

**Australian Government
Treasury**

BLACK ECONOMY TASKFORCE CONSULTATION PAPER (AUGUST 2017)

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We thank Treasury and the Minister for Revenue and Financial Services for this opportunity to make a submission regarding the Black Economy Taskforce Consultation Paper (August 2017). We refer to our [first submission](#) to the Taskforce on the Interim Report (March 2017) which explains our Australian Research Council project that is examining ways to regulate illegal phoenix activity. The purpose of this second submission is to provide comments on a number of the additional policy ideas outlined in the Consultation Paper that relate to phoenix activity.

Policy Idea 1: Individual Identity

In our [first submission](#) to the Taskforce on the Interim Report (March 2017), we recommended the implementation of a Director Identification Number (DIN) to combat illegal phoenix activity and reduce regulatory noise caused by mismatching of director records. We have long advocated for a DIN,¹ both for identity verification² and to enable easy tracking of directors.

We acknowledge the Taskforce's concerns regarding the proliferation of identification procedures and we think it is worthwhile to explore the idea of a more efficient national identity system. However, we have doubts about the feasibility of such a system in the short term and believe that there is an urgent need for a DIN to be implemented in the intervening period to curb illegal phoenix activity and other forms of unlawful activity involving the falsification of director identities.

A national identity system would constitute a major political, legal and administrative reform that would take several years and significant resources to implement. Even if it were

¹ See further Helen Anderson, 'An Ounce of Prevention: Practical Ways to Hinder Phoenix Activity' (2013) 25 *Australian Insolvency Journal* 16. Following the publication of this article, the Australian Restructuring, Insolvency and Turnaround Association (ARITA) adopted the DIN as part of its national policy platform: ARITA, *A Platform for Recovery 2014: Dealing with Corporate Financial Distress in Australia – A Discussion Paper* (October 2014) 13.

² Note that a unique identity number was recommended by the Victorian Law Reform Committee in 1994: VLRC, *Curbing the Phoenix Company: First Report on the Law Relating to Directors and Managers of Insolvent Corporations*, Report No 83 (1994) recommendation 6, [3.3.11]. However, the Committee did not recommend that proof of identity should precede the issuing of a number, and the recommendation of a unique number for directors was not followed up by government. ASIC refers to a 'person number' in relation to its data matching program with the Australian Financial Security Authority (AFSA) but this does not appear to be used as a mechanism for tracking directors and targeting abuse of the corporate form: ASIC, *Data Matching Program with AFSA* <<http://asic.gov.au/regulatory-resources/insolvency/insolvency-for-directors/data-matching-program-with-afsa/>>.

logistically and financially viable to implement such a system, there is a question about whether it would receive sufficient community support, given the strong opposition to the ‘Australia Card’ proposed by the Hawke government in 1985 and the ‘Access Card’ proposed by the Howard government in 2006. The 2014 Financial System Inquiry rejected the idea of a syndicated (centralised) system of digital identity for online financial transactions, partly on the basis that ‘[m]any Australians may object to this option on the basis of privacy concerns. It could be viewed as a digital version of the unpopular Australia Card initiative, which was rejected in 1987, or the Access Card, which was terminated in 2007.’³ The Inquiry also concluded that a syndicated digital identity system involves ‘significant costs for Government and potentially the private sector’⁴ and could ‘impede the adoption of innovative solutions and deployment of the best available technology, reducing overall efficiency over time.’⁵

