S6.8 A Regulatory Impact Statement accompanying the actual legislation must be developed which includes the expected increase in recovery in monetary terms for creditors by classes of creditors. This must include an assessment of the increased powers afforded the Commissioner of Taxation and if it will in practice diminish the pool of assets available to employee creditors.

Recommendations Section 7

S7.1 Immediately restore to ASIC the $128 million in funding cuts to the 2018 and 2020-1 period.

S7.2 Ensure that proposed reforms in this section do not duplicate existing provisions of the *Corporations Act 2001*.

S7.3 Immediately establish a licencing regime for pre-insolvency advisors which as a minimum contains:

- a ‘fit and proper person’ test in order to qualify or renew a licence (with renewals made annually);
- a minimum standard of relevant training; and
- annual reporting to ASIC of the companies assisted.

S7.4 A thorough and independent review of ASIC must be completed which looks at funding, regulatory capture and compliance and enforcement activities.

Recommendations Section 8

S8.1 Establish a centralised fund within ASIC that can be accessed by liquidators to ensure they have the necessary resources to gather sufficient evidence to make application for clawback or voidable transactions.

S8.2 Expand the 12 months look back provisions to ensure they are not tied to a single transaction and allow for consideration of a group of simultaneous and/or consecutive transactions.

10 CONCLUSION

The cost of illegal phoenix activities is escalating rapidly, and the costs are being worn predominantly by workers and taxpayers.

Government cuts to the regulator are not helping.

Reforms to combat illegal phoenix activities must be broad, adequately resourced, appropriately funded and introduced in a way that ensures their provisions will be able to be accessed by industry participants.

Anything less is simply window dressing.