Australian Government
Inspector-General of Taxation

REVIEW INTO THE ATO'S FRAUD CONTROL MANAGEMENT

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We thank the Inspector-General of Taxation for this opportunity to make a submission regarding the review into the ATO's fraud control management. We are a group of academics currently undertaking an Australian Research Council-funded project examining the regulation of illegal phoenix activity. Our aim is to devise ways in which this damaging behaviour can be most efficiently and effectively prevented and deterred, without damaging legitimate business activities to the detriment of the economy.

As well as a series of scholarly and professional publications, we have produced three major reports: *Defining and Profiling Phoenix Activity* (December 2014); *Quantifying Phoenix Activity: Incidence, Cost, Enforcement* (October 2015), and *Phoenix Activity: Recommendations on Detection, Disruption and Enforcement* (February 2017). Please click here to access these reports.

Introduction

In this submission, we recommend a number of measures to improve the identity verification of company directors and the ATO's regulation of illegal phoenix activity. The following is a brief summary of these recommendations, which are discussed in greater depth in the body of the submission.

- **Recommendation 1:** Directors of companies should be required to obtain a director identification number after proving their identity with 100 points of identification.
- **Recommendation 2:** Changes to directorships should only be able to be backdated up to three months.
- **Recommendation 3:** The government should review the desirability of business service providers selling aged shelf companies.
- **Recommendation 4:** The government and ATO should proceed with the implementation and administration of the measure announced in the Budget 2016–17 Mid-year Economic and Fiscal Outlook to allow the ATO to disclose certain tax debt information to registered credit reporting bureaus, which was intended to come into effect on 1 July 2017 but appears to have been delayed.
- **Recommendation 5:** The ATO should be empowered to seek a court order disqualifying a person from managing corporations where they have failed to discharge a duty under Division 269 of Schedule 1 of the *Taxation Administration Act 1953* (Cth) and the disqualification is justified.
- **Recommendation 6:** The ATO should have the power to refuse to grant an ABN to a company which lists a person disqualified from managing corporations as an associate.

- **Recommendation 7:** The director penalty notice ('DPN') regime in the *Taxation Administration Act* should be expanded to include GST liabilities, and an equivalent to the DPN regime should be introduced in state taxation legislation across Australia.
- **Recommendation 8:** 'Single touch payroll' which requires both reporting *and* payment of tax and superannuation obligations should be gradually introduced, or alternatively, the proposal for automated DPNs should be re-considered.

Background

The concept of phoenix activity broadly centres on the idea of a corporate failure ('Oldco') and a second company ('Newco'), often newly incorporated, arising from the ashes of its failed predecessor where the second company's controllers and business are essentially the same. Phoenix activity can be legal as well as illegal. Legal phoenix activity covers situations where the previous controllers start another similar business, using a new company when their earlier company fails, usually in order to rescue its business. Illegal phoenix activity involves similar activities, but the intention is to exploit the corporate form to the detriment of unsecured creditors, including employees and tax authorities. The illegality is generally as a result of a breach of directors' duties in failing to act properly in respect of the failed company and its creditors.

Recommendation 1: Require directors to obtain a Director Identification Number

All existing and new directors should be required to have a director identification number ('DIN') that would allow ASIC and other regulators such as the ATO to track repeat players accurately. Repeat players might try to conceal their later directorships under the guise of a dummy director – an obliging relative perhaps – or a fictitious character, or their own name misspelt or a false date of birth. At present, the registration of an Australian company simply requires the name, address, and date and place of birth of each proposed officeholder.[1] ASIC's incorporation form[2] does not ask for the prior corporate history of a new company's proposed directors, and no supporting evidence about the identity of the proposed directors is required. ASIC does not independently verify the information provided to it.

The limitations of the existing company registration requirements could be overcome through the relatively simple and cheap process of requiring directors to establish their own identity via 100 points of identity proof, which would accord with the well-accepted and uncontroversial practice for opening bank accounts and obtaining passports. Directors would then be allocated a unique DIN, which would enable tracking of company directors who have been involved in multiple corporate failures and who may be likely to engage in illegal phoenix activity. This would allow regulators to know that Frank Nadinic, Frane Nadinic and Frank Nadimic are the same person.[3]

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1 *Corporations Act 2001* (Cth) s 117(2) ('*Corporations Act*').

2 ASIC, *Form 201: Application for Registration as an Australian Company* (11 December 2012, last updated 1 July 2014); *Corporations Act* s 117(4).

3 This true example was cited in Senate Economics References Committee ('SERC'), Parliament of Australia, *'I just want to be paid': Insolvency in the Australian Construction Industry* (2015) ('*SERC Construction Insolvency Report*') [12.31]. Mr Nadinic acknowledged registering 32 to 33 companies under these names.

