ISA SUBMISSON

Warning Signs: Tightening the Belt on Sharp Corporate Practices

TREASURY AND DEPARTMENT OF EMPLOYMENT INQUIRY INTO THE CORPORATE MISUSE OF THE FAIR ENTITLEMENTS GUARANTEE SCHEME

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Industry Super Australia

ABOUT INDUSTRY SUPER AUSTRALIA

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Importance of the Fair Entitlements Guarantee

The Consultation Paper prepared jointly by Treasury and the Department of Employment establishes that costs of the Fair Entitlements Guarantee (FEG) have steadily increased since 2000.[1] The scheme is an important safety net for employees to recover certain employee entitlements and one purpose of the Consultation Paper is to investigate ways to make the scheme more sustainable by amending the law to recover a greater amount of outlays for FEG payments.

ISA supports reforming the law to enable the FEG to recover more of its costs. Strengthening the FEG scheme would provide a stronger safety net for employees vulnerable to the non-payment of wages and other employee entitlements.

ISA also suggests that more attention could be paid to preventing insolvencies using unpaid employee entitlements. New Australian Taxation Office (ATO) real time monitoring systems could be used to redesign systems across several agencies if they work on a cooperative basis.

Unpaid Superannuation as a leading Indicator of Insolvency

Industry Super Australia and CBUS's extensive research on unpaid Superannuation Guarantee (SG) shows that non-payment of SG is a reliable leading indicator of impending insolvency. At present, SG needs only to be paid quarterly, so it is often used to deal with company cash flow issues when imbalances in receipts and payments occur.

This suggests that ATO action to move to real time systems, monthly SG payments and a revision of the Director Penalty Notices could protect employee entitlements before insolvency. If superannuation compliance is improved, wages may also be protected.

Clarifying priority of employee entitlements in insolvent trustee companies

One proposed means of recovering more FEG outlays is to amend the *Corporations Act 2001* (Cth) (Corporations Act) to clarify that employee entitlements have explicit priority in respect of the assets of insolvent trustee companies in specific circumstances. Sections 433, 556 and 561 of the Corporations Act provide for the priority of employee entitlements in the case of an insolvent company. They have been the subject of recent conflicting case law which has considered whether these sections disturb the common law. The common law provides that a trustee has an equitable lien over trust property in order to settle any outstanding debts it has incurred in furtherance of the purposes of the trust, which takes priority over the claims of both beneficiaries and third parties.[2]

While ordinarily amending the law to allow creditors access to trust property would be a cause for grave concern, ISA supports clarifying the law so that these sections also apply to insolvent

[1] What is now called the Fair Entitlements Guarantee was introduced by legislation and took effect on 5 December 2012. Its predecessor, the Employee Entitlements Support Scheme was introduced in January 2000. It was replaced in September 2001 by the General Employee Entitlements and Redundancy Scheme. Treasury and Department of Employment, Reforms to address corporate misuse of the Fair Entitlements Guarantee scheme Consultation paper, May 2017, 1-2 (FEG Consultation Paper).

[2] JD Heydon and PL Loughlan, *Cases and Materials on Equity and Trusts* (1997) Butterworths 5th Ed, 794.

corporate trustees in very limited circumstances. Any amendment should be carefully drafted so as not to dilute the protection of trusts in other arrangements.

Tightening civil penalty provisions for directors

The Consultation Paper proposes reforming sections 596AB and 596AC of the Corporations Act. Sections 596AB and 596AC provide for criminal and civil liability (respectively) where a director or directors of a company have intentionally avoided paying employee entitlements by entering particular transactions.

While it is important that these sections be reformed given that no criminal prosecution or civil proceeding has been successful since their introduction, we propose inserting a new civil penalty provision that eschews the use of a subjective intention element in favour of a reasonableness test. This will make proving a claim under the section easier, but will not unduly disadvantage defendants by making the charge too easy to prove.

Extending liability to related corporate entities

Preventing abuse of corporate structures to avoid paying employee entitlements is a further concern addressed in the Consultation Paper. In particular, it is proposed that the law be reformed to allow the corporate veil to be "pierced" in certain circumstances in order to recover employee entitlements from related corporate entities in the same corporate group as the insolvent entity.

While derogating from the separate legal entity principle (that a corporation is a separate legal entity to its owners, the shareholders) is a significant move, if executed carefully, it would be an important way of recovering employee entitlements.

