

**Australian Government
Treasury**

**COMBATTING ILLEGAL PHOENIXING EXPOSURE DRAFT
August 2018**

Submission by Professor Helen Anderson, Melbourne Law School

7 September 2018

I thank Treasury for the opportunity of making a submission on the exposure draft of the Combatting Illegal Phoenixing Bill 2018. For my background, and for further explanation of the points I make here, I refer Treasury to my submission to the Consultation Paper in September 2017, which appears below.

At this point, I reiterate the point I have made previously to Treasury: for proper public consultation on issues of such importance, the submissions to the Consultation Paper should have been made public.

It is possible that government's measures have wide support – indeed, which political party or industry lobby group would be seen to oppose measures that supposedly deal with illegal phoenix activity – but how can we be sure that these measures do have support when there is no evidence of it?

What suggestions for a better approach have been made, and ignored?

New phoenix offences

- There are already a wide range of provisions that allow action against directors in breach of their duties, and their accessories, in relation to creditor-defeating dispositions. **There is simply a lack of enforcement of these provisions by ASIC**, which prefers to disqualify directors administratively for a maximum of 5 years where it has detected illegal phoenix activity. I refer you to ASIC's media releases for confirmation. Why should we expect to see enforcement here when it has been lacking in relation to the offences and recovery provisions that have been around for many, many years?
- Any phoenix offence that described actions or circumstances, rather than behaviour, provides a roadmap for avoidance. This has been concluded by many commentators over decades of inquiries into this subject. The suggested provisions are easily avoided by
 - Creating two companies – one to accrue liabilities (and enter external administration) and one to hold assets (and survive).
 - Making the disposition in advance of 12 months before external administration.
- In terms of recovery of assets, again there are powers available to both ASIC and liquidators. And again, there is a lack of enforcement of these provisions. The reasons why are complex but in both cases, a lack of money plays a part.

- The proposed asset recovery provisions are unnecessarily complicated and are unlikely to be used by ASIC for the following reasons:
 - ASIC has a frequently stated policy of not intervening to recover assets on behalf of creditors of individual companies. Even though they have powers to do so, it is ASIC's assertion that this is for the liquidators to undertake.
 - The new legislation rightly does not interfere with market value transactions. Under s 588FGAA(4), ASIC is prohibited from making an order to recover the assets if reasons stated in s 588FG(9) apply. These are that there is evidence which, before a court, would suggest a reasonable possibility that consideration of market value or greater was given for the disposition.
 - This provides a very low evidentiary burden for the defendant, and gives ASIC a very legitimate basis on which to argue that it lacks power to intervene on behalf of creditors.
- My concern is that this draft legislation will be seen as 'solving the phoenix problem'. It will not, for all of the reasons made clear in the reports of the research team I have led over the past 4 years. See <https://law.unimelb.edu.au/centres/cclsr/research/major-research-projects/regulating-fraudulent-phoenix-activity>
- **If the proposed phoenix offence and recovery measures are adopted, there should be included in the legislation a review period, as there is with the new insolvent trading safe harbour legislation. The legislation should mandate the collection of data on the use of the provisions by ASIC and liquidators, and the value of creditor-defeating dispositions recovered, so that there can be an informed debate about the effectiveness of the provisions.**

Other proposed legislation

I refer to the earlier submission below, and summarise my comments here:

- The backdating provisions should include limitations on backdating appointments too.
- Where directors resign and continue to manage companies, ASIC may still proceed against them as de facto directors.
- While including GST in the DPN regime is a good idea, a DPN with regard to reported liabilities can be defeated by entry into liquidation or voluntary administration within 21 days. Liquidating may well be what a phoenixer was intending to do anyway.
- Don't expect the DPN to substitute for proper enforcement of taxation and corporate law provisions already available against those engaging in illegal phoenix activity.

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COMBATTING ILLEGAL PHOENIXING (SEPTEMBER 2017)

Submission by Professor Helen Anderson, Professor Ian Ramsay and Mr Jasper Hedges, Melbourne Law School, and Professor Michelle Welsh, Monash Business School, Monash University.

9th October 2017

We thank Treasury and the Minister for Revenue and Financial Services for this opportunity to make a submission regarding the Combatting Illegal Phoenixing Consultation Paper (September 2017). Here, we respond to some of the questions raised in the Consultation Paper; for further detail, we refer to our previous work on illegal phoenix activity, outlined in the Appendix to this submission.

We also reiterate our willingness to consult with Treasury further on the points raised in the Consultation Paper, our suggestions more broadly, or any other matter relating to illegal phoenix activity.

PART ONE – BROAD REFORMS

1. IDENTIFYING ILLEGAL PHOENIX ACTIVITY – A PHOENIX HOTLINE

We support the idea of a phoenix hotline, as proposed by the Consultation Paper. Information collection and sharing is vital to regulators in disrupting and bringing enforcement actions against illegal phoenix activity. We refer to our discussion on this matter in our Recommendations report, at [\[1.3\]](#).