In comparison to a national identity system, the DIN is a discrete, feasible, inexpensive⁶ reform that could be implemented relatively swiftly. The 100-point identity check is an established and tested process available via Australia Post. Even if the DIN were ultimately replaced by a national identity system, the economic savings that the DIN would yield during the intervening period are likely to be significant. As you would be aware, PricewaterhouseCoopers has estimated that illegal phoenix activity costs the Australian economy up to \$3.19 billion per year,⁷ and a recent study conducted by the government found that ‘the incidence of illegal phoenix company activity, and the subsequent costs to the FEG [Fair Entitlements Guarantee] scheme, is increasing.’⁸ A large part of the reason why illegal phoenix activity is so prevalent and costly is that it is currently very difficult for regulators to identify directors who are involved in suspicious patterns of insolvencies. The most damaging and costly cases of illegal phoenix activity are those where the directors *repeatedly* incorporate companies with the intention of allowing them to accumulate liabilities and then liquidate the companies to extinguish those liabilities. Currently, it is very easy for directors to repeatedly falsify their identities to make it appear as though each insolvency is an isolated and genuine insolvency involving ‘different’ directors. The DIN would disrupt this practice and alert ASIC to suspicious patterns of insolvencies, thereby substantially curbing the damage caused by illegal phoenix activity.

The benefits of a DIN go beyond the reduction of illegal phoenix activity. The DIN would disrupt all forms of unlawful activity that involve the falsification of director identities. Any time that a person who is in control of a company intends to use that company for unlawful purposes, they have a strong interest in falsifying the identities of the directors of the company so that regulators and police cannot ‘connect the dots’. The recent Plutus Payroll case is a tragic illustration of the extent of the damage that can be done when people are able to so effortlessly obscure the true identities of directors.⁹ The DIN is an urgently needed

³ Financial System Inquiry, *Final Report* (November 2014) 159.

⁴ *Ibid.*

⁵ *Ibid.*

⁶ The federal opposition has proposed a one-off \$50 fee to cover the cost of implementation of the DIN: Adam Gartrell, ‘Labor Targets Dodgy Company Directors with Crackdown on Phoenix Schemes’, *The Sydney Morning Herald* (Sydney), 24 May 2017.

⁷ PricewaterhouseCoopers, *Phoenix Activity: Sizing the Problem and Matching Solutions* (June 2012).

⁸ Treasury (Cth), *Reforms to Address the Corporate Misuse of the Fair Entitlements Guarantee Scheme: Consultation Paper* (May 2017) 5.

⁹ See the allegations discussed in Neil Chenoweth and David Marin-Guzman, ‘ATO Tax Fraud: Behind a \$191m Gen Y Crime Wave’, *Australian Financial Review* (Sydney), 3 July 2017. See also the series of allegations against Philip Whiteman, Dan Oakes and Sam Clark, ‘Staggering Number of Alleged Crimes in Massive Tax Scam’, *ABC News*, 16 June 2017.

reform to prevent these cases of recurring corporate crime. The Australian Crime Commission (now the Australian Criminal Intelligence Commission) has estimated that serious and organised crime cost the Australian economy \$36 billion in 2013-14.¹⁰ In all cases where such crime involves corporate actors, the DIN would play a role in diminishing the feasibility and attractiveness of the crime. In addition, it would send a strong signal to the public that director misconduct is under scrutiny, which would contribute to raising standards of corporate governance more broadly.

If the DIN is put on hold until the implementation of a national individual identity system – which may not be practically or politically feasible and is likely to involve protracted debate – our view is that this would result in significant preventable economic loss. As such, our view is that the DIN ought to be implemented as a matter of priority, and that consideration of a national individual identity system ought to be dealt with as an entirely separate matter. We believe that the DIN would be well-received by the Australian community, as it has been endorsed by a wide range of organisations, including:

- the Australian Labor Party, which has formally adopted the DIN as a policy;¹¹
- the Productivity Commission inquiry into business set-up, transfer and closure;¹²
- the Productivity Commission inquiry into the workplace relations framework;¹³
- the Senate Economics References Committee inquiry into insolvency in the Australian construction industry;¹⁴
- the Senate Economics References Committee inquiry into corporate tax avoidance;¹⁵
- the Senate Economics References Committee inquiry into superannuation guarantee non-payment;¹⁶
- the Australian Restructuring, Insolvency and Turnaround Association (ARITA);¹⁷
- Governance Institute of Australia (GIA);¹⁸
- the Australian Institute of Company Directors (AICD);¹⁹
- the Australian Small Business and Family Enterprise Ombudsman;²⁰
- the Australian Chamber of Commerce and Industry;²¹
- Master Builders Australia;²²
- Australian Council of Trade Unions;²³ and
- Tax Justice Network.²⁴

¹⁰ Australian Crime Commission, *The Costs of Serious and Organised Crime in Australia 2013–14* (2015).