Include Superannuation Guarantee in the Fair Entitlements Guarantee

Recovering unpaid SG is not currently within the FEG scheme. While it is acknowledged that including unpaid SG in the scheme would initially increase its costs, it would give greater effect to purpose of the scheme, to recover unpaid wages and related employee entitlements. It is incoherent that unpaid SG, part of employee entitlements, is not included in the FEG scheme at present.

Non-payment of SG is an early indicator of a company at risk of not meeting its obligations towards employees. Including unpaid SG in the FEG would bring about better management of the scheme by giving earlier indications of companies in trouble.

Reforming the law to facilitate recovery of employee entitlements in the ways discussed in the Consultation Paper would also make the FEG scheme more economically viable. It makes sense to include unpaid SG in the scheme.

1. Importance of the Fair Entitlements Guarantee

The FEG is a fundamental protection that the Australian government affords to workers. It is reflective of an important role of government: to provide a safety net to vulnerable people in Australia. The power differential between individual workers and the government underscores why the government is best placed to 'insure' employees in respect of their employee entitlements in the case of employer insolvency. It is more able to absorb the immediate costs of employer insolvency and better positioned to recover costs by stepping into the legal shoes of the employee for the purposes of insolvency proceedings.

Of course resources are limited, and the government must be able to recover the costs of providing the FEG. Given Australia's budget constraints, the FEG must be financially viable. While the increasing costs to the FEG are concerning, they can be partly explained by greater public awareness of the guarantee as the initiative ages. This is a measure of the FEG's success as a policy. As outlined in the consultation paper, there are many areas where law reform could assist the Department of Employment to recover more FEG payments.

This submission focuses on how reforms to the law relating to the priority of creditors in insolvency proceedings, civil proceedings against directors personally and liability of corporate groups would assist the government to better recover their FEG outlays.

ISA's primary concern for FEG purposes is the recovery of unpaid Superannuation Guarantee (SG). While this is not strictly within the ambit of the FEG, recovery of SG should be a relevant consideration when weighing up proposed changes to the FEG.

Our submission addresses three broad themes in reforming the FEG:

i. Better use of ATO information on unpaid super and better ATO compliance activities could assist Commonwealth agencies in protecting employee entitlements. Single Touch Payroll and an enhanced Superstream could provide leading indicators of insolvency risk
ii. Legislative reforms to facilitate recovering the costs of FEG
iii. Extending the FEG ambit to include unpaid superannuation guarantee

2. Protecting employee entitlements using the leading indicator of unpaid Superannuation Guarantee

There are at least four reasons for unpaid superannuation guarantee being diverted to assist the cash flow of struggling or sharp businesses:

- Superannuation only needs to be paid quarterly, so it is typically at least four months before an employee can check that their SG has been paid;
- Superannuation is often not tracked by employees and they have limited understanding of how much is due and when it is due;
- The ATO does not currently have real time systems for tracking superannuation – the member contribution statement from superannuation funds, while an annual report on a member's contributions, may not identify which employers have paid contributions into the member's account; and
- The ATO currently does not measure the SG base, ordinary time earnings (OTE). Surprisingly, it is now designing single touch payroll so that it still cannot measure this.

The consequence is that ATO SG compliance is largely based on employee notifications, and many of these are only after the employee has left the irresponsible employer. Because employees have no view of the SG base, they tend to report when they have been paid nothing at all, rather than when they have received a partial payment. The ATO has chosen not to use its superior wage and superannuation contributions data to estimate or identify partial payment, even though it has the option to significantly improve its systems using single touch payroll and real time Superstream information (which is necessary for a real time assessment of balance and contribution caps).

Australian Securities and Investments Commission (ASIC) statistics show that superannuation is unpaid by insolvent companies far more often than employee wages. ASIC Insolvency Statistics[3] for 2015-16 show that 39.2 per cent of administrator reports included unpaid superannuation but only 18.7 per cent reported unpaid wages. Furthermore, the amounts of unpaid super are higher than unpaid wages – 6.9 per cent of reported insolvencies included superannuation debts in excess of $100,000 while only 2.7 per cent of reports had unpaid wages of this scale.

On this basis, real time ATO monitoring of unpaid SG could provide a leading indicator of companies at risk of insolvency. Real time ATO compliance, combined with a revision in the ATO administration of the Director Penalty Notice System could reduce unpaid entitlements subsequently covered by the FEG.

