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CHARTERED ACCOUNTANTS™
AUSTRALIA + NEW ZEALAND

Ms Nathania Nero
Senior Adviser
Corporations Policy Unit
Consumer and Corporations Division
The Treasury
Level 5, 100 Market Street
SYDNEY 2000
Via email: Phoenixing@treasury.gov.au

Dear Ms Nero

Reforms to combat illegal phoenix activity – Draft Legislation

Chartered Accountants Australia and New Zealand welcomes the opportunity to provide a submission to Treasury on the draft legislation – *Reforms to combat illegal phoenix activity*. We have provided our feedback on the key components of the draft legislation. Appendix A provides our detailed submission and Appendix B provides more information about Chartered Accountants Australia and New Zealand.

Key points

- Overall, we support reforms to combat illegal phoenix activity, however we consider that this could have been achieved via amendments to existing laws rather than new, highly complex legislation.
- The impact of the new phoenix offences will be that every disposition undertaken by a business in the ordinary course of business may need evidence to support it was at market value or in good faith. We recommend that amendments are drafted such that the burden of proof reflects circumstances more indicative of phoenix intentions.
- We support reforms to prevent back dated director resignations and preventing a sole director from resigning. The amendments should be extended to prevent the number of directors being below the minimum specified in a company's constitution.
- We are concerned that the amendments to allow the ATO to retain refunds are too broad and should be amended to apply only to specific phoenix situations.

Should you have any queries concerning the matters raised in our submission or wish to discuss them in further detail, please contact Karen McWilliams via email at karen.mcwilliams@charteredaccountantsanz.com or phone (612) 8078 5451.

Yours sincerely,

Simon Grant FCA
Group Executive
Advocacy & Professional Standing
Chartered Accountants Australia and New Zealand

Karen McWilliams FCA
Business Reform Leader
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Appendix A

General Comments

Overall, we support reforms to combat illegal phoenix activity, however we consider that this could have been achieved via amendments to existing laws rather than new, highly complex legislation. We also note that to achieve the policy objective, this legislation needs to be passed alongside proposed reforms to the Fair-Entitlements Guarantee (FEG) scheme and the introduction of Director Identification Numbers (DIN).

Creation of new phoenix offences

We note that the drafted legislation is quite complex and may be particularly difficult for small business directors to understand (see comments below about improvements needed to director education).

We are pleased to see that the safe harbour defence has been extended to cover creditor defeating dispositions for both officers and promoters. However, there are concerns that small business may not be able to take advantage of safe harbour provisions, given these include obtaining external advice which can be costly. Our members have also expressed concerns that an unintended consequence of this legislation could be the manipulation and/or exploitation of the safe harbour defence for outcomes that it was not intended for.

We note that the exemptions to voidable transactions in section 588FE(6B)(c) includes dispositions made under a deed of company arrangement, court arrangement or by a liquidator or provisional liquidator. However it appears that receivership, controller arrangements and voluntary administrations are not included, and we recommend this section is amended to include these appointments as well.

We note that the default presumption is that all dispositions which took place at the time of insolvency or 12 months before are creditor defeating dispositions unless the officer can prove it was at market value or in good faith. We are concerned that the burden of proof that a disposition is not voidable lies with the officer and not the court.

We think that the likely result of this legislation will be that all dispositions will need to have supporting evidence that they took place at market value to protect officers and advisors in the normal course of business. There also appears to be no consideration of materiality or thresholds for creditor defeating dispositions. We note that the explanatory memorandum specifically defines market value as being ascertained in dealings between non-anxious parties, however this is difficult to prove and would also be unlikely in the circumstances given the business may be distressed.

Our members have also expressed concerns about how market value will be tested and proven in practice. We consider that there will need to be a level of judgement and common sense in the application of the legislation and whether transactions are at arm's length. For example, the quality and independence of the valuer used or the nature of the consideration and whether it includes the assumption of certain liabilities or extended payment periods. We also note that there will need to be consideration of how market value can be supported for intangible assets such as a brand, IP and customer lists. Therefore guidance will be needed in relation to the form of evidence that officers will need to support the disposition.

Liquidator and ASIC claw back provisions

There will be costs involved in pursuing voidable transactions, and this is particularly relevant in situations where the company only has liabilities remaining. ASIC's ability to issue a notice on the application of a liquidator to recover a "voidable creditor-defeating disposition" seems to be similar to a Section 139ZQ Notice in a Personal Insolvency situation. We understand that there are some issues with s139ZQ notices in respect of who is liable for the associated costs when the circumstances behind the issue of a notice are deficient. Therefore we recommend that this is considered and clarified during the drafting of this legislation.

Appendix A

The legislation also enables ASIC to pursue this clawback on its own application/initiative in the event that it doesn't think that the liquidator is doing what should be done to recover the transaction. If the property is then subsequently recovered, we recommend there is further clarity around how the funds are then accounted for through the liquidation. For example, would they go back to the existing liquidator to then distribute or is a separate liquidator appointed for this purpose?