¹¹ The Hon Andrew Leigh MP, ‘Exposing Dodgy Directors’ (Media Release, 24 May 2017).

¹² Productivity Commission, *Business Set-up, Transfer and Closure* (2015) recommendation 15.6.

¹³ Productivity Commission, *Workplace Relations Framework*, Report No 76 (2015) vol 1, 48, vol 2, 915, 938.

¹⁴ Senate Economics References Committee, Parliament of Australia, *‘I just want to be paid’: Insolvency in the Australian Construction Industry* (2015) recommendation 36.

¹⁵ Senate Economics References Committee, Parliament of Australia, *Corporate Tax Avoidance – Part 1: You Cannot Tax What You Cannot See* (2015) recommendation 16.

¹⁶ Senate Economics References Committee, Parliament of Australia, *Superbad – Wage Theft and Non-Compliance of the Superannuation Guarantee* (2017) recommendation 20.

¹⁷ Australian Restructuring Insolvency and Turnaround Association, *Policy Positions of the Australian Restructuring Insolvency and Turnaround Association* (February 2015) policy 15-05.

¹⁸ Governance Institute of Australia, ‘Identification Numbers Will Make It Easier to Track Directors’ (Media Release, MR/2015/13, 10 July 2015).

¹⁹ 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).

²⁰ Ibid.

²¹ Ibid.

²² Ibid.

²³ The Hon Andrew Leigh MP, ‘Liberal Says Phoenix Reform ‘Makes a Lot of Sense to Me’ (Media Release, 18 July 2017).

Policy Idea 4: ABN Reform – Fit and Proper Person Test

We support the idea of implementing measures to ensure that ABN holders are fit and proper persons. In particular, we recommend that, when a company applies for an ABN, the ATO should check whether any of the company’s associates are listed in ASIC’s ‘Banned and Disqualified Persons Dataset.’²⁵ If they are, the ATO should notify ASIC that the associates have applied for an ABN, as this may indicate a contravention of their banning or disqualification order and warrant enforcement action by ASIC. In addition, we recommend that the ATO be given the power to refuse to grant an ABN to a company that lists a person who is disqualified from managing corporations as an associate in its ABN application. This would incentivise ABN applicants to more carefully vet prospective directors to ensure that they are not disqualified from managing corporations.

For further information on our recommendation, please see [Recommendation 19](#) in the final report of our ARC Phoenix Project.

Policy Idea 15: Enforcement/Visible Action

We support the idea of increasing visible enforcement action against criminal manifestations of the black economy. In this regard, we have concerns that insufficient enforcement action is taken against illegal phoenix activity. Despite there being a multitude of ways that regulators can take enforcement action against the types of illegal behaviour that can occur during phoenix activity,²⁶ estimates putting the cost of illegal phoenix activity in the billions of dollars suggest that such behaviour continues to be prevalent.²⁷ While it is not possible to identify the exact incidence of illegal phoenix activity or consequent enforcement action due to a lack of available data,²⁸ in our view it is likely that rates of enforcement against illegal phoenix activity are very low relative to the frequency of illegal phoenix activity.

For example, since civil penalties were introduced for breaches of directors’ duties in 1993, there has only been one civil penalty application brought by ASIC for breach of directors’ duties in the context of phoenix activity²⁹ and the only orders imposed were disqualification orders, despite the availability of both pecuniary penalties and compensation orders.³⁰ To put this in perspective, in 2015-16 alone, external administrators reported that they suspected 424 criminal breaches of directors’ duties³¹ and 1,125 civil breaches of the duty not to improperly

²⁴ Ibid.

²⁵ Australian Government, data.gov.au, *ASIC – Banned and Disqualified Persons Dataset* (updated 1 August 2017) <<https://data.gov.au/dataset/asic-banned-disqualified-per>>.

