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16th June 2017

Our Ref:SUBMISSIONACCTG:Ray Barrett

The Manager
Fair Entitlements Guarantee Scheme
ImprovingFEG@employment.gov.au

Dear Sir,

REFORMS TO ADDRESS CORPORATE MISUSE OF THE FAIR ENTITLEMENTS GUARANTEE SCHEME CONSULTATION PAPER – MAY 2017

In response to your consultation paper I make the following points. My comments are made against the background of dealing with insolvent corporations over many years, including dealing with the claims of employees and assisting FEG in processing claims.

Preliminary Points

Moral Hazard

Your consultation paper makes reference to the moral hazard that the present FEG regime creates with particular reference to the actions of employers and their advisors in relation to the misuse of that regime. In my experience that point is well made.

However, I recommend some thought be put into how employees deal with the impending insolvency of their employer and the dynamics of an employee's decision to remain employed in the face of impending insolvency.

My observation is that in many cases the insolvency of an employer does not come as a complete surprise to employees. There are often many tell-tale signs be it indicators about difficulties within a particular industry or a particular firm.

The point I am making is that whilst the FEG scheme is well intentioned to protect vulnerable workers it may in fact be having a perverse effect of reducing the policing effect by that group of persons, apart from senior managers, being best place to sound an alarm on impending insolvency.

An employee armed with this knowledge has a number of choices – he/she can move on to other work sometimes in conjunction with or after a period of retraining, he/she can tough it out with the present employer in the knowledge that for the most part (save for Super Guarantee Contributions ('SGC")) his/her employment entitlements will be underwritten by FEG. This in my observation tends to create a moral hazard in the hands of employees.

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The adverse outcome here is not just to the FEG scheme but also to ordinary unsecured creditors due to the subrogating effect of FEG standing in the shoes of employees in respect of the priority of claims.

Generally speaking it is the unsecured creditors who have the least knowledge of the financial position of their customers. The economic effect of a company continuing to trade deeper into insolvency where all available assets are absorbed by priority creditors has an increasingly adverse impact on the returns to unsecured creditors. If those with the in-house knowledge, or at least an inkling of the adverse financial position of the company had taken steps to protect their own position the knock on effect to unsecured creditors is in my opinion likely to be reduced.

Accordingly, I suggest some measures be taken to place more of the risk of the adverse outcome of insolvent trading on those persons that have the greater access to knowledge. In relation to employees this could be done as follows:

1. Cap annual leave at say 4 weeks. This will encourage employees to take annual leave during the course of employment and avoid an accruing liability,

2. Redundancy payments should be subject to a qualifying period of unemployment. For instance it is only payable say after 6 weeks of unemployment and evidence of job searching in the meantime. In my observation redundancy can be a windfall to those employees that obtain a redundancy entitlement but being employed very soon after the termination of their employment with the insolvent employer. That windfall represents money that would fall into funds available to ordinary unsecured creditors. I note that s120 and 121 of the *Fair Work Act 2009* lends support to this policy position.

I recommend that there be in place a signal to employees that there is a moral hazard as between their interests and the interests of the ordinary unsecured creditors in allowing all assets available in a business to be eroded such that only priority unsecured creditors get paid.

NEW LEGISLATION

1. *Fair Work Act 2009* (‘FWA”)

   In light of my observations above perhaps s120(2) of the Fair Work Act could be amended to give FEG and the insolvency practitioner appointed to the employer standing to make application to Fair Work Commission (“FWC”) for orders contemplated by s120.
   Perhaps the FWA could give some guidelines for the FWC to consider in relation to any such application such as the industry in which the employer operates its regional location and the

prospects of redundant employees being able to find work within the local area (assuming the work force is not of a fly in fly out nature).

Such amendments may require an amendment to the priority provisions of the Corporations Act so that any determination of the FWC has its intended outcome.

2. *Corporations Act 2001* ('the Act")

In my observation, the law as it presently stands for the most part gives rise to sufficient causes of action/remedies to make recoveries a reasonable prospect assuming that the recalcitrant directors/entities have funds to meet any award. It may just be that the circumstances leading to the insolvent corporation have had a deleterious effect on related parties such that there simply are not sufficient assets to meet claims. Any change to the legal regime is unlikely to have much of an effect on the commercial reality of insolvency.

Even if assets can be identified there must be the economic capacity of liquidators to investigate and prosecute claims. Even if new laws are introduced any success with those laws will be limited if the lack of financial capacity to prosecute claims is present.

OTHER REFORMS

Corporate Trading Trusts

I support new legislation to ensure that the priority provisions of the Act apply to corporate trustees as has been the law in Victoria for many years prior to the recent cases of *Re Amerind Pty Ltd (receivers and managers apptd) (in liq)* [2016] VSC 127.

Director Identification Number

I observe in court liquidations the inability to identify the director. In the result books and records and RATA are not obtained.

I expect FEG and ASIC will have a reasonable level of data in respect of non-existent/unidentifiable directors and if the problem is as systemic as my observations may suggest then I believe that a Director identification number and a Verification of Identity regime similar to that which is now established in respect of Land Titles Office transactions in Victoria be introduced.

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INCOME TAX ASSESSMENT ACT 1997

As you may be aware, a company is not entitled to a deduction as against its taxable income provisions in respect of employee entitlements. In essence, they become a tax deduction when paid.

It is true that a company may make provision for these accruing expenses from an accounting perspective but even if this does occur inevitably those provisions are insufficient and cash trading losses soon absorb any working capital that may have supported the provisions.

I suggest that amendments to the ITAA 1997 be considered to allow employers to obtain a tax deduction in respect of some or all of those provisions.

An alternative is to amend the ITAA to allow employers to establish employee benefit trusts into which funds can be paid in respect of accruing entitlements, the tax deduction being allowed in the year of payment to the fund.

Presently the ATO attitude to such structures is restrictive with the costs of establishing the legal structure and the relative uncertainty of them being a significant disincentive to their use. I cannot see why such funds cannot be as popular and useful as SMSF as in a sense they are doing like jobs - that is providing support to employees through one of life's significant transitions.

I accept that there are approved worker entitlement funds but as these require ATO approval they are not and will not be common place for many employers. This is a disincentive for employers to establish low cost flexible arrangements.

For the ATO's attitude, I refer you to Draft Taxation Ruling TR 2014/D1.

Regards,

RAY BARRETT
Director
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