Accurate identity information assists regulators in locating and monitoring those individuals against whom enforcement action might be taken.[4] This sort of identification, done solely based on names and dates of birth and their variants, and in the absence of a unique number, is expensive and extremely time-consuming. A unique DIN, on the other hand, clearly differentiates people and makes them easy to identify. A computer prompt could tell ASIC that a person's DIN has been used for the directorships of dozens of companies that the person is unlikely to be managing or supervising in compliance with their legal obligations.[5] The DIN would also assist other regulators to perform their functions better. For example, the DIN could alert the ATO to potential wrongdoing where an elderly person with no assessable income is the director of numerous companies.[6] The advantages of a DIN are obvious for agencies such as the Australian Criminal Intelligence Commission and the Australian Federal Police, who are seeking to identify and monitor those associated with organised crime[7] and complex illegal phoenix activity.[8] The DIN would also be of benefit to businesses, as the additional transparency would assist in restoring fair competition and trust to the business sector.

The DIN should also be widely circulated. For example, employees should be provided with the DIN of the directors running the employer company on commencement of employment, in the same way that they are provided with the National Employment Standards. Potential creditors should either be provided with the DINs of the company's directors on quotes or other paperwork, or they should be directed towards a company website that contains this information. A duty could be imposed on directors to keep it current.

It is important to note that our DIN recommendation is separate from the debate about revealing, or concealing, the director's home address and date of birth. It has been suggested that this facilitates identity theft.[9] We pass no opinion on whether the current process whereby directors' home addresses are available publicly if a fee is paid should be maintained or not. In that regard, we note that the Irish *Companies Act 2014* has changed address disclosure requirements to enable an officer in specified circumstances to request that their residential address not be shown on the register of companies.[10]

In the event that the recommendation of a DIN is adopted, it must be adequately resourced. ASIC is in favour of checking the identity of directors,[11] and broadly supported the idea

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4 Productivity Commission, Productivity Commission, *Business Set-up, Transfer and Closure*, Report No 75 (2015) 423 ('*Business Set-up Report*') 425.

5 For example, their duties as directors under *Corporations Act* pt 2D.1.

6 See, eg, Australian Broadcasting Corporation ('ABC'), 'Unwitting Clients Signed up as Directors to Failing Businesses', *7.30 Report*, 17 October 2016 (Dan Oakes). The Australian Taxation Office ('ATO') does obtain identity information from 'associates' – those seeking an Australian business number ('ABN') for a company – but this information is not linked to any other company that those associates own or control.

7 See, eg, Australian Crime Commission, *Organised Crime in Australia* (May 2015) 8, 25–6, 65–6.

8 In addition to combatting organised crime and illegal phoenix activity, the DIN would assist in disrupting other forms of financial and corporate misconduct, like the notorious series of alleged incidents involving Mr Philip Whiteman: see Dan Oakes and Sam Clark, *Melbourne Man Identified in Multi-Million Dollar Tax Evasion Investigation Still in Business* (7 February 2017) ABC News <http://www.abc.net.au/news/2017-02-06/melbourne-man-linked-to-tax-avoidance-still-in-business/8244850>.

9 See the concerns of Governance Institute of Australia discussed in Productivity Commission, *Business Set-up Report*, above n 4, 428.

10 *Companies Act 2014* (Ireland) s 150(11); *Companies Act 2014 (Section 150) (No. 2) Regulations 2015* (Ireland).

11 ASIC, Submission No 32 to Senate Economics References Committee, *Inquiry into Corporate Tax Avoidance*, February 2015, 21. The SERC agreed, recommending that 'people who propose to become

before the Productivity Commission,[12] but it has reservations about the cost and logistics of implementation.[13] Some or all of the costs associated with the implementation of this recommendation could be ameliorated if the DIN were introduced as a user pays system. Directors registering for the DIN for the first time could be required to pay a one-off fee to cover or subsidise the cost of the service. The federal opposition has adopted the DIN as one of its policies and suggested a one-off $50 fee to cover implementation.[14] The benefits of incorporation are so significant for business people that the relatively small cost of obtaining a DIN is highly unlikely to discourage any potential entrepreneurs from incorporating a company. If potential directors do not have the financial means to pay a small amount for a DIN, it is unlikely that they are in a position to embark on a new business.

To be effective, DIN information needs to be connected to companies being newly incorporated, existing companies already managed by the director, and deregistered companies with which the director has been associated. The DIN, used as part of the company registration process, would provide significantly more information to ASIC and other regulators such as the ATO than the present paper form does. An online application system, completed by the applicant, is the most efficient. The United Kingdom is moving to an online system.[15] Directors with existing and previous directorships would cite their DIN and the incorporation application form would pre-populate with those details. Directors of existing companies should be required to provide their DIN as part of the completion of the annual review process[16] or annual reporting.[17] Information about associations with previously deregistered companies could be required from directors as part of the process of obtaining DINs.[18] A penalty for false statements would apply, as it does to all other documents lodged with ASIC.[19]

A director's DIN, like a company's ACN, would be publicly available and searchable. That is the point of it. To ensure that wrongdoers do not steal someone else's DIN and utilise it for incorporating companies, it needs to be password protected. Any ASIC lodgement requiring the DIN should require the use of the password.

The proposal to introduce a 100-point identity check and DIN is an urgently needed reform. It will greatly enhance data gathering about directors and their failed companies by ASIC and this data can then be shared with other agencies with enforcement powers including the ATO

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directors of companies be required to provide evidence of their identity to the ASIC': Senate Economics References Committee, Parliament of Australia, *Corporate Tax Avoidance (Part I): You Cannot Tax What You Cannot See* (2015) recommendation 16, [6.75].