²⁶ See Helen Anderson, Ann O’Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, ‘Defining and Profiling Phoenix Activity’ (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, December 2014) 10–13, 16–17, 24–25, 28.

²⁷ PricewaterhouseCoopers and Fair Work Ombudsman (FWO), *Phoenix Activity: Sizing the Problem and Matching Solutions* (June 2012); Australian Taxation Office (ATO), *Targeting Tax Crime: A Whole-of-Government Approach* (July 2009) 16; Treasury (Cth), *Action against Fraudulent Phoenix Activity: Proposals Paper* (November 2009).

²⁸ 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).

²⁹ *ASIC v Somerville* [2009] NSWSC 934; *ASIC v Somerville (No 2)* [2009] NSWSC 998.

³⁰ Ibid.

³¹ This figure includes 150 suspected breaches of the directors’ duty to prevent insolvent trading under s 588G(3) of the *Corporations Act 2001* (Cth).

use one's position in s 182 of the *Corporations Act 2001* (Cth).³² While insolvency-related wrongdoing is a broader category than phoenix activity and these are only suspected rather than proven breaches, the overwhelming disparity between the figures suggests that enforcement of directors' duties is not having the desired deterrent effect. We therefore recommend that regulators prioritise taking enforcement action against illegal phoenix activity.

For more information on our recommendation, please see [Recommendation 25](#) in the final report of our ARC Phoenix Project.

We also emphasise the importance of publicly reporting any enforcement action that *is* taken against illegal phoenix activity in order to generate general deterrence of such activity. This involves two aspects. First, all enforcement actions need to be reported in a systematic way, for example, via media releases, publicly available websites, social media, annual reports, enforcement reports, and so on.³³ The aim is to make the enforcement action as widely known as possible; the more reporting, the better. For example, our research suggests that only about 50% of disqualification orders made by ASIC under s 206F of the *Corporations Act 2001* (Cth) are reported in ASIC's media releases, indicating significant room for improvement in reporting frequency. Second, the phoenix context of any enforcement action needs to be expressly identified. Because there is not a specific legislative provision that defines and prohibits 'phoenix activity',³⁴ it is not sufficient to simply report the legislative provision that was breached, e.g. a breach of directors' duties, as it is not possible to distinguish phoenix-related breaches from other breaches. It is essential to report that the enforcement action was taken in response to circumstances involving illegal phoenix activity.

For further information on our recommendation, please see [Recommendation 26](#) in the final report of our ARC Phoenix Project.

Policy Idea 16: While-blower hotline/incentives

We support the proposed single point of contact for serious black economy-related allegations.

In the final report of our ARC Phoenix Project, we make a number of suggestions aimed at making it easier for members of the public to access advice about illegal phoenix activity and report incidents of suspected illegal phoenix activity. For further information on these suggestions, see [Recommendation 6](#) in our final report.

Policy Idea 17: ATO industry and union partnerships

We support the idea of expanding partnerships between regulators, industry associations and trade unions. Employees are one of the main groups of victims of illegal phoenix activity and

³² ASIC, *Report 507: Insolvency Statistics – External Administrators' Reports (July 2015 to June 2016)* (December 2016), 37–8. In addition, external administrators reported that they suspected 3,636 breaches of s 180, 1,954 breaches of s 181, 329 breaches of s 183, and 5,736 breaches of ss 588G(1)–(2): at 38.

³³ The 'Media outcomes' section of the FWO's annual report provides a good example of the range of avenues that are available to regulators to publicise their enforcement actions: see FWO, *Annual Report 2015–16* (28 September 2016) 14.

³⁴ See Anderson et al, *Defining and Profiling Phoenix Activity Report*, above n 26. We discuss the issue of a phoenix offence at [5.1.1].

they are particularly vulnerable. Because individual employees are unlikely to be in a position to conduct background searches on their employers with the same thoroughness as commercial creditors, there is merit in an expanded role for unions in combatting illegal phoenix activity. We recommend that ASIC notify unions of the availability of the ‘Banned and Disqualified Persons Dataset’³⁵ and request that the unions notify ASIC if it comes to their attention that a director of a company that employs one of its members is managing the company while disqualified. More generally, ASIC and the ATO should encourage unions to report any suspicions of illegal phoenix activity, as they are well positioned to detect such activity.