However, information gathered and shared is only useful in the hands of a regulator – or other party such as a liquidator – who:

- **has the financial and personnel resources to act;**
- **has the motivation to act; and**
- **has the power to act.**

These considerations are also relevant to each of the suggestions made in the Consultation Paper.

It makes no difference which regulator hosts the hotline. Every regulator website, press release, or other publication should have clear, prominent and, above all, consistent instructions on reporting illegal phoenix activity. The important thing is that the information, once gathered, is passed on to the regulator most interested in the breach *who will act in response*.

Three other forms of information sharing have great capacity to deter and disrupt illegal phoenix activity.

1. Supply by the ATO of tax default information to credit reporting bureaus – already on the government’s radar but apparently delayed awaiting legislation.
2. Supply by ASIC of director histories, based on information collated from director identification numbers, to liquidators at the start of insolvency engagements. Let the liquidator – for free – ‘hit the ground running’. Phoenix insolvencies typically involve few assets from which liquidators can be paid to conduct thorough investigations. If ASIC and the government want liquidators to be effective and efficient gatekeepers against director wrongdoing, liquidators need as much information as possible, as quickly as possible, and as cheaply as possible. Charging liquidators for this is a penny-wise, pound foolish approach.
3. Supply of well-linked director information via the ASIC website to the public – for free. This is not private information. It can be purchased by the public from information providers. Let the public protect themselves from possible phoenix operators by encouraging them to do some on-line searching before committing themselves. Serial phoenix operators will think twice about liquidating a string of companies if they know that potential customers and suppliers can discover their history easily and take their business elsewhere. The UK government has recognised the value of this and provides much corporate information for free.¹

The Consultation Paper has not sought feedback on further information sharing between government agencies but we take this opportunity to highlight three significant gaps that could greatly assist in reducing illegal phoenix activity.

1. ASIC currently provides the Australian Business Register (ABR) with information about companies entering external administration or being deregistered for a variety of reasons, including failure to pay fees. This prompts the ABR to cancel the company’s ABN. One innovation that would not require any new legislation would be for the ABR, if it discovered that the people associated with a cancelled ABN were seeking a new ABN, to alert ASIC and other agencies to this activity either directly or via the information sharing capabilities of the government-access ABR Explorer. This would not involve an implication of wrongdoing but simply adds to the useful intelligence held by ASIC that can guide their surveillance and enforcement activities.
2. An application to the ATO by those seeking an ABN for their company requires ‘associate details’, including the name, date of birth, position held and tax file number of all Australian resident directors. At present, the ATO does consult with ASIC regarding ABN applications but only to check the validity of the Australian Company Number. It does not check whether any associates of the company are disqualified from managing corporations or what other companies those associates own or control. This is an oversight that should be addressed.
3. In addition to complaints from employees, superannuation non-compliance is detected and reported to the ATO through third party referrals. The ATO submission to the Senate Economics References Committee inquiry entitled ‘The Impact of Non-payment of the Superannuation Guarantee’ noted that in 2015–16, the Fair

¹ See <https://www.gov.uk/government/news/launch-of-the-new-companies-house-public-beta-service>

Work Ombudsman (FWO) made 2,405 referrals, with 73 from super funds, 651 community referrals, 70 internal ATO referrals and 57 from ‘other’. There was no figure given for referrals from ASIC.

This is not because ASIC is unaware of unpaid superannuation. At the conclusion of an insolvency appointment, the external administrator reports various matters to ASIC, including broad band estimates of unpaid taxes and unremitted superannuation in each administration. In 2015-16, ASIC’s collation of these EXAD reports showed that there was unpaid superannuation in 3,709, or 39.2% of reports. ASIC knows the names of these companies: liquidators, receivers or administrators have looked into the affairs of these companies enough to know that these amounts have not been remitted for their employees.

The Senate ERC recommended that ATO and ASIC review data sharing so that information on insolvency cases is referred by ASIC to the ATO.² It is not clear why such communication is not already taking place. ASIC’s view might be that the contents of EXAD reports are not useful to the ATO because it is then too late to issue a director penalty notice (DPN). However, while liquidation of the company within 21 days of receipt of the DPN allows the director to avoid liability, this only applies to ‘standard’ DPNs where the amount of the liability has been reported but not paid to the ATO. ‘Lockdown’ DPNs, on the other hand, which are issued with respect to *unreported* withholding and superannuation liabilities, are *not* avoided by external administration.

Therefore ASIC, unaware of whether a superannuation liability has or has not been reported to the ATO, should report *all* unpaid superannuation information from external administration reporting to the ATO to allow ‘lockdown’ DPNs to be issued where appropriate and to augment the ATO’s risk profile data collection.

While the EXAD reports are not made available to the public, the regulatory guide governing them makes it clear that ASIC already has the power to release this information to the ATO: ‘We may also disclose information in accordance with s 127 of the *Australian Securities and Investments Commission Act 2001* (Cth) for the performance of our functions or for the exercise of our powers. In particular, we may release information to another government agency under s 127(4) where the information will enable or assist that agency to perform its functions or exercise its powers.’³

2. A PHOENIXING OFFENCE

A new offence

We do not support the creation of a specific phoenix offence, as proposed or otherwise.