Table 1 below from paragraph 170 of the ATO submission to the *Senate Economics Legislation Committee Inquiry into the impact of the non-payment of the Superannuation Guarantee* shows that over 50 per cent of SG debt is irrecoverable because of insolvency.

Table 1 - Trend in SGC debt

SGC	2011-12		2012-13		2013-14		2014-15		2015-16	
	$m	Cases	$m	Cases	$m	Cases	$m	Cases	$m	Cases
Collectable	340.14	11,231	403.35	12,879	461.59	17,389	521.39	25,281	622.62	25,665
Disputed	45.17	358	71.44	483	35.98	380	24.57	212	28.33	247
Insolvent	454.27	6,089	461.17	5,561	517.57	5,774	598.41	6,541	718.34	7,977
Total	**839.58**	**17,678**	**935.96**	**18,923**	**1,015.14**	**23,543**	**1,144.37**	**32,034**	**1,369.29**	**33,889**

Source: ATO submission to Senate Economics Legislation Committee, Inquiry into the impact of non-payment of the Superannuation Guarantee, [170].

Table 2 demonstrates that the industries most at risk of unpaid superannuation also had the least collectable debt.

[3] Australian Securities and Investments Commission, REP 507: Insolvency statistics: External administrators' reports (July 2015 to June 2016), 1 July 2015.

Table 2 - SGC collectable debt by industry (top six) at 30 June 2016

Industry	Debt ($m)	Proportion
Construction	85.0	14.7%
Accommodation and food services	81.5	14.1%
Manufacturing	53.8	9.3%
Administration and support services	52.3	9.0%
Other services	50.8	8.8%
Retail trade	48.2	8.3%

Source: ATO submission to Senate Economics Legislation Committee, Inquiry into the impact of non-payment of the Superannuation Guarantee, [178].

Professor Helen Anderson's submission and testimony to the Senate Economics Legislation Committee Inquiry into the impact of the non-payment of the Superannuation Guarantee (Inquiry into SG non-payment) highlighted that the three week period between the issue of a Director Penalty Notice and the directors becoming liable was a signal to make the company insolvent. One option is to make the liability effective immediately unless a rectification plan is agreed. Professor Anderson is largely concerned with phoenix companies, so her option is to prevent director's becoming directors or principals in new companies. But phoenix strategies are only a proportion of all insolvencies impacting the FEG, and there should be more effective penalties on all directors who do not pay legislated entitlements.

The ATO submission to the Inquiry into SG non-payment also highlighted the need for action on Director Penalty Notices and the quarterly payment of superannuation:

> 185. Administrative improvements to the recovery of SGC potentially could be achieved by improving the systems that support the issuing of DPNs.
>
> 186. It appears that a significant reduction in the amount of unpaid SGC can only be achieved by some improvements in the effectiveness of the Commissioner's and insolvency practitioner recovery powers, or by the introduction of measures that would reduce the capacity or further increase the personal disincentives for employers to incur SGC liabilities.
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> 187. Since 2012, the Director Penalty Regime (Div 269 of Schedule 1 to the Taxation Administration Act 1953) ("the TAA") has applied to company SGC liabilities. This generally enables the Commissioner to achieve recovery of the SGC liabilities by pursuing a parallel liability imposed on the company directors in the form of a penalty.
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> 188. However, the liquidation or voluntary administration of the company automatically extinguishes any director penalty which was not already the subject of a Director Penalty Notice (s269-25 of the TAA) issued more than 21 days prior to the commencement of the insolvency administration or where the associated SGC liability was not reported for more than three months at the time that the administration commenced. Given that the reporting date for SGC is two months following the end of the quarter, it is often the case that the eventual liquidation of the company extinguishes the director penalties related to the past eight months of the company's unpaid superannuation obligations.[4]

One obvious improvement is to make SG payable monthly. This would significantly enhance the real time detection of unpaid superannuation, the use of DPNs and the liabilities of the FEG.

[4] ATO submission to Senate Economics Legislation Committee, Inquiry into the impact of non-payment of the Superannuation Guarantee, [185]-[188].

3. Support legislative reform to make recovering costs of FEG easier

3.1 Priority of creditors and trust assets

This section addresses questions 10 and 11 of the Consultation Paper.

Sections 433, 556 and 561 of the Corporations Act provide for the priority of employee entitlements[5] in insolvency generally (section 556) and in receivership and in liquidation where there are circulating security interests (sections 433 and 561). Treasury proposes reforming the law to clarify that each of these sections applies to insolvent trustee companies.