For more information on our recommendation, see [Recommendation 11](#) of the final report of our ARC Phoenix Project.

Policy Idea 19: Name and shame

We support the idea of naming and shaming proven tax evaders. In this regard, we recommend that 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.³⁶ It was announced that this measure would come into effect on 1 July 2017. However, the ATO published a media release on 13 June 2017 stating that ‘[t]his measure is not yet law and is subject to the normal parliamentary process,’³⁷ suggesting that the process has been delayed. This reform would greatly assist in disrupting illegal phoenix activity and we recommend that it be implemented as soon as is practicable.

Policy Idea 22: A National Criminal Database

We support the proposal to establish a national criminal database. We note that s 206B of the *Corporations Act 2001* (Cth) provides that people who have committed certain criminal offences are automatically disqualified from managing corporations. A national criminal database would greatly assist ASIC in detecting whether prospective directors are automatically disqualified under s 206B. ASIC would need to be provided with direct access to the database and any applicable privacy restrictions would need to be reviewed accordingly. The establishment of this database and information sharing between the database and ASIC would help to ensure that people managing corporations are fit and proper persons.

Policy Idea 46: Labour Hire/Workforce Services

We support the Taskforce’s observation that stronger enforcement of existing laws is needed to stamp out the worst abuses in regard to labour hire, including in the context of illegal phoenix activity. Please see the discussion under Policy Idea 15 above for further comments on the need for stronger enforcement action against illegal phoenix activity.

³⁵ Australian Government, data.gov.au, *ASIC – Banned and Disqualified Persons Dataset* (updated 1 August 2017) <<https://data.gov.au/dataset/asic-banned-disqualified-per>>.

³⁶ Australian Government, *Mid-Year Economic and Fiscal Outlook* (December 2016) 113.

³⁷ ATO, ‘Improve the Transparency of Tax Debts’ (Media Release, 13 June 2017).

Policy Idea 48: Phoenixing

We refer Treasury to the [final report of our ARC Phoenix Project](#), which contains 32 recommendations aimed at enhancing the detection, disruption and deterrence of harmful phoenix activity.

We have attached the Executive Summary of the report as an appendix to this submission.

We would be happy to assist Treasury further in relation to any of the recommendations contained in this submission or the final report of our ARC Phoenix Project.

APPENDIX

EXECUTIVE SUMMARY OF THE ARC PHOENIX PROJECT FINAL REPORT

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

Phoenix activity essentially involves one company taking over the business of another company that is wound up or abandoned where the controllers of both companies are the same people or their associates – Newco arising from the ashes of Oldco, having shed Oldco's debts and other obligations. In practice, phoenix activity has many guises. Newco may be newly formed or may already be in existence; Oldco may or may not transfer assets to Newco, and if it does transfer assets, the price may or may not be arm's length. Oldco's controllers may have legitimate or improper motives.

In our first report, [Defining and Profiling Phoenix Activity](#),³⁸ we identified five categories of phoenix activity.³⁹ The first is 'legal phoenix', often referred to as 'business rescue', which results in a better outcome for creditors and society than letting the business come to an end.⁴⁰ The second is 'problematic phoenix', which is technically legal but involves repeated resurrection of the business by inept entrepreneurs that is harmful to creditors and society.⁴¹ There are three categories of illegal phoenix activity, depending upon whether it involves an unpremeditated intention to defraud creditors arising from financial difficulties ('illegal type 1'),⁴² an intention to defraud as part of a premediated business model ('illegal type 2'),⁴³ or a premediated intention to defraud accompanied by other illegal activity ('complex illegal').⁴⁴ In this report we use the umbrella term 'harmful phoenix activity' to refer to both 'problematic' phoenix activity and the three categories of 'illegal' phoenix activity.