The proposed phoenix offence – ‘to specifically prohibit the transfer of property from Company A to Company B if the main purpose of the transfer was to prevent, hinder or delay the process of that property becoming available for division among the first company’s

² Senate Economic References Committee, *Superbad – Wage theft and non-compliance with the Superannuation Guarantee*, May 2017, recommendation 26.

³ ASIC, *Regulatory Guide 16: External Administrators – Reporting and Lodging* (July 2008) RG 16.18.

creditors’ – only captures phoenixing involving the transfer of property. While asset transfers are a feature of many current instances of illegal phoenix activity, an offence such as the one proposed might encourage the sophisticated phoenix ‘two company approach’.

This involves one company owning the assets, and contracting for their use by an operating company, which incurs the tax and other debts. The assetless operating company is the one that is then liquidated, and the process is repeated. The other common scenario is that the tax, wages and super debts are incurred by an assetless labour hire entity which is placed into liquidation at the first sign of ATO interest. As the Consultation Paper acknowledges, illegal phoenix activity is already a breach of directors’ duties, and these duties capture all improper phoenix behaviour, involving asset transfers or not.

Moreover, there is already a provision – s 588FE(5) of the *Corporations Act 2001* (Cth) (*Corporations Act*) – that allows a liquidator to claw back asset transfers where ‘the company became a party to the transaction for the purpose, or for purposes including the purpose, of defeating, delaying, or interfering with, the rights of any or all of its creditors on a winding up of the company.’ This has two advantages over the proposed provision: it does not require the creditor-defeating purpose to be the ‘main purpose’, and it allows the liquidator to look back at transactions in the previous ten years. The only stipulation relevant here is that it must also be ‘an insolvent transaction’, defined in s 588FC as the company becoming insolvent partly or wholly because of the transaction. Therefore asset transfers made deliberately within the ten years prior to a company’s insolvency to render the company unable to pay its creditors are already subject to considerable recovery powers in the hands of liquidators.

In addition, there is already a creditor-related criminal fraud offence contained in s 596 of the *Corporations Act* that deals with the removal or transfer of property.

Furthermore, uncommercial asset transfers are already actionable both as a voidable preference (by liquidators) and as a form of insolvent trading, via ss 588FB and 588G(1A) of the *Corporations Act*. Both the directors’ duties breaches and insolvent trading already have a number of advantages as avenues for action:

- action can be taken by both the liquidator (in the name of the company) and ASIC; and
- they are civil penalty breaches, allowing:
 - court disqualification on the application of ASIC;
 - penalties payable to the government on the application of ASIC; and
 - compensation orders against directors in breach.

The remedies already available can not only result in the return of the assets, but also have the potential to provide protection of the public, punishment, deterrence and compensation.

An additional concern over the proposed phoenix offence is that it is based on proving an intention – ‘the main purpose’ – to a criminal standard, even with the transfer’s relationship to the imminent insolvency being ‘reasonably inferred from all the circumstances’. The proposed provision is similar to s 596AB, the criminal provision relating to entering into transactions with the intention of preventing or significantly reducing the recovery of employee entitlements. This section has never been used, possibly because of the difficulty of obtaining sufficient evidence to prove the intention element of the offence to the criminal standard of proof, ‘beyond a reasonable doubt’.

As a result of these concerns, and the current existence of adequate provisions to penalise illegal phoenix activity and recover assets, we do not support a specific phoenix offence. The powers to act are already available. What is needed here are more actions by liquidators and ASIC. This depends upon funding and motivation. In the absence of these, no amount of new offences will make any difference.

Appropriate remedies and penalties

We refer to our comments immediately above about the current existence of remedies and penalties against illegal phoenix activity. However, we do consider that additional avenues to recoup assets would be useful, particularly as a signal to both ASIC and the courts. This was one of our recommendations in our Recommendations report, at [\[3.4.3\]](#).

We propose that s 1317H be amended, to allow for orders to be made against Newco where Newco is ‘involved in the contravention’ (within the meaning of s 79 of the *Corporations Act*) or ‘controlled’ (within the meaning of s 50AA of the *Corporations Act*) by the director in breach. Please see our Recommendations report for details of the proposed wording of this amendment.

Section 1317H(2) already allows a court to order the director in breach to compensate Oldco for the profits made by Newco from an undervalued transaction. But what it does *not do* is allow the court to order Newco – an entity not in breach of any law – to hand over its gains. Expanding the reach of s 1317H would both facilitate enforcement and provide important signalling benefits. Courts, and those tempted by illegal phoenix activity, would have a clear indication from Parliament that the beneficiary of the breach of duty should be stripped of the gains it has made. This explicit statement overcomes the need for courts to ‘piece together’ the same outcome which is implicit in s 79 and s 1317H.

In addition, attaching the recovery mechanism to directors’ duties rather than uncommercial transactions avoids the requirement of actual insolvency at the time of the transaction. At the same time, the directors’ duties provisions provide an important limitation on the reach of the recovery mechanism, ensuring that enforcement action is only taken in cases of wrongdoing and not genuine business rescues.