There is evidence in the Consultation Paper to suggest that people may use trust structures to avoid paying employee entitlements.

The common law rules for the distribution of property in case of insolvency reinforce the primacy of the trustee's role as legal custodian for the beneficiaries' property. A trust is not a legal entity, but a legal relationship in relation to identified property. It is a relationship between the legal owner (the trustee) and the beneficial owner (the beneficiary) of the trust property.

When a trustee, acting within its powers, incurs a debt in respect of the trust assets, the trustee is entitled to indemnity in respect of trust liabilities.[6] This indemnity is in the form of an equitable lien over trust property so that the trustee can fully satisfy any debts it has incurred in its capacity as trustee. For creditors, this means that the trust property that the trustee legally owns is not available for distribution among the company's general creditors because it is subject to an equitable lien. The creditors have a right to be subrogated to the trustee's lien and rank pari passu in the distribution of assets.

The present issue is whether, in the case of the distribution of the assets of an insolvent trustee company, employee entitlements take priority over other creditors as specified in sections 433, 556 and 561 or whether the common law rules governing the distribution of trust assets apply. The weight of recent Victoria and New South Wales Supreme Court authority suggests that the existing common law principles remain undisturbed by these sections.

- In *Re Independent Contractor Services (Aust) Pty Ltd (No 2)* (Re Independent Contractors) the New South Wales Supreme Court held that the priorities in section 556 did not apply to trust assets. Justice Brereton reasoned that the trustee is entitled to indemnity in respect of debts that it has incurred in furtherance of the purposes of the trust and that the trustee has an equitable lien over the trust property to satisfy those debts. This property is therefore not available for distribution among the company's general creditors because it is subject to an equitable lien. The creditors have a right to be subrogated to the trustee's lien and in the case of multiple creditors, they rank pari passu and the rules in section 556 did not apply.[7]

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[5] Employee entitlements include wages, superannuation and superannuation guarantee charge payable to employees of the company, amounts due under an industrial instrument to employees of the company and in respect of leave of absence, and retrenchment payments to employees: *Corporations Act 2001* (Cth), section 556(1)(e), (g) and (h).

[6] *Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 245.

[7] *Re Independent Contractor Services (Aust) Pty Ltd (No 2)* [2016] NSWSC 106, [23]-[24].

- The 2017 Victorian Supreme Court decision in *Re Amerind Pty Ltd (Receivers and Managers Appointed) (In Liquidation)* applied the reasoning in Re Independent Contractors with approval in the context of the section 433 priorities.[8]
- However, the Victorian Supreme Court in the 2016 decision of *Re Pharmore* held that the section 556 priorities did apply to trust assets owned by an insolvent trustee company, to the exclusion of the relevant common law rules.[9]

ISA supports reforming the law in limited circumstances to allow employee entitlements to be recovered with priority from insolvent trustee companies. However care must be taken to ensure that the common law is not exposed to watering down other trust arrangements by reason of amending these sections. To avoid diluting the protections of other trust arrangements, the class of creditors who can access trust property in insolvency should be very clearly defined.

3.2 Civil penalty provisions for directors

This section addresses questions 1, 2, 3 and 4 of the Consultation Paper.

Sections 596AB and 596AC of the Corporations Act have been ineffective in curbing phoenix activity.

The Consultation Paper notes that ASIC has not brought any criminal proceedings under section 596AB.[10] Section 596AC has been similarly ill-used.

A new civil penalty provision importing an objective test could provide a solution to the problems presented by the existing provisions.

The major hurdle presented by section 596AB is the difficulty proving the fault element of the charge beyond reasonable doubt. A successful prosecution under section 596AB would prove beyond reasonable doubt that a director entered into a relevant agreement or transaction and that the director entered that relevant agreement or transaction with the intention of either preventing the recovery of the entitlements of employees of a company or significantly reducing the amount of entitlements of employees of a company that can be recovered.

Of course criminal charges must always be proven to the beyond reasonable doubt standard. This submission seeks only to focus on the criminal offence as it is relevant to civil proceedings and recovery of FEG payments. We do not propose to comment on Treasury's proposals regarding reform to 596AB.

Section 596AB is relevant to civil proceedings because it is the test imported for the purpose of civil proceedings under section 596AC.