Estimates have placed the economic cost of phoenix activity in the billions of dollars.⁴⁵ In our second report, [Quantifying Phoenix Activity: Incidence, Cost, Enforcement](#),⁴⁶ we published the results of our empirical study on the incidence and cost of phoenix activity, along with disruption and enforcement measures taken in relation to such activity. While precise quantification was not possible due to a lack of data, our conclusion was that harmful phoenix

³⁸ Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, 'Defining and Profiling Phoenix Activity' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, December 2014) (*'Defining and Profiling Phoenix Activity Report'*).

³⁹ See *ibid* 2.

⁴⁰ See *ibid* 8–10.

⁴¹ See *ibid* 11–12.

⁴² See *ibid* 15–16.

⁴³ See *ibid* 24.

⁴⁴ See *ibid* 27–28.

⁴⁵ See PricewaterhouseCoopers and Fair Work Ombudsman ('FWO'), *Phoenix Activity: Sizing the Problem and Matching Solutions* (June 2012); Australian Taxation Office ('ATO'), *Targeting Tax Crime: A Whole-of-Government Approach* (July 2009) 16; Treasury (Cth), *Action against Fraudulent Phoenix Activity: Proposals Paper* (November 2009) (*'Phoenix Proposals Paper'*).

⁴⁶ Helen Anderson, Ann O'Connell, Ian Ramsay, Michelle Welsh and Hannah Withers, 'Quantifying Phoenix Activity: Incidence, Cost, Enforcement' (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, October 2015) (*'Quantifying Phoenix Activity Report'*).

activity is a significant problem that justifies the commitment of substantial government resources.⁴⁷ Several organisations have raised concerns about the widespread and costly nature of phoenix activity.

- Australian Securities and Investments Commission:
 - ‘11,494 companies [were] identified for the potential to conduct illegal phoenix activity.’⁴⁸
 - ‘As part of our proactive phoenix surveillance program, we have identified approximately 2,500 directors who meet the criteria for triggering the director disqualification provisions of the Corporations Act. These directors currently operate over 7,000 registered companies.’⁴⁹
 - ‘Illegal phoenix activity has far-reaching and unfair consequences. Employees lose wages and entitlements, and creditors—many of whom are small businesses—are left with debts. There are significant unpaid tax liabilities, which have a detrimental impact on tax revenue.’⁵⁰

- Senate Economics References Committee, *Inquiry into Insolvency in the Australian Construction Industry*, 2015:
 - ‘[I]llegal phoenix activity remains a significant issue not only in the construction industry, but throughout the economy.’⁵¹
 - ‘[T]he estimates of the cost of illegal phoenix activity ... suggest a significant culture of disregard for the law. This view is reinforced by the anecdotal evidence received by the committee which indicates that phoenixing is considered by some in the industry as merely the way business is done in order to make a profit.’⁵²

- Productivity Commission, *Inquiry into Business Set-up, Transfer and Closure*, 2015:
 - ‘[E]ven conservative estimates suggest that [illegal phoenix activity] is a significant issue. In terms of the number of phoenix companies, estimates range from between 2000 and 3000 engaging in phoenix activity through liquidation every year, with the lower bound likely to be the more reliable estimate, to an ATO estimate of a total of 6000 phoenix companies operating in Australia in 2011.’⁵³
 - ‘[Illegal phoenix activity] has considerable scope to undermine the confidence of creditors in the insolvency framework, and therefore hinder the efficient closure of business.’⁵⁴

- PricewaterhouseCoopers, *Phoenix Activity: Sizing the Problem and Matching Solutions*, commissioned by the Fair Work Ombudsman, 2012:

⁴⁷ See *ibid* xix.

⁴⁸ Australian Securities and Investments Commission (‘ASIC’), *Annual Report 2015-2016* (14 October 2016) 22.

⁴⁹ ASIC, *Report 444: ASIC Enforcement Outcomes – January to June 2015* (August 2015) [40].

⁵⁰ ASIC, *Report 421: ASIC Enforcement Outcomes – July to December 2014* (January 2015) [28].