Designating Breaches of Existing Provisions as Phoenix Offences

We see no particular disadvantage in designating certain breaches to be ‘phoenix offences’ for the purpose of harsher penalties or invoking the special provisions of a Higher Risk Entity regime, discussed further below. The example given in the Consultation Paper is a failure to keep or provide books and records.

External administrators report a lack of books and records as part of their reporting to ASIC at the conclusion of an administration. ASIC then commonly brings summary prosecutions against these directors resulting in a small fine.

As a response to the books and records issue, the government should consider imposing higher penalties on *all directors* failing to keep or provide financial records (see our Recommendations report at [\[1.2.1.2\]](#)).

ASIC should also review its approach to these failings, and bring insolvent trading action against these directors to send a message of deterrence. Under s 588E(4) of the *Corporations Act*, a company is deemed to be insolvent where it has failed to keep records as required by s

286(1). This means that all debts incurred during that period where there are no books kept involve insolvent trading, with potentially serious consequences – disqualification, pecuniary penalties up to \$200,000, and compensation orders.

3. ADDRESSING ISSUES WITH DIRECTORSHIPS

Appointment and Resignation

We support the government addressing the issue of backdating of director resignations. We previously made suggestions on this matter in our Recommendations report, at [\[2.5\]](#).

Rather than a rebuttable presumption, we concluded that the director should simply be liable for misconduct predating the lodging of the change of directorship form, as a significant motivator towards ensuring that the form is lodged. We did not consider that it would be a compliance burden, particularly if the notification could be lodged online instantaneously by the director using their DIN.

If the director is liable for all of their pre-lodgement conduct and there is no rebuttable presumption as proposed, the measure requires no independent enforcement either administratively or via court action. The director is simply liable for whatever substantive breach is involved, and it is incumbent on ASIC or the liquidator to bring appropriate enforcement and recovery action. A sole director should ensure that if their involvement with the company is at an end and no other person is willing to be its director, the company is placed into liquidation.

Abandoning a Company

It is very pleasing to see the issue of abandoned companies gaining attention. However, the suggestion that the government limit a sole director's ability to resign without either being replaced or winding the company up, by deeming the resignation to be ineffective, does little to change the current situation. Arguably abandoning a company already constitutes a breach of directors' duty to act with care and diligence, for example, which means that such a director cannot escape liability by resigning as part of that abandonment.

In addition, the proposed reforms do not deal with directors who abandon their companies without formally resigning. Where Oldco's liabilities are not sufficiently substantial to make it cost-effective for any one creditor to take action against Oldco to recoup the funds, illegal phoenix operators may simply abandon Oldco without resigning as directors, safe in the knowledge that it is unlikely that they will be pursued. For example, there may be numerous smaller amounts of wages and entitlements owed to employees, yet these employees may not have the means or capacity to take legal action. Thus, it is necessary for agencies such as ASIC, the ATO and the FWO to regulate not only companies that formally have no directors, but also companies that formally have directors but effectively are abandoned and inactive.

The two issues here are volume and enforcement. Our research indicated that there were about 37,600 companies deregistered by ASIC each year for failure to return forms and pay fees. This is nearly five times the amount of companies liquidated. The point of the government's suggestion is that by deeming the resignation to be ineffective, the director remains accountable as a director. However, this does nothing to ensuring that the affairs of those abandoned, deregistered companies are investigated (by whom? paid for how?) or that action will be brought against those directors. Given the sheer number of companies that are

abandoned and the lack of regulatory oversight of abandoned companies, the total quantity of the debts that such companies owe to creditors may be very substantial.

Making it an administrative and/or civil wrong to abandon a company might be a better option but again there is the issue of enforcement. As part of the deregistration process, ASIC can send a penalty notice to the last known address of the last registered director or directors. Whether the penalty is paid is another matter entirely. A much more effective deterrent against this behaviour would be a 'black mark' against the person, via their DIN, such that directors who have previously abandoned companies cannot become the director of any further company without satisfying certain conditions. This is discussed further below in Part II.

It should also be noted here that being a good citizen and voluntarily winding up your company involves considerable paperwork, costs and the payment of fees to ASIC. Abandoning the company means ASIC will get rid of the company for you for free, with no repercussions. It is not surprising that so many companies are abandoned.

5. PROMOTER PENALTIES

We do not support the proposed expansion of promoter penalty laws.

The issue with extending promoter liability to phoenix circumstances is that the very nature of illegal phoenix activity – closing one company and transferring its business to another company, newly created or otherwise – can never be a 'tax exploitation scheme'. The tax liabilities incurred by the first business were income tax, payroll tax, PAYG(W) or superannuation liabilities properly incurred during the life of the company.

The prohibition against promoting 'tax exploitation schemes' is designed to stop advisors actively marketing and encouraging companies, amongst others, to structure their arrangements in schemes that exploit tax laws. These schemes reduce or eliminate the company's liability to pay tax – the incurring of the tax debt. With illegal phoenix activity, the company has simply failed to pay the tax debt that it has properly incurred. Advising an insolvent business to liquidate or enter voluntary administration when it cannot pay its debts is the *only* proper advice that can be given.