Even to a civil proceedings standard of proof on the balance of probabilities, it would be very difficult to prove the elements outlined above.

Instead, we propose the insertion of a new civil penalty provision with an objective test as outlined in the *Phoenix activity: recommendations on detection, disruption and enforcement* report.[11]

An objective test would combat the problems proving specific intention even with a civil proceedings balance of proof. It would also signal to directors of companies that courts will have practical

[8] [2016] VSC 127.

[9] Unreported, Victorian Supreme Court, 2016, extracted in *Re Amerind* [2016] VSC 127, [246].

[10] FEG Consultation Paper, 8.

[11] Helen Anderson, Ian Ramsay, Michelle Walsh and Jasper Hedges, *Phoenix activity: Recommendations on detection, disruption and enforcement*, February 2017, 94.

oversight of company activities around the time of insolvency and that these activities will be scrutinized using a reasonableness test.

3.3 Piercing the corporate veil

This section addresses questions 5, 6 and 7 of the Consultation Paper.

Treasury proposes amending the law to require members of corporate groups to make contributions towards the liabilities of an insolvent company within a corporate group in certain circumstances. This is also known as piercing or lifting the corporate veil and would be an appropriate course because it would better align the law with commercial reality.

The separate legal entity doctrine is the foundation principle of corporations law that on incorporation a company becomes a separate legal entity from its owners (the shareholders).[12] When a company acts it does so in its own right and not just as an alias for its controllers.[13] Likewise, the liability of the owners of the company is limited because they are responsible for the debts of the company only to the extent of the value of their shareholding.

The separate legal entity doctrine was affirmed in the English case of *Salomon v Salomon & Co Ltd* in 1897. This case has since been accepted as part of the Australian common law and enacted in the Corporations Act.[14] While providing for distinct corporate personality has had a profound and important effect on the ability of people to conduct commerce, it is important to remember that *Salomon's Case* was decided in a time before the complex corporate groups that we know today. The continuing relevance of strict adherence to the *Salomon* principles warrants consideration in the context of employee entitlements.

As noted in the Consultation Paper, corporate structures may be misused in a number of ways including, for example:

- Transferring assets to different members within a corporate group to avoid liabilities in insolvency, including employee benefits (phoenix activity); or
- Small partnerships and individual traders using the corporate form to avoid liability.[15]

This misuse of corporate structures produces negative social consequences when used for phoenix activities: employees are left with unpaid entitlements, contractors are left unpaid for services and the FEG scheme is left to recover outlays from the limited assets (if any) remaining.

Treasury's proposal to pierce the corporate veil delineating related corporate entities within a group would be consistent with the established principles (and underlying policy of) corporate law in Australia. While piercing the corporate veil is a significant step, it is not unprecedented. There are many examples in legislation and at common law where the corporate veil has been pierced:

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[12] *Salomon v Salomon & Co Ltd* [1897] AC 22.

[13] Ian Ramsay and David Noakes, 'Piercing the Corporate Veil in Australia' (2001) 19 *Company and Securities Law Journal* 250, 251 citing *Gas Lighting Improvement Co Ltd v Inland Revenue Commissioners* (1923) AC 723, 740-741 and *Hobart Bridge Company Ltd v Federal Commissioner of Taxation* (1951) 82 CLR 372, 385.

[14] See, e.g., *Ascot Investments Pty Ltd v Harper* (1981) 51 ALJR 233; *Alan Bond and Ors v Australian Broadcasting Tribunal* (1989) 89 ALR 185; *Walker v Wimborne* (1976) 137 CLR 1; *Industrial Equity Ltd v Blackburn* (1977) 137 CLR 567; *Pioneer Concrete Services Ltd v Yelnah Pty Ltd* (1987) 5 ACLC 46 and *Corporations Act 2001* (Cth), section 124.

[15] Gonzalo Villalta Puig, 'A Two-Edged Sword: Salomon and the Separate Legal Entity Doctrine' [2000] 7 *Murdoch University Electronic Journal of Law* 32, [16].