⁵¹ Senate Economics References Committee (‘SERC’), Parliament of Australia, *‘I just want to be paid’: Insolvency in the Australian Construction Industry* (2015) xix (‘*SERC Construction Insolvency Report*’).

⁵² *Ibid* [5.33].

⁵³ Productivity Commission, *Business Set-up, Transfer and Closure*, Report No 75 (2015) 423 (‘*Business Set-up Report*’). Footnotes omitted.

⁵⁴ *Ibid* 28.

- ‘On the basis of the available data and a series of assumptions that were tested with stakeholders, the total impact of phoenix activity has been estimated to be \$1.78 – \$3.19 billion per annum.’⁵⁵
- Bruce Collins QC, *Independent Inquiry into Construction Industry Insolvency in NSW*, commissioned by the NSW Government, 2012:
 - ‘A number of stakeholders raised the issue of phoenixing with the Inquiry and their view that this activity was widespread in the building industry and that it was having a significant and lasting detrimental effect on their businesses.’⁵⁶
 - ‘The flight of the phoenix is prevalent in the building and construction industry in NSW.’⁵⁷
- Australian Taxation Office, *Targeting Tax Crime: A Whole-of-Government Approach*, July 2009:
 - ‘The cost to the Australian economy of phoenix and related practices has been estimated at between \$1 billion and \$2.4 billion a year. This cost includes competitors being unfairly priced out of business, trade creditors being left unpaid and employees missing out on vital superannuation payments. The Australian community also bears a significant part of this cost through reduced tax revenue.’⁵⁸
- Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake*, 2004:
 - ‘[M]any submissions commented on the nature and incidence of illicit phoenix company activity. Almost all regarded the problem as a serious one requiring the attention of the legislature and were supportive of strengthening measures against phoenix companies.’⁵⁹
- Royal Commission into the Building and Construction Industry, 2003:
 - ‘There has been significant incidence of fraudulent phoenix company activity in the building and construction industry. Since 1998 the Australian Taxation Office has raised at least \$110 million in taxes and penalties from the detection of fraudulent phoenix company activity in the building and construction industry. For every \$1 spent by the Australian Taxation Office on the detection of phoenix company activity in the period 1 July 2001 to 30 June 2002 \$8 in revenue was raised. Efforts must continue to eliminate fraudulent phoenix company activity in the building and construction industry. Apart from the contraventions of law involved, fraudulent phoenix company activity can adversely affect the public revenue, contractors, employees and creditors.’⁶⁰

⁵⁵ PricewaterhouseCoopers and FWO, above n 45, ii–iii.

⁵⁶ Bruce Collins QC, *Independent Inquiry into Construction Industry Insolvency in NSW* (November 2012) 33.

⁵⁷ *Ibid* 34.

⁵⁸ ATO, above n 45, 16.

⁵⁹ Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: A Stocktake* (2004) [8.35].

⁶⁰ Commonwealth, Royal Commission into the Building and Construction Industry, *Final Report: Reform – National Issues Part 2* (February 2003) 164 (‘*Cole Royal Commission Report*’).

- Victorian Law Reform Committee, *Curbing the Phoenix Company: Second Report*, 1995:
 - ‘The problem of the phoenix company is common and perhaps endemic. It should not be ignored. Attempts to find remedies and to strike the right balance between competing considerations cannot be expected to result in a once and for all solution and should be kept under review.’⁶¹

Our surveys of members of the Australian Restructuring Insolvency and Turnaround Association (‘ARITA’)⁶² and the Australian Institute of Credit Management (‘AICM’)⁶³ bear out the above comments regarding the prevalence of harmful phoenix activity. Thirty percent of ARITA respondents said they ‘often’ encounter liquidations where they believe phoenix activity has occurred, and 51% said they ‘sometimes’ do. A significant proportion of the phoenix activity encountered by the respondents involved suspected unlawful conduct. Twenty-four percent of respondents said they ‘always’ allege a breach of civil obligations in an EXAD report where they believe phoenix activity has occurred, and 29% said they ‘often’ do. The AICM survey yielded similar results. Twenty-eight percent of AICM respondents said they ‘often’ believe, and 33% said they ‘sometimes’ believe, that phoenix activity has occurred in cases where directors are applying for credit and the respondents know the directors have been involved in other failed companies in the past. In regard to the consequences of phoenix activity, 27% of ARITA respondents said the liquidation of a company involving phoenix activity ‘always’ results in zero returns to creditors, and 60% said it ‘often’ does.⁶⁴