The ATO already has the mechanism to capture advisors who recommend illegal phoenix activity – the *Crimes (Taxation Offences) Act 1980* (Cth) (CTOA). It was introduced following 'Bottom of the Harbour' tax evasion in the 1970s – conceptually very similar to illegal phoenix activity. The CTOA imposes criminal sanctions where a person enters into an arrangement with the intention of securing that a company will be unable to pay income tax or a range of other taxes including the superannuation guarantee charge. The penalties are 10 years imprisonment or 1,000 penalty units or both.

Liability can be imposed on advisors under s 6(1) for being an accessory – defined in the usual way as a person who 'directly or indirectly aids, abets, counsels or procures another person, or is in any way by act or omission directly or indirectly concerned in, or party to, the entry by another person into an arrangement or transaction' – 'knowing or believing' that the arrangement is for a prohibited purpose. The CTOA also deals with 'future income tax'. Section 5 of the CTOA requires the main perpetrator to have the intention of securing the

company to be unable to pay the income tax but the accessory under s 6 does not need that purpose, only the knowledge or belief that the other person has it.

Using the existing law is superior to the options in the Consultation Paper. It avoids the difficulties of trying to broaden the definition of ‘tax exploitation scheme’ to include illegitimate behaviour during corporate insolvency or a defence of ‘mere advice for legitimate purposes’. It also avoids relying on a new illegal phoenix activity offence that is dependent on asset transfers. There is no need to create a new offence where there is already an adequate provision in existence.

6. EXTENDING THE DIRECTOR PENALTY NOTICE REGIME TO GST

We support the extension of the DPN regime to GST and this is a suggestion that we have made previously in our Recommendations report, at [\[2.6\]](#). It should be extended for all directors, not just those deemed High Risk Phoenix Operators.

We do *not* support another mooted alternative – the payment of the GST by the purchaser of real estate, where the builder has claimed back GST input credits early in the project but liquidates prior to remitting the GST it owes to the ATO. This was a suggestion made to us by the ATO early in our consultation with it over ways to recover unpaid taxation revenue. However, we could not devise a fair or administratively workable method of achieving this. For example, the builder may not be the person selling the property. If the purchaser deducts GST from the price paid to the developer, the developer has the task of recovering it from the builder.

In terms of including GST in the DPN regime, it is important to recognise the fundamental difficulty with using DPNs to recover any losses caused by illegal phoenix activity. The whole *modus operandi* of illegal phoenix activity is to liquidate a company and transfer the business to a new one. There is no liability on a director under a DPN where there is a prompt liquidation within 21 days of receiving the notice, provided liabilities are reported.

A savvy, deliberate phoenix operator therefore does not fear a DPN, regardless of what it includes. The cost of incorporating a new company – currently \$463 – is worth incurring to avoid tens of thousands in tax debts.

7. SECURITY DEPOSITS

We support improvements to the security deposit laws, including increasing the penalties for non-compliance. Extending the ATO’s powers in relation to the garnishee provisions to recover security deposits, as proposed by the Consultation Paper, might also assist.

However, a lateral approach would be not to target the failing company but rather the operations of a new company. See our recommendation at [\[2.3\]](#). In other words, where a director of a company that failed to pay a security deposit for Company A was trying to obtain an ABN for Company B, the ATO should have the power to deny that ABN until Company B provides a security deposit. We believe that the issuance of an ABN could play an important ‘gatekeeper’ role that protects the collection of tax revenue currently affected by illegal phoenix activity.

At present, the ATO lacks the power to deny an ABN to a company, as it may to an individual where they do not believe the individual is carrying on an enterprise. Even if the ATO has grave suspicions about the individuals controlling a company, it must still grant that company an ABN. This is the case whether those individuals are running one or 100 companies, or whether they have a lengthy history of phoenix activity that the ATO suspects is illegal. The ‘fit and proper person’ test for the issue of an ABN, raised for consideration by Treasury’s *Black Economy Taskforce Additional Policy Ideas*, could be one way of doing this.

PART TWO – DEALING WITH HIGHER RISK ENTITIES

8. TARGETING HIGHER RISK ENTITIES

The designation of an individual as a High Risk Phoenix Operator (HRPO) has the advantage of reminding a person that their conduct is ‘on the radar’ of the regulators. However, the proposed two-tiered approach would place a substantial administrative burden on the ATO.

We have also suggested a method that singles out certain high risk individuals, which we called ‘restricted directors’ in our Recommendations report at [\[2.1\]](#). However, rather than targeting them for special *ex post* enforcement action as the Consultation Paper proposes with HRPOs, we favoured the *ex ante* approach that limits the number of companies that these people can manage while under restriction. Most significantly, restricted status would occur automatically after a certain number of corporate failures. Our proposal therefore is less harsh in consequences than the HRPO proposal and less burdensome administratively.