12 ASIC, Submission No DR 58 to Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, July 2015, [55]–[59].

13 ASIC, Submission No DR 58 to Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, July 2015, [57].

14 Adam Gartrell, 'Labor Targets Dodgy Company Directors with Crackdown on Phoenix Schemes, *The Sydney Morning Herald* (Sydney), 24 May 2017.

15 In the UK, the *Small Business, Enterprise and Employment Act 2015* (UK) requires the Secretary of State to provide, by 31 May 2017, a streamlined incorporations process, which can be completed online on a single occasion: s 15

16 *Corporations Act* ch 2N.

17 Ibid ch 2M.

18 For example, directors could be asked: 'Have you ever been a director or other officer of a company that has been deregistered either with or without being liquidated? If so, please provide the registered company name (if applicable) and Australian Company Number (ACN) of every company of which you have been a director or other officer that has been deregistered either with or without being liquidated.'

19 *Corporations Act* s 1308(2).

and FWO. Importantly it will ensure that illegal phoenix operators cannot escape detection by creating false identities. Our view is that this reform would substantially reduce illegal phoenix activity and the regulatory burden that this imposes on the ATO. This proposal has been supported widely, including by:

- the Australian Labor Party, which has adopted it as one of its policies;[20]
- the Productivity Commission inquiry into business set-up, transfer and closure;[21]
- the Productivity Commission inquiry into the workplace relations framework;[22]
- the Senate Economics References Committee inquiry into insolvency in the Australian construction industry;[23]
- the Senate Economics References Committee inquiry into corporate tax avoidance;[24]
- the Senate Economics References Committee inquiry into superannuation guarantee non-payment;[25]
- the Australian Restructuring, Insolvency and Turnaround Association ('ARITA');[26]
- Governance Institute of Australia ('GIA');[27]
- the Australian Institute of Company Directors ('AICD');[28]
- the Australian Small Business and Family Enterprise Ombudsman;[29]
- the Australian Chamber of Commerce and Industry;[30] and
- Master Builders Australia.[31]

The DIN also has significant support from insolvency, credit and governance professionals:

- we conducted a survey of members of ARITA in which 57% of respondents 'strongly agreed', and 33% 'agreed', that a DIN should be introduced (n = 148);[32]
- we conducted a survey of members of the Australian Institute of Credit Management ('AICM') in which 73% of respondents 'strongly agreed', and 23% 'agreed', that a DIN should be introduced (n = 120);[33]
- a survey conducted by the Australian Institute of Company Directors ('AICD') found that 67% of AICD members supported the proposal that directors be allocated a unique DIN (n = 225).[34]

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20 The Hon Andrew Leigh MP, Shadow Assistant Treasurer, 'Exposing Dodgy Directors' (Media Release, 24 May 2017).

21 Productivity Commission, *Business Set-up, Transfer and Closure*, Report No 75 (2015) 423 ('*Business Set-up Report*') recommendation 15.6 ('*Business Set-up Report*').

22 Productivity Commission, *Workplace Relations Framework*, Report No 76 (2015) vol 1, 48, vol 2, 915, 938.

23 Senate Economics References Committee, Parliament of Australia, *'I just want to be paid': Insolvency in the Australian Construction Industry* (2015) recommendation 36 ('*SERC Construction Insolvency Report*').

24 Senate Economics References Committee, Parliament of Australia, *Corporate Tax Avoidance – Part 1: You Cannot Tax What You Cannot See* (2015) recommendation 16.

25 Senate Economics References Committee, Parliament of Australia, *Superbad – Wage Theft and Non-Compliance of the Superannuation Guarantee* (2017) recommendation 20.

26 Australian Restructuring Insolvency and Turnaround Association, *Policy Positions of the Australian Restructuring Insolvency and Turnaround Association* (February 2015) policy 15-05.

27 Governance Institute of Australia, 'Identification Numbers Will Make It Easier to Track Directors' (Media Release, MR/2015/13, 10 July 2015).

28 Senator Katy Gallagher, 'Who Support's Labor's Plan for a Director Identification Number, to Crack Down on Phoenix Companies?' (Media Release, 25 May 2017) <http://www.katygallagher.net/who_supports_labor_s_plan_for_a_director_identification_number_to_crack_down_on_phoenix_companies>.

29 Ibid.

30 Ibid.

31 Ibid.

32 Survey on file with authors.

33 Survey on file with authors.

Recommendation 1: Require directors to obtain a Director Identification Number

- Directors of companies should be required to obtain a director identification number (‘DIN’) after proving their identity with 100 points of identification.
- At the time of annual reviews or annual returns for existing companies, directors should be required to quote their DIN.
- In relation to previously deregistered companies, directors should be required to provide information about these companies as part of the process of obtaining a DIN.
- A penalty should apply for omitted or incorrect information.
- The DIN should be password protected for directors’ interactions with regulators.
- Like a company’s ACN and ABN, the DIN should be visible to the public, and, in particular, prospective employees and creditors, via the company’s documentation or website, to enable searches of the director’s prior corporate history.
- Directors should be subject to a duty to keep company documentation and websites current regarding their DIN.
- A small charge should be levied on prospective directors applying for a DIN to help defray the cost of implementing the system.