- **Rules against insolvent trading.** Sections 588G and 588V of the Corporations Act provide for situations in which companies other than the insolvent company can be liable for the its debts.
  - **Section 588G** sets out a director's duty to prevent insolvent trading by the company and outlines civil and criminal penalties for breaches. The public policy underpinning this section is to allow for private enforcement by creditors on a company. Significantly, however, the section allows the personal assets of the director to be used for the repayment of the company's debts.
  - Under **section 588V**, the holding company of an insolvent company can be liable for the insolvent company's debts in certain circumstances, such as if there are reasonable grounds for believing that the subsidiary company is insolvent.
- There are a number of grounds at **common law** when the court may decide to pierce the corporate veil. For example:
  - **Corporate groups.** It has been successfully argued that the corporate veil separating entities in a corporate group should be pierced on the basis that the group is operating in such a manner as to make each individual entity indistinguishable.[16]
  - **Fraud.** In *Re Neo* the Immigration Review Tribunal found that a company sponsoring a visa applicant, which had been incorporated on the same day as the visa application, "was merely a vehicle used to circumvent Australian migration law. It was only a façade, its true purpose being to allow the applicants to remain in the country."[17] While this case considered principles of Australian migration law, it demonstrates how the Tribunal was willing to look beyond the separation of ownership and control in the case of fraud of Australian law.
  - **Agency.** In *Barrow v CSR Ltd* the court pierced the corporate veil between parent and subsidiary by finding a parent company responsible for the actions of a subsidiary in relation to an employee of the subsidiary contracting asbestosis.[18]

Benefits

Treasury's proposal would see the corporate veil being pierced in very narrow circumstances. There would be several benefits to this:

- Greater certainty for everyone involved
  - The common law rules dictating when the corporate veil may be pierced are inconsistent. Courts have struggled to reconcile maintaining the sanctity of the separate legal entity doctrine, while developing principles that reflect the economic and social goals of the law.[19]
  - Similarly, the common law rules are focused on the nature of the corporate entity rather than on the outcome for creditors. This is not a criticism of the common law; it is merely an observation.

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[16] *Taylor v Santos Ltd* (Unreported, Supreme Court of South Australia, Doyle CJ, Prior and Olsson JJ, 11 September 1998); *Dennis Willcox Pty Ltd v Federal Commissioner of Taxation* (1988) 79 ALR 267, 272; *James Hardie & Coy Pty Limited v Putt* (1998) 43 NSWLR 554, above n12, 14.

[17] *Re Neo* (Unreported, Immigration Review Tribunal, Metledge M, 30 July 1997) extracted in n 12, above, 12.

[18] Unreported, 4 August 1988, Supreme Court of Western Australia, Rowland J, 5.

[19] See, e.g., Nicholas James, 'Separate Legal Personality; Legal Reality and Metaphor' (1993) 5 *Bond University Law Review* 293.

- By amending the Corporations Act to provide for piercing the corporate veil in limited circumstances, the law would make clear when entities other than the insolvent company itself may be liable for the insolvent company's debts.

- Align the law with the realities of commercial life
  - There is a tension between the realities of commercial life, where (non-legal) persons interacting and transacting with corporate groups may not consider which entity within a corporate group they are dealing with, while the law clearly delineates liability between corporate entities within a group.[20]
  - Amending the law to provide for liability for solvent members of a corporate group would partially address the injustice occasioned by the strict application of the separate legal doctrine rule.
- Balance the focus of corporate law between facilitating economic activity and addressing the social impacts of abuse of corporate structures (such as through phoenix activities)

Concerns

- Allocating risk
  - Allocating risk among entities within a corporate group is an important advantage of corporations law. Australia's economy depends on people being able to confine the risk of liability in order to take commercial risks. Being able to allocate risk in this way is one way that the state encourages innovation and commerce.
  - Any proposal to disrupt the separation of ownership and control as a mechanism to allocate risk must carefully consider the implications for commerce.

The appropriate solution to this is that the law be amended to allow for an insolvent company's related entities to be liable for the employee entitlements. It is appropriate that piercing the corporate veil occur through court proceedings.

A 'just and equitable' test for piercing the corporate veil is a good starting point because it would place the decision in the hands of a court with the benefit of the body of relevant legal principles behind it.

ISA proposes two options:

1. **Legal presumption in favour of piercing corporate veil for employee entitlements in very limited circumstances**

Persons with standing make an application to the court for the insolvent entity's related entities to be liable for employee entitlements. The employees and the liquidator would have standing to make an application.

There would be a rebuttable legal presumption that the insolvent entity's related entities are liable for the employee entitlements of the insolvent entity. This presumption could be rebutted if the related entities could show why it would be "unjust" for them to shoulder the burden.