In our view, deterring and disrupting illegal phoenix activity is best done by restricting or denying a phoenix operator access to what they want:

- the incorporation of a company;
- the right to be its director; and
- an ABN for the company.

Between them, the ATO and ASIC should have the ability to control the granting of these three privileges. The ABN issue is discussed above, and here we discuss the first two.

Incorporation

Incorporation should be done online by the proposed directors, with a requirement that they quote their director identification number and password accompanying that number. Director identification numbers must be password protected to prevent people from stealing and fraudulently using other people’s numbers. The online form should then pre-populate with the directors’ prior and present corporate records – a reminder to the director that ASIC knows what they are involved with, and can share this information with other regulators. Transparency is the key.

We recommend that shelf companies no longer be permitted, at [\[1.1.2\]](#), as the reasons that once existed for their use are no longer applicable. They appear to be potential vehicles for fraud. Why else would someone pay several thousand dollars for a 13 month old company, when they could create one immediately for \$463?

The ‘right’ to be a director

This is not absolute. ASIC can, and should more frequently, remove directors who have been involved in two or more failed companies within the past seven years where there are unfavourable liquidators reports (s 206F). ASIC should also make use of its ability to seek court disqualification for up to 20 years where the person’s behaviour was wholly or partly responsible for its failure (s 206D).

A database of what are effectively ‘High Risk Phoenix Operators’ could be achieved by identifying those who are disqualified twice under s 206F or disqualified once under s 206D, and ensuring they are on ASIC’s and the ATO’s radars for heightened surveillance when they return to running companies. In the event that these people engage in improper conduct – rather than enduring a further incidence of business ‘bad luck’ – enforcement action can be brought against these people in the usual way using the existing directors’ duties, DPN provisions, and other relevant legislative provisions.

Where a person chooses to hide behind a family member as a dummy director, well-publicised enforcement of existing *Corporations Act* provisions, including directors’ duties and insolvent trading provisions, may make people reluctant to take on the role of a dummy director. A properly implemented director identification number that makes it clear to the would-be director that ASIC and the ATO can see their present and previous corporate dealings is vital. In this regard, the information gathering discussed at the start of the Consultation Paper, as well as the improved data capabilities of both ASIC and the ATO, should be put to greater use in bringing actions under existing laws.

The government should consider creating a database of directors who have abandoned companies, and they should also be subject to the increased surveillance of ASIC and the ATO, whether as HRPOs, restricted directors or otherwise. The government should consider whether such people should be allowed to incorporate further companies without having to account for the demise of the abandoned company.

9. APPOINTING LIQUIDATORS

Option 1 – A ‘cab rank’ basis for appointing liquidators for HRPOs

This proposal sounds appealing but will involve a significant administrative workload. It depends on the lengthy process of designating someone a HRPO and then adds a further layer involving the creation of panels of liquidators and ensuring that they are adequately funded.

In the event that Treasury decides to proceed with this proposal, it is vital that it consults extensively with insolvency practitioners about the practical implications. Every insolvency practitioner we have spoken to is concerned about this proposal. ASIC already knows of the 16 or so liquidators who get a disproportionate number of appointments. A targeted investigation of those liquidators – some of whom might simply be doing their jobs effectively and efficiently – would be a good place to start.

There are also adequate tools available that can be used against advisors as accessories who are involved in directors’ duties breaches or CTOA breaches, discussed above. These should be used more frequently.

External administrators submit reports of suspected breaches of the law at the end of an administration. ASIC rarely takes action in response to these reports, especially where small amounts of money appear to be involved. As a result, a ‘colluding’ liquidator can ‘clear’ their own name and report the suspected breaches, confident that ASIC will not make further inquiries. A more active response by ASIC to external administrator reports would be an excellent first step. If ASIC is not resourced to do this, or if it is not one of its priorities, then a government liquidator to deal with MSME insolvencies is worth considering.

Option 2 – A Government Liquidator

This is an idea worth investigating further, and should go beyond liquidations of high risk entities. A government funded liquidator:

- can achieve economies of scale;
- can tap directly into the information held by ASIC and the ATO that might alert them to serial phoenix activity and breaches of directors’ duties; and
- overcomes the funding dilemma, whereby liquidators of assetless companies are not legally required to do work for which they will not be paid (s 545(1)) apart from reporting to ASIC, yet may be criticised for not conducting thorough investigations.

Funding for a government liquidator should be by way of allocation from consolidated revenue. A more efficient system for conducting MSME liquidations, resulting in better detection, enforcement and therefore deterrence of illegal phoenix activity, could result in:

- more tax revenue;
- better payment of superannuation;
- less reliance on the Fair Entitlements Guarantee;
- no need for the Assetless Administration Fund (saving both money and administrative work by ASICs and applicants); and
- a fairer, more competitive market and economic benefits across society.