Recommendation 2: Limit the backdating of directorships

We oppose ASIC allowing the lodging of backdated ‘notification of change to directors’ forms beyond three months. We have heard that there are attempts to frustrate enforcement actions where a debt-laden company lodges a backdated ‘notification of change to directors’ form[35] and appoints a ‘man of straw’ as a director. This tactic is alleged to have featured prominently in the Plutus Payroll fraud.[36] Another example of this was presented by the 7.30 Report,[37] where the homeless client of an accounting firm was registered as a director of companies with outstanding ATO debts. He was then issued DPNs by the ATO. In some instances, the directorship was backdated up to five years.[38] Alarmingly, the alleged perpetrator of this fraud had ‘form’.[39]

At present, the change of directorship form is costless to lodge within one month, with a $75 fee for between one and three months late, and a $312 fee for more than three months late. For some wrongdoers, it is worth paying $312 to avoid a DPN or liability as a director under the *Corporations Act*.

We cannot see the justification for allowing backdated ‘notification of change to directors’ forms beyond three months. This is sufficient time to allow the paperwork to catch up with

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34 Australian Institute of Company Directors, Submission to Productivity Commission, *Draft Report: Inquiry into Business Set-up, Transfer and Closure in Australia*, 3 July 2015, 9.

35 ASIC, *Form 490: Notification of Change to Directors of a Registered Body* (17 January 2011, last updated 1 July 2014); *Corporations Act* s 601CV(1)(c).

36 Neil Chenoweth and David Marin-Guzman, ‘ATO Tax Fraud: Behind a $191m Gen Y Crime Wave’, *The Australian Financial Review* (Sydney), 3 July 2017.

37 See ABC, above n 6.

38 Dan Oakes and Sam Clark, *Melbourne Man Linked to Alleged Tax Evasion Scheme Previously Accused of Ripping Off Investors* (17 October 2016) ABC News <http://www.abc.net.au/news/2016-10-17/unwitting-clients-signed-up-as-directors-to-failing-businesses/7939622>.

39 See Mark Russell, ‘Former Footballers Claim $4 Million Fraud’, *The Age* (Melbourne), 4 March 2012; Mark Russell, ‘Retirees Sue Bankrupt Adviser for $1.2m’, *The Age* (Melbourne), 22 August 2010; Mark Russell, ‘“Toothless” Watchdog Under Fire’, *The Sydney Morning Herald* (Sydney), 29 August 2010; Oakes and Clark, above n 8.

the reality. The departing director remains liable as a director until they are replaced, which should provide an excellent incentive to complete the form in a timely manner.

Recommendation 2: Limit the backdating of directorships

- Changes to directorships should only be able to be backdated up to three months.

Recommendation 3: Review the desirability of aged shelf companies

At present, to register a company, a prospective director must either complete Form 201 and mail it to ASIC with appropriate payment, or must transact through a business service provider who uses software to deal directly with ASIC.[40] This may involve the purchase of an aged 'shelf' company that the business service provider has already registered. However, we are concerned that shelf companies could be used to conceal illegal phoenix activity.

In the past, when incorporation involved weeks of delay while forms were being processed, it made sense to be able to acquire an existing company immediately. However, those days have passed, as a company can now be created online within an hour. We question why aged shelf companies continue to be used. According to Australian Resident Director and Corporate Services,

> Buying a shelf company provides a number of advantages over newly incorporated companies, making them an attractive solution for many clients. These advantages include:
>
> - Increased Business Partner Confidence – older shelf companies project a greater sense of confidence to potential business partners or clients who feel more comfortable dealing with an established company.
> - Access to Restricted Services – Some licensed services require a company to be in business for a certain length of time in an applicable industry in order to be eligible.
> - Improved Credit Options – Banks or financial service providers sometimes hesitate to open bank accounts, provide merchant facilities, or offer credit to new companies. Buying an aged shelf company can rectify this and provide enhanced credit opportunities, allowing for increased borrowing power.
> - Favourable for Immigration Purposes – Used and aged companies are of far greater advantage for Australian immigration purposes, which sometimes require a company to have been in business for several years.
> - Contract Tendering Eligibility – some jurisdictions have strict requirements for tendering, requiring companies to be in business for a period of time before they can be eligible to bid on a contract.[41]

We question the terminology used above, such as companies being 'in business for a period of time' or 'an established company', when the companies themselves are quoted as 'never traded'.[42] Shelf companies are also used in other jurisdictions, and for the same sorts of

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40 See ASIC, *Starting a Company – How to Start a Company* <http://asic.gov.au/for-business/starting-a-company/how-to-start-a-company/>.

41 Australian Resident Director and Corporate Services, *Australian Pre-registered Company* < https://www.ardcs.com.au/corporate-services/australian-shelf-company/>. See also ABN Australia, *Aged Shelf Companies* <https://www.abnaustralia.com.au/services/aged-shelf-companies.html?ref=dga>: 'Sometimes the incorporation age is a consideration for presenting longevity.'