Prevention of directors backdating resignations

We support the prevention of director's back dating their resignation. Consistent with our earlier submission, we recommend that the 28 day lodgement period be reduced to a period consistent with other legislation.

Prevention of sole director's resigning

We support the provisions to prevent a sole director resigning from a company. We note, however, that similar situations could exist if the number of directors of a company falls below the minimum specified in the company constitution. We therefore recommend that this provision is extended to apply to these circumstances.

Restriction of related creditor voting rights

We support the restriction of related party creditor voting rights to the consideration paid for the debt when voting on resolutions relating to the appointment or removal of the external administrator. We understand that in personal insolvency situations, the consideration of assigned debt is applicable for voting purposes for all resolutions. Our members have suggested that this restriction should be applicable to all creditors for these specific resolutions, not just related creditors. This is on the basis that other parties may purchase debts at a discount specifically to influence the outcome of a liquidation. However, we note that this could impact on financing arrangements as some third parties may not wish to disclose the amount they have paid for the debt.

Extension of director penalty notices to include GST

Extending director penalty notices (DPN) to include GST has been discussed on a number of occasions. The black economy taskforce and the phoenix taskforce have highlighted the significant impact that phoenix operators have on the Australian economy. The industries where phoenix operators are prevalent often generate significant GST liabilities. As such, many of our members, but not all, support the extension of director penalty notices to cover GST.

Broadly speaking, we acknowledge that the DPN rules may operate as a tool to motivate timely reporting of BAS debts to the ATO, assuming they are designed to mirror the PAYG regime. We understand that these rules should not modify the priority structure, only the corporate veil in certain circumstances. Therefore, if designed and implemented properly, we would support the extension of the DPN to GST, provided we consider the rules contain sufficient checks and balances/warning systems to ensure fairness for directors, and on balance are in the public interest. It must be borne in mind that both GST and PAYG in Australia involve very complex provisions which are uncertain in their application and can give rise to legitimate disputes as to the existence of tax liabilities. This reality must be accommodated for in any DPN rules so that they strike the right balance between those seeking to comply with the system, and those seeking to game the system.

We also note that the original consultation paper did not raise the possibility of the ATO having the ability to estimate GST. It is unclear why the ATO requires this power given that it already has the ability to issue default assessments. Nor is it clear how the level of care (and thus standard of proof and time) required to issue a GST estimate would be different to that needed to issue a GST default assessment. Thus it is unlikely that the ATO would have any advantage by producing a GST estimate rather than a GST default assessment. In contrast, a taxpayer needs to make a statutory declaration to overcome a GST estimate which could leave the taxpayer open to criminal prosecutions if it is wrong. No such jeopardy faces a taxpayer in making an objection to a default assessment.

Appendix A

We do not support the ATO being able to estimate GST liabilities for the following reasons:

- No justification has been provided for not using the existing default assessment provisions;
- The dispute process regarding GST estimates leaves taxpayers open to penalties that are more severe than those under the existing tax law.

Extend ATO's power to retain refunds

The original policy consultation on combatting illegal phoenix activity envisaged a system whereby phoenix operators were distinguished from other taxpayers by adopting a two-step process: firstly designating them as a higher risk entity and then allowing the Commissioner of Taxation to declare that a high risk entity is also a high risk phoenix operator. In our submission to that consultation, we raised concerns about the Commissioner of Taxation's use of discretion in relation to phoenix activity and called for there to be some high level criteria for consideration by the Commissioner and for a review process.

The draft legislation has dispensed with the proposed system to identify phoenix operators. As such the ability of the ATO to retain refunds can apply to any taxpayer with an outstanding lodgement or other information. These are significant changes to the tax system and application of them could have devastating consequences for taxpayers – particularly small taxpayers who do not have the resources to dispute ATO actions. We recommend that if these proposed provisions are retained, they should be restricted in a manner similar to that outlined in the original policy consultation.

We note that the ability of the ATO to retain refunds where a liquidator has been appointed could adversely impact the ability of the liquidator to manage the entity and affect the entitlements of other creditors. We recommend the legislation be amended to clarify its application in both pre-insolvency situations and following the appointment of an administrator.

Education of new directors and the role of professional advisers in managing risk

Clearly, recent policy initiatives have added substantially to the duties and responsibilities on directors. We are concerned that this is occurring in an environment where ASIC and other regulators are being challenged to "get tough" on suspect companies and their directors. We think it is therefore incumbent on both government and relevant regulators to devote additional resources to the education of directors, particularly those associated with start-up entities.

We are keen to collaborate with regulators on the co-design and roll-out of suitable education materials, which help new directors understand the tasks ahead and the risks associated with their role.

Given the important role our members in public practice play in the business community, we also feel there is merit in exploring (for risk management purposes) how regulators can identify which start-ups are being guided by trusted professionals vis-à-vis those who receive no such support. Good accountants help create and grow good businesses and regulator risk models should acknowledge the quality of adviser input.

Appendix B

About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 120,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation professional accountants across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.