10. REMOVING THE 21 DAY WAITING PERIOD FOR A DPN

This proposal imposes liability on HRPO directors for any reported but unpaid PAYG(W), super and GST. If the liabilities were both unreported and unpaid, the 21 day period would not apply in any case because the DPN would be a ‘lockdown’ DPN. Under the proposal, the issue of the DPN would be an invoice for payment, rather than a notice allowing the director time to get the company’s affairs into order by seeking liquidation. In effect therefore, the proposal means that HRPO directors are personally liable for DPN related taxes that the company cannot pay. It is not clear whether the HRPO director who liquidates the company prior to receipt of the DPN escapes liability.

The rationale is that the new regime takes away the 21 days which the HRPO would use to shift their personal assets, but more thought needs to be given to the behavioural profile here. The HRPO caught by the proposal both reports liabilities and keeps personal assets until faced with a DPN – rather naively it would seem.

A more likely profile of a determined HRPO is that they make themselves DPN-proof by ensuring that they have little if anything in their own name throughout their time as a director. They probably do not report liabilities so that the ATO does not know what is owing, but they do not fear a lockdown DPN since the only penalty is payment of the company’s taxes – from money they do not have.

A better approach could be to impose some other punishment on people determined to use illegal phoenix activity to avoid payment of these taxes. The government should consider giving the ATO power to seek a court ordered disqualification of DPN recipients, where specified circumstances exist. For example, this could be that the person had received more than one DPN and the circumstances indicated that the person was wholly or partly responsible for each company's failure to pay. This would be the tax equivalent of a s 206D application by ASIC. The advantage here is that the ATO is a well-funded and highly motivated applicant, with the recalcitrant director and the relevant facts under its nose. Action should be swift, frequent and well publicised.

Another way of ensuring that PAYG(W) and superannuation are paid is to consider whether the single touch payroll proposal – currently only mandatory for employers with 20 or more employees and only relating to reporting, not payment as originally suggested – be extended further. There are legitimate concerns for small businesses over cash flow because of the tardiness of their own creditors, and we are aware that a requirement for all MSME businesses to pay PAYG(W) and super 'early' is likely to cause financial difficulties for some businesses.

However, the government could consider that their HRPO population be required to report *and* pay these taxes via single touch payroll.

In conclusion, we found that illegal phoenix activity exists because it is:

- easy;
- cheap;
- profitable;
- relatively invisible; and
- rarely followed up by regulators.

Addressing these drivers should result in significant deterrence and disruption of illegal phoenix activity.

APPENDIX

EXECUTIVE SUMMARY OF THE ARC PHOENIX PROJECT FINAL REPORT

‘Phoenix Activity Recommendations On Detection, Disruption And Enforcement’ is the [third and final report](#) of the project, [Phoenix Activity: Regulating Fraudulent Use of the Corporate Form](#) (‘Phoenix Project’), which is being undertaken by staff at Melbourne Law School and Monash Business School. The Phoenix Project is funded by the Australian Research Council’s *Discovery Projects* funding scheme (Project DP140102277). The Project seeks to enhance Australia’s economic stability by determining the best methods of addressing fraudulent use of the corporate form without unduly inhibiting its proper use.

In our first report, [Defining and Profiling Phoenix Activity](#),⁴ we identified five categories of phoenix activity. The first is ‘legal phoenix’, often referred to as ‘business rescue’, which results in a better outcome for creditors and society than letting the business come to an end. The second is ‘problematic phoenix’, which is technically legal but involves repeated resurrection of the business by inept entrepreneurs that is harmful to creditors and society. There are three categories of illegal phoenix activity, depending upon whether it involves an unpremeditated intention to defraud creditors arising from financial difficulties (‘illegal type 1’), an intention to defraud as part of a premediated business model (‘illegal type 2’), or a premediated intention to defraud accompanied by other illegal activity (‘complex illegal’). In this report we use the umbrella term ‘harmful phoenix activity’ to refer to both ‘problematic’ phoenix activity and the three categories of ‘illegal’ phoenix activity.

Estimates have placed the economic cost of phoenix activity in the billions of dollars.⁵ In our second report, [Quantifying Phoenix Activity: Incidence, Cost, Enforcement](#),⁶ we published the results of our empirical study on the incidence and cost of phoenix activity, along with disruption and enforcement measures taken in relation to such activity. While precise quantification was not possible due to a lack of data, our conclusion was that harmful phoenix activity is a significant problem that justifies the commitment of substantial government resources. Several organisations have raised concerns about the widespread and costly nature of phoenix activity.

Harmful phoenix activity, left unchecked, has the capacity to undermine Australia’s revenue base and the competitive ‘level playing field’. It is wrong that legitimate business operators, paying taxes, wages and other debts, might be driven out of business by those engaging in harmful phoenix activity. Minimising business distrust caused by harmful phoenix activity can lower the cost of finance and make it more widely available. If less tax revenue is fraudulently avoided, the economy and society as a whole benefit. If fewer employee entitlements are lost as a result of harmful phoenix activity, there is likely to be less reliance on the Fair Entitlements Guarantee, freeing up government resources for other purposes.

⁴ Helen Anderson, Ann O’Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, ‘Defining and Profiling Phoenix Activity’ (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, December 2014) (*‘Defining and Profiling Phoenix Activity Report’*).