42 Australian Resident Director and Corporate Services, ibid.

purposes, such as '[t]o create an appearance of corporate longevity, which may boost investor or consumer confidence.'[43]

In addition to questioning the utility of aged shelf companies, we also have concerns that they may make it more difficult for regulators to use data analytics to identify companies that are engaged in, or at risk of engaging in, illegal phoenix activity. In cases of cyclical phoenix activity – i.e. where Oldcos are repeatedly liquidated or abandoned to shed debts as part of an ongoing 'business model' – the Oldcos will not usually have a long incorporation age. If a shorter incorporation age is used as one of the parameters for searching regulator databases for 'at risk' companies, aged shelf companies may not be captured by the search. A savvy phoenix operator could use shelf companies of varying ages to create the impression that each company that fails is an established, independent company that has failed due to unforeseen circumstances, rather than as part of a deliberate pattern of fraudulent behaviour. While the introduction of a DIN would go a long way toward identifying this kind of systematic abuse of the corporate form, we think that aged shelf companies pose an unnecessary risk of making it easier to engage in illegal phoenix activity.

Some would-be company directors might feel more comfortable with some assistance from a business services provider in incorporating a company. Where a business services provider is used, the director should still be required to acquire and provide their DIN. Where an existing trading company is purchased, the DIN would be required to be stated on the 'notification of change to directors' form.[44] However, we think that the government should review the desirability of business service providers selling aged shelf companies, as it is unclear whether they continue to serve any beneficial policy objective and we are concerned that they may increase the risk of systematic illegal phoenix activity by thwarting regulators' data analytics.

Recommendation 3: Review the desirability of aged shelf companies

- The government should review the desirability of business service providers selling aged shelf companies.

Recommendation 4: Provide corporate tax debt data to credit reporting agencies

Where directors of companies are seeking financing to run their businesses, lenders, via the services of a credit reporting agency, would benefit from seeing information about prior tax defaults by companies with which those people have previously been associated.[45] Unpaid taxes are often an early sign of the precariousness of a company and its likelihood of defaulting on other debts. If credit reporting agencies could include this sort of information in their advice to prospective lenders and trade creditors, one significant incentive to engage in phoenix activity – its invisibility – would be undermined.

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43 Formacompany Worldwide Incorporations, *Advantages of a Shelf Company* <http://www.formacompany.com/en/advantages-of-shelf-company.php>. See also Hero Ventures, *Old Ready Made Shelf Companies List – Previously Registered* <http://www.readycompanies.com/ShelfCompanies.htm>; Coddan, *Buy a Shelf Company (Off-The-Shelf Company) from Coddan* <https://www.coddan.co.uk/ready-made-off-the-shelf-companies/>.

44 ASIC, *Form 490: Notification of Change to Directors of a Registered Body* (17 January 2011, last updated 1 July 2014); *Corporations Act* s 601CV(1)(c).

45 In early 2016 we conducted a survey of members of the Australian Institute of Credit Management ('AICM') and 95% of respondents agreed or strongly agreed that '[h]aving the ATO list all unpaid tax by commercial entities … would significantly enhance my credit approval/declining decision making.' Survey on file with authors.

While the ATO can use external debt collection agencies to pursue unpaid taxes,[46] it has not been able to register tax defaults with credit reporting agencies, as a bank or trade creditor might. In 2014 the ATO indicated that it would like that information made public. ATO Second Commissioner Geoff Leeper said:

> the fact … a debt to the tax office cannot be disclosed to the markets because of secrecy provisions [means that] there are no credit reference consequences from being in debt to the tax office. … This is a matter for government to consider at some point. The only way around it that we can think of is to propose that the Commonwealth as an entity have the ability to advise a credit market, 'Geoff owes $41,000,' without disclosing the nature of that debt.[47]

In December 2016, the Australian Government announced in its Budget 2016–17 Mid-year Economic and Fiscal Outlook ('MYEFO') that

> [f]rom 1 July 2017, the Government will allow the Australian Taxation Office (ATO) to disclose to Credit Reporting Bureaus the tax debt information of businesses that have not effectively engaged with the ATO to manage these debts. The ATO does not currently provide this information.[48]

The measure would initially apply only to businesses with ABNs and tax debt of more than $10,000 that is at least 90 days overdue. It is estimated that it would provide a gain of $63 million in underlying cash balance terms over the forward estimates period.[49]

However, despite the announcement that this measure would come into effect on 1 July 2017, an ATO media release on 13 June 2017 stated that '[t]his measure is not yet law and is subject to the normal parliamentary process,'[50] suggesting that the process has been delayed. This reform would greatly assist in disrupting illegal phoenix activity and the government and the ATO should proceed with its implementation and administration.

Recommendation 4: Provide corporate tax debt data to credit reporting agencies

- The government and ATO should proceed with the implementation and administration of the measure announced in the Budget 2016–17 Mid-year Economic and Fiscal Outlook to allow the ATO to disclose certain tax debt information to registered credit reporting bureaus, which was intended to come into effect on 1 July 2017 but appears to have been delayed.