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

⁶¹ Victorian Law Reform Committee, *Curbing the Phoenix Company: Second Report on the Law Relating to Directors and Managers of Insolvent Corporations*, Report No 43 (1995) [4.9].

⁶² ARITA is a professional association with over 2,000 members that represents those who specialise in the fields of restructuring, insolvency and turnaround, including accountants, lawyers, bankers, credit managers, academics and other professionals with an interest in insolvency and restructuring: ARITA, *About Us* <<http://www.arita.com.au/about-us>>. The survey of ARITA members was conducted on Survey Monkey from 16 November 2015 to 14 December 2015. The survey was sent to 2,155 members, 213 of whom completed the survey – a response rate of approximately 10%. The questions were optional and the percentage of members who responded to each question ranged from 29% to 100%.

⁶³ AICM is Australia’s leading professional member body for commercial and consumer credit management professionals, with over 2,300 members responsible for maximising the cash flow and minimising the bad debt risk of more than 1,300 Australian companies, including 34 of the ASX100: AICM, *About AICM* <<http://aicm.com.au/about-aicm/>>. The survey of AICM members was conducted on Survey Monkey from 11 January 2016 to 15 February 2016. The survey was sent to just over 2,300 members, 155 of whom completed the survey – a response rate of approximately 7%. The questions were optional and the percentage of members who responded to each question ranged from 37% to 100%.

⁶⁴ For further discussion of these surveys, see Helen Anderson, Jasper Hedges, Ian Ramsay and Michelle Welsh, ‘At the Coalface of Corporate Insolvency and Phoenix Activity: A Survey of ARITA and AICM Members’ (2016) 24 *Insolvency Law Journal* 209.

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

Our first report identified the multitude of legislative provisions that regulators can use to take action against harmful phoenix activity.⁶⁵ These provisions are, for the most part, oriented towards *ex-post* enforcement action. While strong and targeted enforcement is the vital bedrock upon which any regime to eradicate wrongdoing is built, it is only part of the solution, particularly given that not all harmful phoenix activity is illegal (i.e. problematic phoenix activity). Our approach is to attack the drivers of harmful phoenix activity from multiple angles, with a greater focus on *ex-ante* detection and disruption. At present, phoenix activity is easy, cheap, profitable and largely invisible, as a result of which there is little enforcement even where actions are available. We believe that implementing the measures outlined in this report would significantly counteract each of those drivers and reduce rates of harmful phoenix activity. At the same time, nothing we suggest will prevent genuine entrepreneurs from starting new companies, even after previous corporate failures.

Our recommendations come in three chapters.

CHAPTER 1: DETECT ALL PHOENIX ACTIVITY

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

CHAPTER 2: DISRUPT HARMFUL PHOENIX ACTIVITY

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

⁶⁵ See Anderson et al, *Defining and Profiling Phoenix Activity Report*, above n 38, 10–13, 16–17, 24–25, 28.

- Increase the maximum period of ASIC disqualification orders.
- Allow the FWO and ATO to seek court ordered disqualification.
- Increase the penalties for managing a company whilst disqualified.
- Check ABN applicants against the ASIC registers of disqualified and restricted directors.
- Introduce independent valuations of asset transfers between related parties.
- Substantially limit backdating of directorships.
- Include GST in the ATO administered Director Penalty Notice ('DPN') regime and introduce DPNs into state taxation legislation.
- Expand Single Touch Payroll to include payment of tax and superannuation.

CHAPTER 3: PUNISH AND DETER HARMFUL PHOENIX ACTIVITY

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

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

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

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

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

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