Considerations informing an argument about whether it would be "unjust" for the corporate veil to be pierced could include (in addition to those outlined in the consultation paper in relation to the 'just and equitable' test in other jurisdictions):

- Evidence of the structure of the corporate group. For example, to show that the links between the insolvent entity and other entities in the corporate group are tenuous.

[20] *Qintex Australia Finance Ltd v Schroders Australia Ltd* (1990) 3 ACSR 267.

- Evidence that the related entities were not reasonably aware of the insolvent entity's solvency status.

2. **Balance of probabilities 'just and equitable' test**

Persons with standing would make an application to the court for the veil to be pierced by satisfying a 'just and equitable' test.

To achieve the policy intent of the changes, it would be necessary to provide guidance to courts applying the test. This is nothing that the policy intent of these amendments is not to allow the simple metaphysical distinction of separate legal entities to stop recovery.

While there is guidance from other jurisdictions about what constitutes 'just and equitable,' it would be appropriate for the legislature to guide the interpretation of these words in this particular policy context. This is because in New Zealand and Ireland, the 'just and equitable' test applies in respect of general debts of a company rather than specifically employee entitlements.

Guidance could be provided in an explanatory statement when the legislation is introduced, in the speech of the minister introducing the guidance, in the actual legislation or by regulation.

4. It makes sense to include unpaid SG in the FEG

The Consultation Paper's proposed amendments to the Corporations Act aim to assist the Department of Employment to recover more FEG outlays.

The Consultation Paper makes clear that there is increasing use of the FEG since its predecessor's introduction in 2000.[21]

It is essential that we take action to make the FEG scheme sustainable into the future through legislative reform to combat corporate misuse of the scheme, such as through phoenix activities.

While including unpaid SG in the FEG scheme's mandate may increase initial outlays, it makes sense to include unpaid SG in the FEG scheme:

- Not including unpaid SG in the FEG scheme's mandate is a quirk of the legislation that does not reflect the reality of working people.
- Superannuation is part of an employee's wages and is appropriately characterised as 'deferred wages'.[22] It is not a conceptually distinct entitlement that warrants separation from recovery of other workplace pecuniary entitlements.
- Increasing the regularity of SG payments would provide government with an early indicator of businesses in trouble. Many accountants agree that inability to meet SG obligations is one of the first signs that a business is having cash flow problems or heading towards insolvency.[23] This could avoid or lessen the number of people accessing the FEG.
- In Forward Estimates, the Department of Employment estimated that the fiscal impact of including and administering SG as part of the FEG would be approximately $840 million. If this estimate is correct, recovering unpaid SG would likely reduce reliance on the Age Pension and directly add to contributions tax.

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[21] FEG Consultation Paper, 3.

[22] Senate Economics References Committee, *Superbad – Wage theft and non-compliance of the Superannuation Guarantee* (Inquiry into SG non-payment), May 2017, 82

[23] ISA Supplemental Submission, 21; submissions 3, 8 and 25 to Inquiry into SG non-payment.

- Similarly, it would incentivise the government to be more proactive in recovering unpaid SG and preventing serial insolvencies.

Including unpaid SG in the FEG scheme is not unthinkable. The Senate Economics References Committee in their May 2017 final report into non-payment of SG recommended that the relevant government agencies further consider expanding the current FEG scheme to cover unpaid SG entitlements. Now is the time for that expansion to happen.

5. Role of the Australian Tax Office and Other Agencies

When considering including unpaid SG in the FEG scheme's mandate, it is important to consider how the ATO has fared in its role as the custodian of the Australian superannuation system and more specifically, how it has fared in its role recovering unpaid SG.

The ATO is the core public institution responsible for the vital function of collecting federal revenue. It has understandably prioritised revenue collection activities, and reviews of its superannuation responsibilities suggest that these matters have received a lower priority and lower resourcing.[24] It is suggested that this may have affected the execution of these responsibilities.

These factors have affected the manner in which the ATO has performed its role in superannuation over the years.