Recommendation 5: Give the ATO the power to seek disqualification orders

The ATO should have the power to seek court-ordered disqualification in appropriate circumstances given its important role in disrupting illegal phoenix activity. This would avoid the double-handling of a matter that currently exists where the behaviour must be referred to ASIC for investigation and disqualification action. We cannot see any justification in restricting the right to seek court-ordered disqualification to ASIC. In the UK, even a

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46 Note the discussion of this issue in Inspector General of Taxation, *Debt Collection: A Report to the Assistant Treasurer* (July 2015) ch 5 ('*IGT Debt Collection Report*').

47 Evidence to Standing Committee on Tax and Revenue, Parliament of Australia, Canberra, 28 February 2014, 24 (Geoff Leeper).

48 Australian Government, *Mid-Year Economic and Fiscal Outlook* (December 2016) 113.

49 Ibid.

50 Australian Taxation Office, 'Improve the Transparency of Tax Debts' (Media Release, 13 June 2017).

liquidator can seek a director's disqualification.[51] The Australian Competition and Consumer Commission ('ACCC') may seek a person's disqualification.[52] Section 86E of the *Competition and Consumer Act 2010* (Cth) provides that:

> (1) On application by the Commission, the Court may make an order disqualifying a person from managing corporations for a period that the Court considers appropriate if:
>
> (a) the Court is satisfied that the person has contravened, has attempted to contravene or has been involved in a contravention of Part IV [restrictive trade practices]; and
>
> (b) the Court is satisfied that the disqualification is justified.

However, the grounds upon which disqualification is sought must differ from those used by the ACCC. This is because the insolvent company's failure to pay tax is not a contravention of tax law *by the director*. One way around this is to base the proposed disqualification provision on the director penalty regime contained in div 269 of sch 1 of the *Taxation Administration Act 1953* (Cth). Division 269 imposes a duty on directors to ensure that the company meets various taxation obligations or promptly enters liquidation or voluntary administration. A new subsection could be inserted into s 269-20 empowering the ATO to seek a disqualification order against a director in the event that they fail to meet such obligations. In our opinion, allowing the Commissioner to seek the disqualification of that person from managing corporations is a useful adjunct to a DPN. The financial benefit from the behaviour is removed via the DPN, the Commissioner's loss is redressed, and the marketplace benefits from the removal of a person who has failed to understand their taxation responsibilities.

We recommend that the ATO should be empowered to seek court-ordered disqualification against a person for a period the court considers appropriate where (a) the court is satisfied that the person has failed to discharge a duty under div 269 of sch 1 of the *Taxation Administration Act*; and (b) the court is satisfied that the disqualification is justified.

Recommendation 5: Give the ATO the power to seek disqualification orders

- The ATO should be empowered to seek court-ordered management disqualification where a person has failed to discharge a duty under Division 269 of Schedule 1 of the *Taxation Administration Act* and the disqualification is justified.

Recommendation 6: Empower the ATO to Refuse to Grant an ABN to Companies Associated with Persons Disqualified from Managing Corporations

The ATO has the capacity to deny the granting of an ABN to individuals where they do not believe the individual is carrying on an enterprise, but currently, the ATO does not have the ability to deny an ABN to a registered company.[53] In other words, even if the ATO has grave

[51] *Company Directors Disqualification Act 1986* (UK) s 16(2).

[52] The ACCC also has disqualification powers under s 248 of sch 2 of the *Competition and Consumer Act 2010* (Cth) in relation to consumer law contraventions. Section 206EA of the *Corporations Act* provides that a person is disqualified from managing companies if a court order disqualifying the person from managing companies is in force under s 86E or s 248 of sch 2 of the *Competition and Consumer Act 2010* (Cth). The Director of Public Prosecutions can also seek court-ordered disqualification under the *Competition and Consumer Act 2010* (Cth) for certain cartel related offences: s 86E(1A).

[53] See Australian Business Register, *ABN Entitlement* <https://abr.gov.au/For-Business,-Super-funds---Charities/Applying-for-an-ABN/ABN-entitlement/>.

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 illegal phoenix activity. We recommend that the ATO be given the power to refuse to grant an ABN to companies which list a person disqualified from managing corporations as an associate.

The ATO should check whether any of the associates of the company applying for the ABN are disqualified from managing corporations on ASIC's 'banned and disqualified' registers.[54] The ABN application requires 'associate details',[55] including the name, date of birth, position held and tax file number ('TFN') of all Australian resident directors. At present, the ATO does consult ASIC regarding ABN applications but only to check the validity of the ACN. It does not check whether any associates of the company are persons disqualified from managing corporations.

Where the ATO discovers that the associate of a company is a person disqualified from managing corporations, not only should it consider whether it is appropriate to deny the company an ABN, it should report to ASIC that the associate in question may be attempting to manage corporations whilst disqualified in breach of s 206A of the *Corporations Act*.