⁵ See PricewaterhouseCoopers and Fair Work Ombudsman (‘FWO’), *Phoenix Activity: Sizing the Problem and Matching Solutions* (June 2012); Australian Taxation Office (‘ATO’), *Targeting Tax Crime: A Whole-of-Government Approach* (July 2009) 16; Treasury (Cth), *Action against Fraudulent Phoenix Activity: Proposals Paper* (November 2009) (*‘Phoenix Proposals Paper’*).

⁶ Helen Anderson, Ann O’Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, ‘Quantifying Phoenix Activity: Incidence, Cost, Enforcement’ (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, October 2015) (*‘Quantifying Phoenix Activity Report’*).

The aim of this report is to minimise the significant damage that is being done to the Australian economy by harmful phoenix activity without unduly inhibiting legitimate business rescues and beneficial entrepreneurialism. Our recommendations address phoenix activity that, whether presently legal or not, society should not tolerate because it causes unacceptable harm to others.

While strong and targeted enforcement is the vital bedrock upon which any regime to eradicate wrongdoing is built, it is only part of the solution, particularly given that not all harmful phoenix activity is illegal (i.e. problematic phoenix activity). Our approach is to attack the drivers of harmful phoenix activity from multiple angles, with a greater focus on *ex-ante* detection and disruption. At present, phoenix activity is easy, cheap, profitable and largely invisible, as a result of which there is little enforcement even where actions are available. We believe that implementing the measures outlined in this report would significantly counteract each of those drivers and reduce rates of harmful phoenix activity. At the same time, nothing we suggest will prevent genuine entrepreneurs from starting new companies, even after previous corporate failures.

Our recommendations come in three chapters.

CHAPTER 1: DETECT ALL PHOENIX ACTIVITY

- Identify directors properly.
- Tighten the processes for incorporating companies.
- Assist external administrators to collect information.
- Overhaul external administrator reporting to ASIC.
- Revise website information and complaint processes for the public.
- Share information more effectively between regulators, including in relation to abandoned and deregistered companies.
- Make information about directors' corporate histories available free-of-charge where possible.
- Establish an online, free-of-charge, publicly searchable register of disqualified directors and associated companies.
- Enhance information sharing with 'allies' such as super funds, trade unions and credit reporting agencies.
- Improve collection of statistical data about phoenix activity.

CHAPTER 2: DISRUPT HARMFUL PHOENIX ACTIVITY

- Introduce for those with a history of corporate failures a new 'halfway' category of 'restricted directorships', listing these on a publicly searchable register along with disqualified directors.
- Impose consequences for being a restricted director, including:
 - Place limits on the number of concurrent directorships.
 - Increase reporting requirements and regulatory scrutiny.
 - Consider voluntary education for restricted directors.
- Improve the regime for disqualification from managing companies:
 - Prioritise the use of disqualification powers in the phoenix context.
 - Increase the maximum period of ASIC disqualification orders.
 - Allow the FWO and ATO to seek court ordered disqualification.
 - Increase the penalties for managing a company whilst disqualified.

- Check ABN applicants against the ASIC registers of disqualified and restricted directors.
- Introduce independent valuations of asset transfers between related parties.
- Substantially limit backdating of directorships.
- Include GST in the ATO administered Director Penalty Notice ('DPN') regime and introduce DPNs into state taxation legislation.
- Expand Single Touch Payroll to include payment of tax and superannuation.

CHAPTER 3: PUNISH AND DETER HARMFUL PHOENIX ACTIVITY

- Clarify the role of liquidators in the enforcement process and provide them with adequate funding.
- Prioritise taking enforcement action in the phoenix context.
- Improve reporting of enforcement actions against harmful phoenix activity to stimulate general deterrence.
- Amend existing laws that do not work effectively.
- Increase the penalties for breaches of directors' duties and individuals who deliberately liquidate companies to avoid *Fair Work Act* penalties.
- Remove the benefit gained from harmful phoenix activity.
- Expressly address the role of advisors, particularly pre-insolvency advisors.

The two final chapters of the report discuss other ideas and proposals related to phoenix activity in respect of which we have not formulated specific recommendations. In Chapter 4 we discuss other ideas from Australia and abroad that may warrant further consideration:

- Enabling recovery of Oldco's debts from other companies that are related to Oldco by way of franchise or labour hire arrangements.
- Introducing specific rules for certain industries that have a high incidence of harmful phoenix activity.
- Enabling recovery of assets where their transfer has the effect of perpetrating a fraud on employees.
- Making directors liable for company debts where they are disqualified and the conduct for which they are disqualified has caused loss to creditors.

In Chapter 5 we discuss a number of proposals that we think would *not* work to combat harmful phoenix activity or that may increase the risk of harmful phoenix activity:

- A phoenix offence.
- Mandatory capitalisation.
- Compulsory education for all directors.
- Reinstating the tax priority in liquidation.
- More tax offences or more tax civil penalty provisions.
- We also express our concerns about the effect that pre-pack liquidations, streamlined liquidations or a safe harbour defence might have on harmful phoenix activity.