In its 2015 audit of the ATO,[25] the Australian National Audit Office (ANAO) found that the Superannuation Guarantee scheme had been operating largely without ATO intervention.[26] This was despite the ATO's own findings that non-payment of super is "endemic" in certain industries where employees are likely to have a significant need for super to supplement the aged pension.[27]

ANAO observations and concerns about the ATO's approach to superannuation show how transferring responsibility for recovery of unpaid SG to the Department of Employment is desirable:

- In connection with undertaking its superannuation responsibilities, the ATO has in some instances placed excess emphasis on employee notification of unpaid superannuation. This has come at the cost of better use of existing and new information and of field investigations.
- The ATO's prioritisation of superannuation matters may have contributed to the instances in which the ATO has not pursued unpaid super in employer insolvency proceedings, despite employee notice, and the slow responsiveness to employee notifications of non-payment, notwithstanding that this is a situation where time is of the essence given the high correlation between non-payment of SG and employer insolvency.
- A greater attention to behavioural risks and individual experience of superannuation could have aided the ATO review of SG compliance. General SG compliance was assessed by testing whether overall employer contributions exceed the statutory percentage of salary and wages paid. A better methodology might have taken into account that some employers pay higher than legislated levels of SG, while others pay less or make no contributions, and that some

[24] Australian National Audit Office, *Promoting Compliance with Superannuation Guarantee Obligations*, Performance Audit No 39 (2015) (ANAO report).

[25] ANAO report.

[26] ANAO report, 18.

[27] ANAO report, 17-18. The report identified small and micro businesses and industries with large numbers of cash transactions as key problem areas for unpaid SG.

employers pay no SG at all;[28] and a lower reliance on employee notifications regarding unpaid super insofar as employees are "reluctant to complain to the ATO about unpaid SG".[29]

- The ATO's relatively low capacity to prioritise superannuation matters has been illustrated by (i) the instanced in which the ATO has not pursued unpaid super in employer insolvency proceedings, despite employee notice, and (ii) the ATO's responsiveness to employee notifications, which have too often been slow notwithstanding that this is a situation where time is of the essence given the high correlation between non-payment of SG and employer insolvency.

6. Proposed action

Two things are clear: the ATO is not well-equipped to recover unpaid SG and the FEG scheme is. In light of this, we propose that the government legislate to:

1. Include unpaid SG in the FEG scheme
2. Increase the frequency of employer SG deposit to provide government agencies with an early indicator of businesses in trouble
3. Improve information collection and analysis within the ATO as outlined in section 2
4. Enhance and extend information sharing between the ATO and the Fair Work Ombudsman and ASIC to protect employee superannuation entitlements.
5. Amend sections 433, 556 and 561 of the Corporations Act as outlined in section 3.1
6. Insert a new civil penalty provision in the manner suggested in section 3.2
7. Reform the law to allow piercing of the corporate veil in particular circumstances to allow recovery of employee entitlements as proposed in section 3.3

Improved information sharing should not only involve information going from the ATO to the Fair Work Ombudsman and ASIC. Professor Helen Anderson's testimony to the Inquiry into SG non-payment demonstrated that there is considerable scope for ASIC insolvency information to be fed to the ATO.

> **Prof. Anderson:** I am not sure what legislative changes would be required, but it has reminded me of one thing. It is interesting that in the third party reports to the ATO there is a huge amount from the Fair Work Ombudsman and nothing from ASIC. At the end of every insolvency, the external administrator sends a report about a given company to ASIC estimating how much was not paid in wages and super and all sorts of bits of information. ASIC does not appear to pass any of that on to the ATO, and I find that quite startling. There are roughly 8,000 liquidations per year, and that information they have gathered could be passed on. That may be a structural issue within the ASIC Act, perhaps. There are privacy concerns there about disclosing that information, because it does not lead to a specific prosecution, perhaps. But it seems to me that is a valuable amount of information that ASIC gathers as part of its own operations, that could be useful here.
>
> **CHAIR:** On what basis have you formed the conclusion that ASIC is not passing that information on to the ATO?

[28] ANAO report, 20-21, 49-51.

[29] ANAO report, 21; Anderson H and Hardy T, 'Who should be the super police? Detection and recovery of unremitted superannuation' (2014) 71(1) *University of New South Wales Law Journal* 168.

> **Prof. Anderson:** The statistics in one of the submissions—perhaps it was the ATO's submission—had a little table of third-party referrals. It had 3,000-odd referrals, and it had around 2,500 from the Fair Work Ombudsman, and other categories. You will be able to find it I am sure. But given that roughly 40 per cent of insolvencies involve unpaid superannuation and there are 8,000 liquidations per year, you would expect thousands, potentially, to come from ASIC to the ATO.

There is a clear need to modify privacy restrictions so that they do not impede the legislated mandate of Commonwealth Agencies to act when insolvent companies have unpaid employee entitlements.