Recommendation 6: Empower the ATO to Refuse to Grant an ABN to Companies Associated with Persons Disqualified from Managing Corporations

- On receipt of an application for an ABN, the ATO should check with ASIC whether the company's associates are persons disqualified from managing corporations.
- The ATO should have the power to refuse to grant an ABN to a company which lists a disqualified person as an associate.
- The ATO should report to ASIC where it has uncovered disqualified persons attempting to be involved in the management of a company so that ASIC may commence a prosecution under s 206A.

Recommendation 7: Expand the Director Penalty Notice (DPN) regime

In 2009 the Treasury Proposals Paper suggested that GST be included in the Director Penalty Notice (DPN) regime. [56] One of the concerns is that GST is not payable until the sale of the finished item has taken place but that input tax credits can be claimed prior to that time. This is a particular concern in the building and construction industry. According to the November 2013 minutes of the Interagency Phoenix Forum,

- There is a GST focus on the building and construction industry that do not pay the GST until a sale has occurred and yet are legally entitled to claim input tax credits during the project's roll-out.
- Current watch list consists of 2169 groups with 30,000 entities (most in NSW).

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[54] See Australian Government, data.gov.au, *ASIC Banned and Disqualified Persons Dataset* <https://data.gov.au/dataset/asic-banned-disqualified-per>; ASIC, *Search ASIC Registers* <https://connectonline.asic.gov.au/RegistrySearch/faces/landing/SearchRegisters.jspx?_adf.ctrl-state=15mgsebwpo_4>.

[55] Australian Business Register, *Associate Details* <https://abr.gov.au/For-Business,-Super-funds---Charities/Applying-for-an-ABN/What-you-need-for-your-ABN-application/Associates-details/>.

[56] Treasury (Cth), Treasury (Cth), *Action against Fraudulent Phoenix Activity: Proposals Paper* (November 2009) ('*Phoenix Proposals Paper*'), [4.2.2].

- Estimate is that the ATO has written off $10.8 billion over the last 10 years.[57]

Extending the DPN regime to GST was opposed by the Inspector-General of Taxation in 2015:[58]

> 4.52 The above idea was not adopted by the then Government. Whilst stakeholders acknowledge the benefit of DPNs to secure superannuation and PAYG Withholding which properly belongs to employees and support its use in this respect, it is uncertain whether the broader public would consider GST to be of the same importance as employee entitlements. *Furthermore, if the DPN regime was extended to GST, it would effectively elevate the then Government's standing against employees and other creditors.*[59] Such an outcome is contrary to the Government['s] adoption of the recommendations of the 1988 Harmer Report which supported the removal of Commonwealth priority in relation to tax for reasons including:
>
> - the ATO may allow taxation debts to accumulate without prejudicing its position and this may disadvantage other unsecured creditors who may not know that tax is owed;
> - the ATO has no incentive to recover payment in the normal commercial manner;
> - the ATO should obtain no greater priority than any other person claiming in relation to debts misappropriated by the insolvent company; and
> - there would be a reduction in litigation.
>
> 4.53 Accordingly, the IGT is of the view that DPNs should not be expanded to GST at the present time.[60]

Our view is that including the GST in the DPN does *not* elevate the government's standing against employees and other creditors. Employees remain priority creditors in a liquidation, with payment of their entitlements *from the company's assets* ranking behind secured creditors and the costs of the administration. The DPN regime imposes liability for unremitted PAYG and superannuation *on the directors* – an additional and separate source of payment. The most that adding GST to the DPN regime would do is to increase the amount payable *by the director* and if the director has insufficient personal assets to cover the amount of the DPN, there may not be full recovery by the ATO. This could impact on the recovery of superannuation which directly benefits employees. This issue could be addressed by creating a priority arrangement within the DPN regime, such that unremitted PAYG and superannuation are recovered first, and GST second, in the event of an insufficiency of director funds. For these reasons, we support the extension of the DPN regime to GST.[61]

We also support the introduction of a DPN provision for state tax liabilities. In New South Wales, s 47B of the *Taxation Administration Act 1996* (NSW) allows the Office of State Revenue to issue a compliance notice, like a DPN, to a director in respect of unremitted

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57 See ATO, *Inter-Agency Phoenix Forum Minutes* (12 November 2013) item 7 <https://www.ato.gov.au/General/The-fight-against-tax-crime/In-detail/Inter-Agency-Phoenix-Forum/Inter-Agency-Phoenix-Forum-minutes---12-November-2013/>.

58 Inspector-General of Taxation, *Debt Collection: A Report to the Assistant Treasurer* (July 2015) ('*IGT Debt Collection Report*') [4.51]–[4.53].

59 Emphasis added.

60 *IGT Debt Collection Report*, ibid, [4.52]–[4.53].

61 The Senate Committee inquiry into insolvency in the building and construction industry also recommended that consideration be given to ensuring that the DPN regime covers GST liabilities: *SERC Construction Insolvency Report*, above n 23, recommendation 19, [7.47].

payroll taxes. As with a DPN, liability is avoided where the company is placed into VA or liquidation within 21 days. We encourage other state legislatures to adopt such a provision.

Recommendation 7: Expand the Director Penalty Notice (DPN) regime

- The DPN regime in the *Taxation Administration Act* should be expanded to include GST liabilities.
- An equivalent to the DPN should be introduced in state taxation legislation across Australia.

Recommendation 8: Require payment of tax and super via Single Touch Payroll

The original 'single touch payroll' proposal – reporting and paying PAYG(W) taxes and superannuation contributions at the same time the employee is paid – has the capacity to reduce some of the damage caused by illegal phoenix activity. For serial inept entrepreneurs, it stops them unwittingly getting in over their heads, time and time again. For deliberate phoenixers, it takes away much of the benefit of phoenix activity.

In terms of unremitted taxes and superannuation, the government appears to have acknowledged the advantages of prevention with the introduction of 'single touch payroll' ('STP').[62] Initially this was mooted as a mechanism whereby employers would pay their employees' wages *and* related PAYG(W) remittances and superannuation contributions in a 'single touch'. Illegal phoenix activity is attractive because the non-payment of taxes and superannuation are two of the major losses it causes through the liquidation of the failed employer.

However, the government has amended the STP proposal so that now it will only cover the *reporting* of tax and superannuation obligations. This alteration was in response to concerns from business about the 'cash flow' implications[63] of having to pay the taxes at an earlier time than is presently the case. In other words, while wages are generally paid fortnightly, PAYG(W) and superannuation are usually only remitted monthly or quarterly depending on the size of the business and the terms of the super fund trust deed. The objection raised shows the extent to which businesses rely on employee-related sums – 'their money' until it is legally payable – to finance their businesses, and also shows the hesitation of the government to interfere with this practice.

The STP *as a reporting mechanism only* undermines the effectiveness of 'lockdown' DPNs. The DPN regime is designed to provide an incentive for directors to ensure their companies pay their employees' PAYG(W) and superannuation amounts, failing which they themselves will be liable for these payments. Without more, this would be a draconian arrangement, so the DPN regime allows directors to avoid this personal liability if they either cause the company to pay the amount or place their company into external administration within 21

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62 See The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Streamlining Business Reporting with Single Touch Payroll' (Media Release, 21 December 2015).

63 'Nobody disputes that PAYG tax and super is an employee entitlement and must be paid, the sooner the better. But this is an area where a desirable policy objective needs to take into account the fact that many SMEs struggle with cash flow … It takes more than 50 days on average for small business accounts to be paid and many are in a weak negotiation position with key clients': Accountants Daily, *CAANZ Latest to Criticise ATO's Single Touch Payroll* <http://www.accountantsdaily.com.au/latest-news/17-news/8069-caanz-latest-to-criticise-ato-s-single-touch-payroll>, quoting Michael Croker, head of tax at Chartered Accountants Australia and New Zealand. See also Michael Croker, Submission to ATO, *Single Touch Payroll Discussion Paper* (12 March 2015) 10–13.

days. However, this 'escape route' is only available to the directors *if they report* what is owing to the ATO. This is designed to give the ATO the information it needs to send out the DPN. The intended result is either that the tax and super obligations are paid, or the company is placed in external administration and is no longer accruing tax liabilities.

It was recognised that in many instances, amounts were neither paid nor reported, so in 2012, laws amended the DPN regime to create 'lockdown' DPNs.[64] As a result, if the amount owing is not reported, the director loses their right to use the external administration 'escape route'. Provided the ATO becomes aware of the amount owing from some means *other than* reporting by the employer and then sends the DPN, the directors must pay the company's PAYG(W) and superannuation obligations and cannot avoid these by placing the company into external administration.

If the single touch payroll proposal is utilised only to report amounts owing, the result will be that 'lockdown' DPNs will only be effective for those who fail to use STP. The onus will be back on the ATO to send DPNs to all those directors who have reported their company's tax and super obligations but not paid them. Once these directors receive their DPNs, they have 21 days to shed this liability by placing the company into external administration. The 'lockdown' mechanism, which has been used effectively by the ATO,[65] is likely to be less utilised. This puts the onus back on the ATO to manually process DPN notices for all unremitted taxes. In 2012, automatic DPNs were mooted but rejected.[66]

Recommendation 8: Require payment of tax and super via Single Touch Payroll

- 'Single touch payroll' which requires both reporting and payment of tax and superannuation obligations should be gradually introduced.
- If single touch payroll is not expanded as recommended, the proposal for automated DPNs should be re-considered.

Conclusion

This submission has set out a number of recommendations aimed at improving the identity verification of company directors and the ATO's regulation of illegal phoenix activity. For further information on these and other related recommendations, please see our report: Phoenix Activity: Recommendations on Detection, Disruption and Enforcement (February 2017). We would be happy to assist the Inspector-General of Taxation further in relation to any of these recommendations.

[64] See Helen Anderson, 'The Proposed Deterrence of Phoenix Activity – An Opportunity Lost?' (2012) 34 *Sydney Law Review* 411, 416–18.

[65] See 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) 79.

[66] Tax Laws Amendment (2011 Measures No 8) Bill 2011 (Cth) sch 3; Kai Swoboda and Xenia Stathopoulos, *Tax Laws Amendment (2011 Measures No 8) Bill 2011 [and] Pay As You Go Withholding Non-compliance Tax Bill 2011*, Bills Digest No 78 of 2011-12, 21 November 2011, 11.